
PwC's Transfer Pricing Series

Tax information exchange – what will change and how taxpayers should respond



By **Seun Adu**

... hiding information is not tax planning. Working on the assumption that the tax authorities will not find out is a strategy that is very likely in its dying days. You need to have another look at your tax affairs and be sure that you are not setting yourself up for a significant tax liability in the near future.

Imagine you have the opportunity to make some money by sitting for a maths test. You have to answer 20 questions in five minutes. You will get an amount of money for each correct answer. At the end of the five minutes you are given the solutions. You are asked to: score yourself; run your test paper through a paper shredder once you are done; and, afterwards disclose your score to the examiner. What would you do? Would you inflate your score knowing that your dishonesty would not be discovered (you have just shredded all evidence!)? Or would you disclose your actual score?

Dan Ariely and his colleagues performed this experiment, using nearly 40,000 participants, over several years. The results? Nearly 70% of the participants cheated. Dan could tell because the paper shredder had been altered to only shred the sides of the paper! The experiments show that people are likely to cheat if the opportunity presents itself.

The same scenario plays out when it comes to taxes. When taxpayers believe that complete information on their income and expenses cannot be known to the tax authorities, they are likely to yield to the temptation to cheat. This is usually the case when the information is held in a foreign jurisdiction.

Tax authorities all over the world are making use of tax information exchange to combat this tendency. The Federal Inland Revenue Service (FIRS) has also recognised the potential of tax information exchange in combating tax evasion and avoidance and is now doing the same.

Information disclosures and tax compliance

There is evidence to suggest that where information on income is not readily available to the tax authorities, taxpayers are less likely to fully disclose the income and fully comply with the law.

The Internal Revenue Service (IRS) in the United States (US) analysed the tax gap for the US for 2008 to 2010. The analysis showed that when income is subject to substantial third party information reporting (or high visibility or transparency), only between 1% and 7% of the amount is underreported. However, if the income is subject to little or no information reporting (or

little or no transparency), up to 63% of the income is misreported.

Similarly in his paper on information exchange, Markus Meinzer reported that a detailed enquiry by the French parliament into the leaked data of the Private banking business of a major international bank showed that less than 1% of the almost 3,000 French clients holding offshore accounts in the bank had properly declared the accounts in their tax return. There are also similar findings from other countries.

These findings are increasing the drive by tax authorities to improve cooperation in the area of information exchange and reporting.

Information exchange standards

There are three forms that tax information exchange can take. It can be on request, spontaneous, or automatic.

Assuming the FIRS is auditing a certain Company A in Nigeria. Company A is paying a lot of money to Company B in the United Kingdom. Company A claims that Company B is an independent party but the FIRS has its suspicion. What can the FIRS do? It could write to the HMRC to help get information on Company B to determine if indeed both companies are unrelated. This type of information exchange is known as an “on request” information exchange. It is information exchange that happens in respect of a concrete case and the FIRS needs to demonstrate that the information being requested is foreseeably relevant for applying the relevant tax laws.

You probably have that neighbour that is always ready to tell you of all the mischief that your kids have been up to while you were away. Your kids may not like that neighbour, but you sometimes find the information very useful. Spontaneous information exchange happens in a similar way. This is when one tax authority shares information that it believes another tax authority may find useful without the second tax authority making a specific request.

Automatic information exchange has only recently gained global acceptance. Here, countries agree to automatically exchange information periodically. They agree on the specific information to be exchanged, the time of the exchange, and the format of the exchange. If you have been following the news you have probably heard about Country by Country Reporting (CbyCR) and the Common Reporting Standard (CRS) Agreements. These are examples of automatic information exchange agreements.

Legislative framework for information exchange

For a tax authority to be able to exchange information with another tax authority, there must be legislation that allows it to do so.

The primary instruments used for information exchange include: Double Tax Treaties (DTAs), Tax Information Exchange Agreements (TIEA), and the Multilateral Convention for Mutual Administrative Assistance in Tax Matters (The Convention).

Although DTAs are agreements between two countries for the purpose of preventing double taxation, most DTAs contain an article that allows the treaty partners to exchange taxpayer information. TIEA's on the other hand are bilateral agreements that have information exchange as the only subject.

The Convention is a multilateral agreement that allows a country the right to (amongst other things) exchange and receive information from many other countries without having to negotiate individual TIEAs or DTAs with each one of them.

Nigeria and information exchange

Nigeria is starting to appreciate the potential that information exchange has in improving tax compliance and collections. The FIRS now has a unit that is dedicated to information exchange and is receiving support from multilateral agencies.

For example, the Global Forum on Transparency and Exchange of Information (the Global Forum) currently has an “African project” which aims to ensure that African tax administrators are equipped to use available information exchange tools. The project also aims to ensure that African tax authorities actually start to use these tools. Nigeria and seven other African countries are participating as first movers in this project.

As we speak, the FIRS can potentially exchange taxpayer information with up to 114 other countries. This is based on Nigeria's current network of DTAs and the fact that Nigeria has signed up to the Convention. In addition, the FIRS has also signed the CbyCR and CRS agreements which will allow it to automatically exchange specific taxpayer information with up to 63 and 93 other countries respectively.

Conclusion

Have you ever thought to yourself, “why should I bother disclosing this information if the tax authorities will never find out?” You are not alone;

you are like many taxpayers the world over. Available data suggests that taxpayers are taking both corrective and preventive measures in response to the use of information exchange by tax authorities. For example, the Global forum's 2016 report states that almost \$55billion has already been collected through voluntary disclosure programmes and similar measures aimed at encouraging taxpayers to report income and wealth previously hidden from tax authorities in advance of automatic exchange of information.

For Nigerian taxpayers, the bottom line is this: hiding information is not tax planning. Working on the assumption that the tax authorities will not find out is a strategy that is very likely in its dying days. You need to have another look at your tax affairs and be sure that you are not setting yourself up for a significant tax liability in the near future. Tax planning is not a crime; if you have to plan, you must look for legitimate opportunities that help you manage your tax costs.

Seun Adu is an Associate Director and Transfer Pricing Leader at PwC Nigeria. He is a regular writer and public speaker on tax and transfer pricing matters.

Visit our tax blog for in-depth analyses, unique insight and superlative perspective on tax matters: www.pwc.com/nigeriataxblog. *Subscription is free!*

About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with more than 223,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.