
Panel Discussion:

The Impact of
Globalization on Tax
Administration



2010 IRS Research Conference

*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