SUSTAINABLE TAX GOVERNANCE IN DEVELOPING COUNTRIES THROUGH GLOBAL TAX TRANSPARENCY

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CERTIFICATE

This is to certify that the research work entitled **"Sustainable Tax Governance in Developing Countries Through Global Tax Transparency"** is the work done by Sunny Agrawal under my guidance and supervision for the partial fulfilment of the requirement of B.B.A., LL.B. (Hons) degree at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

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DECLARATION

I declare that the dissertation entitled **"Sustainable Tax Governance in Developing Countries through Global Tax Transparency"** is the outcome of my own work conducted under the supervision of Dr./Prof.Tony George, at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

I declare that the dissertation comprises only of my original work and due acknowledgement has been made in the text to all other material used.

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Date

Contents

ABBREVIATIONS:

OECD: Organisation for Economic Cooperation and Development

ATAF: African Tax Administration Forum

CBDT: Central Board of Direct Taxes

CBEC: Central Board of Excise and Customs

DTC: Double Taxation Conventions

TEIA: Tax Information Exchange Agreements

WTO: World Trade Organisation

GATT: General Agreement on Trade and Tariffs

MFN: Most Favoured Nation

AEOI: Automatic Exchange of Information

TARC: Tax Administration Reform Commission

MoU: Memorandum of Understanding

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Chapter I: INTRODUCTION:

The concept of tax transparency means different things for different organisations but generally one expects to obtain information with a view to provide stakeholders with quality information in order to get better insight of their tax profile.

Current aspects of transparency:

- First aspect can be clarity on the complex areas of taxation and providing assurance to the tax payer that they are paying fair share of tax to the concerned tax authority.

- Another aspect of viewing it is the way the governments or concerned administration disclose the payments they receive from taxes and how in turn the tax authorities of different countries cooperate with the host country to share such information about the same tax payer.

The report thus deals with the second aspect of the transparency as the topic itself suggest on how to achieve a sustainable system of tax governance through global tax transparency.

The major part of revenue for the government of any country comes through tax. Tax governance matters a lot in the development of economy of a country. Taxes acts as a lifeblood for government enabling it to deliver essential services and subsequently to make prospective investments in public goods. The report deals with the aspects of implementation of good tax governance in developing world. The report would further study about global tax transparency i.e. sharing of information as a driving force in enhancing the transparency and accountability in tax governance across borders. Thus the project aims to prepare a framework as to how to maintain an extensive database at global level which would ease passing of information between the countries.

The topic itself contains various aspects pertaining to “Tax Governance”, “Sustainable Tax Governance”, “Tax Transparency”, and “How Global Tax Transparency could ensure Sustainable Tax Governance in Developing Countries”.[1]

Tax regimes in developing countries as the trend shows is too dynamic and it is too difficult for the stakeholder to be in consonance with each and every aspect of it and thus in either way it imposes certain liability on the tax payer even if he/she had taken due care of confirming to all the provisions.[2]

Country’s ability to develop is to a much extent depends upon its governance which to a great extent depends on its Tax governance as it is a major source of revenue for governments of developing countries. Thus governance of tax depends on one major factor that the significance of relation between the state and its citizens in terms of policy making and how much it is supportive of growth in economy as well as individual wellbeing.

The tax system or tax regimes play a significant role in shaping the accountability relationships pertaining to state-society relation of bargaining around tax which ultimately helps in attaining effective and accountable state thus tax governance should be centred on the social contract theory which highlights the contract between state and the society which would result in good tax governance.[3]

There had been a tremendous increase in international trade in last 20 years which have led to various reforms such as trade liberalization, and macroeconomic stabilization which ultimately affects the tax base of the developing countries and

[1] OECD, “Governance, Taxation and Accountability”, Issues and Practices.

[2] OECD, “Governance, Taxation and Accountability”, Issues and Practices

[3] Joshua Aizenman,Yothin Jinjarak, “Globalistaion and Developing Countries- A Shrinking Tax Base”, National Bureau of Economic Research (Cambridge), http://www.nber.org/papers/w11933.

have led to switch from traditional approach to new era of taxing system involving trade and financial integration of global markets and economy.

The main aspect of the report is sustainable governance and why it is required. The sustainability factor arises as the past trends is evident of instances of tax evasion and tax avoidance by tax underpayment due to ineffective and stringent tax regimes resulting in poor implementation by the administration as they are themselves not clear with the regimes in role. This give rise to the concept of Black Economy which quantifies the revenue lost due to underpayment of taxes or non-payment of taxes.

The instances of tax evasion and tax avoidance arises due to unclear tax regimes and also due to inability of administration to collect taxes due to lack of information as to what is the actual income, how much assets individual holds within and outside the country , how large such assets are etc. thus this demarcates the need to have an international as well as national database pertaining to consistent updated information regarding individuals which could be ensured through treaties and understanding between the states based on the principle of reciprocity, which would thus ensure global tax transparency. This would help developing countries with unstable tax regimes and with big corruption to obtain such information and ensure curbing of such procedural lapses in their tax governance and further their fiscal transparency.

In the case of developing countries instances of tax evasion and tax avoidance is widespread and thus ultimately its consequences on the tax regime are destructive in nature. Tax evasion and corruption basically shrinks the state revenues and ultimately reduces the states ability to fulfil its obligations to subject that is the society. This amounts to losses in revenues and thus subsequently it reduces the distributive function of tax collection which in turn contributes to increase income inequality.[4]

[4] Tahseen Ajaz & Eatzaz Ahmad, *Effect of Corruption and Governance on Tax Revenue*, Pakistan Institute of Development Economics, Islamabad, URL: http://www.jstor.org/stable/41428665

Good governance results in a good tax system. Sustainable tax governance can be ensured through three major elements i.e. tax payers' willingness to pay tax, tax administration effectiveness, and states legitimacy. The study explains that three key dynamics reflects the relationship between governance, taxation and investment climate. Good tax system positively depends on good governance. Secondly a fair domestic taxation system promotes good governance because efficient tax system allows population to pay fairly. Revenue collection depends positively on well organised administration; trust in government, and political stability. Theoretical considerations suggest that greater political instability and polarisation reduce the efficiency of the tax collection system.

In past recent years, the global economic scenario has brought many states under great pressure with regard to their spending programmes and their need to generate high tax revenues in order to help them with reduction in public sector deficits. Such pressure has put an increasing focus from investors, big businesses, the press, media and others for companies and individuals to be seen to be making their contribution to the public purse. Thus increased transparency in tax system is seen as an essence to deal with these issues.

The quality of governance of country is considered as a major factor in its capability to develop. It is thus to note that surprising how little attention has been given to one of the most basic drivers of building relationship between state and its citizens and the way revenue is generated by the state to look after the well-being of its citizens. Tax governance can contribute to a great extent in shaping accountability relationships and strengthening state capacities to generate more revenue.

Chapter II: HISTORICAL DEVELOPMENT:[5]

Financial globalization makes international engagement necessary as mobile market participants and capital more easily escape unilateral national regulatory supervision. Regulatory tax authorities have constantly responded to the challenge by seeking to propagate global standards, best practices and sensible guidelines through a range of international mediums and institutions. As the nature of global capital market is constantly evolving, many glitches require constant attention and new policy resolutions rather than one-shot solution. Institutions help performers cultivate habits of cooperation and subsequently allow sustained consideration to be brought to endure on common problems.

WTO laws are considered as one of the most developed source of international economic law. It basically covers most of the international economic activities, although it's being limited in scope in some of the cases.

The General Agreement on Tariffs and Trade (GATT) established the forum for negotiations on minimising the tariffs that takes place over the following decades through multilateral trade rounds being conducted by the said forum. The initial negotiations and rounds resulted in an agreement between members which established a set of basic rules and principles that participating countries were to follow, and also established a forum for dispute resolution in case the countries deviated from them. Perhaps the most important of these basic rules which are embodied in the GATT 1947 are the fundamental principle with respect to reciprocity and the non-discrimination principles which include—Most-Favoured-Nation Treatment and National Treatment.

[5] www.brookings.edu/media/press/books/2009/selfenforcedtrade, *"The WTO and GATT: A Principled History"*, Accessed on 1st April 2015, 9:15am.

Reciprocity

The principle of reciprocity which forms fundamentals of GATT, can be entered into an agreement both formally and informally. GATT rounds of multilateral trade negotiations are normally undertaken on a reciprocal basis—frequently between countries with a principal state supplying export interest in the other's state import market.

Now even though this particular approach to negotiations was successful to an extent, it acted more as a rule of thumb in the negotiations phase. Nothing exists in the text of GATT that requires member countries to reciprocally negotiate market access liberalization in order to open access to for other member states. Thus once a contracting party to the said agreement had committed itself to opening up access to its market, and then reciprocity did become a formal rule for renegotiations even if that country subsequently wanted to pull back from its commitment.

There are two broad ways in which countries have backed off from their prior commitments, and the GATT/WTO response to both has typically been based on reciprocity:

- The first instance is that when a country seeks to follow GATT/WTO legal procedures while raising its import tariffs to levels which are higher than the "bound" commitments (or limits) it had promised to keep for the rest of the membership during an earlier negotiating round. Now the Adversely affected trading partners (countries) are then permitted/ acquired right to negotiate a reciprocal market access change in another area of interest. Although it may be possible that this might occur through additional trade liberalization in another sector of interest to the affected exporter of member state, but typically it is implemented through a new "market closing," which, while retaliatory, is limited by this reciprocity principle so as to rebalance the deal being sought between the contracting parties.

- The second instance of backing off is when a country backs off commitments to opening market access in such a way that is not “GATT/WTO legal,” whereby adversely affected trading partners use the dispute settlement process to obtain a legal ruling that allows them to rebalance their market access obligations. Case law that has emerged under the formal trade dispute settlement procedures adjudicated at the WTO has also resulted in use of the reciprocity rule for instances in which compensation needs to be allocated to adversely affected exporters after legal breaches of the GATT/WTO bargain. This second point indicates that reciprocity is thus an extremely important principle when it comes to the issue of disputes.

Most-Favoured-Nation Treatment[6]

MFN in the GATT is a rule for both negotiations and renegotiations. In a negotiating round, when one GATT contracting party offers to lower its tariff to increase the market access available to foreign exporters in another GATT country, that same lower tariff and terms of market access must be then granted to all other GATT countries on a non-discriminatory, MFN basis. This is clearly one of the most important reasons for desired membership in the agreement. Even if a country did not seek to utilize the GATT for its own tariff liberalization negotiations or as an external commitment device to facilitate internal reform (for reasons described in the next section), joining the GATT was useful because it provided some guarantee that the country’s exporters would receive the “best” treatment made available to any other country in the agreement.

This helps to explain why developing countries would want to join the GATT/WTO and establishes that there was some theoretical benefit to them of doing so. Nevertheless, while MFN is an important principle in all aspects of the GATT and the WTO—during formal trade liberalization negotiations as well as renegotiations, for example, that might occur during the settlement of a dispute—this treatment becomes increasingly diluted in the presence of GATT/ WTO-permitted exceptions to MFN. In particular, the GATT/WTO does permit members to sign preferential trade

[6] The principle of MFN treatment is found in Article I of the GATT 1947.

agreements (PTAs) between one another and thus offer lower-than-MFN tariff rates to preferred partners provided that this covers “substantially all trade.”

National Treatment[7]

The basic idea is simple—once a foreign-produced good has paid the price of entry into an import market (an import tariff), it has to be treated just like a nationally produced good. The good cannot then be subject to additional taxes or regulatory barriers that would otherwise differentiate it from a domestically produced good, once the import tariff has been paid. The national treatment rule is there to prevent policymakers from eliminating the market access promised by tariff cuts through subsequent recourse to other domestic policies, such as taxes or subsidies.

Evidence that the coverage of the national treatment principle is broad and powerful is that it is the core issue in a large number of the formal WTO disputes, many of which are examined in later chapters. In fact, in almost any dispute in which a WTO member is alleged to have differentiated unfairly between domestic and foreign-produced goods—whether it be because of a discriminatory tax code, an explicit or implicit subsidy, or a regulatory barrier motivated by concerns over environmental or consumer safety—the heart of the issue is the applicability of and the potential limits to the national treatment principle.

This prospective part for the GATT/WTO comes into show when a government faces deep-rooted political interest groups demanding special guidelines that make it difficult for the government to act unilaterally. In such case, the GATT/WTO can also help the government in convincing its domestic sector the seriousness involved in the reform and ensuring a long term policy for liberal trade.

[7] The principle of national treatment is found in Article III of the GATT 1947

Even though there has been little practical research formally testing the real-world relevance of the commitment theory, one particular element should be noted with regard to the issue of GATT/WTO enforcement. The GATT/WTO institutions virtually do not do any enforcement on their own. Rather, they form a set of self-enforcing agreements: member countries enforce trading partners' commitments embodied in the agreements by challenging each other's missteps through formal dispute settlement. Thus, as described in substantial detail in later chapters, for a country to take advantage of the potential commitment-device role that the GATT/WTO might offer to government policymakers, some other trading partner must be willing to enforce the commitments that a country takes on. If there is no external enforcement—and this is especially relevant to the case of the poorest WTO member countries whose commitments are almost never enforced through dispute settlement—the WTO essentially provides the country seeking the external commitment with nothing.

Thus the above history highlights to important aspects of WTO/ GATT tax and trade regimes. First, the results from the history of the GATT and the WTO negotiations—tariff barriers in developed economies that are massively lower today when compared with those during the Great Depression era of the 1930s—is an unprecedented multilateral outcome for international economic relations. Second, the underlying principle of reciprocity that served to influence these early negotiations turns out to have been an important international force allowing governments to coordinate and simultaneously lower trade barriers. Furthermore, this reciprocal balance of trade obligation across countries is what has allowed them to keep the trade barriers low toward one another, for the most part, over the next 60 years.

Chapter III: GOVERNANCE & TAXATION:[8]

The quality of a country's governance is critical to its ability to develop and make effective use of aid. It is also recognised that a central factor in governance and state-building is the pattern of interaction between state and society.[9] It is surprising, therefore, how little attention is given to one of the most fundamental drivers of the relationship between a state and its citizens—the way public revenues are raised.

Taxation systems can contribute significantly to shaping accountability relationships and strengthening state capacities. State-society bargaining around tax makes a unique contribution to building more effective, accountable states and public institutions. This paper summarises the substantial evidence supporting this proposition. It highlights the potential for taxation to provide the stimulus for effective mobilisation of citizens, and the importance of a "social contract" centred on taxation in establishing better governance. It describes ways in which countries can make their tax systems stronger and more supportive of good governance.

Taxation and Governance: The Evidence

The Historical experience

Historically, the foundation of accountable and active states has been diligently bound up with the emergence of taxation systems.[10] In Western Europe and later in North America, bargaining between rulers and taxpayers helped to give governments an incentive to promote broad economic fortune and improve public policies in ways that meet citizens' demands. The concept of a "fiscal social contract" is central to

[8] OECD, "*Governance, Taxation and Accountability:Issues and Practise*", 02 April 2008, http://www.oecd.org/tax/tax-global/tax anddevelopment.htm.

[9] M.Moore, "*Capacity and Consent:Taxation & State Building in Developing Countries*", Cambridge University Press

[10] M. Moore, *How Does Taxation Affect the Quality of Governance?* Brighton: IDS Working Paper 280, April 2007.

explanations of how representative government and democracy emerged in Western Europe and the United States. Citizens accepted obligations to pay tax in return for rights to be represented in processes of decision-making about how public money was raised and spent. American colonists in the eighteenth century captured this in their famous protest, "no taxation without representation".

The more detailed historical story is less well known. Under constant threat of interstate warfare, some governments (notably in Britain and the Netherlands from the mid-17th Century) negotiated with taxpayers, especially holders of mobile capital, in ways that created joint gains to both rulers and taxpayers. The fact that tax was negotiated meant that tax collection became less costly to administer, less onerous and more predictable. This encouraged governments to undertake better long-term planning, and businesses were encouraged to invest. Rulers had incentives to strengthen the bureaucracy to collect and administer taxes, and to extend its reach. Systems for recruiting, training and managing revenue-collection cadres became the models for civil service efficiency generally. Taxpayers in parliament adopted mechanisms to oversee revenue-raising and public expenditure management. Rulers had a stake in the prosperity of their citizens, and incentives to nurture that prosperity to generate more revenues. By using reliable tax flows to leverage loans from domestic lenders, first the Dutch and then the British were able to turn their tax states into more powerful "fiscal states".[11]

The links between taxation and the emergence of capable government can be illustrated with a wider range of historical experiences. In East Asian countries, developmental states had broadly based tax systems. These were not in the beginning associated with Western-type political democracy; but they did help to forge a relationship between governments and citizens that generated both widely spread economic growth and improved state efficiency. Dependence on broad taxation gives governments incentives to extend their reach into rural and peripheral areas. It also requires governments to develop a widespread taxation apparatus, including basic

[11] C.Tilly, *Coercion, Capital and European States AD 990-1992*, Cambridge, MA: Blackwell.

population registration systems, and a tax collection administration that can become the model for improving the public service more generally.

The natural resource curse

The negative proposal— that governments which do not need to tax their residents have little incentive to be accountable, receptive or efficient—is equally well supported. The most striking instances are those showing the malign effects on governance of abundant natural resource rents, particularly those from oil and minerals—the so-called "resource curse". Evidence of the connection between bad governance and natural resource rents comes from an extensive literature on "rentier" states, including country case studies as well as strong quantitative evidence based on cross-national statistical analysis.[12] Rentier states have limited incentives to build up institutions to collect and administer tax, or to extend the reach of government to poorer, more remote regions. In actual, large oil and mineral revenues are connected with low levels of democracy and states unbound by law.

Taxation and governance in developing countries today[13]

Today's poor developing countries, particularly in Africa, have a different history than those usually cited as specimens of accountable governance. It cannot be a question of simply imitating the experiences of other countries. However, there are good reasons for philosophy that the ancient experience of taxation as the basis for nation building still has relevance for developing countries today. It is a matter of applying the same logic to the different conditions prevailing today. [14]

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[12] M.L. Ross, 'The Political Economy of the Resource Curse', *World Politics* 51:1, 1999, 297-322.

[13] OECD, "*Governance, Taxation and Accountability:Issues and Practise"*, 02 April 2008, http://www.oecd.org/tax/tax-global/tax anddevelopment.htm.

[14] Ibid para 15

In numerous developing states, administrations have little incentive to bargain with structured groups of populations. This is a major part of the description for poor governance. A complex set of historical factors, including state development through colonisation, has resulted in the concentration of political and economic power in the hands of elites. These elites often represent the major tax payers, repel tax reform and are reasonably unrestrained by organised societal interests. [15]

The state tends to be powerful in relation to citizens (and accountability is lacking), but weak in relation to its capacity to make or implement policy (so competence or capability is lacking). The need for states to bargain domestically with organised groups of citizens over tax is further faded by the global context. A mixture of high levels of inequality with increasingly close interaction between rich and poor countries provides unprecedented occasions for political leaders to gain access to large, non-tax sources of income from a range of legal and illegal activities. The accessibility of external military support, especially in heavily aid dependent countries, may further reduce the need for states to tackle difficult tax reforms and to mobilise internal political support for change. [16]

In today's developing countries, some negotiations do take place over outlay. Unlike taxation, issues of spending and the illicit use of these resources feature prominently in public political debates. But bargaining tends to be confined to narrow political and elite circles, and without any link to taxpaying, which means citizens, have little incentive to mobilise or use leverage to influence outcomes.[17]

The lack of ordered negotiating on the revenue side is logical but however unfortunate. Even when the negotiating relationship between the state and groups of citizens is very unstable by historical standards, taxation has the potential to mobilise social groups with genuinely countervailing power and a shared interest in holding governments responsible. Most importantly, it can bring together members of business and trade associations that have common concerns around taxation. Even in economies with quite small formal sectors, the representative bodies of small and

[15] ibid para 16
[16] Ibid para 17
[17] Ibid para 18

medium-sized enterprises (SMEs) are potentially a key group for growing mobilisation around tax. Unlike other classic forms of social protest, such deployment is likely to be continued (because taxation is an on-going process), and it is potentially constructive, because the concerns typically raised are inclined to bargaining and compromise.[18]

Mobilisation of citizens around taxation issues may be a good avenue into their engagement with public policy more generally because tax policy decisions are central to public policy and particularly to public expenditure decisions. Such mobilisation can help, over time, to move the focus of debate over public expenditure from patronage concerns to more broadly based, interest-group bargaining and the provision of public goods. This in turn has the potential to strengthen democratic institutions, for example by giving elected representatives the incentive and leverage to gain more influence over fiscal matters.[19]

[18] Ibid para 19
[19] Ibid para 20

Chapter IV: G20 SUMMIT:

“Developing countries should be able to reap the benefits of a more transparent international tax system, and to enhance their revenue capacity, as mobilizing domestic resources is critical to financing development”.

Highlight of Brisbane G20 Summit:

*“We are captivating actions to confirm the spirit of the international tax system and to secure countries’ revenue bases. Revenues should be taxed where profitable activities deriving the profits are executed and where value is produced. We welcome the important progress on the G20/OECD Base Erosion and Profit Shifting (BEPS) Action Plan to revolutionize international tax rules. We are committed to finalizing this work in 2015, including “**transparency”** of taxpayer-specific verdicts found to establish harmful tax practices. We welcome advancement being made on taxation of patent boxes. To preclude cross-border tax evasion, we endorse the global Common Reporting Standard for the automatic exchange of tax information (AEOI) on a reciprocal basis. We will begin to exchange information automatically with each other and with other countries by 2017 or end-2018, subject to completing necessary legislative procedures. We welcome financial epicentres’ obligations to do the same and call on all to join us. We welcome deeper engagement of developing countries in the BEPS project to address their concerns. We will work with them to build their tax administration capacity and implement AEOI. We welcome further association by our tax authorities on cross-border compliance activities.”*[20]

Thus the above highlight clearly depicts the aim of transparency being taken up by the member states being party to the G20 summit and further discussed the issue of BEPS i.e. Base Erosion and Profit Shifting action plans which ensure transparent cross border taxation. The summit also discussed about the information sharing on the basis

[20] Dr. Jeffrey Owens, “ *The Brisbane G20 and Cairns Communique and Recent Developments in Forum of Tax Administration: Implications for Business”,ITIC Issues Paper, December 2014*

of reciprocity and thus endeavoured to facilitate for the Automatic Exchange of Information (AEOI) on a reciprocal basis.

Reconfirming the G20 pledge to the broad policy principles of the BEPS Project and ratifying the Common Reporting Standard for automatic exchange of tax information on a reciprocal basis have become the foundation of recent messaging. The report recognizes that all the BEPS actions are closely interlinked and that nothing is agreed until everything is agreed.

Highlight of the Cairns G20 Summit:[21]

Major aim of the summit was to ensure deeper engagement of developing countries in the BEPS Project to address their concerns. The first new mandate was to broaden the inclusivity of the BEPS Project. This is a direct reaction (again, perhaps\ belatedly) to the growing economic and political influence of the emerging markets, not to mention their importance in helping define and agree upon a future cross-border tax system. The mandate reads: *"We ask the OECD, IMF, UN, and World Bank Group to build on its current engagement with developing countries and develop a new structured dialogue process, with clear avenues for developing countries to work together and directly input in the G20/ OECD Base Erosion and Profit Shifting project by the Leaders' Summit in November."*

That reference to "structural dialogue" is key. It denotes to the fact that while the OECD has done much to try and bind in as many countries as possible in the BEPS Project, time and resources have been very limited. Although the OECD has steered a series of provincial meetings, there is a feeling that more can be done to draw in the

[21] Dr. Jeffrey Owens, " *The Brisbane G20 and Cairns Communiqué and Recent Developments in Forum of Tax Administration: Implications for Business", ITIC Issues Paper, December 201.*

wider viewpoints of the lesser developed countries (LDCs) sooner rather than later. That's not to mention the fact that while India and China are both members of the G20, there may not be alignment between their interests, and those of LDCs.

Chapter V: BEPS[22]

BEPS denotes primarily to instances where the interface of different tax rules leads to some part of the proceeds of MNEs not being taxed at all. It also relates to arrangements that attain no or low taxation by shifting profits away from the jurisdictions where the events creating those profits takes place.[23]

It should be noted that such arrangement by large MNE's is rarely illegal. In some cases, it is simply a matter of misusing the unintentional discrepancies between the rules of the taxation of MNE's put in place by different tax jurisdictions. In other cases avoidance is possible because internationally developed principles have not kept pace with the global integration of the economy. No, or low, taxation is not a cause for concern per se, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it. In these cases, what matters is when income from cross-border activities goes untaxed anywhere.[24]

BEPS is a universal issue that requires global solutions. Slits in developing country tax legislation, composed with low organizational capacity, are expected to mean that developing countries facing rougher or more aggressive tax avoidance than characteristically encountered in more advanced economies. BEPS solutions need to be developed and evaluated with such issues in mind and BEPS actions for developing countries may need specific stresses or distinctions compared to those more suitable for advanced economies.[25]

[22] OECD, "*Report to G20 Development Working Group on The Impact of BEPS in Low Income Countries"*, July 2014, at page.8
[23] Ibid at para 1
[24] Ibid at para 2
[25] Ibid at para 3

BEPS in Developing Countries [26]

a) The nature of cross-border tax planning [27]

Cultured tax planning arrangements may be less dominant in, or of less pressing concern to, developing countries, where the lack of applicable and effective rules may leave the door open for much simpler tax planning approaches. Unproductive audit ability may do little to discourage more aggressive and borderline tax planning practices. These variances in risks may need custom-made approaches.

b) Lack of necessary legislative measures to address BEPS.[28]

A common issue prevalent for developing countries is the inadequate set of legislation which is inefficiently targeted at the important risks. There subsists many ways in which profits can be shifted cross border, and the legislation which incriminates on its closure or which closes outs it route will render ineffective if it leaves other route open. Example the legislation which prevents profit shifting by means of transfer pricing will be ultimately of limited effectiveness if there exist no effective measure in place to prevent MNE's from introducing excessive interest bearing debt into a country.

c) Accessing relevant information is often difficult. [29]

A common problem for developing countries is incapacities to obtain the information they require from MNEs to sufficiently assess the risk of BEPS or to apply their rules to counter BEPS. This may be due to any or all of the following:

- lack of effective information-gathering rules,

[26] Ibid at page 13
[27] Ibid at para 1
[28] Ibid at para 2
[29] Ibid at para 3

- poor compliance with such rules, or
- limited capacity to implement and enforce them

d) Need for political impetus:[30]

Developing countries has been constantly raising the matter relating to need of achieving political buy-in as a pre-requisite for making legislative changes and further assurance based on resource in order to counter base erosion and profit shifting.

Further the lack of political awareness is also considered as a major hurdle in effectively applying and introducing the rules to address issues of BEPS.

Problem Faced By Developing Countries:

Information needed to asses and address BEPS issues:[31]

One of the major issues with respect to developing countries is the ability to obtain information with respect cross border tax avoidance and thus to take effective steps to counter such avoidance.

Developing countries need information to significantly and efficiently compute tax loss suffered due to cross border tax avoidance and thus need to identify the sources and nature of such loss.

Further the developing countries also need information to select most suitable tax payers for audit, and then to effectually challenge the transfer pricing. Most of the developing countries have recently reported that they are facing weighty challenge with regard to the attaining of information needed to apply their rules based on transfer pricing and cross border tax avoidance, mostly they face difficulty in getting

[30] Ibid at para 5
[31] Ibid at page 15

relevant database which could foster effective implementation of rules being framed to curb this lacunas.

Today several developing countries have already shown strong interest for the introduction of country by country reporting which also helped in the emergence of concept of Automatic Exchange of Information (AEOI). Thus OECD is helping nations in developing platform for sharing of such database which would further global interest of nations.

Implications for developing countries:

- Their exist need for development of indicators that would indicate the economic impact of BEPS and thus tools are needed to monitor and control the effectiveness and economic impact of the actions being taken under BEPS by the member countries.

- Need to expand the developments on Transfer Pricing and information reporting based on transparency and genuine reporting by the member states in order to capture wider BEPS risks involved.

Treaty Abuse:[32]

Developing Countries claim of losing out due to treaty Abuse. Various study reveals that around 3000 bilateral tax treaties exist worldwide out of which only 1000 have developing states as parties. Thus the major concern is to obtain treaty benefits in situations in which such benefits were not intended by the states

Inaccessibility to database to apply arm's length principle:[33]

Current international standards demarcates that MNE's should routinely incorporate domestic transfer pricing rules and thus price their products in their related party transaction in line with the pricing which they would have ought to in case of other

[32] Ibid at page 16
[33] Ibid at page 17

party transaction or unrelated party transaction and thus it forms an essential ingredient to abide by the transfer pricing rules.

Thus there have been frequent concerns being raised by the developing countries about non availability of data for comparative analysis of transaction which are cross border and involves related party transaction.

Lose out from indirect transfer of assets:[34]

This forms a complex issue as it have a significant impact on the tax revenues of the developing countries. The main point around which it centres is the taxation of the profit being generated out of the indirect transfer of asset by the owner. Thus various study reveals that the owner is able to avoid such taxation by way of indirect transfer of such asset, ex. Selling of shares in the company that owns the asset rather than directly selling the asset itself.

Thus even though many jurisdictions have rules which imposes taxation of such transfer but then also challenges arise in discovering such transaction and then taxing the foreign company that sold the shares.

Implications for developing countries:

- Developing countries are required to enact rules to tax capital gains in case of indirect transfer of assets

  .
- Developing countries need proper access to information to identify such indirect transfers
- .Developing countries also need effective mechanism in order to tax foreign company that has recognised such capital gains

[34] Ibid at page 19

Next Steps:

All the above cited problem implicates one major issue which the developing countries are facing at present and that is Information Sharing and thus there exists a much need to build up a platform for such sharing of information between the countries in order to curb above mentioned instances of tax evasion and avoidance and thus ensuring a sustainable tax governance in developing countries through global tax transparency.

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Chapter VI: EXCHANGE OF INFORMATION:[35]

As globalization and technological developments continue to provide new opportunities, Individuals and companies are progressively conducting business across borders, making foreign direct investments and carrying out international financial transactions

Yet, tax sovereignty stops at the border, Tax administrations need information from foreign jurisdictions to control and enforce their tax laws. Tax evasion and tax avoidance including base erosion and profit shifting remain primary global challenges for both developed and developing countries. The recent financial and economic crisis brought into the spotlight the use of tax havens by certain taxpayers to escape their tax obligations. It led to realization of the need for countries to cooperate to safeguard their tax receipts.

In recent years, there has been a dramatic change in the level of tax cooperation throughout the world. In response to the G20 call in Washington have made commitments many jurisdictions worldwide to eliminate obstacles to information exchange in tax matters. They have agreed to the international standard on transparency and exchange of information (hereafter “the international standard”).

The international standard requires jurisdictions to provide information exchange on request, where the information is “foreseeably relevant” for the administration or the assessment of the taxes of the requesting party, regardless of any rules the jurisdiction may have on bank secrecy or a domestic tax interest. The international standard is included in the 2002 Model agreement on Exchange of information (Model TIEA), in Article 26 of the OECD Model Tax Convention and in Article 26 of the UN Model Tax Convention. The Global Forum on Transparency and Exchange of Information for tax purposes (GFTEOI or Global Forum), which has 118 members. It is mandated to promote the universal, rapid and consistent implementation of the standard through

[35] ATAF, “*A practical guide on Exchange of Information for Developing Countries”*, 2013

a process of in depth monitoring and peer review. With this in mind, the Global Forum has developed Terms of Reference which are used by its assessment teams as the standards and key elements against which jurisdictions' legal and administrative frameworks and their actual implementation of the standards are assessed[36]

The Exchange of Information Portal of the Global Forum[37] tracks the expansion of the network of agreements to the standard. The Global Forum, whose members include many developing countries, provides training and technical assistance on implementing the international standard to its members. The international standard has also influenced the Convention on Mutual Administrative Assistance in Tax Matters (hereafter the Multilateral Convention). It was amended by a 2010 Protocol which aligns it to the international standard and opens it to all countries. This change reflects the call of the G20 in London in 2009 to make it easier for developing countries to secure the benefits of this new cooperative tax environment. It is truly a global instrument to combat international tax evasion.

EOI in Developing Countries: [38]

Exchange of information assists tax authorities in various ways. Some of the major ways include detecting tax fraud, tax evasion and avoidance, and in the implementation of DTCs: for the proper allocation of profits between associated enterprises and to ensure that taxpayers claiming the benefits of their DTCs are actually entitled to such benefits.

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[36] Article 26 of the of the OECD Model Tax Convention on Income and Capital and its commentary as updated in 2004.

[37] www.eoi-portal.org, accessed on 31st March 2015, at 1:15 p.m.

[38] ATAF, *"A practical guide on Exchange of Information for Developing Countries"*, 2013, at page 4.

The types of information that can be exchanged are quite varied: information on income, bank information, transfer pricing information, ownership information, etc. Information exchanged may include copies of tax returns, bank statements, accounting records, copies of a contract, tables, diagrams, copies of invoices, letters etc. The information may be maintained in a paper form or electronic form. The information may be directly available to the tax administration (tax return, amount of taxes paid, etc) or held by a third party (e.g. taxpayer, employer, financial institution, company, foundation or trust).

The exchange of non-taxpayer specific information may be useful in detecting tax avoidance and evasion for instance information about tax evasion schemes likely to be marketed or used in another country, tax administration's risk analysis strategies and experiences in auditing transfer pricing issues arising in a particular economic sector.

Exchange of information in detection of tax evasion and avoidance

The tax administrations of developing countries are confronted with many challenges such as the loss of revenues from assets held offshore, typically by wealthy individuals. Assets held abroad may be derived from legal income that has illegally escaped tax or from illegal income. Once held offshore the income derived from those assets can also escape tax in the country of residence of the owner.

A request for information to a treaty partner may be helpful to detect tax evasion and avoidance, as shown in the following example:

Unreported income

Example

Taxpayer T, a resident of Country A, pays interest on a loan made by

Company C which is resident in Country B. Taxpayer T claims not to be the beneficial owner of Company C. Tax auditors suspect that Taxpayer T is the beneficial owner of Company C and that the "loan" was actually an attempt to repatriate previously unreported income earned in Country

A. This could be because Company C does not require any collateral or security for the loan or the credit conditions depart in some way from what is typically agreed between unrelated parties).

In this situation, the competent authority in Country A may typically request the following information to assist with its examination:

- Accounting records/financial statements of Company C for the relevant years;
- Relevant contracts and the related bank information showing the transfers, and copies of signature cards on Company C's accounts;
- All documents indicating the source of the funds if the financial statements show that Company C did not have the necessary capital to make the loan;
- Information on the identity of shareholders and/or beneficial owners in Company C; and
- Formation documents for Company C.

Exchange of information and Transfer pricing audits:[39]

The determination of transfer prices is often very fact-intensive and having the right information is vital to the successful implementation of transfer pricing rules, both in risk assessment/case selection, and in the course of an audit. There are various sources of information that are useful in transfer pricing: documentation, data and other information from taxpayers, public and private databases, company websites etc. While exchange of information is not the primary source of information for tax auditors addressing transfer pricing issues, it can provide assistance concerning transactions within a multinational enterprise

[39] Ibid at page 6, para 3

Tax incentives targeted at foreign direct investment[40]

Many developing countries have tax incentives to attract foreign direct investment or promote exports. Tax revenues may be lost as some investors may improperly claim incentives or shift income from related taxable firms to those qualifying for favourable tax treatment. Tax incentive programmes may be open to abuse from tax avoidance schemes. Exchange of information may assist in identifying these abuses.

Use of requests as a source of intelligence [41]

A request for information itself often contains information that may be relevant to identify a tax risk in the country to which the request is made. Information in a request may be helpful for instance to detect taxpayers who have not filed a tax return or have defaulted in respect of their tax payment obligations. It may identify taxpayers who have been involved in cross border aggressive tax planning arrangements, false invoicing cases, identity theft and identity fraud cases or taxpayers who have carried out independent personal services abroad and not reported these for tax purposes. The tax authority of the requested country may then wish to establish whether the taxpayer(s) so identified possesses substantial assets in the country (e.g. real estate, cash, and shares) that may indicate a tax liability in the requested country.

Other forms of exchange:

Spontaneous Exchange[42]

Spontaneous exchange of information is the provision of information to another

[40] Ibid
[41] Ibid at page 7, para 1
[42] the Module Spontaneous Information Exchange (http://www.oecd.org/dataoecd/15/44/36647914.pdf) of the OECD EOI Manual.

contracting party that is foreseeably relevant to that other party and that has not been previously requested. It should be considered when there are grounds for suspecting that there may be a significant loss of tax in another country. A typical instance would be when there are grounds for suspecting artificial transfers of profits between related companies.

Tax Examinations Abroad[43]

Tax examinations abroad provide for the presence of representatives of the competent authority of the requesting country on the territory of the requested country in order to obtain information. This is only possible if there is an EOI instrument between the two countries and if it is authorised under the law of the requested country. If this is the case, authorised representatives of the foreign tax administration can enter the requested country:

- to interview individuals or examine a person's books and records;
- to be present at interviews or examinations carried out by the tax authorities of the requested jurisdiction – in accordance with procedures mutually agreed by the competent authorities.

The competent authority may invite a representative of its counterpart to attend the interview of the taxpayer or even to be present in a tax examination provided this is possible under its domestic law. In some countries, the foreign representative's presence during a tax audit is admitted only if the taxpayer does not object to it. In others, such presence may be regarded as an infringement of that country's sovereignty or contrary to its policy or procedure. Given that developing countries may have limited resources to respond to requests, this form of exchange can be a useful alternative to the use of their own resources to gather information and free them from the costs implications they may otherwise face.

Simultaneous tax examination

A simultaneous tax examination is an arrangement by two or more countries to examine simultaneously and independently, a taxpayer or taxpayers in whom they have a common or related interest. The examinations are carried out by each country on its own territory with a view to exchanging any relevant information which they

[43] (http://www.oecd.org/dataoecd/16/0/36648066.pdf) accessed on 29th March,2015 at 3.30p.m

obtain. This form of exchange is often used to facilitate exchange of information in transfer pricing audits and also where tax avoidance or evasion schemes involving low tax jurisdictions are suspected. Developing countries may find benefits in undertaking bilateral or multilateral simultaneous tax examinations in transfer pricing cases for instance. Some countries have reported the benefits of undertaking multilateral simultaneous examinations of sister companies in the case of transfer pricing audits.

Countries interested in this form of mutual assistance generally enter into a MOU on the basis of their EOI instrument. A Model MOU can be found in the Module on simultaneous tax examination of the OECD Manual on EOI.

Joint audits[44]

A joint audit differs from a simultaneous tax examination in that it provides for two or more countries to join together to carry out a single audit of a taxpayer, with each country receiving the same information and presentations from the taxpayer. To the extent allowed by their domestic law, developing countries may also consider joint audits for instance when they have difficulty understanding similar or related transactions of a multinational enterprise that uses complex structured transactions. In both joint audits and simultaneous examinations, tax administrations must ensure that the competent authority is part of the joint audit team, or that competent authority status in relation to exchanging information is properly delegated to those who will participate in the STE or joint audit. More information on joint audits can be found in the Module on joint audits of the OECD Manual on EOI.

Industry-wide exchange of information: [45]

An industry-wide exchange of information does not concern information about specific taxpayers but about a particular industry or economic sector (e.g. the banking sector, the pharmaceutical industry, the oil and mining industry or the fishing sector). An industry-wide exchange involves representatives of contracting parties meeting to

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[44] (http://www.oecd.org/dataoecd/16/1/36648057.pdf) accessed on 29th March,2015 at 3.30p.m

[45] (http://www.oecd.org/dataoecd/ 15/42/36648040.pdf) accessed on 29th March,2015 at 3.30p.m

discuss the way in which a particular economic sector operates, the financing schemes, the way prices are determined and the tax evasion trends identified. The purpose of industry‑wide exchange of information is to combine data on industry practices and operating patterns and share intelligence to identify key tax risks. The benefits are a more effective review of tax returns of taxpayers operating within the chosen industry, which in turn allows for an improved use of auditor resources. Specific requests can then supplement an industry-wide exchange and may lead on to a simultaneous tax examination or a joint audit of taxpayers operating within the industry.

Bilateral and multilateral industry-wide exchange can be particularly useful in sharing knowledge and expertise. Not all information exchanged will require the protection of tax confidentiality provisions so experts on the industry can be invited to take part in these exchanges to better understand how that industry operates. The costs of outside experts can then be shared among the countries participating in the industry-wide exchange.

Automatic exchange of information[46]

Automatic exchange (also called routine exchange) involves the systematic and periodic transmission of large volumes of taxpayer specific information by the source country to the residence country concerning specific categories of income or events. For example it may cover income a taxpayer has received from dividends, interest, royalties, salaries or pensions, or it may concern changes of residence, the ownership of immovable property, the purchase or disposition of immovable property, or the provision of VAT credit refunds.

Given the volumes of information involved, this type of information needs to be exchanged in a standardised manner.[47]Some developing countries may receive this

[46] (http://www.oecd.org/ctp/exchangeofinformation/automaticexchangeofinformationreport.htm) accessed on 27th March,2015 at 3.15p.m

[47] (www.oecd.org/tax/eci/toolkit.pdf) accessed on 24th March,2015 at 5:15p.m.

type of information but may not have at present the capacity to match automatically all the information received against taxpayers' returns but the information can still be useful for tax purposes

Principles Governing Exchange of Information:[48]

Exchange of information is governed by a number of principles provided for in the relevant international EOI instruments. The wording of EOI provisions may differ from one EOI instrument to the other as they were negotiated at different points in time and it is important to refer each time to the EOI instrument applying to the particular case. The exchange of information must take place between the competent authorities identified in the instrument. The exchange must concern persons and taxes as provided by the EOI instrument. The information exchanged must be kept confidential and must be used only for the purposes provided for by the EOI instrument. The obligation to provide requested information applies to foreseeably relevant information but there are certain limitations to the obligation to exchange.

Authority to Exchange Information[49]

"Competent authority" is a term used in exchange of information instruments to identify the person who represents the State/jurisdiction in the implementation of the instrument. The term "competent authority" normally applies to the Minister of Finance, the Commissioner or an authorised representative.

In the case of a DTC, the competent authority acts as the official point of contact not only for exchange of information purposes, but also for mutual agreement procedures (MAPs). There may be delegation of competent authority for different functions (e.g.

[48] ATAF, *"A practical guide on Exchange of Information for Developing Countries"*, 2013, at page 16
[49] Ibid at para 3

exchange of information, assistance in tax collection, mutual agreement procedures). The competent authority (Minister of Finance or Commissioner typically designates representatives who will have the authority to exchange information. This will generally be done by an official letter addressed by the competent authority to the designated representative or by an order. When signing an EOI instrument it is important to provide EOI partners with the details of the competent authority and designated representatives. It is also important to provide updates whenever needed.

Exchange of information usually takes place between the competent authorities. This basically ensures that the rules which are applicable to the exchange of information are taken into consideration and are thus respectively applied as per said international standards. Thus by pass of such competent authority would ultimately amount to breach of the tax confidentiality.

Types of Delegation of Competent Authority[50]

Countries use a variety of different representatives designated as having Competent Authority status for EOI purposes. Competent Authority for EOI is commonly delegated to:

- The International Tax Service of the Ministry of Finance
- The International Office of the Tax Administration
- The Director of the International Large Taxpayer Directorate or
- Director of Tax Audit Department
- The Risk and Intelligence Department

Persons covered by exchange of information:[51]

The persons covered by exchange of information are individuals, companies and any other body of persons (e.g. trusts and foundations). Exchange of information is not limited to the residents of the EOI partners.

[50] Ibid page 17 at para 1
[51] Ibid at para 2

DTCs : Double Taxation Conventions[52]

Under Article 26 of the OECD/UN Model Tax Convention, exchange of information is not restricted by Article 1 (i.e. to the persons resident in the contracting states) which means that contracting states can provide information on their residents as well as information on residents of a third country when that information is held by their authorities or is in the possession or control of persons within their territorial jurisdiction. Some older DTCs may limit the scope of exchange to the residents of the contracting states in which case the Article does not include the clause "The exchange of information is not restricted by Article 1". These DTCs are not in line with the international standard on exchange of information.

TIEAs: Tax Information Exchange Agreements[53]

Under the Model TIEA, as provided by Article 2, the obligation to provide information is not restricted by the residence or the nationality of the person to whom the information relates or by the residence or the nationality of the person in control or possession of the information requested.

Taxes covered by exchange of information:[54]

DTCs

Article 26 of the OECD/UN Model Tax Convention provides that information exchange applies to taxes "of every kind and description" and goes on to state that the exchange is not limited by Article 2 (Taxes Covered). This means that under a

[52] Ibid at para 3
[53] Ibid at para 4
[54] Ibid page 18 at para 1

DTC including this wording, information can be exchanged on taxes that are not covered by the Convention, for instance for VAT purposes.

Some older DTCs may not cover ‘taxes of every kind and description’ and may be limited to the taxes covered by the Convention i.e. taxes on income and capital. For example Article 25 of the DTC between Senegal and Canada does not include the phrase “the exchange of information is not restricted by Article 2”.

TIEAs[55]

TIEAs cover, at a minimum taxes on income or profits, taxes on capital, taxes on net wealth, and estate, inheritance or gift taxes) unless both parties agree to waive one or more of them. A Contracting Party may decide to omit any or all of the four categories of direct taxes from its list of taxes to be covered but it would nevertheless have an obligation to respond to requests for information with respect to the taxes listed by the other Contracting Party (assuming the request otherwise satisfies the terms of the Agreement).

Tax years covered by exchange of information:[56]

DTCs [57]

Under a DTC, a request for information can be made concerning information that existed prior to the entry into force of the Convention, as long as the assistance with respect to this information is provided after the Convention has entered into force and the provisions of the Article have become effective.

[55] Ibid at para 3
[56] Ibid page 19
[57] Ibid at para 3

Any restrictions on the ability of a requested Contracting State to obtain information from a person for its own domestic tax purposes at the time of a request (for example, because of the statute of limitations under the requested State's domestic law) must not restrict its ability to use its information gathering measures for information exchange purposes. Where the requested Contracting State has attempted to obtain the requested information but finds that the information no longer exists following the expiration of a domestic record retention period, then it is not obliged to provide the information. However, where the requested information is still available notwithstanding the expiration of such retention period, the requested State cannot decline to exchange the information available.[58]

TIEAs

TIEAs often provide for different years covered for exchange of information in criminal tax matters and exchange of information in all other tax matters and it is therefore important to refer to the Article on entry into force of the relevant TIEA.

Obligation to provide Foreseeably Relevant Information[59]

The obligation to exchange information concerns any information requested that is foreseeably relevant for the administration or enforcement of the domestic laws concerning the taxes covered by the exchange provisions of the relevant instrument and in the case of a DTC, for carrying out the provisions of the Convention. Where the information in possession of the competent authority is not sufficient to reply to a request, it must take all relevant information gathering measures to obtain the information. The standard of foreseeable relevance is intended to provide for exchange of information in tax matters to the widest possible extent and, at the same time, to clarify that it is not possible to engage in "fishing expeditions". This obligation is subject to certain limitations but in no case can the requested party

[58] (http://www.oecd.orgdp/exchangeofinformation/120718_Article26.pdf) accessed on 23rd March, 2015 at 2:30p.m

[59] Supra at para 2

refuse to provide information because it has no domestic tax interest in such information or because the information is held by a bank or other financial institution.

The standard of "foreseeable relevance" was clarified in the 2012 Update of Article 26 of the OECD Model Tax Convention[60].

- The Standard requires at the time the request is made there is a reasonable possibility that the information will be relevant; whether the information, once provided, actually proves to be relevant is immaterial. A request may therefore not be declined in cases where a definite assessment of the pertinence of the information to an on going investigation can only be made following the receipt of the information*;*
- The requesting State determines foreseeable relevance of the request (but an explanation must be provided); once the requesting State has provided an explanation as to the foreseeable relevance of the requested information, the requested State may not decline a request or withhold requested information because it believes that the information lacks relevance to the underlying investigation or examination;
- In cases where the requesting state does not provide the name or address (or both) of the taxpayer, it must include in the request other information sufficient to identify the taxpayer;
- Group requests can meet the standard of foreseeable relevance.[61]

The standard of "foreseeable relevance" can be met in respect of a group of taxpayers that are not individually identified provided the requesting State gives:

[60] (http://www.oecd.org/ctp/exchangeofinformation/120718_Article26-ENG_nocover (2).pdf) accessed on 1st April,2015 at 11:00 pm.

[61] The GFTEI's Terms of Reference reflect the principles of Transparency and EOI as reflected in Article 26 of the of the OECD Model Tax Convention on Income and Capital and its commentary as updated in 2004. The terms of reference make no explicit reference to group requests

- A detailed description of the group and the facts and circumstances that led to the request;
- An explanation of the applicable law and why there is reason to believe that the taxpayers in the group have been non-compliant with that law supported by a clear factual basis; and
- Shows that the requested information would assist in determining compliance by the taxpayers in the group. Usually, although not necessarily, a third party will have actively contributed to the non-compliance of the taxpayers in the group.

Limitations to Exchange information requested [62]

The obligation to supply information is lifted in a limited number of situations. These exceptions are contained in paragraph 3 of Article 26 of the OECD/UN Model Convention, in Article 7 of the Model TIEA and in Article 21 Paragraph 2 of the Multilateral Convention. In the rare cases where the exceptions apply, the contracting parties are not obliged to provide information. It should be pointed out that when the limitations apply, the decision to provide or not to provide the information requested is left to the discretion of the requested competent authority. If it provides the information in cases where the limitations apply, there is no breach of tax secrecy.

No obligation to carry out measures at variance with domestic laws and practices

The underlying rationale is that the requested party should be required to do no more – but also no less – than it would if its own taxation was at stake.

No obligation to provide information not obtainable under domestic law in the normal course of administration

The requested party is free to decline to provide information if the information cannot be obtained under its domestic law or cannot be obtained in the normal course of

[62] ATAF, *"A practical guide on Exchange of Information for Developing Countries"*, 2013

administration. However, irrespective of domestic law or domestic administrative practice, the requested Party cannot use bank secrecy or a domestic tax interest requirement as a basis for declining to provide information. Furthermore, a request cannot be declined because the information is held by a nominee or a person acting in an agency or fiduciary capacity or because it relates to an ownership interest.

The requested Party is obliged only to obtain and provide such information that the requesting party could itself obtain under its own laws in similar circumstances. The Commentary to Article 26 of the OECD Model states that if a Contracting State applies, under paragraph 5, measures not normally foreseen in its domestic law or practice, for instance to access and exchange bank information, that State is equally entitled to request similar information from the other Contracting State. This would be fully in line with the principle of reciprocity which underlies subparagraphs a) and b) of paragraph 3.

Trade, business, professional and other secrets[63]

The Requested party is not obliged to provide information which would disclose any trade, business, industrial commercial or professional secret or information which is the subject of attorney client privilege. A trade or business secret is generally understood to mean facts and circumstances that are of considerable economic importance and that can be exploited practically and the unauthorised use of which may lead to serious damage (e.g. may lead to severe financial hardship). Financial information, including books and records, does not by its nature constitute a trade, business or other secret. The role of the competent authority is to determine whether or not to pass on sensitive information and the local authorities that gather the information in the first instance should point out what might be sensitive.

Exchange of Information in Practise:[64]

Exchange of information upon request: How to Make a Request and how to respond to a Request for Information Before making a request Requests for information are

[63] Ibid page 22 at para 4
[64] Ibid at para 4

generally initiated by tax auditors. Before sending a request, the tax auditor should use all means available in his own territory to obtain the information except where those would give rise to disproportionate difficulties. The tax auditor should attempt to obtain information from publicly available sources, for example by using public and commercial databases and online international phone books and other resources available via the internet. Using the internet and Public and commercial websites to find information directly The information that tax auditors may need may be actually publicly available on the internet, for instance information to determine whether a company is registered in a given country. Using internet searches allows tax authorities to obtain information very quickly and reduces the number of requests to foreign competent authorities who will have more time to devote to the other requests they receive. On-line National Trade Registers are a good source of information.

They often allow basic search functions and are often free of charge. They can also include extensive reports (annual accounts, ownership information, business statistics/ratios).

Ensuring the Confidentiality[65]

Effective mutual assistance between competent authorities requires that each competent authority be assured that the other will treat with proper confidence the information which it obtains. For this reason, all treaties and exchange of information instruments should contain provisions regarding tax confidentiality and the obligation to keep information exchanged as secret or confidential. The confidentiality rules cover competent authority letters, including the letter requesting information. It is understood that the requested State can disclose the minimum information contained in a competent authority letter (but not the letter itself) necessary for the requested State to be able to obtain or provide the requested information to the requesting State, without frustrating the efforts of the requesting State.[66]

[65] Ibid page 34 at para 4
[66] OECD 2012 Report: *Keeping It Safe*

Legal framework to protect the tax confidentiality[67]

The provisions on tax confidentiality of information exchanged are found in Article 26 paragraph 2 of the OECD/UN Model, Article 8 of the Model TIEA and Article 22 of the Multilateral Convention. These provisions require that information be kept confidential and set limits on the persons to whom the information can be disclosed and on the purposes for which the information may be used. Article 26 of the OECD/UN Model and Article 22 of the Multilateral Convention contain the additional requirement that information should be treated "as secret in the same manner as information obtained under domestic law." Under the Multilateral convention, if personal data are provided, the Party receiving them shall treat them in compliance not only with its own domestic law, but also with the safeguards that may be required to ensure data protection under the domestic law of the supplying Party. In addition the 2012 Update to Article 26 of the OECD Model Tax Convention clarifies that the confidentiality rules cover competent authority letters, including the letter requesting the information and that in the case of a breach of confidentiality, the other State may suspend assistance until proper assurances are provided.

Domestic legislation must include provisions on tax confidentiality and provide administrative and criminal penalties for persons or authorities who improperly disclose confidential information. Penalties must be clear and severe enough to discourage breaches. Information exchange partners may suspend the exchange of information if appropriate safeguards are not in place or if there has been a breach in confidentiality and they are not satisfied that the situation has been appropriately resolved.

Administrative Policies and Practices [68]

Before Transmission of information

Prior to sending information the competent authority should have procedures/ processes in place to ensure that the information sent will be kept confidential in the

[67] Ibid page 35 at para 1
[68] Ibid at para 3

recipient country. This includes confirming that the person who has requested the information was authorised to make the request and to receive the information. Steps should be taken to confirm that the competent authority's name and address are correct before sending any information. All confidential information should be clearly labelled as confidential.

In order to ensure the tax confidentiality of information exchanged, the competent authorities may consider including a warning in the competent authority letter and all enclosures (background information, copies of contracts etc).

During transmission:

Physical mail to be sent only via an international registration system where a mail tracking function is in place. Information to be remained confidential which is sent electronically from the sender's computer system and moreover can be encrypted via a secure platform

Legal requirement to notify the taxpayer:

Some countries have rules that require them to notify the taxpayer concerned with a request for information. Notification procedures should not, however, be applied in a manner that, in the particular circumstances of the request, would frustrate the efforts of the requesting State. "For instance, notification rules should permit exceptions from the notification requirement in certain cases e.g. in cases where the information request is of a very urgent nature or in case of tax fraud. Countries with notification requirements should inform their EOI partners at the time of the negotiation of an EOI Agreement.

Case Studies based on Actual Cases of Exchange[69]

Case study 1: Exchange of information on a High Net Worth Individual

The taxpayer is a citizen of Country A, who emigrated to Country B with very little wealth but by the early 1990's the media was prominently depicting him as an extremely wealthy man.

The tax authorities of Country B undertook an initial review in 2000 which revealed an asset base of an equivalent of millions of USD supposedly arising from an annual income of USD 10 000. The initial explanation provided by the taxpayer was that his mother, a resident of country A, had provided initial funding.

In order to ascertain these facts, the competent authority of Country B made a request for information to Country A under their Double Tax Convention. As the Double Tax Convention between Countries A and B provides for assistance in tax collection, Country B was also able to make a request for assistance in tax collection to Country B.

The competent authority of country A responded that the taxpayer's mother could not have been the initial funding. As a result, assessments to the value of millions of USD were raised on the taxpayer and assets secured to ensure payment of the tax debt.

A private jet of the taxpayer was tracked down and located in Country C. Again making use of the Double Tax Convention between Countries B and C, the asset was secured and eventually sold off in part payment of the tax due. Country B made every use of the powers available through its treaty with Country A to put restraining orders in place preventing the disposal of major offshore assets held by the taxpayer and associated enterprises.

Case study 2: Exchange on request Services Re-invoicing Scheme

Company X, a resident of Country A, claims a deduction for services invoiced by Company Y, resident in Country B. The tax official auditing Company X learns that the services were performed by Company Z, also a resident of Country A. The tax official begins an audit of Company Z. The income tax return of Company Z only

69 Ibid page 37

shows income from services invoiced to Company Y. The amount invoiced by Company Z to Company Y for the services performed for Company X is significantly smaller than the amount invoiced by Company Y to Company X for the services. The tax auditor suspects that Company Y is merely re-invoicing these services and that the difference between the amount declared by Company Z and the amount invoiced by Company Y to Company X (minus its re-invoicing fee) is paid into a bank account held by Company Z with a bank resident in Country B. Typically, the Country A tax administration would request from the competent authority of Country B:

- Information about Company Y including the business activity;
- Invoices of Company Z to Company Y and any payments made to Company Z;
- All accounts payable of Company Y with respect to Company Z for the years under examination;
- Accounting and financial records of Company Y (in particular any bank records showing transfers by Company Y to Company Z).

Case study 3: Exchange on request Suspected Unreported Income – Assets Identification

The tax administration of Country A is conducting an investigation of one of its own fiscal residents, Mrs A, a self-employed accountant, following receipt of information received from Mrs Z, her former business associate, who states Mrs A owns substantial assets that were purchased by her whilst enjoying a holiday in Country B. The years under examination are 2002 and 2003. These assets are based in Country B and include a house and boat. Mrs Z advises the tax auditors that these assets were funded through undeclared income in Country A. The auditors interview Mrs Z until they are satisfied they have obtained all the information they possibly can get from her.

The auditors have also exhausted all of their available domestic information sources. They have now established the city where the house is located, the city where the boat was purchased, and approximate dates of when both assets were purchased. The auditors now know that the house is vacant throughout the year and is only occupied by Mrs A when she visits on holiday. The auditors were also advised that Mrs A opened a bank account with Bank J in 2002, at the City K branch, in Country B, and that she may have obtained a loan from that bank to partly fund the purchase of the house and boat.

The competent authority of Country A therefore requests the following information from the competent authority of Country B:

- Details of real property and boat registration searches for Mrs A – the request includes all details provided to the auditors, including the city where the house and boat were purchased, and the approximate dates they were purchased;
- Details of the bank account held in Country B by Mrs A – the request includes all of the details known to the auditors, including when the account was opened and the name and address of the bank; and

Details of any loans that may have been taken out with Bank J to partly fund the purchase of these assets – the request will explain why this information is required.

Chapter VII: TAX GOVERNANCE IN INDIA:

The Rule of Law and Good Governance:

"There is hardly any part of our national life or of our personal lives that is not affected by one statute or other. The affairs of local authorities, nationalised industries, public corporations and private commerce are regulated by legislation. The life of ordinary citizen is affected by various provisions of the statute book from cradle to grave. The rule of law is the cornerstone to democracy and how can there be a rule of law society if the members, and the bulk of whom are too poor to buy legal services, cannot decode the legislators law and therefore obey it incomprehensible law annoys the Administration and estranges the citizen at a time when quick justice and less sterile legislation are the disiderta. The command of law can claim the allegiance of the law only by simplicity in legislation."

The above observation made by Justice Krishna Iyer in *Aluminium Corporation of India Ltd. V. Union of India*[70] in the context of exemption notification issued under the Central Excise Act still holds good. In fact, in a taxing statute it is often repeated that there must be simplicity or easy comprehensibility in drafting legislation including rules and notification affecting the people.

Complexity in Taxing Statute:

Taxation is a statutory field. No tax can be levied and collected except according to the authority of law. There is a fiscal legislation every year much ofit prepared in great secrecy and under severe pressure of time and it directly affects most people. This legislation is complicated and elaborate because of intricate prepositions it has to express, and the variety of circumstances and conditions in which it falls to be applied and the refined distinctions it embodies in order to attempt to cater expressly for them. Consequently, the body of tax statutes as a whole is voluminous and complex in structure as well as in concept and expression.[71] There is another reason for the fiscal legislation being complex and complicated. In fact the taxes are as complex as life.

[70] AIR 1975 SC 2279 at page 2284
[71] K.P Varghese v. ITO AIR 1981 SC 1922, 1927.

The moralist calls for just taxes, but taxes cannot just be just, if we recall the scheme of special bearer bonds for mopping up black money. The administrator asks for simple taxes, but experience shows that they cannot simply be simple. The businessman demands practical taxes, but the financial history proves that it is impracticable to make them practical.

Tax Evasion and Tax Avoidance:

Tax evasion denotes all those activities which are responsible for a person not paying tax that the existing law charges upon him. Such non-payment of tax may be because of failure to make his return or by making of deliberating fraudulent return or non-payment of tax at proper time. Various steps have been taken from time to time to check evasion of tax. To prevent evasion of tax it is necessary that each tax payer is assessed properly and tax is properly paid by him. Coercive steps are taken to prevent evasion of tax. These include imposition of fine, interest, penalty and prosecution.

Tax Avoidance is the legal utilization of the provisions of the tax laws in such manner so as to minimise his tax liability. The tax laws however, contain specific provisions to counter the tax avoidance. In the Income Tax Act, 1961, Chapter X section 92, section 93 and section 94 which provides for special provisions relating to the avoidance of tax.

Under section 92, where a business is carried on between a resident and non-resident and because of close connection between them, the resident is receiving either no profit or less than the ordinary profits in such cases the Income-Tax officer shall determine the amount of which may be reasonably be deemed to have been derived therefrom and include such amount in the total income of the resident.

Section 93 brings to tax the income of the resident that income which he has power to enjoy without having the ownership of property which is the source of income. This happens when a resident transfers to a non-resident any asset but retains for himself the power to enjoy immediately or in future the income arising to non-resident out of the transferred asset.

Thus the special provisions in chapter X are in addition to other provisions of the Income Tax Act whereby the attribution rules are applied to prevent the avoidance of tax. Where a statutory provision is designed to prevent the avoidance of tax through income splitting by deeming any income or loss from property transferred or loaned to spouse or minor child or property transferred to that of the transferor or of the lender and not of the recipient. Thus tax avoidance postulates that the assesse is in receipt of the amount which is realty and in truth his income but on which he avoids payment of tax by some artifice or device.

Now even though the statutes itself contains provisions relating to tax evasion and tax avoidance but then also talking in terms of international perspective there still exists a need to have a sustainable tax regime in order to deal apparently with the international transactions and such regime should be at par with the international norms of taxation prevailing. Further there have been various instances and occasions and also India being a party to various conventions and treaties which invariably shows the intent to subsist the existing law and make it at par with global standards.

Further India also being part of G20 summit being held at Cairns and Brisbane thus cleared the intent to develop a transparent system of tax governance in order to increase tax revenue and also to make it easier for the international companies to make themselves feel comfortable with the regimes of India and thus will attract wealthy investment in the country.

Reforms Intended:[72]

Ministry of Finance, Government of India has issued four reports in 2014 related to tax reforms in India. Second report issued in September 2014 talks about exchange of information and need for such exchange of information.

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[72] TARC, *"Tax Administration Reform in India Spirit, Purpose & Empowerment (Second Report)"*, September, 2014

According to the report legislations should be framed in accordance with global best practices relating to exchange of Information. The report states that Countries across the globe at various stages of development of tax system are accessing more information from various administrations and agencies internationally by entering into international agreements. As the global best practices relating to corporate governance is strengthening in many countries, this pressurizes tax administrations to seek filings and reporting leverage, such as public financial statements or trade regulators to prove their work. Also most tax administrations are facing challenges in understanding the complexity of new business models, transactions and structures as a result of increasing globalization of business and people.

Thus all these have ultimately lighten up the need of exchange of data or information across nations and also have driven a charge on legislators to build up common standards of taxonomy which would adhere to global best practices in order to ensure secured protocols for information and data storage, access and disposal, and secured network for exchange which cannot be breached.

In India CBDT (Central Board of Direct Taxes) and CBEC (Central Board for Excise and Customs) exchange information with each other in bulk to identify their actionable cases but the two Boards, maintains data only for their own use. Even though the two boards along with other agencies involved in the process maintains their database but there is a constant reporting of data mismatch between them and also common access and common usage of data is absent within two departments. This highlights one major issue that when two departments of state are not able to share information effectively between themselves then how to ensure data and information availability on international request being made. Thus there exist a need for well-structured framework for maintaining database which would have common access and usage also ensuring privacy of the tax payer involved in the process.

At present every level of tax governance in India is so scattered which makes it too difficult to maintain a common database thus this decentralized and disintegrated data collection ultimately increase the time and cost incurred in it also the data collected is mostly inconsistent and have inaccurate analytical results.

Thus the commission highlights the need to have a centralized governance framework for data and information collection and thus to ensure it there is need to have valuable resources to execute such planning. Also major hurdle for having such planning is the considerable amount of time and money is involved in such process but at the same time states should look into its sustainability and the help it would provide in increasing revenue of government and also helping domestic regimes to be adhered to international best practices.

The focus of the legislatures of developing nations should be on organizing the data which the agencies hold. Thus the major issue is about how to consolidate database between the two Boards (CBDT & CBEC) . now in order to curb such issue It is important to point out that whatever the framework considered appropriate by the two organisations for data and information exchange – the basic framework for co-operation should there can be an MoU between the Boards and other agencies involved which should mandatorily contain provisions relating to consequences of not sharing the desired information or delay in information or fraudulent information.

Chapter VIII: CONCLUSION

It’s pertinent to conclude that tax forms a major part of revenue for any government which ultimately fosters government to fulfil its obligation under social contract entered into with citizens of the state. Even though government is striving hard for transparent tax regimes for good governance but good governance to a much extent would depend on the concept of Tax Morale i.e. willingness of the individuals to pay tax. As in most of the developing economies the tax morale of the payer is degraded too much extent due to various instances of corruption and the question in their mind that what development are they getting from the government out of the tax they are being paying out of their hardly earned income.

Further the major aspect of the report has to be seen from the perspective of MNE’s and huge tax payers involved in the international transaction as the instances of tax evasion, tax avoidance occurs in cross border transactions involving various jurisdiction in one transaction thus the complexity which arises in such cases can be avoided through the global tax transparency. This tax transparency can be ensured through maintaining a database at global level which would give the requesting state information relating to concerned individual or group. Further signatories to various conventions are also striving hard to initiate an Automatic Exchange of Information which would be updated at regular interval by the state administration.

Thus this global tax transparency through sustainable tax governance could ensure in saving a large amount of revenue for developing country which could be helpful in economic growth and thus would foster sustained development of developing nations.

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