Annex III

Final JAHGA Paper

Enabling Effective Exchange of Information: Availability and Reliability Standard

Joint Ad Hoc Group on Accounts (JAHGA)

6 July 2005

Enabling Effective Exchange of Information: Availability and Reliability Standard

A. Introduction

1. Exchange of information for tax purposes is effective when reliable information, foreseeably relevant to the tax requirements of a requesting jurisdiction is available, or can be made available, in a timely manner and there are legal mechanisms that enable the information to be obtained and exchanged. This requires clear rules regarding the maintenance of accounting records and access to such records.

2. There are a number of ways in which the availability of, and access to, accounting records can be ensured. This paper concentrates on the outcome of ensuring access to and the availability of reliable and foreseeably relevant information.

3. The paper has been developed jointly by OECD and non-OECD countries[1] (the "Participating Partners") through their co-operation in the Global Forum Joint Ad Hoc Group on Accounts ("JAHGA"). The JAHGA participants consisted of representatives from: Antigua and Barbuda, Aruba, The Bahamas, Bahrain, Belize, Bermuda, British Virgin Islands, Canada, Cayman Islands, Cook Islands, France, Germany, Gibraltar, Grenada, Guernsey, Ireland, Isle of Man, Italy, Japan, Jersey, Malta, Mauritius, Mexico, Netherlands, Netherlands Antilles, New Zealand, Panama, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, Seychelles, Slovak Republic, Spain, Sweden, United Kingdom and the United States.

4. The delegates of the Participating Partners developed this paper with the understanding that they were on a common ground and with the common aim of fostering a transparent and well regulated global financial system based on common standards, which seeks the participation of all countries that offer themselves as responsible jurisdictions in a global economy.

5. The paper is built upon the idea that the rules and standards implemented by all Participating Partners must ensure effective exchange of information. The mechanisms must therefore be simple, reliable and equitable.

6. Moreover, no rule or standard should result in creating a competitive advantage for one type of entity or arrangement over another. The paper therefore seeks to apply to all entities and arrangements relevant to this exercise and any reference to the term "Relevant Entities and Arrangements" in this paper is meant to include (i) a company, foundation, Anstalt and any similar structure, (ii) a partnership[2] or other body of persons, (iii) a trust[3] or

[1] Reference in this document to "countries" should be taken to apply equally to "territories" or "jurisdictions."

[2] The Appendix provides an explanatory note on partnerships.

[3] The Appendix provides an explanatory note on trusts.

similar arrangement, (iv) a collective investment fund or scheme[4], and (v) any person holding assets in a fiduciary capacity (*e.g.* an executor in case of an estate).

B. The Availability and Reliability Standard

I. Maintenance of reliable accounting records

7. Reliable accounting records should be kept for all Relevant Entities and Arrangements. To be reliable, accounting records should:

a. correctly explain the transactions of the Relevant Entity or Arrangement;

b. enable the financial position of the Relevant Entity or Arrangement to be determined with reasonable accuracy at any time; and

c. allow financial statements[5] to be prepared (whether or not there is an obligation to prepare financial statements).

8. To be reliable, accounting records should include underlying documentation, such as invoices, contracts, *etc.* and should reflect details of

a. all sums of money received and expended and the matters in respect of which the receipt and expenditure takes place;

b. all sales and purchases and other transactions; and

c. the assets and liabilities of the Relevant Entity or Arrangement.

9. The extent of accounting records will depend upon the complexity and scale of the activity of the Relevant Entity or Arrangement but shall in any case be sufficient for the preparation of financial statements.[6]

10. In the case of a company, it is the responsibility of the country or territory of incorporation to oblige the company to keep reliable accounting records. This means in particular that this country or territory must have the necessary powers to require the company to produce its accounting records. Notwithstanding the responsibility of the country of incorporation of a company to be able to obtain accounting records, a requesting partner may, for example, also address a request to the country or territory of effective management or administration. In case it receives such a request, the country of effective management or administration must respond directly to the requesting country.

11. In the case of a foundation or Anstalt and any similar structure, it is the responsibility of the country under the laws of which such entity is created to oblige the

[4] The term "collective investment fund or scheme" means any pooled investment vehicle irrespective of legal form. See Article 4, paragraph 1, sub-paragraph h) Model Agreement on Exchange of Information on Tax Matters.

[5] For purposes of this paper the term "financial statements" comprises:

- a statement recording the assets and liabilities of a Relevant Entity or Arrangement at a point in time,
- a statement or statements recording the receipts, payments and other transactions undertaken by a Relevant Entity or Arrangement,
- such notes as may be necessary to give a reasonable understanding of the statements referred to above.

[6] In many cases, Relevant Entities and Arrangements prepare financial statements and in more complex cases financial statements may be an important element in explaining the transactions of a Relevant Entity or Arrangement. Where financial statements exist and are requested by another country, they should be accessible to the requested country's authorities within a reasonable period of time. See also Section IV, below.

entity to maintain accounting records. Notwithstanding the responsibility of the country or territory of formation, a requesting partner may, for example, also address a request to the country of effective management.

12. In the case of trusts and partnerships, the governing trust, partnership or other applicable law should result in record keeping requirements and countries should have the power to obtain that information. However, in certain jurisdictions record keeping requirements may not exist in relation to certain types of trusts, such as implied and constructive trusts, which are not used in commercial applications. The principles outlined in this paragraph should also apply to estates and other situations where persons hold assets in a fiduciary capacity.

13. The principles applicable to collective investment funds or schemes generally follow their legal classification. Thus, for instance, the rules on companies apply to any collective investment fund or scheme operated in the legal form of a company. Furthermore, as collective investment funds are typically regulated, the jurisdiction that regulates the fund will generally require that accounting records are kept.

II. Accounting record retention period

14. Accounting records need to be kept for a minimum period that should be equal to the period established in this area by the Financial Action Task Force. This period is currently five years. A five-year period represents a minimum period and longer periods are, of course, also acceptable.

III. Ensuring the maintenance of reliable accounting records

15. Countries should have in place a system or structure that ensures that accounting records, consistent with the standards set out in the first three paragraphs of B.I (Maintenance of reliable accounting records), are kept. There are different ways in which this objective can be achieved. Countries should consider which system is most effective and appropriate in the context of their particular circumstances and the discussion below is intended to give examples of possible approaches without trying to be exhaustive. The design of the system and its composition are for each country to decide. Note that some of the approaches described below may not be sufficient on their own and may need to be combined with others to achieve the intended objective.

16. *Governing Law (including company law, partnership law, trust law) and Commercial Law*. For instance, the governing law may require the maintenance of reliable accounting records and provide for effective sanctions where this requirement is not met. Such sanctions may include effective penalties imposed on the Relevant Entity or Arrangement and persons responsible for its actions (*e.g.* directors, trustees, partners) and may, where possible and appropriate, include striking off an entity from a company or similar registry.

17. The applicable law may further require the preparation of financial statements and may require a person such as a company director to attest that the financial statements provide a full and fair picture of the affairs of the Relevant Entity or Arrangements. The law may further require that the financial statements be audited. Furthermore, financial statements may have to be filed with a governmental authority or the law may require the filing of a statement to the effect that complete and reliable accounting records are being maintained and can be inspected upon request. Filing of incorrect information would typically trigger significant penalties or other sanctions. Such mechanisms either implicitly

or explicitly assist in ensuring that reliable accounting records exist and enhance the integrity and credibility of the information.

18. *Financial Regulatory Law, Anti-money Laundering Law or other Regulatory Law*. Financial regulatory law may impose the obligation to keep reliable accounting records on all regulated entities and a failure to comply with such obligation may trigger significant penalties such as monetary fines and a possible withdrawal of the authorisation to conduct the financial business in question. Furthermore, anti-money laundering rules typically require the retention of transactional records by all persons covered by the legislation or implementing regulations and violations of these obligations trigger a range of penalties which may include criminal law consequences.

19. The keeping of reliable accounting records may also result from the regulation of company and trust service providers. For instance, a company and trust service provider acting as a trustee or company director or manager may be required to keep adequate and orderly accounting records for all trust or company transactions. A screening process focused on the integrity and competence of persons wishing to perform company and trust services along with adequate ongoing supervision of their activities, significant monetary fines for rule violations and the possibility that a license may be withdrawn could be effective ways of ensuring that reliable accounting records are kept.

20. *Tax Law***.** Tax laws will typically require that taxpayers keep reliable accounting records. Tax laws contain a range of sanctions in cases where reliable accounting records are not kept (*e.g.* interest charges, monetary penalties, assessment on the basis of an estimated tax, possible criminal consequences).

21. *Effective Self-executing Mechanisms*. In certain cases the maintenance of reliable accounting records may also be helped through the respective interests of the parties involved. For example, in the area of collective investment funds, commercial realities may be such that, in practice, a fund would not be able to attract and retain investor funds if it did not have in place a system to ensure the maintenance of reliable accounting records.

IV. Access to accounting records

22. Where accounting records are requested by another party they should be accessible to the requested country's authorities within a reasonable period of time. In particular, the requested country's authorities should have the power to obtain accounting records from any person within their jurisdiction who has possession of, or has control of, or has the ability to obtain, such information. This also means that a requested country should have effective enforcement provisions, including effective sanctions for non-compliance (*e.g.* sanctions for any person who, following notification, refuses to supply information, destroys documents in his possession or transfers them beyond his control). The particular design of enforcement provisions will often be influenced by the approach chosen to ensure that reliable accounting records are kept.[7]

23. This obligation does not necessarily entail a requirement to keep accounting records onshore. However, where accounting records are permitted to be kept offshore, countries should have a system in place that permits their authorities to gain access to such records in a timely fashion.

[7] The principles outlined in this paragraph should also apply to the ability of countries to obtain financial statements, where financial statements exist.

Appendix to the Final JAHGA Paper

Explanatory Note on Trusts

1. Definitions of a trust are to be found in the domestic trust law of those jurisdictions where such laws exist. Alternatively the definition can be taken from the Hague Convention on the Recognition of Trusts.
2. As an example of a definition incorporated in a trust law, the following is taken from the Trusts (Guernsey) Law, 1989, which mirrors the definition in the Jersey (Trusts) Law, 1984:

   "A trust exists if a person (a "trustee") holds or has vested in him, or is deemed to hold or have vested in him, property which does not form, or which has ceased to form, part of his own estate –

   a. for the benefit of another person (a "beneficiary"), whether or not yet ascertained or in existence;

   b. for any purpose which is not for the benefit only of the trustee."

   The Hague Convention on the Law Applicable to Trusts and their Recognition (1985) provides as follows in Article II –
3. "For the purposes of this Convention, the term "trust" refers to legal relationships created …. by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose".
4. The definition of a trust whether included in domestic law or in the Hague Convention normally embraces a wide range of types of trust.
5. It is important to remember that a trust is not a legal entity, it is a relationship between juridical persons – settlor, trustee, beneficiary.

Express Trusts

6. These are trusts created voluntarily and intentionally, either orally or in writing –

   – inter-vivos by the settlor executing an act or instrument of settlement made between the settlor and the trustees under which the settlor transfers assets to the trustees to hold subject to the terms of the trusts set out therein;

- inter-vivos by the settlor transferring assets to the trustees and the trustees executing a declaration of trust (to which the settlor is not a party) whereby the trustees acknowledge that they hold the assets subject to the terms of the trusts set out in the instrument; or
- on death by the Will of the testator taking effect, whereby the testator's executors are directed to transfer all or part of the testator's estate to trustees (who may be the executors) to hold subject to the trusts set out in the Will.

7. The following are forms of express trusts. Within any trust, different elements of the following may be found.

(a) Bare/Simple Trust

A bare trust is one in which each beneficiary has an immediate and absolute right to both capital and income.

(b) Discretionary Trust

This is a form of trust where the interests of the beneficiaries are not fixed but depend upon the exercise by the trustee of some discretionary powers in their favour. As such it is the most flexible of all trusts.

(c) Interest in Possession Trust

This is a trust where a particular beneficiary (the "life tenant") has a right to receive all the income arising from the trust fund during his life time. The trustee will usually also have a power to apply capital to the life tenant. Often there are successive life interests in favour of an individual and his spouse. On the death of the life tenant the remainder of the trust fund is often held on discretionary trusts for the other beneficiaries.

(d) Fixed Trust

A trust where the interests of beneficiaries are fixed. The trustees will have control over the management of the assets but the interests of the beneficiaries are defined in and by the trust instrument. Typically such a trust may provide an income which is paid, say, to the wife of the settlor and capital to the children on her death.

(e) Accumulation and Maintenance Trust

This form of trust is usually created for the children or grand-children of the settlor, where the trustees have powers during the minority of each beneficiary to pay income in a way beneficial for the upbringing or education of the beneficiary, and to accumulate income not so applied. On attaining a certain age each beneficiary will become entitled to a particular share of the trust fund.

(f) Protective Trust

A trust where the interest of a beneficiary may be reduced or terminated, for example on the happening of events (a common scenario may be if the beneficiary attempts to alienate or dispose of his interest in income or capital).

(g) Employee Share/Options Trusts

Trusts established by institutions in favour of their employees.

(h) Pension Fund Trusts

Trusts established to provide pensions for employees and their dependants.

(i) Charitable Trust

A trust established purely for charitable purposes. In this case there needs to be an enforcer.

(j) Purpose Trust

A trust established for one or more specific purposes. There are no named or ascertainable beneficiaries and there is commonly an enforcer to enforce the terms of the purpose trust.

(k) Commercial Trusts

The major applications include –

- unit trusts;
- debenture trusts for bond holders;
- securitisation trusts for balance sheet reconstructions;
- client account trusts for lawyers and other providers of professional services, separate from the provider's own assets;
- retention fund trusts, pending completion of contracted work.

Implied Trusts

8. A trust can also arise from an oral declaration or by conduct and may be deemed by the Court to have been created in certain circumstances. On account of their very nature there are no formal requirements for those trusts. Usually the existence of such trusts is only recognised as a result of legal action.

Resulting Trusts

9. Both express and implied trusts require an intention for their creation. A resulting trust arises where the intention is absent and yet the legal title to property is transferred from one person to another. By way of example, where X transfers £100 to Y at the same time as executing an Express Trust in respect of £80, only the balance of £20 is held on a Resulting Trust to be retransferred back to X. In this situation, in the absence of intention, the beneficial ownership remains with the Transferor.

Constructive Trusts

10. Constructive Trusts are those Trusts that arise in circumstances in which it would be unconscionable or inequitable for a person holding the property to keep it for his own use and benefit absolutely. A constructive trust can arise in a number of differing scenarios covering a broad spectrum of activity. The proceeds of criminal activity can be traced into the hands of the recipient's bankers who, once alerted, would hold them as constructive trustee on behalf of those to whom they actually belong.
11. Trusts may also be classified according to why they are created and may include –
    - private trusts – made for the benefit of specific private individuals, or a class thereof;
    - public trusts – made for the benefit of the public at large, or a section of the public – for example a charitable trust established to relieve poverty, to advance education or to promote religion;
    - purpose trusts (see above).
12. This brief, and limited, description of trusts shows that the concept encompasses a wide variety of arrangements. Essential to them all is that legal ownership and control is passed from the settlor to the trustee.

Explanatory Note on Partnerships

Partnerships exist under the laws of many jurisdictions. While definitions vary among jurisdictions, a common characteristic is that a partnership is an association of two or more persons, formed by agreement to jointly pursue a common objective.

In many common law jurisdictions an essential element of a partnership is that the "common objective" must consist of the carrying on of a business for profit. For instance, Section 1 of the UK Partnership Act 1890 defines a partnership as "the relation which subsists between persons carrying on a business in common with a view of profit." Identical definitions are found in the laws of Australia, Bermuda, Canada, Ireland and many other jurisdictions that have followed UK legal principles. Very similarly, under the U.S. Uniform Partnership Act[8] a partnership is defined as "an association of two or more persons to carry on as co-owners a business for profit."

In many civil law countries, such as Germany or Spain, partnerships may be formed to pursue a common objective either of a business or a non-business nature and a profit motive is not a necessary prerequisite.

The laws of many jurisdictions distinguish between general partnerships and limited partnerships. The most noteworthy features of a general partnership are that all its partners

[8] Uniform Partnership Act, Sec. 6(1); Revised Uniform Partnership Act, Sec. 101(4).

have unlimited liability for the financial obligations of the partnership and that all partners have the right to participate in the management of the partnership. In contrast, the limited partners of a limited partnership do not have unlimited liability for the financial obligations of the partnership and they do not have a statutory right to manage the affairs of the partnership. The liability of limited partners for the obligations of the partnership is limited to the amount of their capital contribution required under the terms of the partnership agreement and the applicable law. Furthermore, limited partnerships must have at least one general partner with unlimited liability.

The laws of many jurisdictions also recognise other types of partnerships. One such type is the limited liability partnership. A limited liability partnership is a hybrid of a general and a limited partnership. It typically allows participation in the management of the partnerships by all partners but limits the liability of the partners for financial obligations of the partnership. The limited liability partnership itself is liable for all its debts and obligations and its liability is limited to its own funds. The partners are shielded from all liabilities, other than liabilities arising from their own acts.