



Automatic Exchange of Information

WHAT IT IS, HOW IT WORKS, BENEFITS,
WHAT REMAINS TO BE DONE



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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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I. INTRODUCTION

As the world becomes increasingly globalised and cross-border activities become the norm, tax administrations need to work together to ensure that taxpayers pay the right amount of tax to the right jurisdiction. An open international architecture where taxpayers operate cross-border but tax administrations remain confined to their national borders, can only be sustained where tax administrations co-operate. One key aspect of international tax co-operation is exchange of information.

Exchange of information comes in different forms and includes exchange upon request, spontaneous information exchange and automatic exchange of information. The OECD has a long history of working on all forms of information exchange and Article 26 of the OECD Model Convention provides a basis for all three forms of information exchange.

The OECD's work on exchange upon request and the more recent peer review work of the Global Forum on Transparency and Exchange of Information¹ are well known. The OECD also works on other forms of exchange of information, including automatic exchange of information, where it has been active in facilitating such exchanges for many years. The OECD's work in this area is focused on helping make automatic information exchange into an effective compliance tool for countries wishing to use it and does not suggest a change in the current international standard, which is information exchange upon request.

The work has ranged from creating the legal framework for such information exchanges to developing technical standards and seeking to improve automatic exchange at a practical level. In addition, the OECD has produced guidance on automatic exchange and provided training to countries interested in developing the necessary framework and operating automatic exchange on a practical level.

¹ See www.oecd.org/tax/transparency.

Another key component in connection with automatic exchange of information is the need to ensure that information exchanged is kept confidential. This aspect has long been a key focus for the OECD in respect of all forms of exchange of information, not just automatic exchange, but it is particularly pronounced in the automatic exchange area. To engage in exchange of information, and in particular automatic exchange of information, countries need a high degree of comfort that the information is kept confidential both in law and in practice and is only used for the purposes allowed under the applicable exchange instrument.

This report informs the wider public on key aspects of automatic exchange of information and the work of the OECD in this area. In particular it answers the following basic questions:

- What is automatic exchange of information?
- How does it work?
- What is the legal basis?
- What is the current state of play?
- Does automatic exchange work?
- What is the OECD doing in this area and what still needs to be done?

II. WHAT IS AUTOMATIC EXCHANGE OF INFORMATION?

The automatic exchange of information² is understood to involve the systematic and periodic transmission of “bulk” taxpayer information by the source country to the residence country concerning various categories of income (*e.g.* dividends, interest, royalties, salaries, pensions, etc.).

The information which is exchanged automatically is normally collected in the source country on a routine basis, generally through reporting of the payments by the payer (financial institution, employer, etc). Automatic exchange can also be used to transmit other types of useful information such as changes of residence, the purchase or disposition of immovable property, value added tax refunds, etc. As a result, the tax authority of a taxpayer’s country of residence can check its tax records to verify that taxpayers have accurately reported their foreign source income. In addition, information concerning the acquisition of significant assets may be used to evaluate the net worth of an individual, to see if the reported income reasonably supports the transaction.

² Also called routine exchange by some countries.

III. HOW DOES AUTOMATIC EXCHANGE OF INFORMATION WORK?

The basic process of automatic exchange of information can be divided into seven steps:

1. Payer or paying agent collects information from the taxpayer and/or generates information itself³.
2. Payer or paying agent reports information to the tax authorities.
3. Tax authorities consolidate information by country of residence.
4. Information is encrypted and bundles are sent to residence country tax authorities.
5. Information is received and decrypted.
6. Residence country feeds relevant information into an automatic or manual matching process.
7. Residence country analyses the results and takes compliance action as appropriate.

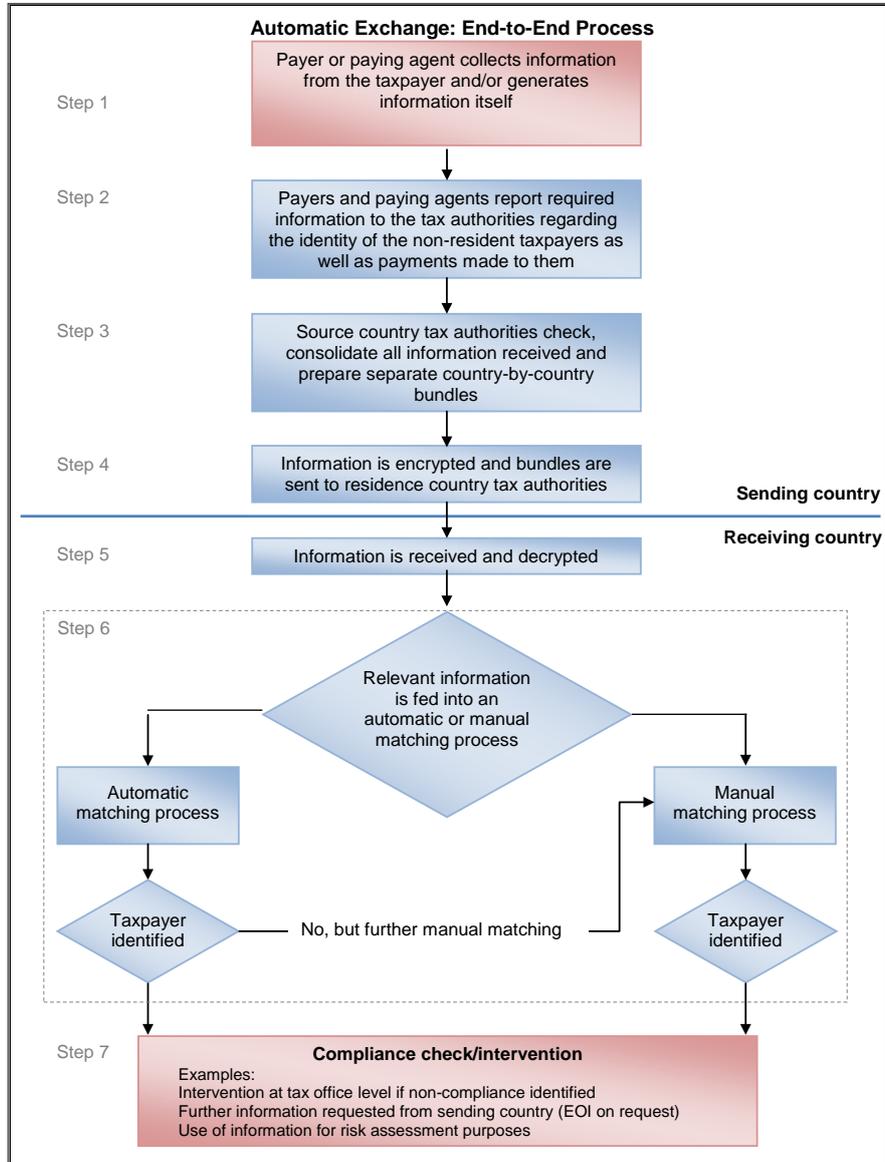
The process starts with the provision, by a taxpayer, of information regarding his or her identity to a payer or paying agent and/or with the generation of information by the payer or paying agent (first step). According to domestic rules in the source country, payers and paying agents are required to report to the tax authorities information regarding the identity of the non-resident taxpayer as well as payments made to them (second step). Once the information has been received by the source country tax authorities the information will be consolidated and bundled according to the country of residence (third step). Next, information is transmitted from the source country to the residence

³ While most tax systems operate in this way, some require the taxpayer to file a refund claim directly to the tax administration. It is from this refund claim that the tax administration obtains the information to exchange.

country. The source country must ensure that the transmission is done securely, with a sufficient level of encryption. Information may be transmitted electronically or by CD ROMs. If the CD ROMs are sent by mail, it must be done via an international registration system where a mail tracking function is in place (fourth step).

The fifth step in the process is the receipt and decryption of the information by the residence country tax authorities. Next, relevant information will be fed into an automatic or manual matching process. The processing and use of the information varies from country to country depending on the risk assessment parameters, processing and technology systems used. The key aspect is to be able to identify the taxpayer and “match” the information with the domestic records. In this respect many countries have developed sophisticated automatic matching systems, allowing them to run all of the information received through a database to identify matches. This is often followed up by manual matching of the previously unmatched data. Other countries use only a manual matching system (sixth step). Based on the results of the matching process, the tax authorities may commence compliance action against a taxpayer that may not have complied with reporting obligations, or make a specific request for information from the source country to obtain additional information. In addition to using the specific information received, some countries use the information for more general risk assessment (seventh step).

Throughout the entire process feedback can be given from the receiving to the sending country, but also from the country collecting the information to the reporting payers or paying agents.



IV. WHAT IS THE LEGAL BASIS FOR AUTOMATIC EXCHANGE?

The legal basis for the automatic exchange of information is generally (1) the exchange of information provision of a double taxation convention based on Article 26 of the OECD or UN Model Convention, (2) Article 6 of the Convention on Mutual Administrative Assistance in Tax Matters, or (3) for EU member countries, domestic laws implementing EU directives which provide for automatic exchange.

While the treaty law contains the legal basis for automatic exchange including rules on reciprocity some countries require, and others have a policy to require, a special working agreement or memorandum of understanding (MOU) setting forth the terms and conditions of the proposed automatic exchange. Such an MOU typically sets forth the types of information to be exchanged automatically, details about the procedures of sending and receiving information and the appropriate format to use. The OECD has designed a Model Memorandum of Understanding on Automatic Exchange⁴ that can be used as a basis for an operational working agreement between tax administrations. The Multilateral Convention on Mutual Administrative Assistance in Tax Matters specifically requires an agreement between the Parties willing to provide each other information automatically.

⁴ See [C\(2001\)28/FINAL](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C(2001)28/FINAL&docLanguage=En) (available under [www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C\(2001\)28/FINAL&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C(2001)28/FINAL&docLanguage=En))

V. CURRENT STATE OF PLAY

Results of a recent survey on automatic exchange conducted by the OECD^{5,6} show widespread use of automatic exchange of information regarding country coverage and income types, transaction values and records exchanged. Certain facts and figures in each of these areas are summarised below.

Country coverage and income types

Automatic exchange is widely used both within and outside the European Union (EU) with many non-EU members having extensive automatic exchange relationships. Among the most frequently exchanged income types are: interest, dividends, royalties, income from dependent services and pensions. All 38 countries (100%) receive information automatically from treaty partners and 33 (85%) of them send information automatically to treaty partners. Denmark, as the country with the largest number of automatic exchange relationships sends information automatically to 70 countries. The charts below give further details on country coverage.

⁵ Responses were received from the following countries that participate in the work of the OECD's Committee on Fiscal Affairs: Argentina, Australia, Austria, Belgium, Canada, Chile, China, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, India, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Russia, the Slovak Republic, Slovenia, South Africa, Spain, Sweden, Turkey, the United Kingdom and the United States.

⁶ The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Figure 1. Automatic exchange relationships - Information sent automatically to number of countries by

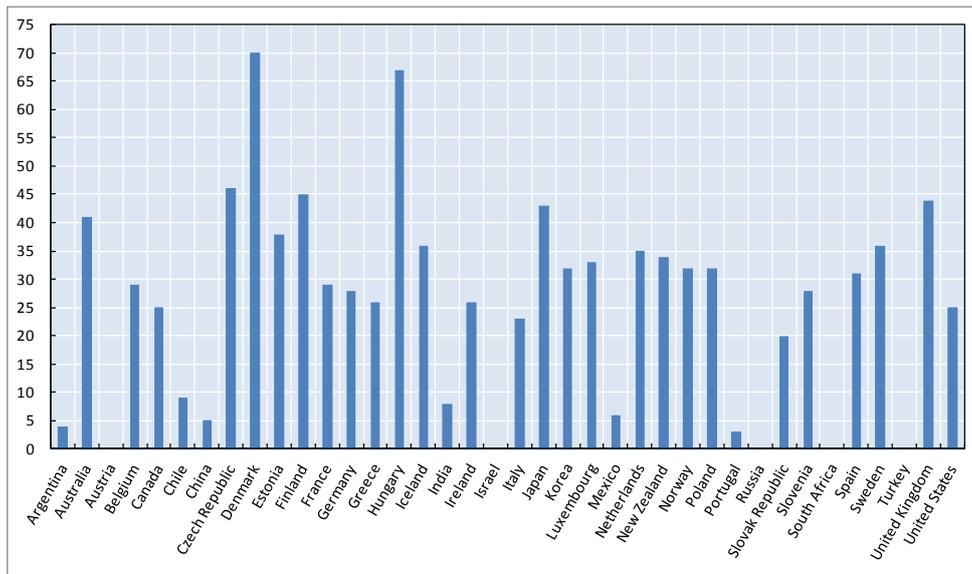
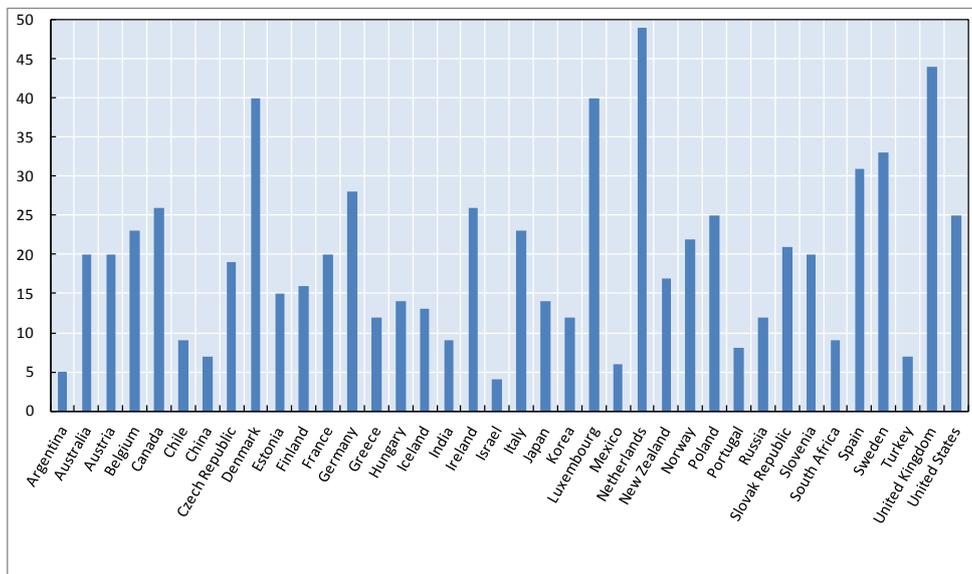


Figure 2. Automatic exchange relationships - Information received automatically from number of countries by



Transaction value

Transaction value relates to the amounts of income and capital reported on records exchanged automatically. The survey shows that the amounts represented by records received can range from as little as several million of Euros to well over EUR 200 billion for a particular year.⁷ Five countries, including Italy, reported receiving records relating to more than EUR 15 billion each in a particular year. Further, most countries reported exchanging information in the billions of Euros. While these amounts do not represent tax but income and assets, applying average tax rates to such amounts and even assuming a low non-compliance rate can add up to significant numbers.

Records exchanged

Many countries also keep statistics on the numbers of records exchanged:

- Eight countries⁸ sent more than one million records in a particular year⁹.
- One country (United States) sent 2.5 million records in a particular year⁹.
- Thirty one countries¹⁰ combined sent 17.8 million records in a particular year⁹.

⁷ Depending on the last year of available statistics in a country, the year for which the information was provided may vary.

⁸ Australia, Belgium, Canada, France, Spain, Sweden, United Kingdom, United States.

⁹ Depending on the last year of available statistics in a country, the year for which the information was provided may vary.

¹⁰ The following 31 countries provided numbers of records sent: Argentina, Australia, Belgium, Canada, Chile, China, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Iceland, India, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Slovenia, Spain, Sweden, the United Kingdom and the United States.

VI. DOES AUTOMATIC EXCHANGE WORK?

As a tool to counter offshore non-compliance automatic exchange has a number of benefits. It can provide timely information on non-compliance where tax has been evaded either on an investment return or the underlying capital sum. It can help detect cases of non-compliance even where tax administrations have had no previous indications of non-compliance. Other benefits include its deterrent effects, increasing voluntary compliance and encouraging taxpayers to report all relevant information. Automatic exchange may also help educate taxpayers in their reporting obligations, increase tax revenues and thus lead to fairness – ensuring that all taxpayers pay their fair share of tax in the right place at the right time. In a small number of cases countries have been able to integrate the information received automatically with their own systems such that income tax returns can be prefilled.

In a purely domestic context the impact of information reporting can be seen when the compliance rates of salaried employees are compared with the compliance rate of self-employed individuals. An employee who knows that his or her salary will be reported to the tax administration is far less likely to under report that income than someone whose income has not been directly reported to the tax authority. Similarly in an international context the same holds true. The EU experience with the Savings Directive suggests that in the absence of automatic exchange of information in excess of 75% of taxpayers may not have complied with their residence country tax obligations.¹¹

¹¹ This number is calculated taking into account the number of taxpayers that chose withholding over information reporting based on published numbers. See *Accord sur la fiscalité de l'épargne / statistique du 01.01.2008 au 31.12.2010*, Switzerland (available on www.estv.admin.ch). The underlying assumption is that there is practically no reason for anybody wishing to comply with the tax laws in his/her home jurisdiction to opt for withholding.

The risk of non-compliance on foreign source income is also borne out in practice as illustrated by examples from Norway and Denmark:

- In 2009, Norway received automatic exchange of information from a number of its treaty partners. Files above a certain threshold were verified against the returns of income filed by taxpayers in Norway. Results of the investigation disclosed that in **38.7% of the cases income** which was taxable in Norway **had not been reported**.
- Under a special project, Denmark used information received automatically to conduct 1 000 audits, resulting in additional tax revenue. In addition 1 100 letters were sent out to other taxpayers with the information that the Danish Tax Administration received on foreign income. This resulted in 440 persons reporting **foreign income** in their tax return which they had not reported in previous years, indicating a **non-compliance rate of 40%**.

Ultimately the goal of tax administrations is to increase the voluntary compliance rate on foreign income on a go-forward basis. One way to achieve this goal is to educate taxpayers about the amount of information being exchanged automatically as evidence shows that the compliance rate increases with increased information reporting.

VII. WHAT IS THE OECD DOING IN THIS AREA AND WHAT STILL NEEDS TO BE DONE?

The OECD has been active in facilitating automatic exchange for many years by creating the legal framework, developing technical standards, providing guidance and training and seeking to improve automatic exchange at a practical level.

The OECD's work has identified eight key components in successful automatic exchange. Those elements are with respect to both the sending and receiving country and all require some degree of international understanding or agreement to maximise the benefits and efficiency of the automatic exchange.

Eight key components in successful automatic exchange

From the perspective of the **receiving country**:

1. **What** – Defining the scope of income / transactions to cover.
2. **Who** – Defining the information to capture regarding the taxpayer/beneficial owner.
3. **Quality** – Ensuring data quality; *e.g.* data validation, TIN verification, general due diligence standards.
4. **When** – When to receive the information.
5. **How to exchange** – The format to use, encryption and transmission system.
6. **How to use** – Risk assessment, matching, compliance action.

From the perspective of the **sending country**:

7. **Confidentiality** – Keeping information protected both in law and in practice.
8. **Reciprocity, acknowledgement and feedback.**

The OECD has developed a number of guidance and training materials to facilitate the implementation and use of automatic exchange by countries. In particular, the OECD has developed the following documents:

- A Model Memorandum of Understanding on Automatic Exchange¹².
- Manual on the implementation of exchange of information provisions for tax purposes (which contains a specific module on automatic exchange)¹³.
- A toolkit on automatic exchange¹⁴.
- Country profiles on automatic exchange have been compiled (on the type of information exchanged automatically, the preferred standard to receive information etc).

The OECD has also been very active on technical standards. The standardisation of formats is crucial so that information can be captured, exchanged and processed quickly and efficiently in a cost effective manner by the receiving country. OECD work on standardisation has taken advantage of technological developments starting with a paper standard format, then moving to the standard magnetic format (“SMF”), and finally to a more advanced standard using XML language (“STF”)¹⁵. As currently the SMF and STF both exist depending on the tax administration, bridging programmes have been developed to achieve conversion between the two formats, thus enabling treaty partners to engage in bilateral automatic exchange notwithstanding that they might each use a different standard format.

¹² See footnote 3.

¹³ www.oecd.org/ctp/eoi/manual

¹⁴ www.oecd.org/tax/eoi/toolkit

¹⁵ The STF has many advantages including separation of the content of a message from any display structure, readability both by humans and machines, modularity and flexibility and validation of the information *i.e.* ability to check the conformance of documents with the “contract” about its structure.

The EU Council has adopted standard formats for the implementation of the EU Savings Directive which are largely based on the OECD STF (into FISC 153 format). In addition to the adaptation of the STF format, the EU has also developed specifications to ensure a good quality of data and monitors the functioning of the format. In 2011 the EU adopted a new Directive on administrative cooperation which provides for the development of new formats for five income types: income from employment, income from immovable property, director's fees, pensions and life insurance products not covered by another EU legislation on administrative cooperation. To develop the formats the EU works in close collaboration with the OECD with the common objective to have one technical standard for the automatic exchange of information with schemas being released as much as possible at the same time by both the OECD and the EU.

While the work on automatic exchange has shown that automatic exchange can be an effective tool for compliance it has also identified some challenges and areas where more work needs to be done on both the practical and policy sides. The true measure of success is not the quantity of information exchanged but the compliance that is achieved. Also important is to reduce as much as possible related compliance costs, through, for instance, common standards and processes, for third parties and tax administrations. Finally, a cost/benefit analysis in respect of the different types of information exchanged and the level of detail needed to support it may allow countries to focus on further efficiencies.

The remainder of this section highlights some of the focus areas of ongoing and future work.

Developing common standards on capturing information

In order to ensure concrete results from automatic exchange it is essential that the receiving country is able to match the information received and use it within their tax administration. Given that the information is “bulk” information a process of automatic matching will often be essential. Thus, if the information collected in one country is aligned with the information needed in the other countries, a common standard of what is collected and what is used in matching and compliance can greatly improve effectiveness of automatic exchange. Standardisation of reporting and due diligence will also reduce compliance costs.

For instance, the OECD survey indicates that when the residence country receives information which contains a Tax Identification Number (TIN), the matching rate is increased significantly and as a result the identification of the taxpayer. For example, the results of the survey indicate that on average the matching rate increases by 30% if the residence country TIN is provided. Absent a TIN, the data items most frequently required by the residence country to identify its taxpayer are name, address and date of birth, with almost all countries already requiring the capture of name and address.

Improving data quality

It is one thing to capture the information, but for that information to be useful it must be included in the data package transmitted to the residence country and it must be accurate. For example, for a TIN to be useful it must be the residence country TIN (not a source country TIN) and it must be a valid number without errors.

The quality of the information begins with the capture of the information by the payer or paying agent and the accurate transmission of that information by the source country to the residence country. The quality and accuracy of a TIN for instance, is significantly higher where the TIN is included in an official document (which is the case in many Nordic countries) which can then be verified by the payer or paying agent. The quality is also improved where the country provides the algorithm against which the structure of the TIN can be verified and validated by the payer or paying agent (this will not, however, confirm that the TIN actually belongs to the particular taxpayer).

Similar quality issues exist with the name and address which is further complicated by different languages, multiple first names and family names, different alphabets and different address formulations from country to country. The quality of the address and the ease of use in the residence country can be significantly improved if the name and address are provided in a fixed format XML as opposed to a free format. XML based format allows automatic validation of the data and the structured format allows the receiving country to more easily identify and distinguish the particular data pieces. For example, this will avoid the difficulty of distinguishing the first name from the family name and in the address, the apartment number from the street number.

Timely receipt of information

Timely receipt of the information is critical for the information to be able to be effectively used in the receiving country. All countries have limitation periods beyond which they cannot make an adjustment to the amount of tax owed for a particular taxation year (in some cases there are exceptions in the case of fraud). Taking into account the limitation period, a taxing authority must receive the information with enough time to allow it to assess the information and evaluate whether or not a particular taxpayer has been compliant.

Standardising technical formats and investment in IT

Standardisation of formats is critical to the efficiency and effectiveness of automatic exchange. As technology continues to evolve, the applicable technical standards and processes must evolve and it is critical for governments to make sufficient investments in IT and related back office functions to keep pace with the developments. At a time when business uses advanced technology to securely transmit and use effectively large data sets, governments cannot stand behind.

Confidentiality and related issues

To engage in automatic exchange of information, countries need a high degree of comfort that the information is kept confidential both in law and in practice and is used only for the purposes allowed under the applicable exchange instrument. Furthermore, a sending country may want to consider issues of reciprocity in its exchange relationship.

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WHAT REMAINS TO BE DONE

This report describes the key aspects of automatic exchange of information and explains the work of the OECD in this area. In particular, the report gives answers to the following basic questions: (i) what is automatic exchange of information, (ii) how does it work, (iii) what is the legal basis, (iv) what is the current state of play (v) does automatic exchange work, and (vi) what is the OECD doing in this area and what still needs to be done.

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Additional reading

Keeping it Safe: The OECD guide on the protection of confidentiality of information exchanged for tax purposes

