

## Taxpayers Holding Cross-border Financial Assets Must Be Careful: International Exchange of Information is Gaining Momentum

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It is a fact that international transactions - despite global disasters such as the Covid19 pandemic - continue inevitably and without slowing down. Hence, the scope of information exchange between countries on the assets of citizens and residents is also expanding, in order to ensure that the taxes are paid in the right amount to the right jurisdiction. Information exchange between countries matter not only for dual citizens but also for people who profit or make investments overseas.

With globalization, it has become difficult for countries to monitor the movement of money and as a result the loss in tax revenues has increased. This situation has led countries to share information especially on financial accounts, and various studies have been carried out on the subject under the leadership of the OECD.

Information exchange between countries is far from a brand-new idea. OECD's model convention on the prevention of double taxation, ["**Model Tax Convention on Income and Capital**"] which is also adopted by Turkey, regulates information exchange in its Article 26. Other legal grounds for information exchange are bilateral information exchange agreements signed with countries often referred to as tax havens. However, while the regulations in these agreements do not provide detailed rules on the method of information exchange, information is mainly provided "on demand" and is insufficient to meet the needs of the relevant authorities.

For this reason, with the initiative of G20 countries, **Convention on Mutual Administrative Assistance in Tax Matters** was signed to create a common framework for all kinds of information exchange. While Turkey signed this agreement on November 3, 2011, the agreement entered into force after 6 years, when it was ratified on November 26, 2017.

This agreement sets out 3 basic methods for cooperation. Accordingly, the exchange of information between countries can be achieved by one of the following methods:

1. Exchange of information on request
2. Spontaneous exchange of information
3. Automatic exchange of information

The focal point of the convention is automatic exchange of information. Hence, we will focus on this subject in our following explanations.

### Automatic Exchange of Information

In automatic exchange of information, information on various income categories obtained in the country of origin is regularly reported to the counter-party country. The purposes of information exchange carried out by this method can be listed as follows: [i.] to maximize tax compliance, [ii.] to take all necessary security measures by creating a single global standard, [iii.] to increase tax revenues by preventing tax evasion, and [iv.] to create a database for risk analysis for local tax administrations. Automatic exchange of information takes place in the following 6 steps:

1. The person or agency making the payment collects information from the payer and / or the person generating the information.
2. The payer or agency reports the information to the tax authorities.
3. The tax authorities of the country of origin consolidates the data for the country of residence / citizenship of the taxpayer.
4. The consolidated data is sent to the country of residence / citizenship of the taxpayer.
5. The submitted information is decrypted by the recipient country.
6. The results are analyzed, and a conformity check is carried out.

Automatic information exchange is mainly carried out in two distinct frameworks, namely “Foreign Accounts Tax Compliance Act” [“**FATCA**”] which is a US-specific system, and “Multilateral Competent Authority Agreement” [“**CRS-MCAA**”] which was formed by OECD.

## **A. FATCA**

FATCA is an act enacted by the USA to create cross-border tax compliance by adopting international standards through automatic exchange of information regarding taxpayers. The act aims to increase the transparency of the information collected by the American tax authority IRS about US citizens who earn income outside the USA.

This law was enacted right after the 2008 economic crisis, and information exchange issue was regulated for the first time as an independent matter from double taxation. FATCA arranges two different model agreements, each of these two models includes two different sub-models.

- **Model 1:** This model is signed between the tax authorities of the USA and the respective countries. Financial institutions in the party countries report the account information of their natural and legal person customers they identify as US persons to their national tax authorities, and national administrations forward them to the IRS. A Model 1A agreement is signed with the countries where the exchange of information will be carried out mutually, and a Model 1B agreement is signed with countries where the USA will unilaterally collect information.
- **Model 2:** In this model, the agreement is signed directly between the IRS and the foreign financial institution. The financial institutions that have signed the agreement make the notification directly to the IRS, not to their local administration. Model 2A is signed if there is no Information Exchange or Double Taxation agreement signed between the foreign financial institution's country of residence and the United States; while Model 2B is signed if there is already such an agreement in force.

Turkey signed a FATCA Model 1A agreement on 29 July 2015. Accordingly, information on every individual living and legal entity operating in our country who is a taxpayer in the USA will be regularly reported to the Turkish Revenue Administration, and the Administration will share such information with the IRS. Despite the agreement was approved and ratified in October 2016, information exchange is still not active, as the technical infrastructure has not yet been established, according to information on the IRS official site.

## **B. Model Multilateral Competent Authority Agreement on The Automatic Exchange of Financial Account Information**

Based on Article 6 of the Convention on Mutual Administrative Assistance in Tax Matters, "Automatic Exchange Standards Concerning Financial Information in Tax Matters" was established by the OECD. The agreement model CRS-MCAA mentioned above is essentially included in this standard together with the Common Reporting Standard ["CRS"].

CRS-MCAA is based on the principle of reciprocity. That is to say, the countries that have signed the model agreement include a list of the countries they will carry out automatic information exchange in the annex of the agreement. Automatic exchange of information is activated between countries that are mutually included in this list.

Turkey signed the model agreement on 21 April 2017 and committed to start automatic information exchange in 2018. However, the agreement entered into force on December 31, 2019, with a delay of two and a half years. [2] While a communiqué on the implementation of the agreement was drafted and sent to financial institutions for their advisory opinions [namely, "General Communiqué on Automatic Exchange of Financial Account Information in Tax Matters"], this draft was later published as a guide. In this respect, our domestic legislation regarding implementation arguably remains insufficient.

As of December 2020, there are more than 4400 mutual information exchange relationships activated between more than 100 countries. In this context, Turkey has sent information to 59 countries so far and collected information from 78 countries. Considering that these numbers were only 1 in 2017 and 2 in 2018 [Norway and Latvia], the pace in which these agreements become effective becomes evident.

## **C. Key Differences Between FATCA and MCAA**

The main difference between these two models is the criteria the information exchange is based on. While FATCA is based on the criterion of citizenship, MCAA is based on the criterion of residency. In other words, while information within the scope of MCAA is shared with the country of residence of the taxpayer, it is shared with the country of citizenship in FATCA.

Another important difference arises in terms of sanctions. Namely, while IRS imposes 30% withholding tax on some income items in the USA to individuals and institutions that it qualifies as noncompliant, there is no such penalty in MCAA.

It should also be added that FATCA introduces a bilateral system, while MCAA is a multilateral and reciprocal agreement model.

#### D. Conclusion

Regardless of the method, it is unquestionable that countries are increasingly cooperative in sharing financial information. With the impact of the Covid-19 pandemic, it can be predicted that the economic uncertainties in our country and the world will lead countries to further strengthen this cooperation in order to minimize tax losses. Therefore, it is imperative for those who have assets outside the country to closely follow these developments in the international arena.

[1] GEDİKLİ Betül, Vergilendirmede Otomatik Bilgi Değişimi Üzerine OECD ve ABD Çalışmaları [*OECD and USA Efforts on Automatic Exchange of Information in Taxation*], Marmara University Institute of Social Sciences Department of Fiscal Affairs, MSc Thesis, 2018, s.27

[2] With the Presidential Decision No. 4025 published in the Official Gazette dated June 1, 2021, the effective date of the agreement was determined as February 3, 2020, to be applied to the taxation periods starting from January 1, 2019 at the earliest.

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