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EXECUTIVE BRIEFING

Automatic Exchange of Information and its Impact on You

ARE YOU READY?

- Global Inter-Governmental Co-operation on Tax Related Matters
- Timely provision of client information to regulators in instances of non-compliance where tax has been evaded
- Increased sharing of client data including detailed personal financial information across multiple Global jurisdictions
- Enhanced ability to scrutinize figures disclosed by multiple countries

A Trestle Group Publication

Automatic Exchange of Information and its Impact on You

The alpine nation renowned for its culture of banking secrecy is busy rebranding itself as a tax enforcer by taking an active role in the Automatic Exchange of Information (AEI). AEI is a global initiative designed to regularly transmit taxpayer information from the country of citizenship to country of residence. The support of AEI by Swiss Regulators will undoubtedly result in increased scrutiny of anyone failing to disclose income or assets in accordance with OECD guidance and local laws and legislation. Similar regulations, like the US led Foreign Account Tax Compliance Act (FATCA), resulted in the threat, as FORBES indicates, that "non-compliant institutions could be frozen out of U.S. markets." At a minimum, substantial fines and penalties were waged in the case of FATCA non-compliance. Unlike FATCA, which was very specific to US related citizens, AEI promises to be a global initiative impacting all participating OECD countries and every citizen within their jurisdiction.

The OECD led initiative, which becomes operational in 2017, dictates that tax authorities in participating states share information about taxpayers including account and tax identification numbers, names, addresses and dates of birth, interest, dividends, asset sales, income and account balances, and is particularly relevant for Switzerland because the country holds more than 25% of global assets invested cross-border.

AEI will target taxpayers with an account in a country other than their country of origin. Government authorities will automatically forward the data about these individuals to the tax authority in the correspondent partner country once per year with the responsibility for compliance resting largely with the financial institutions that maintain client data.

AEI is a valuable tool for enhancing global transparency and cooperation on tax related matters. According to the OECD, "The current international standard, exchange of information on request, allows tax administrations to request information from treaty partners if it is foreseeably relevant to a taxpayer's obligations. AEI is a more proactive tool: it can inform countries of its residents' wealth that has been concealed offshore, undetected and escaped tax. It simultaneously deters future non-compliance."

Legal Framework

Before AEI can go live, each participating country needs to fit the process to their legal system. This can occur by means of a bilateral treaty or a Multilateral Competent Authority Agreement (MCAA). Each country will need to inform the MCAA secretariat that they want to exchange information automatically and once that occurs, firms within a country's jurisdiction will be obliged to submit customer information to their local authorities.

Almost 100 countries committed themselves to AEI

Almost 100 countries committed themselves to AEI in the Global OECD Forum. Switzerland became the 52nd country to sign the MCAA on AEI. The agreements now all need to be converted to local law and enforced.

Petrit Ismajli, Head of International Tax Issues at the Swiss Bankers Association, said that the Swiss authorities do not plan to involve third parties to implement the MCAA agreements due to the fact that data is very sensitive. "The government and banks are hiring new IT [employees]. The first step needs to be done by the authorities, and the private sector will follow."

All laws surrounding AEI need to be cemented before the private sector can begin work on their IT arrangements. The consultation process for legislation was closed at the end of April 2015 but a working group has been established to discuss practical implementation challenges. The Swiss authorities created a working group for the guidance composed of representatives from the administration and also representatives from the private sector, including the Swiss Banking Association, the Swiss Insurance Association, and others. The Swiss Federal Administrators will publish more detailed guidance and the pressure is mounting as the first bilateral agreement between Switzerland and Austria has already been signed.

"I hope that 90% of the legal and IT Frameworks are completed by end of 2015," Ismajli said.

As IT projects can take an average of 15-18 months, if the Swiss government approves AEI by the end of 2015, Switzerland will be on target for their 2017 launch date, with the first exchange of data occurring in 2018. However, if Switzerland needs to hold a referendum on AEI or there are complications in the implementation of countrywide or bank specific IT solutions, then it is unlikely the 2018 deadlines will be met.

People, Process and Technology costs for the private sector

According to Catherine Chammartin, Head of Section, Information Exchange and Individual Taxation at the State Secretariat for Financial Questions in Bern, the Swiss government has no current plans to create a centralized IT system for tax data collection. However, financial institutions are allowed to work with third party providers. AEI therefore requires the private sector to consider people, process and technology components required for tax data collection under such a complex bilateral arrangement and to begin putting those components in place.

"This is the bank's responsibility. Large banks – i.e., UBS, Credit Suisse, etc. – have their own systems and because they're very big, they can use their own systems in different countries."

She added, "If a bank is operating in 20 different countries, it is practical to set up the systems for AEI all at the same time."

These changes to IT, amendment of processes, etc. will cost Swiss banks approximately CHF 300-600 million, according to the Swiss Bankers Association.

"We want to give them the option to outsource," she said. "In other jurisdictions, this may not be the case. We won't be developing any computer systems for banks to use. But banks can hire someone else to do this for them."

Larger institutions have an advantage when it comes to implementation. "It's clear that bigger institutions have more know -how in all operating areas. So from an operating perspective, it will be easier to implement AEI. Smaller institutions will face a higher initial burden," Ismajli said.

AEI is FATCA on steroids.

According to Thomas Gustinis, a Managing Partner at Trestle Group Regulatory Compliance and Risk Management practice, "AEI is FATCA on steroids. Firms that are familiar with FATCA and have implemented a robust FATCA solution will have a head start over companies who have simply applied a Band-Aid to existing customer onboarding and screening processes. Our firm is particularly interested in developing a robust transition roadmap to help organizations address the complexity of this regulation in a cost effective manner."

Ed Royan, Chief Operating Officer, EMEA, at AxiomSL, a provider of regulatory reporting software, agreed there are many overlaps between AEI and FATCA, which firms can exploit to reduce the burden of compliance. "Like FATCA, AEI will require firms to collect client data from multiple databases, cleanse it, validate it and fill in gaps in client records, before filing reports to the tax authorities. Therefore, if firms use a scalable, flexible reporting platform for FATCA, they will also be able to harness it for AEI, saving themselves a lot of time and money."

Chammartin agreed that AEI might have a negative competitive impact on smaller financial institutions. "Setting up the system there will be some fixed costs. These are the same if you have one client or 1000 clients. Therefore, the outsourcing will be important for smaller institutions with fewer resources – they can purchase software from other firms," according to Chammartin.

Firms will also face ongoing costs due to the need to continually monitor the changes that tax authorities in the participating countries make to the version of the AEI report template, which they mandate. "Tax authorities in each of the participating countries are likely to tailor the AEI report template to their needs," explained Royan. "With so many countries set to participate in AEI, it will be very challenging for firms to keep an eye on all of the amendments to the report template announced in each country. However, firms can avoid this overhead by partnering with a vendor that monitors all of the changes and provides them with updated templates."

The tax authorities will scrutinize AEI

The tax authorities will scrutinize AEI, and the resulting reviews conducted within Swiss financial institutions could ultimately lead to certain bilateral agreements requiring approval via Swiss referendum.

"Once AEI has entered into force, we will do an audit," Chammartin said. "A team will go to the bank, look that the system is set up and look to see that the standards have been implemented correctly. We can also help them with implementation. We are working on the basis that in 2017 we will go live."

Guidance

Due to the complexity of AEI, the Swiss government is offering guidance and support papers to the private sector to assist with setting up their new operations.

"It's a very complex set of rules," Chammartin said. "We will issue a comprehensive guidance in order for financial institutions to implement them."

"The idea is to anticipate questions that will arise once AEI is in practice. The guidance will look at it in detail from a very practical perspective," Chammartin said.

Potential Hurdles

Some questions remain about how the authorities plan to execute their responsibilities and how regulatory arbitrage can be prevented.

For example, the US has approved the OECD's AEI standard but certain exceptions will apply in a transitional period due to the fact that FATCA is already in place.

"The exception for the US and the inconsistent application of the rules for client identification are a flaw," according to the Swiss Bankers Association, which also maintains that there are better and more efficient solutions than AEI to ensure that clients are tax compliant -- for example, a flat rate withholding tax.

Another dilemma is the uneven playing field with regard to money laundering regulations. Only approximately 100 of the 192 countries in the world have committed to AEI and there will likely be some jurisdictions that never participate, which may undermine its overall effectiveness.

Chammartin argues on the other hand, that the risk of capital flight to non-participating regions is inconsequential. "The OECD is committed to helping developing countries with the adoption of AEI. Often the countries that do not comply with international tax regulations are developing or have unstable political or economic systems. So individuals looking to avoid tax should consider whether it is worth keeping their assets in risky areas."

To address this the OECD has published guidance for developing countries wishing to adopt AEI standards in recognition of the need to support all interested parties (http://www.oecd.org/tax/transparency/global-forum-AEOI-roadmap-for-developing-countries.pdf).

AEI: Business Opportunity or Threat?

As AEI becomes the international standard, winners and losers will emerge. Switzerland and other participating governments will benefit from additional tax revenues caught from early adoption, but there appears to be little benefit of early adoption from a business perspective.

"We have a very time-consuming legislation. I don't see any advantages of early adopting aside from some cross-fertilization opportunities within a bank, in terms of infrastructure or employees, which may happen from FATCA to AEI projects," Ismajli said.

Chammartin agrees. "For a financial institution, implementing AEI is cost-intensive. It is not a service to the client."

For individuals, AEI will render tax avoidance in most developed countries challenging, if not impossible. "As a taxpayer, you know that your info is being transferred. So you need to declare your income correctly. I think it will become very difficult or even impossible to hide money in the financial sector. Of course, outside of the financial sector, there will still be loopholes."

For the Swiss, the new regulations are undoubtedly a challenge to their traditional culture of banking secrecy. Yet, "it will be good for Switzerland's reputation," Chammartin explains, adding that AEI will amplify the key strengths of Switzerland as a financial center – including stability, protection and high quality the world has come to associate with Switzerland.

About the Author

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TRESTLE GROUP

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