



**THE ACCOUNTS AND FILING OR AUDITING
REQUIREMENT**

20 June 2002

**DRAFT BY THE OECD SECRETARIAT
(COMMENTS ARE REQUESTED BY 5 AUGUST 2002)**

CONFIDENTIAL

GLOBAL FORUM JAHGA(2002)1

THE ACCOUNTS AND FILING OR AUDITING REQUIREMENT

Background

1. Exchange of information can only be effective where it is combined with a regulatory framework that ensures that (1) relevant and reliable information exists and that (2) the authorities can obtain and provide such information for the purposes of information exchange in a timely manner. In connection with companies and other persons this means, very generally, that financial accounting information, including supporting books and records, must be maintained, must be reliable and must be accessible to the relevant authorities.
2. The availability of, and the access to, such information for tax purposes is an important element of the concept of transparency. This element of transparency is reflected in the commitments through references to the requirements to keep and audit or file accounts (the “accounts requirement”). Many commitments also foresee certain exceptions to these requirements. The Global Forum Working Group on Effective Exchange of Information considered addressing the scope of the accounts requirement in the Agreement on Exchange of Information on Tax Matters (the “Agreement”), but ultimately agreed to remove the relevant Article from the Agreement. The Group decided that the Agreement should, like other model exchange agreements, only address issues relating to the exchange of information and not to the obligation to maintain information.
3. The Forum on Harmful Tax Practices has established an ad hoc group (the “Joint Ad Hoc Group on Accounts”) consisting of OECD member countries and committed jurisdictions to develop a proposal on the precise scope and application of the accounts requirement.
4. In preparation for the work of the Joint Ad Hoc Group on Accounts, the OECD Secretariat has prepared this paper as a first discussion draft. The paper discusses in detail how the accounts requirement could be applied in practice. The paper seeks to balance the need to ensure that adequate information is available with the need to avoid unnecessary burdens on entities and administrations.
5. This note consists of two parts. The first part discusses the scope of the accounts requirement. It explains under which circumstances a person is subject to the requirement. The second part discusses the obligations that result for any person subject to the accounts requirement. It explains the four types of obligations that would result from being subject to the accounts requirement:
 - (i) annual accounts need to be prepared and must be accessible to the authorities,
 - (ii) books and records need to be kept and must be accessible to the authorities,
 - (iii) accounts and books and records must be kept for a minimum retention period, and
 - (iv) except in cases where the de minimis exception applies, accounts must be filed or audited.
6. For purposes of this note, the term “accounts” means income statements and balance sheets. The term “books and records” refers to any documentation or information supporting the accounts.

I. SCOPE OF THE ACCOUNTS REQUIREMENT

7. This section discusses the three questions that determine whether an entity falls within the scope of the accounts requirement in a given jurisdiction:

- (1) Is the entity a “person”?
- (2) Does the entity have nexus to the jurisdiction?
- (3) Does the entity engage in the type of activities that trigger the accounts requirement?

8. If the answer to each of these questions is yes, the entity is subject to the accounts requirement. In all other cases, the entity is not subject to the accounts requirement. The remainder of this section discusses these three questions in turn.

9. Before turning to these questions, it is important to recall the context of the accounts requirement. The accounts requirement prescribes a specific type of information to which a jurisdiction has committed to have access. The accounts requirement does not restrict any obligation to obtain and provide any information that is otherwise available within the jurisdiction. Thus, where accounts and books and records exist for persons not covered by the requirement, a request to provide such information pursuant to an agreement to exchange information can not be declined on the basis that the person is not covered by the accounts requirement.

10. More generally, it is important that the application and implementation of the accounts requirement in domestic law and practice should not have the legal or practical effect of impeding the accounts obligation from being complied with in a satisfactory manner by the persons concerned.

A. Is the entity a “person”?

11. The Agreement on Exchange of Information on Tax Matters, developed by the Global Forum Working Group on Effective Exchange of Information, defines the term person in Article 4, paragraph 1, sub-paragraph c) and d). The definition reads:

- c) the term “person” includes an individual, a company and any other body of persons;
- d) the term “company” means any body corporate or any entity that is treated as a body corporate for tax purposes.

12. The commentary elaborates on the meaning of the term in paragraphs 16 through 23. The commentary has to be read with a view to the operational provision of Article 5. Article 5, paragraph 4, sub-paragraph b) requires that contracting parties ensure that their competent authorities have the authority to obtain and provide certain ownership and other related identity information on a wide range of entities. The interpretation of the term in the commentary is very broad and includes organisational structures, such as trusts, that may not constitute persons under the applicable domestic law. See paragraph 18 of the commentary.

13. This note proposes to use the same definition for purposes of the accounts requirement but suggests one clarification and one modification. The clarification goes to the question of how the accounts requirement is applied to organisational structures that do not constitute persons under domestic law. In

cases where organisational structures lack sufficient entity characteristics under the applicable domestic law, they continue to constitute “persons,” as under the Agreement, but the obligations flowing from the accounts requirement are imposed on the person that can reasonably be expected to assume the actual compliance burden. This clarification is necessary because the obligations flowing from the accounts requirement can not be imposed on a structure that does not have legal personality under local law. For instance, a trust that under domestic law is treated as a purely contractual arrangement is a person for purposes of the accounts requirement, but the obligations flowing from the accounts requirement would be imposed on the trustee. Similarly, where collective investment funds or schemes are organised in a form that lacks sufficient entity characteristics the obligations flowing from the accounts requirement could be imposed on the fund manager.

14. The modification of the definition used in the Agreement relates to the application of the accounts requirement to natural persons. This note suggests excluding natural persons from the definition of “person” unless, as discussed in the preceding paragraph, they act on behalf of organisational structures that constitute persons under the definition. Hence, for instance, a natural person acting as a trustee would have to comply with the accounts requirement imposed on the trust.

B. Does the person have nexus with the jurisdiction?

15. The accounts requirement need only apply to persons that have a sufficient nexus with a jurisdiction. Any one of the following factors establishes nexus with a jurisdiction:

(1) incorporation or organisation under the laws of the jurisdiction; or

(2) place of effective management within the jurisdiction; or

(3) permanent establishment within the jurisdiction; or

(4) in the case of trusts or any person that under domestic law can not itself be made subject to the obligations flowing from the accounts requirement, the residence of the trustee or the residence of any other person which can reasonably be expected to assume the compliance burden.

16. The first factor refers to “incorporation or organisation under the laws of the jurisdiction.” This factor is widely used in OECD countries and should generally be simple to apply.

17. The second and the third factor are given the meaning that these terms have under the OECD Model Convention on Income and on Capital. In order to avoid a cross reference to a text that might change in the future, the meaning of these terms would then be determined by reference to the OECD Model Convention on Income and on Capital in force at the time this paper is agreed by the Joint Ad Hoc Group on Accounts.

18. The next factor addresses trusts and certain other organisational structures. It first provides that the nexus of a trust to a jurisdiction is determined by reference to the residence of the trustee. This rule should be seen as taking precedence over the second factor (i.e., in case of trusts the residence of the trustee and not the place of effective management is the controlling factor). The special rule on trusts does, however, coexist with the first and the third factor and thus a trust might have nexus with several jurisdictions. For instance, the first factor might apply in the rare cases where a country’s laws require registration for trusts. The third factor might apply where a trust is engaged in business activities and those activities constitute a permanent establishment. The same rule is applied to any person that lacks sufficient entity characteristics and therefore does not constitute a person under the applicable domestic law. In this

case the nexus is determined by reference to the residence of the person who can reasonably be expected to assume the compliance burden. . This rule seeks to ensure that the nexus rule parallels the rules on the attribution of obligations described under A. For example, if a collective investment fund is organised in a form that does not constitute a person under the applicable domestic law, the obligation flowing from the accounts requirement would be imposed on the person that , can reasonably be expected to assume the compliance burden, e.g. the fund manager. The special nexus rule then makes sure that the jurisdiction where the fund manager is resident is the jurisdiction where the accounts requirement applies.

19. There are no special rules for foundations, “Anstalten” or similar arrangements. The nexus is, therefore, determined under the general factors.

C. Does the entity engage in the type of activities that trigger the accounts requirement?

20. Paragraph 6 of the 1998 OECD Report “*Harmful Tax Competition: An Emerging Global Issue*” (the “1998 Report”) provides that the work on harmful tax practices is focused on “geographically mobile activities, such as financial and other service activities, including the provision of intangibles.” As is made clear throughout the 1998 Report “geographically mobile activities” also include the holding of passive investments.

21. In addition, the Memorandum of Understanding (“MOU”) refers to an exception for “entities that are not engaged in offshore activities and do not have foreign ownership, beneficiaries, management or other involvement.” The same or similar language is found in many commitments.

22. Rather than trying to separately define the terms “geographically mobile activities,” “offshore activities” and “foreign ownership, beneficiaries, management or other involvement” this paper proposes to develop a list of exempted activities. Any person wholly engaged in activities identified on the list would not need to be subject to the accounts requirement. Furthermore, this exemption would seek to address the activity-related aspects of de minimis and other exceptions mentioned in several commitments.

23. The list of exempted activities would read as follows:

The accounts requirements need not apply to any person that is wholly engaged in:

- (i) *the process of manufacturing or assembly of property;*
- (ii) *purchasing or selling of property manufactured or assembled in the jurisdiction;*
- (iii) *purchasing or selling property for use, consumption, or disposition within the jurisdiction;*
- (iv) *selling tangible property to natural persons present in the jurisdiction at the time of sale (e.g. duty free sales);*
- (v) *fishing, agriculture, mining or similar exploitation of natural resources;*
- (vi) *the provision of services for use within the jurisdiction and to natural persons present in the jurisdiction at the time the services are rendered (e.g. hotels, restaurants).*

II. OBLIGATIONS RESULTING FOR PERSONS SUBJECT TO THE ACCOUNTS REQUIREMENT

A. Annual accounts must be prepared based on generally accepted accounting standards and such accounts must be accessible to the jurisdiction's authorities

24. Persons subject to the accounts requirement must be required to prepare annual accounts based on generally accepted accounting standards. No such separate obligation needs to be imposed on any person that is required to file a tax return on income in the jurisdiction, provided such tax filing obligation demonstrates a sufficient self-interest in ensuring that the relevant information is correct and can be verified (i.e. books and records supporting the filed return are kept and are readily accessible to the authorities). In such a case, i.e., where a tax filing obligation in substance corresponds to the obligations described in this section, the goals set out in paragraph 1 of this note are met and the imposition of a separate accounts requirement would seem duplicative and unnecessarily burdensome.

25. The preparation of the accounts should be based on any generally accepted accounting standards that ensure that the accounts give a true and fair view of the person's affairs.

26. If the accounts are not filed with the authorities of the jurisdiction (because the de minimis rule applies or because the accounts are audited) the accounts must be kept in a way that makes them accessible to the relevant authorities of the jurisdiction. Accounts are accessible to the relevant authorities if they are kept within the jurisdiction in a way that permits effective access by the relevant authorities in case of a request. In this regard, it is not sufficient to impose the obligation to keep accounts within the jurisdiction only on the person itself. This obligation needs to extend to at least one natural person who is within its territorial jurisdiction (e.g., a resident director or officer, a resident trustee, a resident accountant, a resident corporate service provider). The regulatory regime should include effective means to ensure compliance with this obligation both by the person itself and in particular by the natural person within its jurisdiction (e.g. imposition of significant penalties, revocation of licenses etc.).

27. Where the accounts requirement is triggered by the presence of a permanent establishment, a jurisdiction may decide to have the permanent establishment prepare full accounts only for the activities and assets of the permanent establishment. Alternatively, a jurisdiction may not insist on full separate "branch" accounts and instead only require income and expense statements for the branch activities and otherwise accept a copy of the global accounts of the person provided those accounts comply with the standard set out in paragraph 26.

B. Books and records supporting the accounts must be kept and must be accessible to the jurisdictions' authorities.

28. Any person required to prepare accounts needs to keep books and records supporting the accounts and such information must be accessible to the jurisdiction's authorities within a reasonable period of time. The information is considered accessible to the jurisdiction's authorities if it is kept within the jurisdiction in a way that permits effective access by the relevant authorities in case of a request. It is not sufficient to impose the obligation to keep such information within the jurisdiction only on the person itself, but the obligation needs to extend to at least one natural person who is within its territorial jurisdiction (e.g., a resident director, the resident trustee, a resident accountant, any other resident corporate service provider) The regulatory regime should include effective means to ensure compliance with this obligation both by the person itself and in particular by the natural person within its jurisdiction (e.g.

significant penalties, revocation of licenses). Regulatory regimes that do not require the information to be present in the jurisdiction would only be appropriate if they achieve the same level of accessibility of the information.

C. Accounts and books and records supporting the accounts must be kept for a reasonable period of time

29. For exchange of information to be effective there needs to be a reasonable minimum document retention period for both the accounts and the books and records supporting the accounts. A document retention period of 5 to 7 years following the end of the relevant accounting period would be a reasonable period.

D. Accounts must be filed or audited unless the de minimis exception applies

30. Any person required to prepare accounts that does not qualify under the de minimis exception (discussed below) is obligated to file or have audited its annual accounts. If a country chooses the auditing option it should have rules to ensure that the audit is performed only by independent and properly qualified personnel. If a jurisdiction chooses the filing option for some or all persons subject to the accounts requirement, it is free to determine the process, the relevant authority, etc. However, the jurisdiction should have rules and regulations in place that are designed to ensure the accuracy of the accounts filed as well as powers of access and enforcement to ensure compliance with such rules and regulations.

31. The MOU and several commitments refer to a de minimis exception. However, there is no single formulation of the de minimis exception and the wording varies from commitment to commitment.

32. This note proposes to develop a de minimis exception based on a fixed amount.¹ While there are certainly other approaches, an approach based on a fixed amount would seem the most practical approach. An entity that qualifies for the de minimis exception could then be exempted from the obligation to file or have audited its annual accounts. The de minimis exception would not affect the obligations specified under A, B and C. These obligations apply to all persons subject to the accounts requirement, irrespective of whether or not the person qualifies for the de minimis exception.

33. A de minimis exception, based on a fixed amount, could read as follows:

Any person, required to prepare accounts, whose annual turnover does not exceed _____ and whose gross assets, at no point during the financial year, exceed _____ qualifies for the de minimis exception.

34. In connection with such a de minimis exception it would be possible to use a different threshold amount for turnover and gross assets. For instance, a lower threshold amount for gross assets as compared to turnover could result in a less burdensome filing /auditing requirement for smaller asset holding entities as opposed to trading or re-invoicing companies.

35. The de minimis rule could be coupled with certain anti-abuse rules to ensure that it can not be circumvented by a simple break-up of one entity into several entities. The ease with which entities can be created would otherwise turn the exception into the rule and the audit or filing obligation may become

1. For a complete exemption of certain persons based on the activities in which they engage, see already section I.C.

essentially meaningless. Thus, anti-abuse rules could be added to ensure that the de minimis threshold applies on an aggregate basis and not on an entity basis.

36. The remainder of this section briefly discusses a possible anti-abuse rule and its application on both a “per jurisdiction” and a “worldwide” basis. For instance, such a rule could read as follows:

Any person, required to prepare accounts, whose annual turnover does not exceed _____ and whose gross assets, at any one point during the financial year, do not exceed _____ qualifies for the de minimis exception. In cases where two or more persons are owned, directly or indirectly, by the same person or group of persons the threshold amounts specified in the preceding sentence shall be applied on an aggregate basis. Similarly, in cases where two or more persons have the same beneficiary, the threshold amounts specified in the first sentence shall be applied on an aggregate basis.

37. For instance, if non-resident shareholder A owns companies B and C, incorporated in country B, the de minimis rule would be applied by aggregating the turnover and gross assets of companies B and C. If the combined numbers exceed the threshold, neither company B nor company C qualifies for the de minimis exception. If non-resident shareholder A owns company C through company B the same aggregating rule applies (of course with adjustments to avoid double counting of the gross assets held directly by company C and indirectly by company B).

38. The anti-abuse rule could be applied on a “per jurisdiction” basis or on a worldwide basis. The operation of the anti-abuse rule on a jurisdiction basis is already illustrated in the examples contained in the previous paragraph. The application of the anti-abuse rule on a worldwide basis would mean that the turnover and gross assets of all persons required to prepare accounts (i.e., all persons that are subject to the accounts requirement and that are not excluded from the requirement by virtue of the tax filing obligation) would have to be aggregated. For instance, assume shareholder A, resident in country A, owns company B, incorporated in country B, and company C, incorporated in country C. Assume that both company B and company C are required to prepare accounts. Further assume that companies B and C have no nexus with any country other than their country of incorporation. Both country B and country C apply the de minimis rule by aggregating the turnover and gross assets of companies B and C. If the combined numbers exceed the threshold, neither company B (in country B) nor company C (in country C) qualifies for the de minimis exception.

39. In applying such a de minimis rule any jurisdiction would necessarily have to rely to a large extent on information provided by the shareholders, beneficiaries or other persons involved in the management of the person. Thus, there would need to be rules to ensure that the exception is only available in cases where it is intended to apply. For instance, the exception could be granted only if representations are made to the relevant authorities confirming that the person qualifies for the exception. The regulatory regime of the jurisdiction would then need to include effective means to ensure that such representations are accurate.