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Governments and Information Gathering: Impact on MNE Planning

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INTRODUCTION[1]

It was not that long ago when the relationship between an outside tax adviser or banker and a corporate client — such as a multinational enterprise (MNE) — was marked by confidentiality borne of attorney-client privilege or the banking relationship. For attorneys, the discussions were secret, sacred, and sacrosanct. In advice on a plan of action, it was understood that a taxpayer had no obligation to pay more tax than the minimum amount due. Identifying any disjunctures in the tax laws of two jurisdictions was the sign of a sophisticated adviser and no one thought twice about characterizing a cross-border transaction inconsistently in different jurisdictions. There was no expectation of exchange of information and all loyalty of the adviser was to the client. Bankers were more than willing to finance transactions put together by tax advisers or investment advisers and designed to reduce the tax burden of the client. Fees for tax advisers and bankers were substantial.

A sea change has taken place in the world — and the relationship between the outside tax adviser and the corporate client is no longer simple and direct. Many jurisdictions require that lawyers and financial advisers complete anti-money laundering/know-your-client procedures before taking on a new client. The reports must be made available to local authorities. It is not uncommon for the adviser to advise the client that all relevant information regarding a transaction will be disclosed in all jurisdictions touched by the transaction. Disclosure may be made in advance as part of an open dialogue with the tax authorities or in a tax return. If a plan that results in tax benefits for

[1] Stanley C. Ruchelman, The Ruchelman Law Firm.

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the client is agreed, the confidence level of the client in the anticipated results must be disclosed. If the client is ''taking a flyer,'' it must do so publicly. If there are intercompany transactions that cross borders within a group, disclosure must be made to tax authorities regarding transfer pricing decisions, pricing methodology, and variances from statistical data. Cross-border consistency of treatment may be mandatory, and inconsistencies may be viewed as a sign of abusive planning. Exchanges of information by tax authorities in different countries should be anticipated, and exchanges by offshore jurisdictions such as Liechtenstein and the Bahamas are mandated under tax information exchange agreements with other countries. This all takes place with the knowledge that substantial penalties may be imposed for non-compliance with the above rules.

This article addresses the current state of affairs in selected jurisdictions, including the Netherlands, the United Kingdom, Germany, Austria, Norway, and the United States.[2] Trends suggest that tax authorities are adopting similar rules designed to promote transparency for tax, regulatory, and anti-money-laundering purposes.

REPORTING BY PROFESSIONAL SERVICE PROVIDERS AT THE BEGINNING OF A CLIENT RELATIONSHIP: EXPERIENCE IN THE NETHERLANDS[3]

Since February 1, 1994, Dutch law has contained the Identification (Financial Services) Act (*Wet identificatie bij financiële dienstverlening* (*WID*)) and the Disclosure of Unusual Transactions (Financial Services) Act (*Wet melding ongebruikelijke transacties* (*MOT*)). The WID requires the identification of clients and the conduct of client identification research. The MOT requires the reporting of unusual transactions. The provisions of the WID and MOT are based upon the 40 recommendations of the Financial Action Task Force (FATF) to combat money laundering. The FATF is an organization of 31 countries and two international organizations, which was set up by G-7 in 1989. The 40 FATF recommendations form the basis of the international rules against money laundering and have also been used in drafting the third EC directive, Directive 2005/60/EC for the prevention of the use of the financial system for money laundering and the financing of terrorism (the ''Directive'') and the Directive 2006/70/EC in which implementation measures are included with respect to so-called politically exposed persons (the ''PEP Directive'').

Anti-Money Laundering Act

On August 1, 2008, the Prevention of Money Laundering and Terrorism Financing Act (*Wet ter voorkoming van witwassen en financieren van terrorisme* or ''Anti-Money Laundering Act'') entered into force. It combines the legislative proposal to: (1) implement the Directive and PEP Directive; and (2) combine the WID and MOT into one act. The Anti-Money Laundering Act therefore constitutes a combined WID/MOT in which the Directive and PEP Directive are implemented in Dutch laws. The enactment of this combined WID/MOT provides institutions (which term, as further defined below, includes not only financial institutions, but also professional service providers) greater opportunities to focus their identification policy on the concrete risks involved in money laundering and the financing of terrorism within the institutions. The Directive envisions providing a framework that is more ''risk-based'' than ''principle-based.'' This means the institution is required to fulfill the objective of the law — namely, the combating of money laundering and the prevention of financing of terrorism — but allowed a certain amount of discretion as to the manner in which it carries out the policy. Institutions may adjust the degree of the investigation according to the type of client, relationship or transaction.

A number of other amendments were also introduced. For example, the Anti-Money Laundering Act obliges institutions to establish the identities of the ultimate beneficiaries of the transaction. In accordance with the PEP Directive, a more stringent client investigation will have to be conducted for the providing of services to politically exposed persons. In accordance with the Directive, a more stringent client investigation will also have to be conducted if there is an increased risk of money laundering or financing of terrorism. Note that the Anti-Money Laundering Act is not applicable with respect to representation of a client in litigation and the rendition of related advice, participation in an introductory meeting (intake meeting) before services are provided, and preparation of simple income tax returns or inheritance tax returns.

The main elements of the Anti-Money Laundering Act are summarized in the following subsections.

Scope

The scope of the Anti-Money Laundering Act is restricted to ''institutions.'' This includes credit institu-

[2] On June 3–4, 2010, the American Bar Association Section of Taxation and the International Fiscal Association hosted the 10th Annual Tax Planning Strategies — U.S. and Europe Conference. This article has its origin in a panel presentation at that conference.

[3] Mark van Casteren, Loyens & Loeff, Amsterdam.

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tions, financial institutions, life insurance companies, investment firms, investment institutions, financial service providers, money market institutions, trust offices, professional service providers (such as external accountants, tax advisors, lawyers and notaries), casinos, credit card distributing companies and certain natural or legal persons trading in goods, to the extent that payments are made in cash in an amount of €15,000 or more. The scope can be extended by royal decree.

Client Identification Investigation

The main rule of the Anti-Money Laundering Act is that institutions conduct client investigations wherein the following are of importance:

- The identity of clients must be established and verified. If the client is a legal person or if another person is represented, this representative must also be identified.
- Under certain circumstances, the ultimate beneficial owner (''UBO'') must be identified and sufficient measures must be taken to verify the UBO's identity.
- If the client is a legal entity, foundation or trust, measures must be taken to gain insight into the ownership and control structure of the client.
- Information must be obtained such to determine the object and the nature of the business relationship.
- If possible, the business relationship and the transactions must be subject to ongoing monitoring.

Institutions must in principle conduct client investigation:

- If the client enters into a business relationship in or from the Netherlands;
- If the institution effects a transaction of €15,000 of more for a client;
- If there are indications that the client is involved in money laundering or financing of terrorism;
- If the institution has doubts as to the reliability of data previously received; or
- If there is a risk of money laundering or financing of terrorism that gives reason to conduct a client investigation.

An institution is not allowed to enter into a relationship or to effect a transaction if a client investigation has not been conducted or if this investigation has not led to the intended result. If the institution already entered into the business relationship, the relationship should be ended. The identity of natural persons must be established on the basis of documents, data or information obtained from a reliable and independent source. If the client is a legal entity established in the Netherlands, identity is established on the basis of an excerpt from the trade register or by means of a deed executed by a civil law notary. Contrary to provisions of the WID (the former act dealing with these issues), this excerpt may be an electronic (not certified) excerpt. If the transaction concerns a foreign legal entity, identity can be established on the basis of reliable standards in international business practice, documents, data or information acknowledged by law as a valid means of identification in the country of origin.

Ultimate Beneficial Owner

As mentioned above, institutions must identify the UBO in order to prevent a person who is engaged in criminal activities from being able to hide behind one or more legal entities. The explanatory memorandum clarifies that the UBO should be determined only in situations with a high risk of money laundering or financing of terrorism. However, the Act does not identify the circumstances in which this is the case and leaves this decision to the institution.

The UBO is defined as the natural person who is the ultimate owner of, or who has control over, the client and/or the natural person for whose account a transaction is effected or activity is performed. It must be established that the UBO is a natural person who owns 25% or more of the shares or voting rights or otherwise exercises substantial control over the enterprise. In the case of, for example, a foundation or a trust, the institution must establish that the UBO is the beneficiary of 25% or more of the equity of the foundation or trust or is the one who has the special control over 25% or more of the equity.

Simplified Identification Procedure

Institutions may apply a simplified identification procedure if, for example, the client falls under one of the following categories:

- Credit institution;
- Financial institution;
- Money transaction office;
- Life insurance company;
- Investment firm;
- Investment institution;
- Financial service provider insofar as it acts as an intermediary in insurance as referred

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to in the Financial Supervision Act (*Wet op het financieel toezicht*);

- Listed company the securities of which are admitted to trading on a regulated market in one or more Member States of the European Union (EU);
- Government authority insofar as it satisfies the following four conditions:
  - The authority is charged with a public function by virtue of the Treaty on the European Union, the European Communities or a derivative version thereof.
  - The authority is due to render account to authorities of the Member State or to a Community authority or with respect to which other appropriate procedures exist for the purpose of examining the activities.
  - The identity of the authority is accessible to the public, transparent and unequivocal.
  - The activities and accounting practices of the authority must be transparent.

If a client does not fall under one of the categories to which the simplified procedure is applicable, under certain circumstances a simplified procedure may be applied if the client is considered to be of low risk. Before a simplified identification procedure can be applied, however, an investigation must be conducted into whether the client, the products or transactions could be accompanied by a risk of money laundering or terrorism.

The institution is expected to continue to exercise supervision over these clients throughout the course of the service-providing relationship for the purpose of ensuring that no complex or unusual transaction is effected without a clear economic or visibly lawful objective. If the simplified procedure can be applied, this means in principle that identification of the client does not have to take place. Sufficient data must be collected, however, to establish whether the simplified procedure can be applied. In many cases, even when the simplified procedure is applied, it would seem necessary, for example, to request an extract from the Chamber of Commerce or to inspect the public register of the Netherlands Authority for the Financial Markets or the public register of the Dutch Central Bank. Thus, it must first be established whether an institution is one to which this procedure applies. Other exemptions to identification apply. For example, the main rule does not apply to certain relationships or transactions concerning life insurance policies, or certain pension products, or — under certain circumstances — electronic money within the meaning of the Financial Supervision Act (*Wet op het financieel toezicht*). Sufficient data should be collected to establish whether or not a relationship or transaction concerns a product to which the exemption applies.

Enhanced Customer Due Diligence

In situations that naturally hold a heightened risk of money laundering and/or financing of terrorism, enhanced customer due diligence must be conducted.

Client Who Does Not Appear in Person

If a client does not appear in person, the enhanced customer due diligence will have to consist of the identity of the client being established by means of supplementary documentation, data or information. Alternatively, the documents that have been presented must be assessed as to their authenticity, or the first payment that bears connection with the relationship or transaction is made in favor of or charged to an account of the client with a bank with its seat in an EU Member State or other state designated by the Minister of Finance if the bank is licensed to operate its business in that jurisdiction.

Politically Exposed Person

Special attention must be devoted to politically exposed persons or other natural persons who hold or have held prominent public positions — and this is particularly so with regard to those who originate from countries known for corruption. An institution must have a risk-based policy to determine whether the client is a politically exposed person. This concerns solely persons who are not resident in the Netherlands. Politically exposed persons are persons who fulfill political functions at a national level and functions equivalent thereto. Here, consider government leaders, members of parliament, people employed by a Chamber of Audit, members of Supreme Courts and senior army officers. Persons who have held a politically prominent position continue to be deemed a politically prominent person for one year after termination of the relevant function. Direct family members or other near relatives must also be deemed politically exposed persons. It is not the intention that an institution conduct intensive investigation into the family members of politically prominent persons. It only concerns family members of persons who are publicly known. If it has been established that an institution is dealing with a politically exposed person, the institution must have internal permission from designated persons to enter into the relationship with the politically exposed person. Once such a relationship has

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been entered into, sufficient measures must be taken in order to establish the source of the equity. Monitoring of the relationship throughout the course of the entire period that services are provided must also be tightened up.

Reporting Obligations

The Anti-Money Laundering Act contains the obligation for institutions to report unusual transactions. This is considered an important means to combat money laundering and the financing of terrorism.

All institutions to which the Anti-Money Laundering Act applies are subject to this reporting obligation. Such institutions should use a short list of objective and subjective indicators provided by the Act to determine whether a certain transaction should be reported.

Under Article 16 of the Anti-Money Laundering Act, an institution has the obligation to report any unusual transaction, whether executed or only contemplated, within a period of 14 days after the institution became aware of the unusual character of the transaction. The obligation is thus very broad, as it covers contemplated transactions as well as ones that have taken place. It also appears to cover unusual transactions that have taken place (or were contemplated) in the past, even if the institution was not involved with the client or transaction at that time. The latter has become specifically relevant and topical with respect to taxpayers who want to report unreported income from the past, typically held in undisclosed bank accounts. Because of decreasing bank secrecy protection against exchange of information arrangements in favor of the country of residence of the bank account holder and the adoption of domestic measures encouraging individuals to report unreported income from the past, many Dutch individuals with undisclosed bank accounts in countries such as Switzerland, Belgium and Luxembourg have decided to report their undisclosed bank accounts during the last year. This creates issues with respect to the reporting obligations of the tax lawyer/tax adviser who is advising such a taxpayer, under the Anti-Money Laundering Act.

In contrast to the current law's short list of objective and subjective indicators, the Act's predecessor, the MOT, contained more detailed rules for determining whether a transaction should be reported. Internal rules of the various associations of professional service providers (such as the Netherlands Bar Association, the Netherlands Association of Tax Advisors, the Royal Dutch Registeraccountant Institute and the Royal Dutch Notarial Society) still include more detailed rules on when a (contemplated) transaction should be reported. As most of the professional service providers are members of one of these associations, in practice, these detailed rules are still relevant. In any case, the Act is expected to include more detailed rules in the future.

In case of an unusual transaction, the institution should report the following information:

- The identity of the client and, if possible, the identity of the persons for whose benefit the transaction is or will be executed;
- The nature and number of the identification document of the client;
- The nature, timing and location of the transaction;
- The amount, destination and origin of the funds, securities, etc., that were part of the transaction;
- The unusual circumstances of the transaction;
- A description of high-value assets in transactions exceeding €15,000.

The information should be reported to the Financial Intelligence Unit — Nederland (FIU-NL), which may request further information as needed.

Any information reported by an institution under Articles 16 and 17 of the Anti-Money Laundering Act cannot be used in a criminal investigation against that institution. The respective institution also cannot be held liable for damages of third parties, as a result of the information reported under the provisions of the Anti-Money Laundering Act.

PRESSURES IMPOSED ON BANKS AND FINANCIAL INSTITUTIONS

Know Your Customer Rules in Belgium[4]

In Belgium, the focus of financial institutions is directed to the Markets in Financial Instruments Directive (MiFID) regulations and guidelines and the Anti-Money Laundering regulations.

MiFID

MiFID came into effect on 1 November 2007. It addresses four issues:

- Know your customer;
- Inform your customer;
- Corporate business reorganization;
- Best execution on the financial markets.

[4] Henk Verstraete, Liedekerke Wolters Waelbroeck Kirkpatrick.

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Know your customer. Rules are aimed at enhancing the knowledge about customers. Financial institutions must place customers in one of several categories — (1) eligible counterparties; (2) professional customers; and (3) non-professional customers — in order to know them better and, with better knowledge, to advise them better. The categories are changing.

Inform your customer. On the basis of the category in which a particular customer falls, MiFID imposes on the financial institution an obligation to provide information, which must be correct and clear without being misleading, and timely. As the level of customer protection increases, so does the need for information.

MiFID also specifies strict requirements for the financial institution's internal and corporate business organization (*Corporate business reorganization*). Finally, the financial intermediary must take all reasonable steps to obtain the best possible result for the customers (*Best execution on the financial markets*).

Anti-Money Laundering

Directive 2005/60/EC addresses the prevention of the use of the financial system for the purpose of money laundering and terrorist financing. The directive establishes detailed rules for customer due diligence, including enhanced customer due diligence for high-risk customers and business relationships in order to determine whether a person is a politically exposed person or a financial institution is a shell bank. These rules call for:

- Identification and verification of customer;
- Identification and verification of beneficial owner;
- Information on the purpose and intended nature of the business relationship;
- Conducting ongoing monitoring of the business relationship; keep documents, data and information up-to-date.

The directive requires the internal establishment of compliance management procedures and policies, including reporting and record-keeping. Tax authorities may see information held by financial institutions as a good source of all kinds of information, which leads to the following questions:

- Can financial institutions be obligated to turn this information over to the tax authorities?
- When receiving a request for data regarding a customer of a financial institution, can the institution respond without violating privacy laws and data protection laws?

The answers to these questions are not yet clear.

U.K. Code of Practice on Taxation for Banks[5]

In the Budget of April 2009, the U.K. government announced plans for a ''code of tax conduct'' for banks operating in the United Kingdom. A consultation document and draft code were issued by HM Revenue & Customs (''HMRC'') in June 2009 and, following consultation with business, a revised code of conduct was published on 9 December 2009 (the ''Code''). The Code applies to all organizations (both U.K. and non-U.K.) undertaking banking activities in the United Kingdom, including predominantly non-banking organizations to the extent that they undertake banking-type activities in the United Kingdom. The Code itself is a relatively short document, focusing on three main areas: (1) governance; (2) the relationship between the bank and HMRC; and (3) tax planning. Adoption of, and compliance with, the Code are on a voluntary basis. HMRC have stated that the main objective of the Code is to ''encourage banks to follow the spirit as well as the letter of the law.'' However, there are concerns about the application, enforcement and precise ambit of the Code.

Governance

The Code requires participating banks to enact a formal, documented tax policy setting out strategy and process for tax matters, in which banks must commit to comply with tax obligations. Banks must also ensure, via approval committees or other means that such tax policy is properly taken into account in commercial decision-making. The aim of these provisions is to control the types of transactions banks enter into by ensuring that tax considerations are factored into business decisions. The obligation is strengthened by making the U.K. board of directors, or a senior accountable person for foreign banks, accountable for the tax policy.

The Relationship Between the Bank and HMRC

In order to achieve a transparent and constructive relationship, the Code lists certain behavior expected of the bank and of HMRC. The list includes: full disclosure of significant uncertainties in respect of tax; seeking to resolve issues before returns are filed; engaging with one another in a cooperative, supportive and professional manner; and focusing on significant issues with the aim of early resolution and achieving certainty on such issues. There is also provision for the bank to ''discuss its plans in advance'' with HMRC in order to help the bank assess its compliance with the tax planning rules detailed below. However, HMRC have clarified that the Code does not enact a clearance procedure and is not a mechanism for agree-

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[5] Michael McGowan, Sullivan & Cromwell LLP.

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ing the technical tax analysis of a transaction (there is a separate procedure for obtaining internal HMRC clearances on the effects of certain kinds of business transactions). HMRC envisage that their response to any discussions initiated pursuant to the Code will be limited to communicating a view on the question that arises under the Code (i.e., whether the proposed transaction is ''contrary to the intentions of Parliament''). Situations in which the bank does not agree with HMRC's view will not automatically be considered a breach of the Code, and HMRC propose to engage in ''common-sense dialogue'' to understand the commercial motivations of a bank, while reserving the right to inquire into the bank's returns and assess a bank's general approach to implementing the Code over a period of time.

Tax Planning

Of the three main areas, implementing the Code's provisions on tax planning is likely to have the most substantial impact on the way banks conduct their business. The guiding principle of this section of the Code is that banks should not engage in tax planning ''other than that which supports genuine commercial activity.'' The key criterion in this respect is that banks must ''reasonably believe'' that the tax result of a transaction is not contrary to the ''intentions of Parliament.'' This does not mean the intentions of Parliament as determined by the courts when interpreting tax legislation. In particular, in a Supplementary Guidance Note published on 9 December 2009, HMRC set out their view that tax results are ''contrary to the intentions of Parliament'' where such results are ''too good to be true.'' The Code prohibits the structuring of transactions that will have tax results for the bank that are ''inconsistent with the underlying economic consequences, unless there exists specific legislation designed to give that result,'' in which case a reasonable belief that this reflects the intentions of Parliament must be considered to justify undertaking the transaction. Banks must also refrain from promoting arrangements to other parties unless the bank ''reasonably believes'' that the tax results for the other parties are not contrary to the intentions of Parliament. The ''reasonable belief'' standard is said to be a common-sense test, ''no more than what a reasonable person would believe given the facts and circumstances, having considered the proposed transaction in the round.'' There is also a specific obligation on banks to structure remuneration packages for employees so that the bank ''reasonably believes'' that proper amounts of tax and national insurance contributions are paid. HMRC have stated that this obligation will require the bank to ask whether or not the result of a proposed arrangement is contrary to the intentions of Parliament, applying the ''too good to be true'' test.

The provisions of the Code can be seen as aiming to restrict the activities of banks by reference to the ''spirit'' of the law, which is an inherently ambiguous concept. This concept goes beyond purposive interpretation of tax legislation, as understood by the U.K. courts. For example, securing a reduction in tax by legitimate means may seem ''too good to be true,'' but may nonetheless be within both the wording of the legislation and the intentions of Parliament. Such a test seems more difficult to evaluate and apply than a general anti-avoidance rule (''GAAR''), as a GAAR requires examination of the intentions of the parties to the transaction, whereas the ''intentions of Parliament'' are arguably more difficult to quantify. Rather than looking to its own motivations, as a bank would do primarily under a GAAR, that bank must instead rely on whatever information is available of the intentions of Parliament to reach a view on whether its activities are Code-compliant.

Enforcement

Banks are not required to sign up to the Code and do not have to publish their compliance with it. There are no formal sanctions for non-compliance. However, HMRC will review the efficacy of the Code 12 to 18 months after the Code's operative date (9 December 2009), and have reserved the possibility of enacting further measures to promote adherence such as requiring in the accounts a statement that the bank has complied with the Code. HMRC have indicated that they will report a bank to the appropriate professional body where non-compliance with the Code is deliberate and in breach of the rules of that professional body. HMRC envisage that this action should apply only in exceptional circumstances because ''simply taking a commercial decision that HMRC or the Government did not like'' would not be grounds to make such a report.

For banks whose U.K. tax affairs are managed within HMRC's Large Business Service, compliance with the Code will be reviewed via the bank's existing Customer Relationship Manager at HMRC, who will be responsible for deciding whether an approach received from the bank regarding compliance with the Code requires consideration by HMRC specialists. HMRC undertake to record and monitor all approaches under the Code for consistency. As detailed above, HMRC will not give a view on whether a bank should enter into a particular transaction, and acting contrary to the opinion of HMRC may not necessarily be a breach of the Code. However, HMRC will report to the Treasury matters that HMRC consider are not in keeping with the ''spirit'' of the law, and this is likely to result in legislative changes. It is difficult to envisage a situation in which HMRC disagree with a bank on the ''intentions of Parliament'' and would

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still allow the controversial transaction to proceed without proposing legislation or challenging the relevant returns of the bank. Moreover, HMRC have stated that a bank not adopting (or adopting and failing to comply with) the Code will be subject to greater audit scrutiny because that bank will not be considered ''low-risk.''

Implications

The provisions of the Code, insofar as they relate to governance and the bank's relationship with HMRC, are less burdensome than originally proposed by HMRC in summer 2009. However, the restrictions on tax planning activities are likely to cause concern for signatories and are likely to deter banks from signing up to the Code, even if they run a higher risk of HMRC investigation by not adopting the Code.

In addition to the problems of ensuring consistency and properly interpreting and applying the standards set out in the Code (such as the ''intentions of Parliament'' test), respondents to the HMRC consultation raised concerns that the Code discriminates against banks, and would put banks at a competitive disadvantage against banks that have not adopted, or entities not subject to, the Code. HMRC admit that the rationale in applying the Code to banks is to address the perceived aggressive tax planning and promotion of tax-driven schemes undertaken by the financial services sector, particularly at a time when the government has given substantial aid to that sector. HMRC counter the assertion that the Code creates a competitive mismatch by reiterating that the responsibility for business decisions remains with the bank itself, regardless of any consultation with HMRC under the Code.

EU Savings Directive — Reporting by Banks[6]

Development of the EU Savings Directive

Since 1 July 2005, the EU Directive on taxation of savings income in the form of interest payments — EU Savings Directive, 2003/48/EC (''EUSD'') — is applicable to all EU Member States and 10 dependent or associated territories of EU Member States (Anguilla, Aruba, British Virgin Islands, Cayman Islands, Guernsey, Isle of Man, Jersey, Montserrat, Netherlands Antilles, Turks and Caicos Islands), and five European third countries (Andorra, Liechtenstein, Monaco, San Marino, Switzerland).

Tax evasion scandals prompted the EU Council to react and to amend the EUSD. In this context the European Commission on 13 November 2008 adopted an amending proposal to the EUSD [7] with a view to closing existing loopholes and better preventing tax evasion. The amended EUSD (''Amended Draft EUSD'') is part of an amendment package regarding also the Draft EU Directive on Administrative Cooperation in the field of taxation [8] and the already adopted EU Directive on the recovery of tax claims.[9] The draft EUSD is not yet in force and, due to the opposition of some Member States (e.g., Austria), work on the EUSD is currently ''on hold.''

Focus of the EUSD

General

Under the EUSD, each EU Member State has to automatically provide information to other Member States regarding interest paid from that Member State to individual savers resident in those other Member States. However, for a transitional period, Belgium, Luxembourg and Austria apply a withholding tax instead of providing information (15% from 1 July 2005 to 30 June 2008; 20% from 1 July 2008 to 30 June 2011; 35% from 1 July 2011 onwards). With effect from 1 January 2010, Belgium replaced the withholding tax by an automatic exchange of information. The EUSD is based on the paying agent principle and not on the debtor principle. Therefore, interest is covered by the Directive irrespective whether the paying agent is also the debtor of the interest or not.

The Amended Draft EUSD does not contain changes to these main principles of the EUSD. However, the draft contains substantial amendments of the EUSD regarding:

- The extension of beneficial ownership concept and the persons covered;[10]
- The extension of information reporting;[11]
- The new definition of ''paying agents'';[12]
- The extension of ''interest'' definition;[13]
- The clarifications within the withholding tax system.[14]

Persons Covered — Beneficial Owner

Only individuals who are beneficial owners of the interest are covered by the EUSD. The definition of

[6] Gerald Gahleitner, Leitner Leitner.

[7] Commission Proposal of EUSD, 13 November 2008, 2008/0215 (CNS).

[8] *See* chapter 2 of the Amended Draft EUSD.

[9] Council Directive 2010/24/EU concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures.

[10] *See* Amended Draft EUSD, chapter 1.2.2.

[11] *See id.*, chapters 1.2.3 and 1.2.6.

[12] *See id.*, chapter 1.2.4.

[13] *See id.*, chapter 1.2.5.

[14] *See id.*, chapters 1.2.7 and 1.2.8.

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the term ''beneficial owner'' is formalistic and does not correspond to the definition generally used in international tax law. Thus, an individual — under the current Art. 2 ¶1 EUSD — is not a beneficial owner if he acts:

- As a paying agent within the meaning of Art. 4 ¶1 EUSD;
- On behalf of a legal person, an entity that is taxed on its profits under the general arrangements for business taxation, an authorized UCITS (undertakings for collective investments in transferable securities), or an entity that is a paying agent according to Art. 4 ¶2 of the Directive, and in the last case, discloses the name and address of that entity to the person paying the interest, who communicates such information to the Competent Authority of its Member State of establishment; or
- On behalf of another individual beneficial owner disclosing the identity of the beneficial owner.

The Amended Draft EUSD establishes further criteria for not being regarded as beneficial owner. The material at the second bullet, above, is replaced by the following amendment:

> . . . He acts on behalf of an entity or a legal arrangement and discloses the name, the legal form and the address of the place of effective management of the entity or, in the case of a legal arrangement, the name and the permanent address of the person who primarily holds legal title and primarily manages its property and income, to the economic operator making or securing the interest payment.

With the new draft amendment, the recipient of the payments has extensive disclosure obligations whenever he acts on behalf of any entity or legal arrangements.

In addition, the Amended Draft EUSD provides that if an economic operator within the scope of the Money Laundering Directive 2005/60/EC makes an interest payment to an entity or legal arrangement mentioned in Annex I (a list of categories of entities and legal arrangements resident in non-EU jurisdictions that do not ensure appropriate and effective taxation), the definition of ''beneficial owner'' under the EUSD will include ''beneficial owner'' as defined under the Money Laundering Directive 2005/60/EC, which generally means the individual person at the final stage of international structures. With this, the Amended Draft EUSD intends to use the information collected under the Money Laundering Directive for its purposes in cases where trusts are interposed between beneficiaries and the economic operator is paying the interest. The Amended Draft EUSD does not intend to extend the Directive to all legal entities or arrangements in other Member States or in non-EU states as this seems to be an inappropriate solution. Information already available under the Money Laundering Directive 2005/60/EC will be used.

Identity and Residence of Beneficial Owners

The paying agent must establish under the current Art. 3 EUSD the identity of the beneficial owner, consisting of the name, address and, if there is one, the tax identification number (TIN). This information will be collected on the basis of the passport or of the official identity card presented by the beneficial owner. The address may also be proved by other documentary proof of identity. If the TIN is not shown on the mentioned documents and is not indicated on a certificate of residence, the identification must be supplemented by the place and date of birth that appears on the passport or official identification card.

The residence of the beneficial owner is established on the basis of the address. If the beneficial owner declares that he is resident in a third country, residence must be established by means of a tax residence certificate issued by the third country.

According to the Amended Draft EUSD, the paying agent must, in any case, establish the TIN or its equivalent allocated by the respective Member State if the beneficial owner is an EU resident. Consequently, according to the Amended Draft EUSD, the residence state for tax purposes must be established. In addition, the paying agent is asked to refer to the ''best information available to him at the paying date.'' This ensures regular updating of the information on the permanent address.

Paying Agents

Paying agents are obligated to exchange information or to withhold taxes. The paying agent is the last economic operator in any chain of economic operators, and consequently, the one that makes the payment to or for the benefit of the beneficial owner.

''Paying agent'' means any economic operator who pays interest to, or secures the payment of interest for the immediate benefit of, the beneficial owner.[15] Economic operators are individuals or corporate persons such as banks, mutual funds, debt issuers, administrators, transfer agents or investment managers.

In addition, any entity established in a Member State to which interest is paid or for which interest is secured for the benefit of the beneficial owner is con-

[15] Art. 4 ¶1 EUSD.

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sidered a paying agent.[16] This rule applies if the economic operator paying the interest has reason to believe, on the basis of official evidence produced by that entity, that: (1) such entity is a legal person, or (2) its profits are taxed under the general arrangements for business taxation, or (3) it is a recognized UCITS (as discussed below). If one of the exceptions applies an exchange of information or retention at source need not be executed. If such entity is considered a paying agent, the economic operator must communicate the name and address of the entity and the total amount of interest to the Competent Authority of its Member State of establishment. That Competent Authority forwards this information to the Member State in which the entity is established.

Under the Amended Draft EUSD and the current version, an economic operator is considered to be a paying agent if the payment is made for the immediate benefit of the beneficial owner. In addition the Amended Draft EUSD provides that a payment made to a trust or legal arrangement covered by the Money Laundering Directive 2005/60/EC is deemed to be made for the immediate benefit of the beneficial owner.[17] Further, the Amended Draft EUSD foresees that it is irrelevant whether the economic operator concerned is the debtor or issuer of the debt claim. It is up to the Member States to avoid any overlap of paying agent responsibilities in respect of the same interest income.

In addition, an economic operator must be considered a paying agent if it makes an interest payment for another economic operator established outside the territorial scope of the Directive and the first economic operator has evidence that the second economic operator will pay the interest to a beneficial owner resident in a Member State (circumvention by third state paying agent). in such a case the second economic operator is disregarded and the first economic operator has to fulfill the obligations under the new EUSD.

Finally, entities or legal arrangements (a positive list is provided in Annex III — e.g., EU trusts, partnerships, foundations) that are not taxed on the income are considered to be a paying agent upon receipt of interest and consequently are disregarded and the payments deemed to be directly made to the individual who is legally entitled to the assets or income or to the individual having directly or indirectly contributed to the assets. This last concept does not apply if (1) the entity or legal arrangement is a collective investment fund, (2) it serves the management of the assets of a pension fund or an insurance business, (3) it is a charitable institution, or (4) it is a shared beneficial ownership for which the identity and residence of all beneficial owners are established and therefore acts itself as paying agent.

Interest Covered

The definition of ''interest'' in Art. 6 EUSD covers interest from debt-claims of every kind, including cash deposits and corporate and government bonds and other similar negotiable debt securities. The definition of interest is extended to cases of accrued and capitalized interest. This includes, for example, interest that is calculated to have accrued by the date of the sale or redemption of a bond of a type where normally interest is paid only on maturity together with the principal (''zero-coupon bond''). The definition also includes interest income obtained as a result of investment via certain collective investment undertakings.

The Amended Draft EUSD aims to cover not only the above-mentioned savings income in the form of interest payments, but also other substantially equivalent income from innovative financial products and from certain life insurance products that are comparable to debt claim products. The term ''interest payments'' includes income paid or credited to an account relating to securities of any kind under which the investor receives a return on capital whose conditions are defined already at the issuing date, and also receives at the end of the term of the securities at least 95% of the capital invested, if the securities producing that income were first issued on or after 1 December 2008.

At present, Art. 6 EUSD only covers income obtained through UCITS authorized in accordance with Directive 85/611/EEC. In the future, the reference to this Directive will be replaced by a reference to the registration of the undertaking or investment fund or scheme in accordance with the rules of any of the Member States.

Regarding funds established outside the EU, in the future income obtained through any collective investment fund or scheme will be covered. The definition used in the Amended Draft EUSD now corresponds with the Organisation for Economic Co-operation and Development (OECD) definition of ''collective investment fund or scheme'' and clarifies that all investment funds are covered irrespective of the applicable regulation and how such funds are marketed to investors.

The new Art. 6 ¶6 EUSD not only is extended to legal arrangements but also clarifies that both — direct and indirect investments — made by collective vehicles in debt claims and in securities must be considered in the calculation of the percentage of the investment in debt claims in relation to the other assets in order to allow Member States to exclude specific interest payments from ''interest'' under the EUSD.

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[16] Art. 4 ¶2 EUSD.

[17] *See* Chapter 1.2.2.

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Another amendment is that in the future interest received not only by entities, but also by legal arrangements that have exercised the option to be treated as investment funds, will be covered by ''interest payment.''

Also to be covered as ''interest payments'' are benefits from a life insurance contract providing for a biometric risk coverage that, expressed as an average over the duration of the contract, is lower than 5% of the capital insured and its actual performance fully linked to interest or income — if the contract was first subscribed on or after 1 December 2008.

Information Reporting by the Paying Agents

According to Art. 8 EUSD, the paying agent must, as a minimum, report the following information to the Competent Authority of its state of establishment:

- The identity and residence of the beneficial owner;
- The name and address of the paying agent;
- The account number of the beneficial owner or, where there is none, identification of the debt-claim giving rise to the interest; and
- Information concerning the interest payment.

The EUSD will not impose additional administrative burdens to the paying agent and consequently the reporting approach is rather formalistic. The paying agent has no further obligation to investigate whether the individual is the beneficial owner by, for example, requesting a certificate of residence by the beneficial owner of the interest other than as provided above.

According to the draft amendments, the paying agent has further reporting obligations. It must report the tax identification number to the Competent Authority of the other Member State. Also, the concept of beneficial ownership is extended. Consequently, the paying agent must report information on the ultimate beneficial owner.

In order to reduce the administrative burden for the State of residence of the beneficial owner, information concerning interest payments that must be reported by the paying agent will be extended in the future. As of now, the minimum amount of information concerning interest payments is reported by the paying agent and the report should distinguish payments in the following ways:

- In the case of interest paid or credited to an account relating to debt claims of any kind, the report should distinguish between the amount of interest paid or credited;
- In the case of interest accrued or capitalized at the sale, refund or redemption of the debt claims or of shares or units in undertakings or entities, the report should distinguish the amount of interest or income embedded in the full amount of the proceeds from the sale, redemption or refund;
- In the case of income derived from investment funds, the report should distinguish between the amount of income and the full amount of the distribution;[18]
- In the case of an interest payment received by EU partnerships or trusts, the report should distinguish the amount of interest attributable to each of the member entities; and
- In the case where a Member State allows the paying agents to annualize the interest over a period of time and to treat it as an interest payment, where no sale, redemption or refund occurred, the report must distinguish the amount of annualized interest and other relevant income.

According to the Amended Draft EUSD, the paying agent has additional reporting obligations to the Competent Authority of its Member State of establishment concerning the reporting of the full amount of the proceeds from the sale, redemption, refund or distribution of a debt security. Under the terms of the new Amended Draft EUSD, there is an option for simplified reporting obligations that may be implemented by the Member States.[19]

Exchange of Information

Aside from Austria and Luxembourg (discussed below), the other EU Member States and Anguilla, Aruba, Cayman Islands, and Montserrat provide information to the resident state of the taxpayer on interest paid. The information is automatically communicated in a standard format at least once a year.

Withholding Tax System

In Austria and Luxembourg as well as in several third countries (Andorra, Liechtenstein, Monaco, San Marino, and Switzerland) and some dependent or associated territories (British Virgin Islands, Guernsey, Isle of Man, Jersey, Netherlands Antilles, and Turks and Caicos Islands), a withholding tax is applied instead of providing information. Of the amount withheld, 75% is transferred to the resident state of the taxpayer. The residual 25% is retained to cover the administrative costs in applying the withholding tax system.

Double taxation does not arise, because the resident state will credit the withheld taxes against the tax due

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[18] Art. 6 ¶1.C EUSD.

[19] Art. 6 ¶4 EUSD.

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by the taxpayer in that state. If the withheld taxes exceed the tax due in the resident state, the resident state will refund the remainder of the withholding tax.

If the taxpayer presents a certificate from the tax authorities of his state of residence that confirms their awareness of the foreign investment, no withholding tax is retained. The certificate must verify that the resident includes in its tax assessment the foreign savings income. The certificate must contain details of the beneficial owner and the paying agent and must be valid for a period not exceeding three years.

The HIRE Act and Foreign Person Reporting Obligations Under FATCA[20]

FATCA Provisions — Introduction

The current U.S. withholding tax regime provides for a 30% withholding tax on items of U.S.-source fixed or determinable annual or periodical income paid to non-U.S. persons, if the items are not effectively connected with the recipient's conduct of a U.S. trade or business. Withholding tax may be reduced by the presentation of a Form W-8BEN with a U.S. taxpayer identification number. The W-8BEN certifies that the foreign recipient is the beneficial owner of the income and that it is not a conduit or a fiscally transparent entity for U.S. income tax purposes. There is generally no withholding on gross proceeds — sales proceeds — paid to foreign persons and no withholding on U.S. persons, except to the extent ''domestic back-up withholding tax'' is imposed, because a W-9 Form does not contain a valid taxpayer identification number.

The current U.S. withholding tax regime provides that foreign financial institutions and fiscally transparent entities may enter into a Qualified Intermediary (QI) agreement with the U.S. Internal Revenue Service (IRS) to limit the identification of the foreign beneficial owners of U.S.-source fixed or determinable annual or periodical income. U.S. persons who are beneficial owners of an account opened with a QI must be reported to the IRS, and a Form 1099 must be issued. However, non-U.S. QIs have no reporting obligation with respect to U.S. customers who invest in non-U.S. bank accounts or non-U.S. securities. QIs and U.S. withholding agents have an obligation to report on U.S. persons when a foreign entity that is fiscally transparent and that has a U.S. member receives an item of U.S.-source fixed or determinable annual or periodical income.

In July 2008, the Senate Permanent Subcommittee on Investigations held hearings on use by U.S. persons of foreign accounts to hide income. In conjunction with the hearings, it issued *Tax Haven Banks and U.S. Tax Compliance*, which lists abuses by UBS and LGT. Among other things, the report stated that, in the period since 2001, LGT and UBS have collectively maintained thousands of U.S. client accounts with billions of dollars in assets that have not been disclosed to the IRS. UBS alone maintained in Switzerland for U.S. clients an estimated 19,000 accounts with assets valued at $18 billion, and the IRS has identified at least 100 U.S. taxpayers with accounts at LGT.

Various legislative proposals were offered in the two years that followed the hearings and on March 18, 2010, President Obama signed into law H.R. 2847, the ''Hiring Incentives to Restore Employment Act of 2010'' (the ''HIRE Act'').[21] The HIRE Act targets job creation by providing tax incentives to employers, such as business credits for newly hired employees. The revenue loss for the new business credits is offset, in part, by a slightly modified version of the previously proposed Foreign Account Tax Compliance Act of 2009 (''the FATCA Provisions''). FATCA imposes obligations on ''foreign financial institutions'' (''FFIs'') and ''non-financial foreign entities'' (''NFFEs'') to disclose to the IRS offshore accounts or investments of U.S. persons. Failure to comply subjects FFIs and NFFEs to new 30% withholding tax on certain payments.

FATCA Provisions — In General

In comparison to the ordinary income withholding tax provisions under §1441 of the Code,[22] where information on foreign beneficial owners is crucial for purposes of allowing reduced withholding tax rates provided by treaty, the FATCA withholding tax is a negative incentive designed to encourage foreign entities to report on U.S. taxpayers investing through foreign entities and financial institutions. Viewed in this light, the FATCA provisions are designed to mitigate offshore tax evasion through increased information reporting and penalty taxes designed to provide enhanced reporting on U.S. residents and citizens. The tax withholding requirements that were incorporated into the HIRE Act include:

- The imposition of a new 30% withholding tax on certain U.S.-source payments made to FFIs and NFFEs that refuse to identify U.S. account holders and investors with at least a 10% ownership in the FFI or NFFE, even if such U.S. persons hold

[20] Stanley C. Ruchelman, The Ruchelman Law Firm. The contribution of Deborah J. Jacobs is acknowledged. Ms. Jacobs is of counsel to The Ruchelman Law Firm and is primarily responsible for an earlier version of this material.

[21] P.L. 111-147.

[22] Unless otherwise indicated, all section (''§'') references in this part of this article discussing U.S. law are to the Internal Revenue Code of 1986, as amended (the ''Code'').

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only non-U.S. bank and securities accounts (either directly or indirectly);

- The denial of a deduction for interest paid on foreign-targeted bearer bonds and the denial of the portfolio interest exemption from the 30% U.S. withholding tax required on interest paid to foreign persons in the absence of treaty protection. However, the HIRE Act maintains the exemption from the excise tax imposed by §4701(b) on foreign-targeted bearer bonds;
- The imposition of penalties as high as $50,000 on U.S. taxpayers who own at least $50,000 in offshore accounts or assets but fail to report this on their annual income tax returns;
- The imposition of a 40% penalty on the amount of any understatement attributed to undisclosed foreign assets;
- The imposition of a 30% withholding tax on substitute dividends and dividend equivalent payments that are received by foreign persons;
- The extension of the statute of limitations to six years for "substantial" omissions — omissions exceeding $5,000 and 25% of reported income — derived from offshore assets;
- The requirement that any U.S. shareholder in a passive foreign investment company (PFIC) file an annual report containing such information as the IRS may require;
- The presumption that a foreign trust has U.S. beneficiaries if a U.S. person directly or indirectly transfers property to the trust; and
- The expansion of the foreign trust reporting requirements and the establishment of a $10,000 minimum failure-to-file penalty for certain foreign-trust-related information returns.

Withholding Tax

Section 501 of the HIRE Act creates new Code §§1471 through 1474, which, collectively, impose a 30% withholding tax on "withholdable payments" made to FFIs, including qualified intermediaries (QIs) or to NFFEs if the FFI, QI, or NFFE fails to comply with new reporting and disclosure obligations. As a result, these rules create new reporting, disclosure and withholding obligations for U.S. withholding agents and multinational corporations. These provisions are subject to a grandfather provision, which exempts payments on, and the gross proceeds from the disposition of, obligations outstanding on March 18, 2012. Any withholdable payment made after December 31, 2012, to an FFI or an NFFE is subject to the 30% withholding tax.

A withholdable payment is defined in §1473 of the Code. It is any payment of interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States, and any gross proceeds from the sale or other disposition of any property of a type that can give rise to interest or dividends from sources within the United States. Thus, in comparison to the withholding tax under §1441, sales proceeds of debt and equity securities will be potentially subject to the tax under new §1471.

Section 1471 imposes a 30% withholding tax on withholdable payments made to FFIs unless the FFIs agree to identify certain U.S. account holders and provide information regarding these persons to the IRS. Under this section, an FFI is defined as any foreign entity that: (1) accepts deposits in the ordinary course of a banking or similar business; (2) is engaged in the business of holding financial assets for the account of others, or (3) is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting or trading securities, interests in partnerships, commodities or any interest (including futures or forward contracts or options) in such securities, partnership interests or commodities. In theory, this definition could include certain investment vehicles such as private equity funds and hedge funds.

Section 1471 provides that each FFI will be subject to the 30% withholding tax on "withholdable payments" unless it agrees to enter into an agreement with the IRS containing the following terms:

- To obtain information from each account holder as is necessary to determine which accounts are "U.S. accounts";
- To comply with verification and due diligence procedures (to be prescribed by the IRS) with respect to the identification of "U.S. accounts";
- To report on an annual basis the information with respect to "U.S. accounts";
- To deduct and withhold a 30% withholding tax on any pass-thru payment to a recalcitrant account holder or to another FFI that does not comply with the obligations imposed under §1471;
- To comply with requests by the IRS for additional information with respect to any U.S. account maintained at the FFI; and
- To attempt to obtain a waiver from a foreign state if its laws prevent such disclosure, and to close the account if the waiver cannot be obtained.

Section 1471(c) provides that the information reporting requirements are satisfied and the 30% with-

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holding tax can be avoided if the FFI reports the following information to the IRS:

- The name, address and U.S. taxpayer identification number of each account holder that is a U.S. person;
- The name, address and U.S. taxpayer identification number of each substantial U.S. owner of any account holder that is a U.S.-owned foreign entity;
- The account number;
- The account balance or value (determined at such time and in such manner as the IRS may provide); and
- The gross receipts and withdrawals or payments from the account.

In general, a ''U.S. account'' is defined as any financial account that is held by one or more specified U.S. persons or U.S.-owned foreign entities. Section 1472 provides similar rules for withholdable payments made to NFFEs. Thus, the withholding agent must deduct a 30% withholding tax in the case of any withholdable payment made to a NFFE, unless all the following facts are present:

- The beneficial owner or payee provides the withholding agent with: (1) a certification that the beneficial owner or payee does not have a ''substantial U.S. owner''; or (2) the name, address, and TIN of each substantial U.S. owner of such beneficial owners;
- The withholding agent does not know, or have reason to know, that any information provided by the beneficial owner is incorrect; and
- The withholding agent reports such information to the IRS.

A substantial U.S. owner is a U.S. person that holds more than 10% of the foreign entity.

FFIs and NFFEs face severe implementation challenges regarding the reporting obligations under the FATCA provisions. First, the FFI definition is very broad as it includes banks, broker/dealers, hedge funds, private equity funds, collective and family investment vehicles, and securitization vehicles. All of these entities will be required to design and implement an information system that can report on U.S. accounts and accounts with substantial U.S. owners. At a minimum, there are likely tens of thousands of FFIs that have invested in U.S. securities. All must comply. Substantial administrative burdens have been placed on the IRS, which must administer direct agreements with the FFIs and the FFIs themselves.

Second, it is not clear how an FFI goes about proving a negative fact: that an account holder is not a U.S. person. Current financial know-your-customer rules are not designed to identify dual citizen individuals carrying more than one passport. The IRS has been urged to adopt a set of grandfather rules for existing accounts in order to simplify the process of designing an adequate system. However, it is unlikely that grandfather rules will be adopted.

Withholding agents are not exempt from these burdens. Because of the difference in rules applicable to an FFI and an NFFE, a withholding agent must distinguish between these categories when it engages in a withholdable transaction with a foreign entity. The burden would be lessened if safe harbor presumptions are adopted, but it is not clear that the IRS intends to detract from the negative incentive for compliance.

Bearer Bonds

Section 502 of the HIRE Act has changed the U.S. tax treatment of interest on certain obligations that are not in registered form. These obligations, commonly referred to as bearer bonds, lack a formal registration system to identify their holders and allow the holders to remain unknown, providing them with the opportunity for tax avoidance. Prior to the effective date of this provision, U.S. law provided an interest deduction for interest on certain bearer bonds to issuers and non-U.S. beneficial owners if the obligations were: (1) made by a natural person; (2) matured in one year or less; (3) were not of a type offered to the public; or (4) were ''foreign-targeted obligations,'' i.e., were issued under arrangements reasonably designed to ensure the sale (or resale) of them only to non-U.S. persons.

Section 502 of the HIRE Act makes interest paid on bearer bonds to a non-U.S. person ineligible for the portfolio interest exemption from the 30% withholding tax in the case of interest on registration-required bearer bonds that are foreign-targeted. Section 502 also denies to issuers of registration-required bearer bonds a deduction for interest paid on foreign-targeted bearer bonds. However, §502 maintains the exemption from the excise tax imposed by Code §4701(b). Section 502 also extends bearer bond tax penalties to any such bonds marketed to offshore investors, and prevents the U.S. government from issuing bearer bonds.

This section of the HIRE Act is effective for bonds issued after March 18, 2012.

Substitute Dividends and Dividend Equivalent Payments

Effective with respect to payments made on or after September 14, 2010 (180 days after the March 18, 2010, enactment of the HIRE Act), §541 of the HIRE

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Act creates a new provision, originally Code §871(l), subsequently redesignated as §871(m),[23] which changes the U.S.-source and character rules for ''dividend equivalent payments'' on ''specified notional principal contracts'' (''NPCs'') such as equity swaps. However, this section does not change the rules with respect to interest rate swaps, currency swaps, credit default swaps, and other NPCs.

Under the law before the HIRE Act amendment became effective, payments to foreign persons on NPCs that reference equity of U.S. corporations were usually treated as foreign-source income and, thus, were not subject to U.S. withholding tax. This tax treatment is the opposite of the tax treatment on the payment of a dividend on U.S. portfolio stock held by a foreign person, which, absent a treaty benefit, is subject to the 30% withholding tax. Section 541 of the HIRE Act makes the withholding tax treatment of dividends and ''dividend equivalent'' payments consistent and treats both of them as U.S.-source income subject to the 30% withholding tax, absent a treaty benefit.

Under §871(m)(2), a ''dividend equivalent'' is defined as:

- Any substitute dividend made pursuant to a securities lending or a sale-repurchase (''repo'') transaction that (directly or indirectly) is contingent upon, or determined by reference to, the payment of a dividend from sources within the United States;
- Any payment made pursuant to a ''specified notional principal contract'' that (directly or indirectly) is contingent upon, or determined by reference to, the payment of a dividend from sources within the United States; and
- Any other payment determined by the Treasury Secretary to be substantially similar to a payment described in the first two clauses above.

Under §871(m)(3), there are two definitions of ''specified notional principal contracts.'' The first definition is for payments made on or after September 14, 2010. At that time, a ''specified notional principal contract'' is defined as any NPC that meets any one of the following five tests:

- In connection with entering into such contract, any long party to the contract transfers the underlying security to any short party to the contract;
- In connection with the termination of such contract, any short party to the contract transfers the underlying security to any long party to the contract;
- The underlying security is not readily tradable on an established securities market;
- In connection with entering into such contract, the underlying security is posted as collateral by any short party to the contract with any long party to the contract; or
- For payments on or before March 18, 2012, such contract is identified by the Treasury Secretary or authorized designee as a ''specified notional principal contract,'' or, for payments after March 18, 2012, such contract is any NPC unless the Secretary determines that such contract is of a type that does not have the potential for tax avoidance.

Section 871(m) effectively revokes Notice 97-66 [24] for securities lending and repo transactions. Notice 97-66 was issued to mitigate overwithholding on distributions in lieu of dividends. However, §871(m)(6) provides that, in the case of any chain of dividend equivalents one or more of which is subject to tax under §871(m) or §881, the IRS has the option to reduce such tax, but only to the extent the taxpayer can establish that such tax has been paid with respect to another dividend equivalent in such chain, or is not otherwise due, or as the Secretary determines is appropriate to address the role of financial intermediaries in such chain. In addition, new §871(m)(5) provides that ''dividend equivalent'' payments are to be computed on a gross rather than a net basis.

Penalties — Failure to Disclose Offshore Accounts or Assets

Section 511 of the HIRE Act adds a new Code §6038D, which provides that any U.S. taxpayer who, at any time during the taxable year, holds any interest in ''specified foreign financial assets'' totaling more than $50,000 (or such higher amount as the IRS may prescribe) must include a disclosure statement on his annual income tax return. ''Specified foreign financial assets'' means any financial account maintained by a foreign financial institution and any assets held outside of a foreign financial institution that consist of the following:

- Any stock or security issued by a non-U.S. person;
- Any financial instrument or contract held for investment that has an issuer or counterparty that is other than a U.S. person); and
- Any interest in a foreign entity (possibly including stock in a foreign corporation that is publicly traded in the United States or on a U.S. exchange).

[23] *See* P.L. 111-226, §217(b)(2).

[24] 1997-2 C.B. 328.

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Any U.S. taxpayer who fails to furnish information on his annual income tax return will be subject to a penalty of $10,000. An additional $10,000 penalty is due for every 30 days (or fraction thereof) during which such failure persists longer than 90 days after notice of the failure is mailed to the taxpayer, up to a maximum of $50,000. However, no penalty will be imposed if the failure to furnish such information is due to reasonable cause and not due to willful neglect.

This section of the HIRE Act is effective for taxable years beginning after March 18, 2010.

Penalty for Failure to Disclose Foreign Assets

Section 512 of the HIRE Act amends Code §6662 to provide that if a U.S. person understates income that is related to an ''undisclosed foreign financial asset,'' then such person will be subject to a 40% penalty. An ''undisclosed foreign financial asset'' is defined as any asset for which information was not properly provided but is required to be disclosed as an interest in a ''specified foreign asset'' or under any of a number of other Code provisions enumerated in §6662(j).

This section of the HIRE Act is effective for taxable years beginning after March 18, 2010.

Statute of Limitations for Substantial Omissions

Section 513 of the HIRE Act amends Code §6501(e) to provide an extension of the statute of limitations on tax assessment to six years for significant omissions of income derived from ''specified foreign assets'' in an amount exceeding $5,000 in any taxable year. Under previous law, this exception applied only to a ''substantial omission'' of an amount equal to 25% of gross income stated in the return. Section 513 also amends Code §6501(c) to provide that in the event of a failure to furnish information required to be reported under §6038D or any of eight other enumerated provisions concerning foreign assets and U.S. owners or managers, then the statute of limitations on tax assessments for any tax return, event, or period to which the information relates will not expire before the date that is three years after the required information is furnished. The extension of the limitations period under §6501(c) is limited to the items related to the failure if the failure is due to reasonable cause and not willful neglect.[25]

This section of the HIRE Act is effective for tax returns filed after March 18, 2010, and for returns filed on or before March 18, 2010, if the assessment period for such tax returns has not expired as of that date.

Enhanced PFIC Reporting

Section 521 of the HIRE Act amends Code §1298 to require that a U.S. person who is a shareholder in a PFIC must file a Form 8621 or a ''Return by a Shareholder of a Passive Foreign Investment Company or Qualifying Fund'' on an annual basis. Previously, a U.S. person was required to file a Form 8621 only for a taxable year in which the person:

- Recognized a gain of a direct or indirect disposition of PFIC stock;
- Received certain direct or indirect distributions from a PFIC; or
- Made a reportable election.

This section of the HIRE Act is effective on March 18, 2010.

Presumption — Foreign Trust Has U.S. Beneficiaries

Sections 531 and 532 of the HIRE Act clarify and expand the rule for determining whether a foreign trust created by a U.S. person should be treated as having a U.S. beneficiary. Where those facts exist, the trust is a grantor trust and the income, deductions, gains, and losses are attributed to the U.S. settlor of the foreign trust. These sections amend Code §679 to clarify that an amount is to be treated as accumulated for the benefit of a U.S. person where a U.S. person is a contingent beneficiary. In addition, with respect to a discretionary trust, the trust will be treated as having a U.S. beneficiary if any person has the discretionary power to make a distribution from the trust to, or for the benefit of, any person unless the terms of the trust specifically identify the class of persons to whom such distributions may be made, and none of said persons is a U.S. person during the taxable year.

This section of the HIRE Act is effective for taxable years beginning after March 18, 2010.

Reporting Requirements of U.S. Owners of Foreign Trusts and Penalties

Section 534 of the HIRE Act amends Code §6048(b) to provide that a U.S. person who is treated as the owner of any portion of a foreign trust under grantor trust provisions must provide information returns as required with respect to the trust, in addition to ensuring that the trustee of the trust complies with reporting requirements. This section of the HIRE Act is effective for taxable years beginning after March 18, 2010.

Section 535 of the HIRE Act amends Code §6677(a) to increase the penalty for failing to timely file information returns related to certain foreign trusts. If such reporting obligations are not met, a minimum penalty of $10,000, or 35% of the gross reportable amount, may be imposed.

This section of the HIRE Act is effective for information returns required to be filed after December 31, 2009.

[25] §6501(c) as amended by P.L. 111-226, §218, effective as if included in the HIRE Act.

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DEVELOPMENTS IN CORPORATE TAX COMPLIANCE

Horizontal Monitoring in The Netherlands[26]

Introduction

The tax environment and the way tax lawyers have carried out their activities has changed significantly over the past 10 years. On the one hand, globalization has had a great impact on the way the companies do business across the border. It has increased the tax planning possibilities of multinational enterprises and also increased the complexity of the planning tools. On the other hand, financial scandals (such as Enron) have changed the way ''tax'' has been handled by multinational enterprises. For them, in today's world, ''tax'' is a risk factor as any other risk is for a multinational enterprise. The number one priority of the Board of Directors of such a multinational enterprise is to be ''in control'' of any risk, including ''tax,'' and to be able to issue an ''in control'' statement to that effect. As a result, ''tax risk management,'' ''corporate governance,'' and ''corporate social responsibility'' are at present day-to-day factors to deal with for the board of a multinational taxpayer and its advisors.

In Control of Tax — Not Only From a Taxpayer's Perspective

The above-described developments have not only had an impact on how multinational taxpayers deal with ''tax''; they have also had an important impact on the way the tax authorities operate. The complexity of international (tax planning) transactions has increased tremendously, due to (or leading to) a continuously increasing complexity in the law, including anti-abuse provisions and case law. In any case, globalization has contributed to increasingly complex cross-border transactions, involving multiple jurisdictions at the same time. This obviously has an impact on the role of the tax authorities. In the international and complex world of today, it is simply not possible to control the positions all taxpayers take in their tax returns. The tax administrations generally lack the people and knowledge to keep up with this, which has resulted in the following consequences:

- Less tax audits/less control and less mutual trust;
- More time between the issuance of the tax assessments and the period to which they relate (working in the past, as opposed to working in the present);
- If corrections are made (as a result of an audit or a more limited scope investigation), these corrections often regard a year that is long ago (which leads to a higher tax risk with regard to past years for multinational enterprises);
- Unwillingness by the tax authorities to cooperate in discussing the tax consequences of a specific transaction due to a lack of trust and issues outstanding from past years.

As mentioned above, the Boards of Directors of multinational enterprises want to control their tax risks, but the same is true for the tax administrations. For the administrators, the amount of tax collected is a risk that needs to be better managed. All of these developments have caused taxpayers and tax authorities to review their situation — and that review has led to a trend that has been summarized by the OECD as ''enhanced relationship between revenue bodies and taxpayers.'' The basic, traditional relationship between revenue bodies and taxpayers is usually defined by reference to what each party is legally required to do without any urging or persuasion from the other. The development toward an enhanced relationship has been driven by the recognition that tax compliance can be improved by blending incentives to full compliance with the traditional penalties for noncompliance, the typical carrot and the stick approach.

An Enhanced Relationship with the Tax Administration in the Netherlands

In the Netherlands, we like to think we are ''pioneers'' in developing an enhanced relationship between tax authorities and taxpayers. Dutch taxpayers traditionally are able to discuss matters with tax authorities in advance. Our ruling system existed many years before similar systems emerged in other jurisdictions. This has always been based upon a certain level of mutual trust and transparency.

A pilot study of our own version of enhanced relationship, called the ''horizontal monitoring,'' was introduced in April 2005, when 20 multinational taxpayers were invited to enter into an agreement with the tax authorities regarding rights and obligations that are not necessarily derived from the law. Horizontal monitoring was chosen based upon queries made by tax authorities about a tax declaration, sometimes resulting in an in-depth investigation, and enforcement measures to correct the calculation of the tax payable and to collect the increased amount of tax payable. Horizontal monitoring should be based upon mutual trust and transparency where tax authorities and taxpayers deal with each other on an equal footing. It entails a revision of the rights and obligations of both parties to the agreement.

The International Context

Working Paper 6 of the OECD Tax Intermediaries Study Group, published in July 2007, builds on the

[26] Mark van Casteren, Loyens & Loeff.

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enhanced relationship concept. The Dutch system of horizontal monitoring is mentioned as an example, as are the systems in the United States and in Ireland. Also the United Kingdom has been very active in pursuing enhanced relationships with taxpayers. In the ensuing time, the OECD has been encouraging EU Member States to create their own system of enhanced relationships. This was also expressed during the Cape Town Communiqué issued in January 2008. Since then, more countries have been taking steps in the direction of some sort of a system where the relationship is enhanced. Spain, for instance, has created a discussion group in which large enterprises are invited to express their views. This may be seen as an important step to enhance the relationship between taxpayers and authorities.

How the Dutch System of Enhanced Relationship Works

The Dutch process starts with an invitation. Only very large businesses are considered. The tax administration invites them to enter into a so-called compliance covenant (or maintenance agreement), which forms the basis of the enhanced relationship. In a typical compliance covenant, the rights and obligations of each party are recorded. These rights and obligations do not necessarily have a legal basis. The taxpayer will become responsible for swiftly providing information that may be relevant from a tax point of view and will need to actively put forward issues that may have a tax uncertainty. It will share the tax analysis and arguments with the tax authorities. These are obligations that do not automatically follow from legal provisions. Tax authorities oblige themselves to provide certainty on tax issues within a short period of time and to issue tax assessments promptly. The starting point is an agreement based upon mutual trust and equality between the parties.

The tax administration imposes certain requirements upon the very large businesses they invite to enter into a compliance covenant. They require that these taxpayers maintain a ''tax control framework'' that is actively monitored on a continuous basis.

A compliance covenant includes the following elements:

- The taxpayer should inform the tax administration about any position of which the tax consequences may not be certain and any tax risks;
- The tax administration will quickly give its reaction;
- The taxpayer will provide the tax administration with the complete facts on an uncertain position or risk, without delay;
- The taxpayer must maintain a tax control framework that meets the minimum conditions imposed by the tax administration;
- Both parties have periodical meetings to discuss potential tax issues;
- The taxpayer will file its corporate income tax returns as soon as practical after the end of the taxable year;
- The tax administration will issue the corporate income tax assessment as soon as practical after the filing of the return; and
- The parties will agree upon the term within which questions should be answered by the taxpayer.

A typical compliance covenant does not have a term and is evaluated periodically by the tax administration as well as the Board of Directors of the taxpayer. Either party may cancel the agreement. There is no provision for dispute resolution in the maintenance agreement.

As mentioned above, the enhanced relationship starts with an invitation. The not-so-large enterprises and individuals have not yet been invited. Businesses may seek agreements with the professional organization to which they belong on certain technical matters. Technically, this is not horizontal monitoring, but it is part of the same policy statement. In addition, agreements may be concluded between tax authorities and professional organizations of tax advisors. These agreements also deal with the way the tax returns will be presented and include a provision to bring forward any possible tax issues.

Benefits for the Taxpayer

There are many advantages for a taxpayer that enters into a compliance covenant with the tax administration.

- First, the taxpayer will be able to obtain certainty about its tax position at a relatively early stage. That is important in today's world of corporate governance and Boards of Directors that must be ''in control'' of all risks at all times.
- Second, when entering into the agreement in the Netherlands, all ''old'' matters, subject to discussion and extensive scrutiny will be settled. This may not all be in the form as desired by the taxpayer, but ''cleaning up'' the past leads to a clearer tax position in the financial accounts of the taxpayer. In practice, when dealing with various issues from the past at the same time, the tax administration is more likely to settle through compromise.
- Third, the communication with the tax administration focuses on the present and the future. That is better than communication in the course of audits of older years.

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- Fourth, preliminary consultations about the viewpoints of the tax authorities are easily accomplished, as the taxpayer will have guaranteed access to the tax administration. In addition, the tax administration will also be obliged to react within a short period of time.
- Fifth, as tax authorities will already have insight into the tax position of a taxpayer, the corporate income tax return will only be reviewed to a limited extent, and in some cases rubber stamped.

Finally, the aim is also to avoid tax litigation as much as possible. Only where there is a ''question of law'' will matters lead to a case in the courts.

The Down-Side Exposures

Several aspects of the program are contentious. First, participation is based upon selection by the tax authorities among large enterprises. That raises a concern with respect to the requirement of equal treatment of all taxpayers. This system, which is ostensibly based upon mutual trust and transparency, looks not at all transparent for those taxpayers left outside the select group. This is especially so where the maintenance agreements are published in an anonymous way for confidentiality reasons. In those published agreements, the ''deals'' that have been concluded for the past are not included. This leads to the question of whether taxpayers have been given equal treatment. And as only very large businesses are invited, it may lead to the suggestion that they have a preferred position with the authorities. While few tax advisers believe this to be true, an appearance of impropriety is something that a government should try to avoid at all times.

An additional concern arises where the tax authorities invite only taxpayers ''whose tax control framework'' is in order. This may cause a reputational damage for those businesses who choose not to conclude an agreement. Others (including their financial auditors) may believe that a client's behavior in tax matters is not up to the standard of the tax authorities. While concluding an agreement is voluntary, the question remains how much freedom actually exists to continue or terminate the agreement.

A second contentious area is the requirement to disclose information for which disclosure is not obligatory under law. Under tax legislation in the Netherlands, details relevant for tax purposes must be provided to the tax authorities only when the tax return is filed. These facts and details can then form the basis of an investigation. Tax authorities can subsequently require the taxpayer to provide information, but only if that information is relevant for tax purposes. A taxpayer cannot be required to share a legal analysis with the tax authorities or to give insight in the tax advice that they have been given by third parties. Pursuant to the compliance covenant, the taxpayer must discuss all material issues the tax consequences of which are unclear. This may lead to a problematic situation in the case of due diligence in the context of an acquisition or sale. In these situations, the first question that arises is to what extent the taxpayer needs to discuss any past tax risks that are discovered during the performance of due diligence of a target company. When does the taxpayer need to discuss these matters with the tax authorities? What if the proposed acquisition is being discussed (and would be required to be discussed at that time in accordance with the compliance covenant), including any tax issues that have come up from the due diligence — and the acquisition subsequently does not actually take place? Could this lead to an aggressive examination of the target? Another example involves a taxpayer that conducts vendor due diligence in preparation for a potential sale of one of its group companies. Would it be required to discuss any and all issues which came to light as a result of the due diligence exercise? If a stock purchase agreement transfers tax risks from the seller to the buyer, should the buyer be discussing issues with the tax administration that relate to the seller?

Also, the determination whether an issue must be disclosed and discussed with the tax administration can be problematic. What if the taxpayer considers something not to be a potential tax issue, but the tax administration maintains a different view? The term ''tax risk'' is not defined. It is anticipated that these kinds of disputes will arise in the future and it is absolutely unclear how they will be solved. The only possibility provided in the agreement is to cancel the agreement (with the potential reputational damage as described above). It is unfortunate that the agreement does not include a dispute resolution that provides for mandatory mediation or arbitration.

What's Next?

Nonetheless, a maintenance agreement appears to be satisfactory in practice for the parties involved. A survey in the Netherlands indicated that the parties that have participated in the program have been very happy with the results, although the fact that old matters have been settled first may have had something to do with those positive answers. Still, it is good to pay attention to the legal position and legal rights of the taxpayer. The legal perspective is very relevant and has not been sufficiently considered in the current Dutch practice of an enhanced relationship. Where accountants are very pleased with the better management of risks, lawyers are concerned about the legal position of the taxpayer.

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FIN 48 Primer — U.S. GAAP[27]

Background

FIN 48 is an accounting standard that mandates disclosure of uncertain tax positions. It was adopted in light of the concern expressed in Congress regarding potential manipulation of reported profits by Securities and Exchange Commission (SEC) registrants. The example was Enron and the accounting failures leading up to its bankruptcy. The concern focused on three items: (1) the lack of consistency in the standards for reporting ''uncertain tax positions''; (2) the flexible standard for recognizing reserves for tax contingencies that could be used to manipulate earnings; and (3) the need for greater transparency. In part to prevent Congressional action addressing accounting standards for SEC registrants, the Financial Accounting Standards Board (FASB) acted to mandate transparency for uncertain tax positions.

The entities affected by FIN 48 are: (1) SEC registrants and private for-profit companies; (2) not-for-profit organizations; (3) pass-through entities (partnerships and LLCs); (4) collective investment vehicles (REITs, RICs, etc.); and (4) foreign corporations that issue publicly traded ADRs and use U.S. Generally Accepted Accounting Practices (U.S. GAAP) to report financial results.

Uncertain Tax Benefits

FIN 48 applies to all tax positions accounted for in accordance with FAS 109, Accounting for Income Taxes. Thus, it applies to U.S. federal, state, and foreign taxes. A tax position includes both a position in a previously filed tax return and a position expected to be taken in a future return that is reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods. The tax position can be permanent or temporary. Tax positions include:

- Decisions not to file state or foreign income tax returns;
- Expected state tax return filing positions, such as to file a unitary tax return or a separate company tax return;
- Temporary differences arising from depreciation and amortization of assets;
- Amended returns or refund claims;
- Use of tax carryforwards;
- Business reorganizations and restructurings; and
- The effect of partnership tax positions.

Principal areas of focus include the following issues:

- Is the taxpayer doing business in a state so that a tax return must be filed in the state and tax paid?
- Is the taxpayer doing business in a foreign country through a permanent establishment so that a tax return must be filed and tax paid?
- Is the transfer pricing policy of the group arm's-length, both in the United States and abroad?
- Does Subpart F apply for a company that has permanently invested its profits outside the United States?

Recognition of an uncertain tax position is made for each ''Unit of Account'' for all open taxable years. A Unit of Account is the item that has a tax benefit that requires measurement. Companies must identify the appropriate Unit of Account that relates to an uncertain tax position. Identification of a Unit of Account is a matter of judgment by management that must be applied consistently. For example, a company has several research and development centers. The activity at those centers result in credits to reduce U.S. income taxes and state taxes (because of a comparable provision in state tax law). If the expenditures made at each facility are significant, each facility is a separate Unit of Account. The credits claimed at each Unit of Account must be measured under a consistent standard.

More-Likely-Than-Not Standard

To qualify for benefit recognition, a tax position must have at least a more-likely-than-not chance of being sustained, if challenged by tax authorities. This requires an analysis of tax law, regulations, published and private rulings of the applicable tax authority, other pronouncements, court cases and widely understood administrative practices and precedents. A widely understood administrative practice and precedent is a term with limited application under FIN 48. The analysis must lead to determination that the taxpayer's position has a greater than 50% likelihood of being affirmed in light of the relevant facts and circumstances. In making the determination, it is expressly assumed that the tax authority will have full knowledge of all relevant information. No consideration is given for detection risk. It is assumed that the tax authority will challenge the position through the level of a court of last resort.

In reaching a determination, the impact of indirect tax benefits are not taken into account. Examples of indirect benefits are U.S. foreign tax credits on Subpart F income and U.S. income tax deductions that may arise from state taxes on uncertain tax positions.

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[27] Stanley C. Ruchelman, The Ruchelman Law Firm.

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Measurement

After concluding that a tax position should be recognized, the amount of the tax benefit should be measured. Measurement is based on probability concepts. The amount recorded represents the largest amount of tax benefit that is likely to be realized, with likelihood measured under a greater-than-50% standard. Interest must be recognized in the first period interest would accrue. Penalties are recognized in the period in which the tax position is actually taken. Past practices may be considered when recording the amount of penalties.

No uniform method is provided for determining the probability of each possible outcome. In many instances, probability is measured on an all-or-nothing basis — full deduction or no deduction. In other instances, probability is based on the weight of technical authority applied to the facts — such as where the case law is conflicting but of comparable merit and three out of five cases support the benefit.

Measurement is a continuous process. Remeasurement may be based on ''new information,'' changes in case law, new rulings of the applicable tax authority, and the results of tax examination if there is only a remote likelihood of re-examination.

Disclosure

The total amount of uncertain tax positions that impact the effective tax rate of the entity, if recognized, must be disclosed in the financial statement. Disclosure is intended to assist financial statement readers in quantifying uncertain tax benefits. Interest and penalties are recorded to tax expense for the current year and the cumulative accrual of interest and penalties is recorded on the balance sheet. Disclosure continues in subsequent statements as long as the year remains open in a major tax jurisdiction.

IRS Tax Return Disclosure Requirements for Uncertain Tax Positions[28]

Background

Since the revelations of the tax and non-tax issues surrounding the collapse of Enron Corporation, the U.S. tax authorities have shown increasing doubts about the adequacy of the traditional audit process. This was an adversarial proceeding in which the Internal Revenue Service (IRS) reviewed the tax returns and information returns, requested additional documentation, and made its findings based on the materials it had reviewed. In the wake of Enron and the dramatic growth of corporate tax shelter transactions, the IRS concluded that taxpayers had been successful in disguising transactions and were relying ever more on the ''audit lottery'' (nondisclosure) in maintaining their tax positions. The result was a steadily broadening series of reporting requirements — initially applying to tax shelters — that were intended to force taxpayers to disclose various sensitive transactions. These new reporting requirements (with increasingly severe penalties attached thereto) included:

- ''Listed Transactions'': Disclosure required for specific disfavored transactions (tax shelters) listed by the IRS;
- ''Reportable Transactions'': Expanded requirements to disclose on Form 8886, in addition to Listed Transactions, much broader classes of transactions (e.g., loss transactions);
- Form 8275: Disclosure of tax positions to avoid exposure to ''substantial understatement'' and other penalties;
- Schedule M-3: Reconciliation of financial statement net income to taxable net income providing for a much more detailed breakout of book /tax differences; $10 million asset threshold for filing this schedule.

These measures began a shift from an audit/review model to a regime of compulsory taxpayer self-disclosure under the threat of severe penalties. But these were as yet still limited to restricted classes of transaction.

While tax return disclosure requirements were multiplying, the issue of the transparency of the tax reserves was getting increased scrutiny from the accounting perspective under U.S. GAAP. As mentioned above, the supervisors of the accounting regulatory bodies came to the conclusion that the global ''tax reserve'' had become an opaque and inappropriately flexible tool for ''managing'' earnings. The response was the issuance of FIN 48 in 2006, later codified as FASB ASC-740-10 on ''Uncertain Tax Positions.'' FIN 48 mandated much more specific disclosure of the tax reserves (if appropriate, by item). A two-step process was introduced to force reporting entities to make a more objective initial determination of their tax reserves regardless of the likelihood of discovery. Coupled with this much more detailed roadmap for disclosing uncertain tax positions, increased stress was laid on auditor review of the supporting documentation for the reporting entity's positions — including legal opinions.

The interaction of these developments put growing stress on the issue of privilege: attorney-client privilege and attorney work-product privilege. For if finan-

[28] Stuart Chessman, Director, Taxes — Vivendi.

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cial auditors were demanding vastly increased access to the support for a taxpayer's positions, the taxpayer would have a much greater risk of losing any privilege for the legal advice it had received. The IRS successfully asserted that it could require disclosure of tax accrual work papers.[29] In practice, however, the IRS generally followed a policy of ''restraint'' when it came to actually demanding such documentation. In several highly publicized cases, however, the IRS recently has litigated the extent of its access to material otherwise subject to privilege that had been disclosed to financial auditors. In *Textron*, the IRS prevailed at the Court of Appeals level.[30] In *Deloitte*, litigated in a different circuit, the IRS lost on a similar issue.[31] A conflict regarding the scope of privilege between two federal circuit courts is now formally presented in the United States.

Draft Schedule UTP of April 19, 2010, and the Reaction

In Announcement 2010-9,[32] the IRS revealed in January 2010 that it was developing a new schedule for disclosure of uncertain tax positions that would be required to be attached to corporate tax returns. The stated purpose of the new requirement was to minimize the amount of time spent by the IRS auditors on discovery of issues. A ''large'' corporation would be required to provide both a concise description of each uncertain tax position for which it or a related entity recorded a reserve in audited financial statements and the maximum potential U.S. income tax liability attributable to each uncertain tax position. IRS Commissioner Douglas Shulman clarified ''concise'' to mean ''a few sentences that inform us of the nature of the issue, and not pages of factual description or legal analysis.'' In Announcement 2010-30,[33] a draft Uncertain Tax Position (UTP) schedule to Form 1120 and accompanying instructions were published (the ''Draft Schedule UTP'').

The requirement to file the Draft Schedule UTP was imposed on corporations that had (1) UTPs on their audited financial statements or those of a related party and (2) assets equal to or exceeding $10 million. A UTP is defined as any reserve for a tax exposure. The taxpayer also had to report items if a decision had been made not to record a tax reserve for that position because of either (1) an IRS administrative practice to accept — or not to dispute — such a position or (2) the taxpayer's expectation that it would prevail in litigation should the IRS not agree to settle such matter.

The Draft Schedule UTP required these main items of information:

- A ''concise'' description of the UTP, including a description the ''legal rationale'' of the taxpayer's position;
- The Internal Revenue Code sections involved (room for three sections was provided);
- Whether the UTP represented a permanent or temporary difference; and
- The maximum tax adjustment (MTA) attributable to that item.

The MTA was the maximum tax impact if the tax position is denied. It did not include the effect of offsets by other attributes except to the extent those attributes arose from the position creating the UTP. The MTA was determined on an annual basis by reference to each specific item. The schedule provided some relief for reserves relating to transfer pricing or valuations. For these items an MTA was not necessary but such exposures could be ranked in order of reserve magnitude. For this purpose, separate rankings were to be made for transfer pricing and valuation issues.

Taxpayer comments were requested and were forthcoming in abundance — primarily negative. A main concern was whether the requirements to describe the reasoning related to the UTP and to calculate the MTA potentially constituted a waiver of privilege regarding the legal analysis that underlay these determinations. Commentators were concerned that the Draft Schedule UTP signaled a change in the IRS ''policy of restraint'' in requesting the disclosure of such support. The new reporting burden was also a widespread cause of concern, given that a ''large'' corporation subject to the filing requirement needed only to have assets of $10 million. In contrast with financial accounting reporting practice, the Draft UTP schedule had no concept of materiality. The IRS's authority to require this disclosure was also questioned. Comments are summarized in Announcement 2010-75.[34]

As to the question of authority, in September 2010, the IRS issued Prop. Regs. §1.6012-2(a)(4), which would require corporations to disclose UTPs under Code §6012 (which mandates the filing of income tax returns).[35] On September 24, 2010, the final schedule UTP was released, accompanied by much more voluminous guidance compared to its draft predecessor. On that day the IRS issued:

- The final Schedule UTP (''Schedule UTP'');
- The instructions to the schedule (the ''Instructions'');

[29] *U.S. v. Arthur Young & Co.*, 465 U.S. 805 (1984).

[30] *U.S. v. Textron, Inc.*, 577 F.3d 21 (1st Cir. 2009) (*en banc*), *cert. denied*, Dkt. No. 09-750 (5/24/10).

[31] *U.S. v. Deloitte LLP*, 610 F.3d 129 (D.C. Cir. 2010).

[32] 2010-7 I.R.B. 408.

[33] 2010-19 I.R.B. 668.

[34] 2010-41 I.R.B. 428.

[35] REG-119046-10, 75 Fed. Reg. 54802 (9/9/10).

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- Announcement 2010-75 (reviewing the history and comments received but also supplementing the Instructions);
- Announcement 2010-76 (redefining and expanding the IRS ''policy of restraint'');
- A Directive from the Deputy Commissioner to the ''Large Business & International Division'' outlining principles for integrating Schedule UTP into the IRS audit practice; and
- The text of the ''prepared remarks,'' focusing on the UTP schedule, given on this same day by IRS Commissioner Shulman to the American Bar Association.

Schedule UTP: Who Must File and What Must Be Reported

Schedule UTP is an attachment to the Form 1120, the U.S. federal income tax return for domestic corporations. It also applies to foreign entities that must file a return on Form 1120-F because, for example, a branch is maintained in the United States. For 2010, corporations having assets of $100 million or more at the beginning or at the end of the taxable year are required to file Schedule UTP. However, the IRS intends to phase-in the much lower filing level of $10 million that was provided by the Draft Schedule UTP. The filing threshold will be reduced to $50 million for the 2012 taxable year and $10 million for 2014. The amount of assets should be the same as the number reported on page 1, Item D of Form 1120 or on Form 1120-F, schedule L, line 17. However, the Instructions now make clear, that, in the case of a foreign corporation filing an 1120–F, the asset value must be calculated on a worldwide basis.

Qualifying taxpayers having audited financials under any method of accounting that provides for the recording of tax reserves are required to file Schedule UTP. Thus, accounts prepared under international financial reporting standards (IFRS) are captured even though IFRS currently has no direct equivalent of FIN 48 (which uses the term ''UTP''). A taxpayer must file if a UTP is reported on the books of account of a related party, for example, on the books of the foreign parent of a U.S. subsidiary. A related party is an entity that has more than 50% ownership relationship to the taxpayer or is included in the consolidated financial statements that include the taxpayer. ''Audited financials'' are accounting statements where an auditor has given his opinion regarding the accounts.

A UTP is defined as a U.S. federal income tax position that, if not sustained, will result in an increase of U.S. federal income tax liability and for which a reserve is established on the books of account of that entity or a related entity. Thus, the UTP schedule is restricted to the U.S. federal income tax liability and not state, foreign, or non-income taxes. A position means an item that is subject to measurement as a ''unit of measurement.'' The final instructions tie the definition of a unit of measurement much more closely to the practice of the taxpayer on its books of account. This principle is not unrestricted, however — the instructions provide that a unit of account consisting of the entire year or the entire tax return would be inappropriate.

The UTP schedule requirement applies if a tax reserve has been established on the books of account. It also applies, however, where the taxpayer has not set up a reserve because of its ''expectation to litigate.'' This refers to an exception to the FIN 48 requirement to quantify the extent to which a tax position can be sustained once the recognition of the tax benefit has been established. In certain situations, the tax authority will not or cannot settle an item, or the taxpayer — because of the significance of the item — cannot enter into negotiations with the tax authority. In such cases, where the taxpayer intends to litigate and where the outcome is expected to be all-or-nothing, the accounting standards provide that the taxpayer may book the full benefit of the tax position.[36]

Under the Instructions, a tax position must be reported on Schedule UTP if:

- There is a less than 50% probability of reaching a settlement with the IRS on the position;
- No reserve was recorded on the financial books because the taxpayer intends to litigate; and
- The taxpayer determines that it more likely than not will prevail on the merits in the litigation.

This rule is subject to the following two further exceptions:

- A UTP for which no reserve has been established, and is either (1) highly certain or (2) immaterial, does not need to be disclosed on Schedule UTP. These concepts are derived from U.S. GAAP.
- Schedule UTP no longer requires the taxpayer to report a UTP for which a reserve has not been set up because the taxpayer expects the position to be sustained pursuant to established IRS administrative practice.

The Schedule UTP filing requirement applies to tax returns for fiscal years ending on or after December 31, 2010. Thus, prior years and short 2010 years are not subject to the filing requirement. There will be a ''part B'' of the schedule (irrelevant for 2010) to re-

[36] *See, e.g.,* PwC Guide to Accounting for Income Taxes at 16.4.1.5 (2009).

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port UTPs relating to prior years' tax returns. A UTP is reportable for the 2010 year if the decision to record a reserve is made more than 60 days prior to the filing of the 2010 tax return. If the decision to record the reserve is made within 60 days of the return filing date, the taxpayer can report it either on the following year's Schedule UTP or on the current schedule.

UTPs relating to positions taken on returns filed prior to 2010 need not be reported. Increases or decreases to a UTP reported in a prior year to which UTP reporting applies will not need to be reported in a subsequent UTP schedule. However, recurring items affecting multiple years (such as differences in amortization rates) must be reported on the UTP schedule for each year that is affected by the uncertain position, provided that the taxpayer has set up a reserve for each such taxable year's exposure on its books in 2010 or later.

Filling Out Schedule UTP

The taxpayer, after entering and numbering the UTP, must list the primary Code sections involved (there is space for three),[37] and then, following GAAP principles, identify the UTP as a permanent or temporary item.[38] If the UTP relates to an item on a pass-through entity (like a partnership) the taxpayer identification number of that entity must be listed.[39] Apparently all UTPs that have been reserved, regardless of size, must be broken out and reported.

In contrast to the earlier draft, Schedule UTP drops the requirement to report a maximum tax amount involved (''MTA''). Instead, the option of ranking transfer pricing and valuation issues has been extended to all UTPs. The list is to start in the order of the size of the reserve recorded for that position. The IRS, however, has not totally abandoned its desire to require the taxpayer to disclose the amount of the individual UTPs in some way, as it requires the taxpayer to identify (by checking a box) ''major tax positions'' — identified as those having a value of 10% or more of the total reserve amount listed on Schedule UTP.[40] These changes were intended to address privilege concerns expressed by taxpayers.

A special rule applies to UTPs that have not been reserved because of the expectation to litigate. These UTPs must also be ranked, but, the taxpayer apparently has discretion to select the order of ranking. Because there is no size that needs to be determined for these UTPs, they are also apparently excluded from the application of the 10% ''Major Tax Issue'' identification rule.

An additional case of a ''non-disclosed'' UTP arises where the taxpayer cannot determine whether a tax position is a UTP because of an inability to obtain information from related parties. In such a case, a box at the beginning of the UTP Schedule must be checked.

The taxpayer must finally provide a ''concise description'' ''that should not exceed a few sentences'' of each UTP on Part III of Schedule UTP. After much negative commentary, Schedule UTP no longer requires the taxpayer to set forth in Part III the ''rationale and nature of the uncertainty.'' This once again addresses privilege concerns. What is required now is a brief description of the relevant facts and sufficient narrative to inform the IRS of the nature of the issue involved.

Coordination with Other Disclosure Forms and Penalties for Noncompliance

Effective March 30, 2010, Internal Revenue Code §7701(o) codifies the case law ''economic substance'' requirement. A 40% ''strict liability'' penalty is imposed if a position is disallowed for lack of ''economic substance.'' This penalty is reduced to 20% if the transaction is ''adequately disclosed.'' ''Complete and accurate'' disclosure on the UTP schedule fulfills this requirement (other than for ''reportable transactions'').[41] As for ''reportable transactions, ''the taxpayer disclosing a position on Schedule UTP must also meet the disclosure requirements for reportable transactions (see below) to avoid the 40% penalty applying to that position.[42]

The Instructions provide that ''complete and accurate'' disclosure of a position on the Schedule UTP will be treated as if the taxpayer filed Form 8275 or Form 8275-R. The taxpayer thus no longer needs to file these forms to avoid the ''substantial understatement'' and other accuracy penalties.

As for ''reportable transactions,'' Announcement 2010-75 addresses the suggestions of taxpayers that disclosure on the Schedule UTP should preclude the need to file Form 8886. The Announcement states, however, that the IRS is only ''considering'' this issue, so separate Form 8886 reporting is still required for items disclosed on the Schedule UTP.

The IRS has not announced what penalties it thinks apply for noncompliance with the UTP reporting rules. According to Announcement 2010-75, the IRS will study the issue, taking into account the experience of compliance with the new requirements.

Impact Upon Privilege and Audit Procedure

The IRS has made an effort to defuse the concerns regarding privilege in the Schedule UTP and its ac-

[37] Schedule UTP (a) and (b).

[38] Schedule UTP (c).

[39] Schedule UTP (d).

[40] Schedule UTP (e).

[41] §6662(b)(6), (i).

[42] Notice 2010-62, 2010-40 I.R.B. 411.

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companying announcements. As noted, compared to Draft Schedule UTP, the requirements for describing and quantifying UTPs have been substantially relaxed. But the IRS has gone farther and has substantially expanded the "policy of restraint." Announcement 2010-76 [43] provides that the IRS will not assert that privilege has been waived if documents otherwise privileged under the attorney-client or work-product doctrine have been provided to an independent auditor as part of the audit of the taxpayer's financial statements. This constitutes a major retreat by the IRS from its historical position and does not appear to be limited to the UTP process. This expanded policy of restraint will not apply if the taxpayer has waived privilege by actions other than disclosure to independent auditors as part of the financial statement audit or if "unusual circumstances" exist or if the taxpayer claimed the benefits of a listed transaction. This relief applies to disclosures of the "taxpayer's" financial statements — it is not clear whether it also applies to disclosures of a related party's financials (which can trigger the Schedule UTP filing requirement).

The IRS will continue to ask for tax reconciliation work papers. If they are related to Schedule UTP, however, the taxpayer can provide a redacted version. The taxpayer can withhold information concerning (1) comments on or drafts of the "concise description" of tax positions, (2) the amount of reserves related to reported tax positions, and (3) computations determining the ranking of a tax position or the designation of a position as a major tax position (equal to or greater than 10% of reported positions).

Finally, the IRS Deputy Commissioner for Services and for Enforcement issued a Directive to all personnel of the Large Business and International Division (LB&I), announcing a centralized process (called by Commissioner Shulman the "triage" process) to review and analyze UTPs and evaluate the UTP process. The Directive makes the following statements:

- "[Schedule UTP is not intended to] substitute for other examination tools or for the independent judgment of the examiners, and it should not be used to shortcut other parts of the audit process or the careful and considered examination of issues and objective application of the law to the facts."
- "UTPs are uncertain for a number of reasons, including ambiguity in the law and a lack of published guidance on issues."

These statements are undoubtedly intended to assure taxpayers who may fear that the examining agent will immediately write up the positions disclosed in the UTP schedule. In my view, the Deputy Commissioner's Directive confirms that this is indeed likely to be the case. It is uncertain what support the Directive gives a taxpayer concerned about the use of the UTP Schedule by IRS examiners.

The IRS also has provided some assurance that reported UTP information would not be released "automatically" to foreign governments. U.S. treaties and information exchange agreements only provide for the release of information where reciprocity exists. Commissioner Shulman stated in his presentation to the ABA that it would be "very, very rare" to exchange such information unless reciprocity existed regarding UTPs — meaning that the foreign jurisdiction would need to gather similar information it could exchange with the IRS. And even there, the IRS would consider "other factors" before exchanging the information.[44]

Going Forward

On September 21 at the FEI Policy Conference, Commissioner Shulman spoke of the UTP Schedule as a "game changer in the service's relationship with corporate taxpayers." On September 24, he spoke to the American Bar Association, less dramatically, about the objectives of the UTP process as:

- Greater transparency;
- Easier identification of issues; and
- Better allocation of resources.

And Deputy Commissioner Miller, in his Directive, described the objectives of the UTP Schedule as:

- Reducing the time it takes to find issues;
- Ensuring more time is spent discussing the application of the law to the facts rather than finding information;
- Identifying areas of uncertainty requiring guidance; and
- Helping to prioritize selection of issues and taxpayers for examination.

The UTP schedule may well serve to gather useful information for the IRS on overall legal or policy issues. However, this likely was not a main motivating force behind its introduction. Rather, the objective is clearly to promote "transparency" — to circumvent the perceived inefficiency of the current audit process and to force the identification of issues by the taxpayer. The IRS intends to enlist the financial auditors — whom the IRS may assume to have access to more complete and accurate information on their client's

[43] 2010-41 I.R.B. 432.

[44] Announcement 2010-75 (at 15–16), 2010-41 I.R.B. 428.

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tax positions — to aid in the effort to better audit the taxpayer.

The UTP process raises numerous difficulties. It introduces into the tax law concepts and terms from financial accounting literature. In the understanding of such terms, there are differences between the IRS and the accounting community that will need to be worked out. But even beyond understanding the letter of the accounting rules, there is a basic difference in the approach between the two disciplines. Two taxpayers with identical tax positions may nevertheless record different levels of tax reserves based on the materiality of the position to the overall reporting entity, the appetite for risk of each corporation's management, and the history of the relationship with the auditors. In other words, the tax reserves do not provide a scientific or legal assessment of the taxpayer's tax liabilities viewed independently from the unique characteristics of each reporting entity.[45]

Schedule UTP also puts the financial auditors squarely in the middle of the tax return preparation process. The pre-Schedule UTP model was a three-step process in which tax positions were evaluated and taken, the result reported on the tax return, and the return later audited by the IRS. Parallel to this process, the financial accounting consequences of tax positions taken during the year and on the return were evaluated by the taxpayer. These were then presented to the financial auditors of the company and the accounting treatment thereof reviewed for the corporation's quarterly or year-end reporting. In this second process, the effective tax rate of the reporting entity was determined as well as the scope of any necessary reserves or disclosures on the financial statements.

After the introduction of Schedule UTP, the financial auditors of a corporation are put in the position of providing input to the tax return itself. Before the filing the return, the corporation will want to review its reserve position with the auditors as part of preparing Schedule UTP. And there will undoubtedly be even greater stress on avoiding UTPs from the start. The corporation will put more pressure on its auditors to accept its accounting and tax positions. Greater efforts will be made to increase the level of comfort provided by the opinions of the corporation's tax advisors. The corporation will expand the use of techniques such as pre-filing agreements, Advance Pricing Arrangements, and contemporary audit processes to reduce uncertainty. Commissioner Shulman seemed to acknowledge this by including in his ABA presentation some favorable words about the CAP program and Industry Issue resolution. Commissioner Shulman expressed the wish that these initiatives would help taxpayers achieve greater certainty on tax positions — even before the tax return is filed.

Reporting by Corporations as Part of German Tax Compliance Requirements[46]

Introduction

The importance of compliance for corporations as a means of avoiding criminal charges and liability as well as for improving a company's reputation is currently increasing among managers of German companies. Throughout German legal literature, compliance systems are regarded as mandatory for major corporations wishing to avoid various disadvantages, and future court decisions are expected to adopt this view.

This development was partially influenced by an amendment to §107 (3) 2 of the German Stock Corporation Act (*Aktiengesetz* (*AktG*)) which was introduced by the Modernization of Accounting Law Act (*Bilanzrechtsmodernisierungsgesetz* (*BilMoG*)) in 2009. The revised §107 (3) 2 *AktG* explicitly states that supervisory board members can be held personally liable for a corporation's failure to comply with accounting and annual return regulations to the extent that they do not properly monitor the corporation's respective compliance systems. Supervisory board members who neglect these duties can be held liable for any damages resulting from such neglect.

This provision widens the circle of persons who are potentially liable for a corporation's failure to meet its reporting obligations so that it includes the supervisory board members in addition to the corporation and its managers. Given the potential liability to all individuals involved, meeting reporting obligations under accounting and tax laws is an increasingly important part of corporate compliance.

General Reporting Obligations Under German Tax Law

Under German law, tax authorities are obligated to investigate the facts necessary for determining the existence and extent of a taxpayer's tax burden. While the tax authorities must determine the facts of a case, the taxpayer must cooperate with such investigation, for example by filing a tax return as required by German law.

In addition to annual income tax returns, corporations are also required to file monthly or quarterly preliminary VAT returns, depending on their level of income, and an annual VAT return. Annual returns must

[45] PwC Guide to Accounting for Income Taxes at 16.4.1.3 (2009).

[46] Peter H. Dehnen, DEHNEN.Rechtsanwälte.

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generally be filed by 31 May of the calendar year following the relevant fiscal year. Preliminary VAT returns must generally be filed by the 10th day of the month following the period covered by the return. Where professional advisers prepare the tax return, the due date is generally extended to 30 September and filing dates may also be extended upon request of the taxpayer. Generally, all tax returns are filed electronically and all returns are reviewed by the tax authorities. For all these returns, the taxpayer has a duty to disclose any errors that may have occurred within a tax statement and to correct them as soon as possible after discovery by the taxpayer.

While the duty of cooperation is generally limited to providing correct and complete information regarding the facts relevant for taxation as well as supporting documentation, in certain situations the taxpayer's duty to cooperate is increased. The two most important areas of increased cooperation are transactions with cross-border aspects and audits by the tax authorities.

Cross-Border Transactions

Where cross-border transactions are involved, a taxpayer must set forth the facts of a case and provide necessary evidence in support of the facts. The taxpayer must exhaust all factual and legal possibilities for providing such evidence. This increased obligation on taxpayers in regard to cross-border matters arises from the limited right of the German tax authorities to investigate tax matters relating to foreign countries unless such investigation is allowed by double taxation conventions (DTCs) or tax information exchange agreements (TIEAs). In cross-border situations, all information regarding foreign countries is regarded as being within the taxpayer's sphere of influence rather than within the reach of the German tax authorities. This assumption particularly applies to business relations between related companies in which case documentation and disclosure of evidence is mandatory in order for the taxpayer to be granted tax benefits such as the deduction of business expenses paid to related companies.

A recently enacted *Act to Combat Destructive Tax Practices and Tax Fraud* extends these obligations to dealings with persons in those foreign countries that are specified by the German Finance Ministry as not in compliance with OECD transparency standards and exchange of information requirements. These countries are viewed as tax havens. The act imposes increased documentation and verification obligations in regard to business relationships involving tax havens while denying the tax exemption of intercompany dividends and the deduction of business expenses in transactions related to such jurisdictions. While this law has entered into force, the German Finance Ministry has not named any countries that fail to meet the specified standards.

The increased duty of a taxpayer to cooperate and provide information is not unlimited. It ends where the cooperation asked by tax authorities is of no relevance for German taxation. For example, it may end where the tax authorities request information relating to the taxation of persons or companies that are not subject to German taxation.

Tax Audits

The German tax authorities are authorized, and in some cases required, to conduct tax audits in regard to taxpayers who engage in commercial or freelance work or other taxpayers whose annual income exceeds €500,000. In general, local tax authorities are competent in regard to tax audits and are given discretion as to the taxpayers, the type of taxes, the circumstances and the time frames to be audited. However, in the Tax Audit Regulations (*Betriebsprüfungsordnung* (*BpO*)), the Ministry of Finance has issued administrative regulations as to the way discretion must be exercised. Large companies must be audited regularly and without excluding any fiscal years. The practice in this regard over the last few decades has been to audit large companies every three years. For other companies, no special audit terms are specified.

Taxpayers have an increased duty of cooperation during tax audits. A taxpayer's representatives must assist the auditor in assessing the facts necessary for the determination of taxation. The main duties of cooperation in tax audits are the presentation of any business documents as well as the disclosure of circumstances that are relevant for the taxation determination. An auditor cannot, however, require information that a taxpayer is not obligated by law to provide or that is not relevant to the taxation determination. These limits extend to any electronically stored information to which the examiner might request access.

Consequences of Late, Incomplete or Incorrect Reporting

German courts have held that the German tax authorities must believe the statements made by the taxpayer unless reasonable doubts exist where, for example, a taxpayer fails to comply with its duty to provide information.

The main consequence of non-compliance with the obligation to provide information is refusal by the tax authorities to allow a deduction for expenses claimed by the taxpayer. The tax authorities may disallow a deduction where, for example, the taxpayer fails to name the recipient of the expenditure. Such information is used by the German tax authorities for issuing so-called control notices (*Kontrollmitteilung*), which ensure that the recipient declares as income the

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amounts received from the taxpayer. In cases involving a foreign recipient, the taxpayer must have knowledge of facts regarding the recipient. If the recipient is, or is regarded by the German tax authorities as, a shell corporation, the taxpayer must identify the final beneficiary of the payment. If a taxpayer refuses to cooperate and the factual investigation fails due to insufficient information, the tax authority is entitled to estimate the tax base. Furthermore, German tax authorities may compel fulfillment of the taxpayer's duty to cooperate by imposing late payment fines or compulsory levies.

A taxpayer's breach of the duty to cooperate that results in tax evasion may constitute a tax crime or misdemeanor in which case the tax authority can initiate criminal or penalty proceedings against the taxpayer.

Recent Developments

The German tax climate used to be one of cooperation in which local tax authorities were willing to discuss issues with taxpayers in order to find mutually acceptable solutions to various domestic and cross-border tax issues. Over the past few years, however, an increasingly adversarial tax environment has arisen in Germany. This change in the German tax climate together with constant amendments to existing laws have resulted in increasing uncertainty in tax planning and an increased use of litigation as a means for ensuring a correct and fair application of Germany's tax laws.

The tightening criminal tax laws and the denial of tax relief for expenses increase the need for proper tax compliance systems to ensure that all relevant and necessary information is made available to the tax authorities. Liability for mistakes or breaches of the duty to cooperate can arise for the company, its legal or tax advisor, and the company's representatives.

The increasing scope and complexity of German tax law and, in particular, the impact of the German legislative process on reporting obligations can be illustrated through the example of two regulations introduced by the German Business Tax Reform of 2008. The *Zinsschranke* and *Mantelkauf* regulations were intended to combat the misuse of tax saving possibilities under German tax law and require the taxpayer to prove that certain prerequisites are met in order to deduct interest payments (*Zinsschranke*) or utilize the loss carryforwards of acquired companies (*Mantelkauf*). While these provisions were somewhat eased by the Act for the Acceleration of Economic Growth passed in 2009 during the worldwide financial crisis, this was accompanied by the imposition of an obligation on taxpayers to prove that prerequisites for deduction were met. This increased the taxpayer's obligation to provide information. These obligations evidence a trend toward imposing a greater burden of cooperation and proof on taxpayers in order to be granted tax relief as a result of changes in law and administrative practice.

Roles and Responsibilities of U.K. Company's "Senior Accounting Officer"[47]

Overview

In the 2009 Budget, the U.K. government announced plans to make Senior Accounting Officers (SAOs) personally liable for establishing and monitoring the tax accounting arrangements of "qualifying companies" by requiring SAOs to certify the adequacy of such arrangements to HM Revenue & Customs ("HMRC") in respect of each financial year. HMRC is concerned to ensure tax accounting systems are "fit for purpose" because delivering correct and accurate tax returns hinges on the performance of the tax accounting systems. HMRC also perceived and sought to address an "accountability gap" where companies have a duty to provide full and correct tax returns, but no requirement is imposed on any particular person to ensure the proper function of underlying tax accounting arrangements. The obligations of an SAO are enforced via penalties for both the individual SAO and the company in the event of noncompliance. Enacting legislation is contained in the U.K. Finance Act 2009.[48] These provisions have effect for all financial years beginning on or after 21 July 2009.

Parameters

Qualifying Companies

A company is a qualifying company if (1) it is U.K.-registered and (2) its turnover in the previous financial year exceeded £200 million *or* its gross assets in the previous financial year exceeded £2 billion. Controlled foreign companies, U.K. permanent establishments (PEs), and non-corporate entities (e.g., partnerships) are not caught, and open-ended investment companies (OEICs) and investment trusts are carved-out from the legislation. However, foreign PEs of a U.K.-incorporated company are within the scope, and companies that are U.K-incorporated but not U.K.-resident are covered by the legislation, but only to the extent that they are trading in the United Kingdom. For groups (based on a 51% effective shareholding test), the turnover and gross assets tests are applied to the aggregate turnover and assets of the U.K. companies in the group; therefore, small or medium-sized companies may be caught by the legislation.

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[47] Michael McGowan, Sullivan & Cromwell LLP.

[48] §92, and Schedule 46 to the Act.

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The SAO

An SAO is the company director or officer (or, in respect of groups, a director or officer of any company in the group) who, in the company's reasonable opinion, has overall responsibility for the company's financial accounting arrangements. A person can be designated an SAO for more than one company, and HMRC have confirmed in published guidance that an SAO need not be a U.K.-resident individual. A qualifying company must ensure at the time of filing its accounts that HMRC is given the name of each person who was its SAO at any time during the year. In practice, HMRC envisage notification being given to a company's HMRC Customer Relationship Manager. A notification may be given in respect of multiple qualifying companies, e.g., for companies within a group having the same SAO. A qualifying company that fails to properly notify HMRC of the identity of its SAO is subject to a penalty of £5,000 per financial year.

Main Duty of SAO

The core duty of an SAO is to take ''reasonable steps'' to ensure that the company establishes and maintains ''appropriate tax accounting arrangements,'' which are defined as ''accounting arrangements that enable the company's relevant liabilities to be calculated accurately in all material respects.'' Published guidance indicates that such arrangements encompass the framework of responsibilities, policies, appropriate people and procedures in place for managing tax compliance risk, as well as the systems and processes that put the framework into place. Therefore, the arrangements cover the entire process of formulating tax returns, from initial data input, to adjustments and analysis. HMRC suggest that this framework encompasses a process for gathering and recording data; mechanisms for communicating roles and responsibilities; monitoring activities for efficiency; and designing and implementing control activities to mitigate tax compliance risks. Whether such arrangements are ''appropriate'' is to be determined case by case based on factors such as the size, complexity and nature of the business.

In respect of a foreign PE of a U.K.-incorporated company (which will generally be subject to tax in the foreign jurisdiction), HMRC do not expect ''reasonable steps'' to encompass an ''in-depth check'' of the foreign tax position, but suggest checking that the foreign tax has actually been paid. Outsourcing functions to third parties does not relieve an SAO of its responsibility, and HMRC have indicated that in such circumstances ''reasonable steps'' will include making an assessment of whether the third party is suitably competent, qualified, and controlled to ensure that appropriate tax accounting arrangements are maintained. Following a merger or acquisition, an SAO is expected to take reasonable steps to identify any shortcomings in the tax accounting arrangements of the new company and have a plan to rectify these, using certificate described below.

Compliance

Certification by SAO

For each financial year, an SAO must provide a certificate accompanying the qualifying company's accounts, stating whether the company had appropriate tax accounting arrangements throughout the year and, if it did not, giving an explanation of the respects in which the company failed to maintain such arrangements. A certificate may relate to more than one qualifying company. HMRC suggest that such certificate is expressed to be given to the best of the SAO's knowledge and belief.

Penalties

As mentioned above, a qualifying company is subject to a penalty of £5,000 per financial year if it fails to notify HMRC of the identity of its SAO. If the company is a member of a group, the group cannot be assessed to a penalty for this failure more than once per financial year.

In addition, the SAO is assessable for penalties of up to £10,000 per financial year: £5,000 if the SAO fails to comply with their main duty described above, and £5,000 if the SAO fails to provide a certificate or provides an incorrect certificate. An SAO cannot be assessed a penalty for the same failure in respect of more than one company in a group in the same financial year, regardless of the number of companies for which that individual is SAO. Therefore, companies in a group may wish to appoint a single SAO to minimize the persons within the group subject to personal liability.

HMRC can assess a penalty no later than six months after the failure comes to their attention, or not more than six years after the company's accounts have been filed for the relevant financial year. HMRC have discretion to decide whether to impose a penalty, although the amount of the penalty is fixed in the legislation and can be varied only by the enactment of regulations.

A penalty can be avoided if the SAO or the qualifying company can satisfy HMRC that there is a ''reasonable excuse'' for the failure, and the failure is being corrected without unreasonable delay. Insufficiency of funds, lack of information, ignorance of basic law, and delegation to another person (unless the delegator took reasonable care to avoid the failure) are not considered ''reasonable excuses.'' HMRC note that what is a ''reasonable excuse'' will differ from person to person, and envisage that such an excuse is

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likely to be ''an unforeseeable, exceptional event beyond the person's control.''

Impact

HMRC have indicated that they are not seeking to catch small or insignificant errors, and are focussing on significant risks, hence the standard prescribed that appropriate tax accounting arrangements should be sufficient for a company's relevant liabilities to be ''calculated accurately in all material respects.'' However, it is questionable whether imposing personal liability on an officer of a company is the most effective way to encourage companies to deal with tax compliance risks in a ''spirit of openness'' with HMRC.

DATA IN SUPPORT OF TRANSFER PRICING

New Norwegian Disclosure Rules For Transfer Pricing[49]

Introduction

The Norwegian Tax Act (NTA) Section 13-1 adopts the arm's-length principle. This codifies language in a pre-2008 Supreme Court decision (Agip 2001) to the effect that the OECD Guidelines were assumed to be relevant to Section 13-1. In 2008, Section 13-1 was revised to explicitly incorporate the OECD Guidelines.

There are no Norwegian statutory rules governing documentation and burden of proof in tax cases. The taxpayer has an obligation to file a tax return under the Tax Assessment Act and to provide sufficient and correct information to support the validity of the net taxable income reported in the return. Before introduction of the new rules, the obligation to provide information was limited to facts pertaining to the taxpayer itself and not third parties. In the *Baker Hughes* judgment (Supreme Court 1999), the Norwegian taxpayer (''TNO'') was a branch of a U.S. company. The rent TNO paid for the equipment that was used in the activity in Norway was determined by the U.S. parent. The tax administration claimed that TNO in its tax return was obligated to explain further how the parent determined the rent. The Court expressly doubted that the obligation to provide information under the Assessment Act was that comprehensive.

Current Rules Under Assessment Act Section 4-12, No. 2

Under the new rules, companies that have a turnover and number of employees exceeding specific thresholds are obligated to report in the tax return all controlled transactions or accounts. Additional documentation of arm's-length pricing must be submitted within 45 days following a request from the tax administration. The purpose of this rule is to provide tax authorities with a better basis for assessing controlled transactions and accounts according to arm's-length principles. The regulations define and clarify the scope and extent of the documentation requirements regarding:

- Information concerning the enterprise, the group and the business activities;
- Information concerning financial matters;
- Information concerning the nature and scope of controlled transactions;
- Description of transactions; and
- Description regarding OECD Guideline Comparability factors.

The documentation requirements focus on:

- Functional analysis;
- Special requirements pertaining to centralized services;
- Special information concerning intangible property;
- Information concerning the selection and application of the price-setting method
- Information concerning comparability analysis; and
- Information concerning agreements.

Because of the importance of the oil and gas industry to the Norwegian tax base, the transfer pricing rules are relevant to that industry. Income from the production of oil and gas in Norway is subject to a special tax of 50% in addition to a special tax of 28% — the total tax amounts to 78%. Income from the production of oil is subject to a norm price system. This system does not apply to the income from the production of gas. A recent government white paper analyzed the transfer pricing practices in the industry. It concluded that significant manpower resources are required to evaluate whether intercompany prices for gas are arm's-length. Because of the high tax rate and the level of sales, small deviations from an arm's-length price may have a significant impact on revenue. Consequently, tax authorities need the broadest possible factual basis for their assessments. Currently applicable provisions in the Assessment Act are not considered a legal basis for the systematic collection

[49] Eirik Jensen, KLUGE advokatfirma DA.

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of all relevant market information required in order to perform the desired control and assessment of income from controlled sales of gas. Hence new rules were required.

New rules have been proposed in the Petroleum Tax Act under which taxpayers subject to the special tax on the sale of gas must provide information regarding all sales of natural gas that are subject to special tax. The tax administration will be empowered to require a copy of all sales agreements. Information must be provided quarterly. Companies that do not provide the requisite information may be subject to fines calculated at the discretion of the Ministry of Finance. This information will undoubtedly be used by the tax authorities to develop anonymous comparables in order to assess whether the prices and conditions of controlled transactions regarding gas are arm's-length. These rules, which most likely will be adopted in the near future, will probably represent a contentious area. Use of secret comparables is frowned upon by the OECD transfer pricing guidelines unless taxpayers have an opportunity to challenge the data. See ¶3.30 of the Guidelines.

Data in Support of Transfer Pricing in Germany [50]

Introduction

A German taxpayer has a general duty of cooperating with the German tax authorities in the determination of its income as well as a duty to provide documentation in support of its tax positions. This duty is increased in cases involving cross-border transactions with related companies because the taxpayer is assumed to have greater access to supporting data than the tax authorities who traditionally have been limited in their ability to obtain tax information from foreign countries.

In a 2001 decision, the German Federal Tax Court limited this duty of cooperation somewhat by stating that the regulations in effect at that time imposed an obligation on taxpayers only to provide existing documents. The creation of new documents was not required. In response to this decision, a new provision was added to the German Fiscal Code (*Abgabenordnung* (*AO*)) in 2003, expanding the duty of cooperation in transfer pricing cases to include the creation of documents specifically for the purpose of supporting transfer pricing policies. Taxpayers are not merely required to provide documents they have prepared in regard to the pricing of transactions with related foreign parties but must create additional documents to support determination of such pricing.

[50] Peter H. Dehnen, DEHNEN.Rechtsanwälte.

Supporting Data for Transfer Pricing

The legal basis for the duty to provide supporting data appears in a section of the AO addressing the records a taxpayer must keep in order to support the transfer prices and other business conditions applicable to transactions with affiliated companies. Other important legal provisions are contained in:

- The Foreign Relations Tax Act (*Aussensteuergesetz* (*AStG*)) in which the principles for determining acceptable transfer prices are established;
- Regulations Regarding the Documentation of Profit Allocations (*Gewinnabgrenzungsaufzeichnungsverordnung* (*GAufzV*)), which specify details of the information necessary for recording the economic and legal bases of the transfer pricing determination; and
- A decree of the German Finance Ministry on the application of the obligation to provide supporting data in regard to transfer pricing cases.

Within the German tax system, the use of administrative decrees to explain and solidify the application of legal provisions is common in regard to transfer pricing issues. In regard to the documentation duty described above, the *AO* sets forth the economic and legal basis of transfer pricing determinations in a single paragraph, and the *GAufzV* sets forth clarifying regulations in eight paragraphs. The decree issued by the Federal Finance Ministry comprises 42 pages. While such decrees do not have the same importance as laws and regulations, they represent the instructions the tax authorities must follow in applying the law and can be challenged by taxpayers only through judicial proceedings. Therefore, in order to satisfy all of its documentation obligations, a taxpayer involved in transactions with related companies in other countries must familiarize itself with all 42 pages and nine paragraphs, and develop a system for compliance.

Necessary Documentation

The records that must be created for transfer pricing purposes must document the relevant facts as well as the appropriateness of the determined transfer price. Documenting the appropriateness of the transfer prices used is not limited to the level of prices. It includes demonstrating that the method chosen for determining the prices is appropriate. Details regarding business conditions, profit allocations, and margins that third parties would have expected in comparable transactions must also be documented.

Documentation regarding transfer prices are divided into the following categories:

- General information such as ownership, organizational and operating structures within the affiliated

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group, descriptions of the taxpayer's activities and business strategies, overviews of the contracts on which the business relation is based, and other similar information;

- Information regarding the specific business relationship such as the nature and extent of transactions within the affiliated group;
- An analysis of the functions performed by various members of the affiliated group involved in the transactions;
- Information regarding the allocation of risks within the affiliated group; and
- A transfer pricing analysis including the basis for the chosen pricing method and the reasons why the method used led to an appropriate arm's-length price.

Form and Timing

Generally, the above-mentioned records must be made available in written or electronic form in a manner that will enable the tax authorities to investigate the relevant facts within a reasonable period of time. While no regulation exists as to when documents must be created, the documentation must be made available within 60 days following a tax authority request, which generally occurs within the scope of a tax audit. As it may be difficult to create the necessary documents within this 60-day period, they are generally prepared not later than the time of receipt of notice regarding a planned tax audit. Whenever created, they must be maintained for a period of 10 years following the fiscal year of creation.

Special regulations apply to extraordinary business transactions such as restructurings within the affiliated group, the conclusion or amendment of long-term contracts that are significant for the entire group, and transfers of business functions or changes in the risk allocation within the group. Such transactions must be documented ''promptly,'' which is generally interpreted as not later than six months after the end of the fiscal year in which the business transactions are carried out. These documents must be provided within 30 days following a request by the tax authorities.

Transfers of Business Functions Abroad

The Business Tax Reform Act of 2008 introduced special rules for the pricing of business functions transferred to affiliated companies in other countries. The legislative intent of these new rules is to subject German-made assets to German taxation and to avoid a decrease of German tax revenue caused by relocation of assets abroad. It constitutes an exit tax on income that might otherwise have been realized in Germany.

The rules applicable to transfers of business functions abroad diverge substantially from the pricing of other transactions and also from international standards such as those of the OECD. They create significant increases in the data provision and documentation burdens of affected taxpayers. The regulations and other guidelines are so extensive that they are not easily applied by most businesses.

The Legislative Process

The main provision in regard to transfers of business functions abroad is contained in §1(3) 9 *AStG*. It provides that if a function, inclusive of the corresponding opportunities, risks, and assets, are transferred abroad (''function-transfer''), the taxpayer must determine the price range of a deemed sale of the transferred function based on a transfer of the function as a whole (''transfer package'') taking into account the capitalization rates adequate for the functions and risks transferred.

The regulations that were adopted to interpret this provision (*Funktionsverlagerungsverordnung* (*FVerlV*)) comprise 13 paragraphs and specify how the transfer price of a business function is to be determined. Additionally, the Ministry of Finance has issued a draft decree setting forth its understanding as to how the *FVerlV* is to be applied. This 72-page decree contains the interpretation of provisions that are not included in either the *AStG* or the *FVerlV* and, in the case of a so-called ''doubling'' of a business function, even adds a provision that was expressly excluded from the regulations. Generally, a transaction that results in the doubling of a business function is not considered a ''transfer'' under the *AStG* or the *FVerlV* with the result that no transfer prices for such transaction need be developed. Through its definition of ''doubling'' and its differentiation from the concept of ''transfer,'' however, the draft decree redefines much of what was intended as a doubling by the German legislature into a transfer with the resulting pricing and documentation obligations imposed on the taxpayer.

The draft decree also increases the general recordkeeping and documentation obligations by specifying that, in addition to the determinations required by the *AStG* and the *FVerlV*, documentation must be provided in regard to the economic background and advantages created by the function-transfer from the perspective of the group as a whole as well as of the companies directly involved in the transfer. This documentation requirement has been criticized as excessive by various business organizations and it is therefore expected that the decree will be amended before entering into force.

Pricing of Business Functions

The main difference between determining a transfer price for the transfers of a business function abroad

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and other transfer price determinations is that, if the standard methods for determining arm's-length prices — such as the comparable uncontrolled price method, the resale-price method and the cost-plus method — cannot be adequately applied and adjusted for factors such as the corresponding opportunities and risks of the business function, the taxpayer must determine a ''package price'' by carrying out a ''hypothetical arm's-length comparison'' that takes into account various additional factors such as the profit expectations of the function.

Documentation

Generally, the documentation and recordkeeping requirements in regard to the transfer of business functions abroad are governed by the same provisions applicable to other transfer pricing determinations. Additionally, however, if no standard arm's-length method is applicable, documentation must be provided to support the determination of a hypothetical transfer price and to prove the appropriateness of the transfer price so determined. In such case, the documentation must include not only a calculation of the profit potential and an appropriate price range, but also evidence supporting a specific price within that range. The main types of documentation that must be created in regard to transfers of business functions abroad are:

- Information regarding all relevant facts, particularly the impact of the function-transfer on the operative structure of the affiliated group and the employee structure including all contracts relevant to the transfer;
- Documentation supporting the appropriateness of the price for the business function from the perspective of all involved parties based on profit expectations — including, in particular, information as to the calculations and expectations on which the decision to carry out the function-transfer were based, showing the actual reasoning behind such decision;
- Documentation regarding long-term service or delivery arrangements including all relevant contracts; and
- Information as to the taxpayer's research and development activities within the three-year period before the function-transfer, but only if the taxpayer regularly conducts research and development activities and already keeps records regarding such activities for internal purposes.

Because the transfer of a business function is generally considered to be an extraordinary business transaction, the increased documentation obligations and prescribed timing for submission upon the request of the tax authorities will also be applicable to such transfers.

EXCHANGES OF INFORMATION UNDER DTAs AND TIEAs

New Developments in Information Exchange and Administrative Assistance Matters[51]

Introduction

The international financial crisis has highlighted the need for a better exchange of tax information process among the EU and the OECD Member States. National banking secrecy laws (e.g., as in Austria or Luxembourg) became the target.

On the EU level, an amendment package regarding the EU Savings Directive and the EU Directive on the recovery of tax claims was prepared. The Draft EU Directive on Administrative Cooperation in the field of taxation — EU Administrative Cooperation Directive (''EUACD'') — forms part of this amendment package and will replace the Directive 77/799/EEC on Mutual Assistance by the Competent Authorities of the Member States in the field of direct taxation. The draft EUACD is not yet in force and, due to the opposition of some Member States (e.g., Austria), the workings on the EUACD are currently on hold. This portion of the article provides an overview of the draft EUACD.

OECD

In April 2009, the OECD published a ''black list'' of countries that have not committed to cooperate in the efforts of the OECD against tax abuse. In addition, a ''grey list'' identifies ''moderate cooperative countries'' (e.g., Austria) that do not implement the information exchange standards of Article 26 of the OECD Model Convention. The main consequence of Article 26 is that national bank secrecy laws should not constitute a hindrance for information exchange for tax purposes. Therefore, Austria, as a country with strict bank secrecy, was asked to change its tax treaty policy with respect to the OECD developments and to conclude at least 12 exchange of information agreements in order to be cancelled from the ''grey list.''

EU Developments — The Draft EUACD

General

The draft EUACD contemplates the exchange of information that is foreseeably relevant to the admin-

[51] Gerald Gahleitner, Leitner Leitner.

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istration and enforcement of the domestic laws of the Member States.

Taxes Covered

All taxes are covered by the EUACD (Art. 2) irrespective whether they are levied by or on behalf of a Member State or the Member State's territorial or administrative subdivisions except for: (1) compulsory social security contributions; and (2) VAT, customs duties, or excise duties already covered by other EU legislation. The scope of the current Directive 77/799/EEC is extended by the EUACD as the current Directive covers taxes only on income and capital and on insurance premiums.

Persons Covered

The EUACD covers individuals as well as legal persons, association of persons recognized as having the capacity to perform legal acts but lacking the status of a legal person, and any other legal arrangement, of whatever nature and form, that has legal personality or not, owning or managing assets generating income that is subject to any of the taxes covered by the EUACD.[52] The current Directive 77/799/EEC does not define a personal scope but only states in a general manner that information that may enable the Member State to effect a correct assessment of taxes on income and on capital shall be exchanged.

Income and Situations Covered

Transmission on request. According to the EUACD,[53] the transmission of the information may be executed on request. Under the contemplated procedure, the requested authority transmits the information that it has in its possession within two months or transmits information that it obtains as a result of administrative inquiries within six months. The provisions under the current Directive 77/799/EEC are similar, except that they are limited to taxes on income and capital.

Automatic transmission. According to the EUMAD (EU Parliament report)[54] an automatic exchange of information is foreseen only for the following specific categories of income and capital:

- Income from work;
- Directors' emoluments;
- Dividends;
- Capital gains;
- Royalties;
- Life insurance products not covered by other Community legal instruments on the exchange of information and other similar measures;
- Pensions; and
- Ownership of property and income derived therefrom.

The automatic transmission of the information is to take place at least once each year. An automatic exchange for additional categories of income and capital may be agreed on only in bilateral or multilateral agreements among the states. Despite the limitation of the automatic exchange of information to the mentioned categories of income and capital, a floor is foreseen on the amount that will trigger exchanges. Furthermore, Member States must ensure customer privacy protection under Directive 95/45/EC. Under the current Directive 77/799/EEC, an automatic exchange of information may take place only if determined under a consultation procedure.

Spontaneous transmission. Under the EUACD,[55] information is communicated spontaneously in the following circumstances:

- A Member State has grounds for supposing that there may be a loss of tax in the other Member State;
- A person liable to tax obtains a reduction in or an exemption from tax in the one Member State which would give rise to an increase in tax or to liability to tax in the other Member State;
- Business dealings between a person liable to tax in a Member State and a person liable to tax in another Member State are conducted through one or more countries in such a way that a saving in tax may result in one or the other Member State or in both;
- The Competent Authority of a Member State has grounds for supposing that a saving of tax may result from artificial transfers of profits within groups of enterprises; and
- Information forwarded to the one Member State by the Competent Authority of the other Member State has enabled information to be obtained which may be relevant to in assessing liability to tax in the latter Member State.

This information is to be transmitted within one month after it becomes available.[56] Under the current Directive 77/799/EEC, the provisions are similar to the draft of the new Directive.

[52] Art. 3 ¶11.

[53] Art. 5, *et seq.*

[54] Art. 8 ¶1.

[55] Art. 8a ¶1.

[56] Art. 9 EUACD.

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Presence at Inquiries

The EUACD foresees that authorized officials from the requesting state will be present during the administrative inquiries and take part thereon.[57] Furthermore, rules for simultaneous controls in different Member States are provided for.[58] The current Directive 77/799/EEC provides for such participation only if under a consultation procedure it was agreed thereon by the respective Member States.

Protection of Transmitted Information

According to EUACD,[59] information communicated between Member States in any form must be covered by the obligation of official secrecy and must enjoy the protection extended to similar information under the national law of the Member State receiving it. The current Directive 77/799/EEC provides for similar protection.

According to Art. 16 of the EUACD, limits on the transmission of information are provided for in the Directive and are similar to the limitations under Article 26 of the OECD Model Convention. However, the transmission cannot be refused because the information is held by a bank or other financial institution. The agreement by all Member States to lift national bank secrecy rules is the most important legislative innovation in the EUACD. Under the current Directive 77/799/EEC, Member States are not obliged to suppress national bank secrecy rules.

Taxes Not Covered

Under the EUACD, the information transmitted may nevertheless be used for the assessment and enforcement of other taxes and duties. According to the current Directive 77/799/EEC, the rules are stricter and require the permission of the providing state before the information can be used in relation to other taxes.

Third-Country Relation

Under the EUACD, information may be transmitted to third states with permission of the state from which the information originates. A most-favored-nation clause guarantees that the Member States have among themselves the same level of cooperation as they have with third countries. The current Directive 77/799/EEC provides for similar provisions but does not include a most-favored-nation clause.

Effective Date

The EUACD will take effect in January 2012. However, the automatic exchange of information first becomes effective January 2014. The current Directive 77/799/EEC will be repealed by the new Directive.

The Austrian Reaction to the OECD Developments

IEIA, DTA, and TIEA

The Austrian legislation limiting exchanges of information from banks only to criminal investigations is cancelled with effect from 13 March 2009 due to the pressure by international organizations (EU, OECD, G-20). Moreover, the Information Exchange Implementation Act (IEIA), implementing the new Austrian tax treaty policy and the future EU exchange of information policy, has been enacted by the Austrian Parliament. The IEIA is applicable as of 9 September 2009 and provides for the legal basis to receive bank account information for tax purposes in the course of cross-border exchange of information. Against this background, Austria since September 2009 has also already signed several amendments to existing double taxation agreements (DTAs) and several TIEAs following the information exchange standards of Article 26 of the OECD Model Convention. As of June 2010, 13 Austrian DTAs and four TIEAs fulfilling the required standards to suppress the Austrian bank secrecy rules were signed. The DTAs are with Bahrain, Belgium, Denmark, Ireland, Luxembourg, Mexico, Netherlands, Norway, San Marino, Sweden, Singapore, Switzerland, and the United Kingdom. The TIEAs are with Andorra, Gibraltar, Monaco, and St. Vincent & Grenadines.

Consequently, on the basis of the IEIA and the new information exchange rules, the Austrian banking secrecy of §38 Banking Act (BA) is not operable in the case of qualified requests by foreign tax authorities in cross-border situations that provide assistance in a foreign tax determination procedure (foreign state request).

Requests Under the IEIA

A foreign tax authority's request for banking information from an Austrian bank or financial institution must meet the following requirements according to the IEIA:

- The exchange of information must be based on concrete cross-border legal provisions (DTA, TIEA, or EUACD in future).
- A special request of a foreign tax authority must be addressed to the Austrian Ministry of Finance; neither spontaneous nor automatic exchanges are permitted.
- In order to disregard the banking secrecy, the information requested by the foreign tax authority

[57] Art. 10.
[58] Art. 11 EUACD.
[59] Art. 15.

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must be foreseeably relevant for the enforcement of the double tax treaty or the cross-border legal rules or the foreign tax law.

The request is foreseeably relevant if it at least refers to a specific or a determinable person (in general the account holder or the beneficial owner of the banking account) declaring personal data such as the name, address, date of birth, civil status, tax number, etc. The respective bank must be mentioned in the request. The bank account number need not be provided. The request must contain the tax purpose for which the information is requested, the type of information sought, and the particular fiscal period involved in the request. ''Fishing expeditions,'' merely to identify whether any foreign citizen or any resident in Austria has a bank account, are impeded by the foregoing requirements. In addition, the information may be provided by the Austrian Ministry of Finance only if the foreign tax authorities have applied all procedural domestic instruments to receive the information.

Legal Protection

The person concerned in the request is entitled to the benefit of a specified degree of legal protection. The Ministry of Finance has the obligation to notify the concerned bank and person about the existence of the request and the type of the requested information. Within two weeks after the obligatory notification the concerned person has the option to file a legal application with the competent Austrian tax authority to issue a decision clarifying whether the requirements of the IEIA are actually met. In the affirmative, the Ministry of Finance sends a formal request to the Austrian Bank with the order to transfer the respective information. If the bank does not transmit the concerned information, a fine up to €5,000.00 is due. Alternatively, the person who is the subject of the request may file a complaint with the Administrative or Constitutional Supreme Court within six weeks. The complaint against the decision of the Ministry of Finance will not suspend the transmission of information once the six-week period has expired and the transmission of the information must then be carried out by the bank. However, on application of the account holder, the Supreme Administrative Court or the Constitutional Court may grant the injunctive relief that prevents the transmission of information. Parallel to the complaint, the account holder must file a second application — including a duplicate of the complaint filed with the Administrative or Constitutional Supreme Court — to the Ministry of Finance in order to prevent a transmission of the banking information during the period in which the Court considers the application for relief.

Exchanges of Information Under DTAs and TIEAs: The Belgian Perspective[60]

The principal objective of Belgium was to be removed from the OECD tax haven list via the protocols to existing bilateral treaties and the conclusion of tax information exchange treaties. Belgium is in the process of amending numerous existing income tax treaties so that an exchange of information article is inserted. The first was with the United States in 2006. Since the second half of 2009, numerous protocols have been signed. These protocols are based on the most recent version of Article 26 of the OECD Model Convention. They provide for, *inter alia*, an exchange of information on request, automatic exchange of information, and spontaneous exchange of information. In addition, Belgium has been in the process of concluding tax information exchange agreements with a number of countries since the second half of 2009. These TIEAs are based on the 2002 OECD Model Agreement. In comparison to protocols to DTAs, these agreements provide for exchanges of information on demand.

As a matter of background, Belgian's bank secrecy rules provide a legal obligation for the financial institution to protect the confidentiality of customer information. The only existing exception prior to 2009 was for direct taxation, and even then, only for Belgian private accounts — not for professional accounts. The bank secrecy law prohibited inquiries into books of a financial institution with a view to taxing the clients of the financial institution. It also prohibited the use of information obtained with a view of taxing the clients of the financial institution. An exception has always been provided with regard to an inquiry relating to tax fraud or a criminal offence. Additional exceptions allowed information to be provided in the event of an investigation into a customer's complaint or if needed for the purposes of tax collection.

Financial institutions have a confidentiality obligation with regard to their clients. In order to provide information, three questions must be addressed:

- What information is Belgium, with the cooperation of the financial institutions, obligated to give to its partners? Is it full access to Belgian financial institutions' files as part of a tax audit of the customer in requested by another country? The answer is that the information must be ''foreseeably relevant.'' Thus there can be no ''fishing expedition,'' and the requested country must have

[60] Henk Verstraete, Liedekerke Wolters Waelbroeck Kirkpatrick.

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pursued all means of investigations available.[61] If relevant, the bank secrecy rules are not an obstacle.

- Which information can be requested from abroad in connection with an investigation in a foreign financial institution's files requested by Belgium? Here, the answer is that the Belgian tax authorities cannot request information from a foreign tax authority that cannot be obtained from a Belgian bank under the Belgian bank secrecy rules. Belgium thus cannot take advantage of an the rules of another country and ignore the restrictions contained in its domestic law, unless there is an explicit derogation in an applicable income tax treaty.
- Which information can Belgium use upon receiving the information from a foreign financial institution? Here, the answer is that the information can be used only if permissible under the existing bank secrecy rules. The restrictions on the use of bank information cover foreign bank information in addition to Belgian information, again, unless a derogation from domestic law is provided in an income tax treaty.

Joint Government Initiatives: The German Perspective[62]

Introduction

Germany is part of an international network for the cross-border exchange of information for tax purposes and is committed to fighting international tax evasion by means of international cooperation as well as by unilateral measures.

Cross-Border Information Exchange

In Germany, cross-border information exchange is based on European laws, bilateral tax treaties, exchange of information agreements, and unilateral domestic laws.

European Information Exchange

Cross-border information exchange between the tax authorities of the EU Member States is governed by the European Council Directive 77/799/EEC of 19 December 1977 concerning the *Mutual Assistance by the Competent Authorities of the Member States in the Areas of Direct Taxation and Taxation of Insurance Premiums*, which Germany implemented in 1985. This Directive provides that the Competent Authorities of the Member States must exchange any information that would enable them to carry out a correct assessment of taxes on income and on capital as well as any information relating to the determination of taxes on insurance premiums.

Information is provided by the German tax authorities upon request of another EU Member State's tax authority, but the German tax authorities may *not* provide information to foreign tax authorities if:

- The transmission of the requested information is not in accordance with German law;
- Data protection is not guaranteed in the other Member State;
- The public order is not respected in the other state, particularly in regard to international tax secrecy; or
- The danger exists that a resident taxpayer may suffer damage through the disclosure of trade or business secrets.

The German tax authorities may also, in their sole discretion, provide information spontaneously (i.e., without being requested to do so) to other EU Member States, if there are concrete indications that tax laws of the other state have been breached — such as possible tax evasion or avoidance and transfer pricing agreements that do not meet arm's-length standards.

Affected German taxpayers are entitled to be heard prior to the transmission of any information abroad and may challenge such transmission.

Bilateral Tax Treaties

The OECD Model Convention includes exchange of information provisions not only to enforce the relevant tax treaty (limited exchange of information clause) but also to enforce domestic tax claims of one of the Contracting States (extended exchange of information clause). Under the extended exchange of information clause, the Competent Authorities of the Contracting States must exchange all information which is foreseeably relevant for carrying out the provisions of the convention or for the administration or enforcement of the domestic tax laws of either state to the extent that the resulting taxation is not contrary to the convention.

The exchange of information clauses have regularly been amended in order to strengthen the powers of the Contracting States to pursue tax-relevant information that is available only in the other state. One such amendment, which appeared in the OECD Model Convention of 2005, adopted the following changes:

- An easing of confidentiality obligations to allow the forwarding of obtained information to supervisory authorities;

[61] *See* Belgium's reservation on Article 26 of the OECD Model Convention.

[62] Peter H. Dehnen, DEHNEN.Rechtsanwälte.

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- Clarification that a state can also provide information in which it does not, itself, have an interest; and
- Clarification that a state may not claim bank secrecy as a reason for denying the information request of the other Contracting State.

All of the 88 double tax conventions (DTCs) that Germany has concluded include an exchange of information clause, and a dozen of these include the exchange of information standard of the OECD Model Convention 2005. The latest amendments of DTCs to include that standard were concluded with Luxemburg, Albania, and the United Kingdom. Negotiations with Liechtenstein and Austria are pending.

Exchange of Information Agreements

Tax Information Exchange Agreements (TIEAs) are another form of cross-border agreement that serves to promote the exchange of tax-relevant information between Contracting States.

Germany has concluded or amended a number of such agreements (e.g., with Jersey, Aruba, and the Bahamas) in the aftermath of the February 2008 ''Liechtenstein affair'' in which an employee of the Liechtenstein LGT Bank stole a CD containing the names of several hundred German residents who had deposited untaxed capital in the accounts of the bank and sold it to the government. TIEAs are particularly useful for small countries — which are often classified as tax havens — because they can be signed, ratified, and implemented in a much shorter period of time and with less effort than is generally required for the conclusion of DTCs.

Domestic German Law

Cooperation by exchange of information may also take place between Germany and a non-European, non-treaty country on the basis of German domestic law under which the German tax authorities may provide information to the extent that:

- Reciprocity is granted by the other country;
- The recipient country observes tax secrecy practices comparable to those applicable in Germany;
- The state requesting information agrees to avoid possible double taxation by way of a Mutual Agreement Procedure; and
- The request does not interfere with either public order or with trade or business secrecy standards.

As in regard to other exchanges of information, affected taxpayers have the right to be heard before information is sent to foreign tax authorities.

German tax law also allows German tax authorities to request information from foreign tax authorities and allows the disclosure by the German authorities of information otherwise protected by tax secrecy provisions where disclosure is necessary for purposes of the information request.

All exchanges of information between German and foreign tax authorities are subject to the principle of appropriateness, which means that requests for information must be absolutely necessary in order to ensure proper taxation. Foreign tax authorities must generally show that they have exhausted all means available to them for procuring the information internally before the German authorities will grant an information request. Note that the German constitution, through the right to informational self-determination (*Recht auf informationelle Selbstbestimmung),* also prohibits cross-border information exchanges unless they are absolutely necessary and German-resident taxpayers are legally protected.

Multilateral Cooperation on Information Exchange for Tax Purposes

In April 2008, Germany joined the *OECD and European Council Convention on Mutual Administrative Assistance in Tax Matters*. This Convention implements instruments to counteract international noncompliance in today's open and more integrated economy. It covers all types of taxes and allows exchanges of information and multilateral, simultaneous tax examinations as well as mutual assistance in tax collection.

Germany is part of the G-7 and G-20 groups of countries and, together with France, has initiated two conferences on the *Fight Against International Tax Fraud and Evasion by Promoting Transparency and the Exchange of Information in Tax Matters*. Germany's intent in this regard is to enforce implementation of the OECD standards.

Germany's efforts in this regard can be seen by examining the outcome of the second *Conference on the Fight Against International Tax Fraud and Evasion* held in Berlin on 23 June 2009. The following are the most important aspects as well as future objectives set forth by the conference:

- Endorsements of the OECD information-exchange standards by many significant financial centers.
- Implementation of a multilateral, impartial and transparent monitoring and peer-review process for all jurisdictions to ensure effective implementation of the standards on a global basis. This process is already being carried out within the scope of the OECD Global Forum on Taxation.

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- Development of defensive measures to protect the tax base of participating states against those countries and territories that do not implement the OECD standards, including:
  - Increased withholding taxes in regard to a wide variety of payments made to noncooperative jurisdictions;
  - Denial of deductions for expense payments to recipients resident in noncooperating jurisdictions;
  - Termination of treaties with countries and territories that refuse to participate in exchanges of information;
  - Increased disclosure requirements for national and foreign financial institutions and collective investment vehicles to report transactions involving noncooperating jurisdictions;
  - Denial of the participation exemption; and
  - Requests to international financial institutions to review their investment policies with respect to noncooperating jurisdictions.

Additionally, the conference recognized the importance of the availability of information regarding the beneficial owners of bank accounts, investment vehicles, and other financial assets for taxation purposes. The Conference also asked the OECD, the Financial Action Task Force (FATF), and the EU to explore ways to facilitate access to information in regard to trusts, foundations, shell corporations, and other arrangements that may be used for tax evasion purposes.

German Solo Attempts

The *Act to Combat Destructive Tax Practices and Tax Fraud* (the ''Tax Fraud Act''), passed in 2009, extends taxpayers reporting obligations to dealings with persons in tax havens — foreign countries specified by the German Finance Ministry as being in noncompliance with OECD transparency standards and exchange of information requirements. The Tax Fraud Act imposes increased documentation and verification obligations in regard to such business relationships while denying the tax exemption of intercompany dividends and the deduction of business expenses related to such transactions. While this law has entered into force, the German Finance Ministry has not named any countries that do not meet the specified standards.

Nevertheless, the Tax Fraud Act fulfilled its intention of putting increased pressure on countries that do not comply with the OECD standards regarding the international exchange of tax-relevant information. Even though the OECD ''black list'' was empty when Germany started the legislative procedure in regard to the Tax Fraud Act, German Finance Minister Steinbrück pointed out that until the promises of the ''gray-list'' states are kept and the respective information exchange agreements are concluded, the need for regulations to prevent tax fraud resulting from insufficient information exchange continues to exist. Since passage of the Tax Fraud Act, several states have entered into negotiations with Germany in regard to TIEAs.

Another path Germany is taking to put pressure on states that do not comply with OECD exchange of information standards is data purchase. As mentioned above, the first purchase of data regarding tax evasion occurred in the Liechtenstein Affair of 2008. While the German government paid €4.6 million for the CD, to date it has collected approximately €200 million in evaded taxes and penalties through criminal proceedings as well as from self-reporting by taxpayers, and another €100 million are expected to result from additional criminal proceedings currently pending. In February 2010 another ''tax-evader CD'' — which reportedly contains information on approximately 1,500 persons who have deposited money into Swiss bank accounts without declaration to the German tax authorities — was purchased by the Federal Government for €2.5 million. The open discussions on whether Germany should buy the data, and the subsequent purchase, resulted in self-reporting by more than 16,000 taxpayers through the end of April 2010.

In Germany, taxpayers committing tax fraud can obtain exemption from prosecution by self-reporting but only if the self-reporting is made before a crime is discovered by tax or prosecution authorities and only in regard to the self-reported crimes. Evaded taxes plus interest for the time of delay must be paid to the tax authorities within a period set in the discretion of the relevant tax authority. So far, Germany has obtained approximately €1.25 billion from self-reporting in reaction to the purchase of the Swiss data CD.

The information purchase was strongly criticized by the Swiss government, which threatened to discontinue cooperation with Germany in tax matters. After Germany nevertheless bought the data, a bilateral working group was created by Switzerland and Germany. Its main goals are ensuring the German taxation of undeclared assets deposited in Switzerland as well as negotiating a revision of the DTC currently in force.

Since appearance of the Swiss CD, a number of other CDs have been offered to various German Federal States. Some have agreed to purchase and others

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have declined because of qualms about legality. CDs containing the names of tax evaders are still in negotiation with various German tax authorities.

JOINT INTERNATIONAL TAX SHELTER INFORMATION CENTRE (JITSIC)[63]

Overview

JITSIC was established in 2004 by the IRS, HMRC, and the tax authorities of Canada and Australia to identify and curb ''abusive'' tax avoidance transactions via ''real time'' information sharing. JITSIC was originally headquartered in Washington, D.C., and now operates out of dual offices in Washington, D.C., and London. Its membership expanded to include Japan in 2007, and China and Korea participated as observers in 2008 and 2009 respectively. JITSIC has been credited with effects beyond bringing schemes of tax avoidance to the attention of tax authorities, such as sharing best practices and promoting understanding of the member countries' tax regimes. JITSIC's territorial growth is matched with a newly broadened remit that includes information sharing on transfer pricing compliance, offshore arrangements, and high-net-worth individuals.

U.K. Perspective

U.K. delegates to JITSIC are part of HMRC's Anti-Avoidance Group, and JITSIC was cited in the 2008 Budget and 2009 Pre-Budget Report as specific evidence of international cooperation in controlling tax revenue. HMRC's International Manual makes clear that any requests for information relating to ''aggressive/abusive tax avoidance schemes'' with an Australian, Japanese, Canadian, or American connection are dealt with by JITSIC, which thereby enhances pre-existing information exchange procedures under double taxation treaties, tax information exchange agreements and EU law.

HMRC's website publicizes the purpose of JITSIC to:

- Provide support to the parties through the identification and understanding of abusive tax schemes and those who promote them;
- Share expertise, best practices and experience in tax administration to combat abusive tax schemes;
- Exchange information on abusive tax schemes, in general, and on specific schemes, their promoters, and investors consistent with the provisions of bilateral tax conventions; and
- Enable the parties to better address abusive tax schemes promoted by firms and individuals who operate without regard to national borders.

By contrast, information sharing with non-JITSIC countries is dependent upon the United Kingdom being able to reciprocate if a similar request were made of it, and HMRC note that this can make information from overseas tax authorities difficult to obtain. JITSIC by its nature as a continuing information-sharing service for mutual benefit can be seen to avoid this issue because it looks at information on a general level, rather than on a case-by-case basis. JITSIC also reduces time delays inherent in requesting information on an ad hoc basis.

Scope

On its inception, JITSIC delegates from member tax authorities were charged with exchanging information on ''abusive tax schemes'' pursuant to the terms of the tax treaties concluded between member countries, and this language is retained in the JITSIC statement of purpose on the HMRC website. Noting that HMRC in a 2007 press release talked in wider terms of ''combating tax avoidance,'' commentators have expressed concern that this expansion blurs the line between information sharing on abusive schemes, and targeting tax avoidance schemes that are within the law. Because the activities of JITSIC are not public, and HMRC has not disclosed specific information on the impact of JITSIC in the United Kingdom, it is difficult to evaluate whether the apparent shift in emphasis has taken place, and to what extent this has filtered into legislative measures in the United Kingdom. What is known is that member countries agreed in 2009 that JITSIC's activities should extend beyond its initial scope of investigating cross-border transactions and should include:

- Tax administration issues arising from the global economic environment;
- Scrutiny of offshore arrangements;
- The activities of high-net-worth individuals; and
- Transfer pricing compliance. In this context, it should be noted that in 2009, HMRC won a significant victory before the U.K. Tax Tribunal in a major transfer pricing case, apparently assisted by IRS personnel. This was the first U.K. judicial decision to consider transfer pricing methodologies in detail.

Impact

Counteracting Tax Schemes

Several high-profile successes of JITSIC have been publicized. For example, the U.S. Treasury Depart-

[63] Michael McGowan, Sullivan & Cromwell LLP.

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ment acknowledged that the IRS learned of transactions to generate foreign tax credits through information provided by HMRC via JITSIC. The United States has subsequently enacted regulations to counteract such transactions, as well as challenging such arrangements in the courts. JITSIC also helped the IRS identify the marketing of a U.S.-Canada transaction that resulted in alleged improper deductions and unreported income from retirement account withdrawals.

Sharing Best Practices

For example, the IRS has expressed interest in adopting the HMRC risk allocation strategy for large businesses, so that ''high-risk'' organizations are subject to greater scrutiny and more frequent audits.

Promoting Mutual Understanding and Cooperation

JITSIC has been instrumental in furthering tax administrators' understanding of the regimes of member countries, and it has been suggested that the U.K.'s anti-arbitrage rules (enacted in 2005) are the direct result of the U.K.'s participation in JITSIC. Increased cooperation has also led to multiple-jurisdiction audits and joint examinations.

In addition to the overriding objective to deter promotion of and investment in abusive tax schemes, HMRC have set out further aims of JITSIC that will be achieved via information exchange and knowledge sharing:

- Increasing public awareness of the potential civil and criminal risks of promoting and investing in abusive tax schemes;
- Sharing best practices among the member countries' tax administrations for identifying and addressing abusive tax schemes;
- Enhancing each member country's compliance and enforcement efforts through coordinated and ''real-time'' exchanges of tax information consistent with the provisions of bilateral tax conventions;
- Developing new Internet search and other techniques for early identification of promoters and investors involved in abusive tax schemes;
- Identifying emerging trends and patterns to anticipate new, abusive tax schemes; and
- Improving member countries' knowledge of techniques used to promote abusive cross-border tax schemes.

The publicity JITSIC has received, most notably in the United States, indicates that many of these aims are being met. From a U.K. standpoint, comparatively little evaluative information is available.

As to JITSIC's general impact, speaking at a joint meeting of the American Bar Association Section of Taxation in 2007, Dave Hartnett, Deputy Chief Executive of HMRC, promised to make tax practitioners' ''blood pressure rise'' by explaining how organizations such as JITSIC have enabled tax agencies to ''close the circle'' on abusive cross-border transactions. Hartnett also referred to a ''cultural change'' brought about by increased international information sharing, and warned that CEOs and corporate directors should accept that abusive cross-border transactions cannot be tolerated.

CONCLUSION

The foregoing discussion suggests that a sea change has taken place in the way that nations view the tax obligations of their residents and guests. In a sense, governments view themselves as partners in the taxpayer's business, entitled to a specified share of partnership profits. A fiduciary duty is imposed on taxpayers to avoid aggressive tax planning that unilaterally reduces the government's share of the profits. To enforce that duty, it is logical that taxpayers must notify the tax administration of instances where aggressive planning may have taken place. It is also logical that penalties must be imposed where taxpayer violations occur. Theft must be punished.

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