Panel Discussion:
The Impact of Globalization on Tax Administration
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Impact of Globalization

- Traditionally, tax administrations have been concerned with large corporate taxpayers in the cross-border environment
  - Emphasis has been on ensuring these taxpayers are properly applying international tax rules
  - Identifying the taxpayer base not a major problem because big corporations are relatively transparent and a small population

- Globalization, however, makes international markets and investments more accessible to smaller business and individuals
  - This dramatically increases the sheer number of taxpayers with which tax administrations must be concerned
  - This in turn puts pressure on government’s means for identifying the taxpayers engaged in cross-border activities
Tax Administration Trend
Focus on Information Exchange

- In the corporate realm, tax administrations have already learned that better sharing of information can lead to better tax enforcement in the global economy
  - Exchange on request (traditional)
  - Spontaneous exchange (traditional)
  - Automatic exchange (new emphasis)
  - “Real-time, cooperative exchange”
    - JITSIC
    - Joint audits

- Countries are striving to extend their network of full bilateral Tax Treaties and Tax Information Exchange Agreements (TIEAs)
  - Incorporate “Article 26” model information exchange provisions

- New Multi-lateral Convention on Administrative Assistance in Tax Matters
  - Incorporates “Article 26” model information exchange provisions
  - Available to be signed by any country
Tax Administration Trend
Focus on Active Cooperation

- Active cooperation and coordination on live cases depends on real-time information exchange

- Joint International Tax Shelter Information Center (JITSIC)
  - Formed in 2004 to identify and combat abusive cross-border corporate tax shelters
  - Currently, five full-member countries with two others approaching membership after observership and two others becoming new observers
  - Operating under the information exchange authority found in bilateral tax treaties, delegates are permanently co-located and work together on difficult cases on a daily basis

- Joint Audit initiative
  - Concept is being developed by the Forum on Tax Administration, a body of 41 member countries working on matters of common importance to tax administrations around the world
  - Two or more tax administrations work together to conduct a single audit of a taxpayer engaged in cross-border transactions or investment
Focus on Individuals Brings New Challenges

- Traditionally, countries have ensured tax compliance of residents ("residence-based taxation") through domestic information reporting mechanisms (in the United States, W-2 and 1099 reporting)
  - Presumption has been that residents generally work and invest domestically
  - Rules have been relatively lax on reporting on foreign investment
    - FBAR requirement
    - For the most part, no obligation imposed on foreign intermediaries to report U.S. investors
Gathering Information on Foreign Individuals

- In addition to taxing residents, most countries tax the investments of foreign persons through withholding at source (“source-based taxation”)

- But source-based systems are not generally concerned with the identity of offshore payees
  - More focused on status of payee as a non-resident and/or a resident of a treaty country eligible for a lower withholding tax rate

- Information is difficult to come by as investment flows may pass through chains of foreign intermediaries
  - U.S. Qualified Intermediary (“QI”) system attempts to enforce compliance with U.S. source-based taxation regime through chains of intermediaries
    - But little information about investor identity comes to the U.S. government

- U.S. persons wishing to hide behind offshore investment generally willing to absorb a 30% withholding tax on dividends on U.S. equities
  - Either invest for gains or invest in non-U.S. securities
Foreign Account Tax Compliance Act ("FATCA")

- As a result of the UBS matter, earlier this year Congress passed what has become known as FATCA as part of the HIRE Act
  - FATCA will result in a sort of “hybrid” system
    - Enforces residence-based taxation by imposing a source-based-style withholding tax on U.S. source income (and gross sales proceeds) unless a foreign financial institution ("FFI") receiving the income as agent or custodian agrees to identify to the IRS any U.S. beneficial owners of the income
    - Depends on FFI agreements (like QI agreements) to commit foreign intermediaries to compliance enforcement measures

- FATCA thus depends on FFIs to provide information to ensure compliance of U.S. residents like U.S. employers and financial intermediaries are depended upon in the W-2 and 1099 systems
  - Raises multilateral considerations and questions about reciprocity
Treaty Relief and Compliance Enhancement ("TRACE") Project

- Originated at OECD as a project to rationalize administration of source-based withholding tax regimes
  - Harmonize information reporting to support treaty-based claims for relief at source
  - Information reporting rules originally focused on reporting to source country
- Scope of project extended to address residence-based taxation considerations
Summary

- Globalization has forced tax administrations to consider cross-border compliance of individuals and small businesses.
- Vast population necessitates dependence on automatic information reporting/exchange.
- Currently, systems/requirements for reporting offshore information are rooted in source-based taxation considerations and thus are relatively low-grade.
- But multilateral information exchange is clearly in focus for tax administrations around the world and there have been successes in other areas.
- New information systems for ensuring residence-based taxation in a global economy are inevitable.