Financial institutions' reporting requirements and the criteria for a good tax system

Author(s): Kontkanen, Erkki; Lindgren, Juha

Title: Financial institutions' reporting requirements and the criteria for a good tax system.

Year: 2022

Version: Accepted manuscript

Please cite the original version:

Kontkanen, E. & Lindgren, J. (2022). Financial institutions' reporting requirements and the criteria for a good tax system. In: Kalmi, P., Auvinen, T. & Järvenpää, M. (eds.) *Responsible Finance and Digitalization: Implications and Developments,* 204-218. Routledge International Studies in Money and Banking. London: Routledge. https://doi.org/10.4324/9781003144427-16

Alternative Banking

Financial Institutions' Reporting Requirements and the Criteria for a Good Tax System

1. Starting points

   Business structures have been in transition during last two decades, especially due to the internationalization of business and technological developments. In a globalized context, the need to obtain market information has further increased. A lack of information is regarded as having contributed to the onset and deepening of the 2008 financial crisis.

   The financial crisis and the associated increases in sovereign debt, together with technological developments, internationalization and international tax competition[1] have also highlighted the need to step up efforts to prevent both international tax evasion[2] and international tax avoidance. The latter has indeed become a priority in the development of tax regulation over last decade and has also brought the need for an adequate information base to the fore. It has become clear that preventing aggressive tax planning calls for a better information base to support efficient tax assessment, and in particular the strengthening of the international tax information exchange system.[3] To this end, in 2015 the OECD and the G20 finalized and published the Base Erosion and Profit Shifting (BEPS) package.

2. Financial institutions' role in the prevention of the tax evasion

   The primary function of financial intermediaries is to collect funds from savers and allocate them to people and companies that have a funding deficit in order to allow them to meet their financial needs. In the context of this intermediary role, financial institutions, in particular banks, have extensive access to financial information about their clients. The financial flows of societies pass widely through the financial system.

   Due to the key economic role played by financial institutions it is unsurprising that information in their possession is utilized for tax purposes. The technological developments that have taken place in recent years have contributed to the wider use of such data in the taxation process. For example, in Finland it has been possible since 2010 to make

---

1 At corporate level, aggressive tax competition between states manifests itself in three ways in particular: moving ('stripping') earnings from one (higher tax) country to another (lower tax) country; profit shifting through transfer mis-pricing; and taking advantage of differences between tax regimes.

2 The factors that led to the 2008 financial crisis, in addition to aggressive international tax planning, were examined in reports published by the OECD, among others. See e.g. OECD, *Building Transparent TAX Compliance by Banks* (OECD 2009) 18; OECD, 'Sixth Meeting of the OECD Forum on Tax Administration, Istanbul 15-16 September 2010: A Framework for a Voluntary Code of Conduct for Banks and Revenue Bodies'; and OECD, *Study into the Role of Tax Intermediaries* (OECD 2008).

3 OECD, 'OECD/G20 Base Erosion and Profit Shifting Project: Mandatory Disclosure Rules, Action 12: 2015 Final Report' (OECD 2015).

‘comparative data audits’.[4] Pursuant to section 21 of the Act on Assessment Procedure (*laki verotusmenettelystä*, VML)[5] a tax audit is carried out solely for the purpose of collecting information that can be used in the taxation of another taxable person. In that case, the information is in principle not used at all for the taxation of the party providing information.

Internationally, financial institutions, especially banks, have also been seen to have direct connections with aggressive tax planning schemes, so use of the information in their possession for tax assessment has also been justified from this perspective. The OECD report on bank tax compliance highlights three issues in relation to the role played by banks in enabling aggressive tax planning. First, banks have access to capital and the tax planning arrangements used by large corporate taxpayers often involve a substantial flow of funds through a number of entities and jurisdictions. Second, banks have global reach and are in a unique position due to the role they play in relation to global leading businesses to channel funds through multiple entities. Third, banks often develop and utilize the financial instruments used in commercial dealings and aggressive tax planning arrangements.[6]

3. Reporting requirements for financial institutions

Internationally the most visible starting point for the use of information held by financial institutions for tax assessment purposes is the automatic account information exchange system established in 2010 under the US Foreign Account Tax Compliance Act (FATCA).[7] At European level the main legislative framework is laid down in the Directive on Administrative Cooperation[8] (DAC). It provides three different procedures for the exchange of information: (1) exchange of information on request, (2) spontaneous exchange and (3) automatic exchange of information. Under DAC, the exchange of information is limited by the standard of foreseeable relevance, further clarification of which can be found in the case-law of the Court of Justice of the European Union (CJEU).[9] The request for information may relate to one or more taxpayers if they are individually identified. Otherwise, a request can relate to a group of taxpayers if a common set of characteristics is described.[10]

Worldwide, a key starting point for the further development of the international exchange of information is provided by the OECD report ‘Automatic Exchange of Information: What It

---

[4] Until 2010, comparative tax audits could not be performed at banks. However, information obtained in the past from banks’ tax audits could be used for customer taxation purposes.

[5] L 18.12.1995/1558.

[6] OECD (2009) Building Transparent Tax Compliance by Banks 19-20. On the role of the financial sector in aggressive tax planning, see European Parliament, ‘The Role of the Financial Sector in Tax Planning: Study for the TAXE 2 Special Committee’ (2016).

[7] See T. Falcão & A. Lara Yaffar, 226. The report points out that there was no global system in place before FATCA to share account information between countries, other than those available via exchange of information agreements. The OECD established the Common Reporting Standard (CRS) for the reporting and automatic exchange of financial account information between treaty partners inspired largely by FATCA.

[8] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC [2011] OJ L64/1.

[9] See especially C-682/15 *Berlioz Investment Fund* ECLI:EU:C:2017:373. However, according to Ronco no specific decision has been rendered in particular as regards the compatibility with data protection safeguards of automatic exchange of information, neither at EU level nor within the FACTA and CRS frameworks. See S. Maria Ronco 6.

[10] See R. Biebel & J. Voje, 249.

Is, How It Works, Benefits, What Remains to Be Done'.[11] Based on this the OECD published in 2014 its 'Standard for Automatic Exchange of Financial Account Information in Tax Matters' (AEFI). The OECD standard includes two elements: a model agreement between the competent authorities of the contracting states (MCAA); and a common standard on reporting and due diligence for financial account information (CRS). Under the CRS, automatic data exchange is performed in a standard format using selected data transfer formats and communication channels.[12] Reporting financial institutions include, inter alia, banks and insurance companies.[13]

DAC has been amended as follows: a 2014 amendment implemented the CRS standard in the DAC; a 2015 amendment added provisions on mandatory exchange of information on Advance Cross-Border Rulings (ACBR) and Advance Pricing Agreements (APA) in cross-border situations; two 2016 amendments added provisions concerning the mandatory automatic exchange of country-by-country reporting information for multinational enterprises between tax authorities and regulating tax authorities' access to client identification procedures for the prevention of money laundering; and a 2018 amendment imposed an obligation on tax intermediaries to notify the tax authorities of certain cross-border arrangements that may involve tax avoidance.[14]

The amendments made to DAC detailed above differ in scope to some extent. The starting point for the amendments made in 2015 was to impose reporting requirements on banks and other financial institutions (DAC2). However, other amendments also have implications for financial institutions' reporting obligations. One of the main purposes of the amendments made in 2016 (DAC5) was to ensure that information on beneficial owners can be used to monitor financial institutions' compliance with the identification and reporting obligations set out in the anti-money laundering directive.[15] The latest round of amendments (DAC6) focus primarily on tax planning services. In principle, services provided by financial institutions do not focus on tax planning services. However, while a financial institution does not provide tax planning services per se, DAC may nonetheless have a significant impact on its activities. In assessing financial institutions' reporting obligations, it may be necessary to assess the degree of awareness the service provider may have acquired about a client's overall financial arrangements and their tax consequences. For example, a bank may, in the course of providing its normal range of services, assist its clients in handling international payment transactions by opening a foreign account for the client in a country outside the scope of the system of the international exchange of tax information. The bank is then required to report, if it knows or if it should know, that the foreign account is part of a tax arrangement. If the scope and content of the reporting obligation remain unclear, the

[11] Available at http://www.oecd.org/ctp/exchange-of-tax-information/automatic-exchange-of-information-report.pdf accessed 9 January 2021.
[12] The Multilateral Convention on Mutual Administrative Assistance in Tax Matters sets out agreement, inter alia, on confidentiality and the use of information in connection with the exchange of information.
[13] In Finland, following international developments in this area, the tax administration has been active in developing preliminary procedures. The customers of Large Taxpayer Office (LTO) of the Finnish Tax Administration, including financial institutions have had the opportunity to engage in preliminary discussions with Tax Office representatives.
[14] For reporting and IT requirements for reporting and other most recent reporting obligations, see B. Kuijper, T. Cameron & Z. Szatmari 584-588.
[15] Directive (EU) 2016/2258 (DAC5), recital 3.

bank has to assess the extent to which it must report transactions. At the same time, the bank will have to weigh the aspects of bank secrecy with regard to possible disclosure.

4. Reporting requirements of financial institutions and a good tax system

The additional reporting duties imposed on taxpayers and financial institutions offer new tools for the prevention of the tax avoidance as well as for collecting taxation information. The new reporting requirements can also be seen as increasing regulatory complexity and interpretability. Therefore, developments should be assessed in the light of the criteria for a good tax system discussed below.

There is no unambiguous generally accepted definition of a good tax system. Assessment of the criteria for a good tax system is influenced not only by social and economic policy considerations, but also by the perspective from which the criteria for a good tax system are examined. If the matter is considered from the taxpayer's point of view, the review will focus on legal certainty issues from that perspective. From the tax authorities' point of view, the focus is again inevitably on the fiscal and administrative aspects of the efficiency of the whole system. Due to these differences in perspective, the criteria applicable to each side of the relationship are in a degree of tension with each other.

The criteria for a good tax system have generally been based on those developed by Adam Smith as early as 1776, in which he emphasizes equality, certainty, convenience and economy/efficiency. The issues emphasized by Smith have been reflected in several subsequent classifications.[16]

The setting of criteria for a good tax system has traditionally been based on the needs of the tax recipient and the taxpayer. From the tax recipient's point of view, a tax procedure must guarantee a fiscal return. This means tax efficiency, which at national level requires the coverage of the tax system, cost-effectiveness and minimization of tax evasion. Alongside tax assessment, the proactive guidance of the tax administration implements the objectives of a cost-effective tax system. From the point of view of tax compliance, the vast majority of taxpayers want to act correctly, so that instead of control, the use of preliminary rulings, guidance and other preliminary procedures and the improvement of services can ensure the accumulation of tax revenue at a lower cost.

From the taxpayer's point of view, a good tax system emphasizes safeguarding the taxpayer's rights. In particular, the predictability, legal certainty and clarity of taxation are becoming key factors in both corporate and personal taxation and include the goal of limiting administrative burdens and compliance costs. This objective is present in several countries at national level from the point of view of both legislation and the tax procedure. The latter thus emphasizes the efficiency of each country's tax administration. In a good tax system, the goal is to minimize the costs associated with taxation. The traditional view is

[16] See e.g. C. Alley and D. Bentley 586-588.

that these costs include the compliance costs incurred by the public sector in the collection of taxes, attributable both to the taxpayer and the tax administration.[17]

The use of information technology has become increasingly important in improving the efficiency of the tax system. Indeed, technological developments have made possible not only the far-reaching automation of the taxation process, but also, inter alia, new, more comprehensive and effective means of tax assessment. At the same time, technological developments can in many respects be seen as reducing the cost of tax administration. In assessing Smith's criteria, Alley and Bentley have pointed out, that in respect of the taxation of e-commerce the authorities have an incentive to shift the administrative costs of the tax system to taxpayers and third parties.[18] Technical progress has made it possible to utilize information held by third parties for tax purposes more widely than before. At national level the transition in several countries to a pre-filled tax return procedure, where the information used for taxation comes directly to the tax authorities from third party notifiers, is a widely influential example of this development.

The use of information held by third party notifiers in the tax procedure significantly reduces the administrative burden for the majority of taxpayers. The reduction of the administrative burden on natural persons is thus made possible by the actions of third parties. In the regulation of the international exchange of tax information, financial institutions, in particular, are firmly integrated into the information exchange system. In this respect, the costs of obtaining information have been outsourced to them. For example, the cost to financial institutions of setting up a reporting system under DAC (DAC2) has been estimated to be as much as ten times the cost to Member States.[19]

Financial institutions that are notifying parties are not directly involved in the tax relationship between the tax authorities and the taxpayer. Their operating and regulatory starting points differ from those of the actual parties to the tax relationship. They provide financial services as their business. The main starting point for the need to regulate financial markets is to protect investors and thereby safeguard the stability of financial markets.[20] Although a well-functioning tax system is likely to increase the stability of society and also of financial markets, the objectives of a good tax system are to some degree in tension with the objectives of banking regulation, for example in a situation where financial institutions incur additional non-business-related costs as result of the tax system's rules.

The role of financial institutions and the diversity of tasks in the development of the tax procedure are reflected both in credible tax assessment and in reducing the administrative burden on other taxpayers. It is therefore appropriate also to look at the criteria for a good tax system from the perspective of third-party notifiers.

[17] C. Alley and D. Bentley 611.
[18] ibid 596.
[19] Evaluation of Administrative cooperation in Direct Taxation 78. European Commission 2019. See also L. Finèr and A. Tokola.
[20] For more specific information on the objectives of financial regulation, see e.g. J.Armour and others 61-72.

There are many open questions related to the evaluation of the developments that have taken place. If, from the tax recipient's point of view, fiscal return and, from the taxpayer's point of view, the taxpayer's legal protection are the determining criteria for a good tax system, what is the most important feature of a good tax system from the point of view of third-party notifiers? Is it possible to disregard the role and costs involved in reporting, tax assessment and, more generally, the promotion of tax efficiency by third-party notifiers. To what extent can the resulting obligations be justified, for example, by the involvement of international banking in the aggressive tax planning carried out by and for wealthy individuals or international enterprises? Should, and possibly how, the differences in the role of different banks, for example, be taken into account? Is it possible for third-party notifiers to limit the administrative burden only on the basis of data protection provisions? These and other issues should be addressed at both national and international levels.

Pasquale Pistone addressed some of these concerns at the 2019 EATLP Congress 'Tax Procedures'. According to Pistone there are two critical issues: the proportionality of the burden imposed on third parties to supply information and tax authorities' right to access confidential information concerning taxpayers.[21] Similar problems exist on a smaller scale when third parties have to provide information on request, in respect of which the question of compensation also arises. If the information required is not readily available to the third party it would be reasonable to offer fair compensation for open-ended costs that may be incurred in respect of fact-finding. The need for this kind of information on request may be legitimized by the interests of the community but it may be seen as fair for the community also to bear the costs of obtaining it. This type of mechanism in the framework of cross-border mutual assistance can be found where, in bilateral agreements, it may apply successfully to the supply of so-called 'extraordinary information' which is not available to the requested authority.[22] Tax authorities' rights in relation to information held by third parties raises proportionality issues.

All costs, including those incurred by third-party notifiers, should be taken into account when assessing the efficiency of the tax system and the total cost of tax collection. In addition to the amount of costs, assessment of the fulfilment of the efficiency criterion of a good tax system should pay attention also to the allocation of costs arising from the tax system. The passing of costs to third parties should in any case be treated with caution in order to safeguard the tax system's transparency.

If the costs to third parties are significant and relate to only some of those operating in the financial sector, these costs may also have an impact on market structures. Increased reporting requirements may contribute to regulatory arbitrage[23] by diverting activities to non-regulatory actors or, for example, to account products that are outside the regulatory framework. Obligations can also contribute to creating a platform for the formation of alternative banking. An operator that is not subject to the reporting obligation may, in turn,

[21] P. Pistone 40.
[22] According to Pistone especially after the increase of the costs connected to the implementation of the FATCA 'banks and financial institutions either shift the economic burden of these cost down to their clients or even de facto force them to shut down their accounts'. See P. Pistone 41.
[23] See e.g. K. Alexander 301.

seek to develop its business in such a way as to avoid being subject to the reporting obligation. If the administrative burden and costs of reporting are significant, they may also be likely to strengthen, inter alia, the trend towards market concentration. The tax system may then have, to some extent, detrimental effects on market efficiency.

The extension of the reporting system can also be seen as having an impact on the achievement of the simplicity objective of the tax system raised in the definitions of a good tax system. The criterion of simplicity[24] can be seen as contributing to the efficiency of the tax system as well as to its legal certainty and predictability. Tax regulation and implementation should be as simple as possible to avoid imposing unnecessary burdens on business.

The development of information technology has enabled more efficient use of data and a functioning international reporting system in taxation. It has also contributed a platform for standardization and harmonization that helps both simplify tax systems and achieve fiscal targets. On the other hand, the international reporting systems are likely to lead to structural and substantive regulatory complexity and interpretability,[25] thus increasing legal uncertainty and the administrative workload in respect of tax matters. International regulation has to reconcile the needs of very different national tax systems.

In recent years the need to prevent international tax evasion has led to a focus on the need to limit opportunities to take advantage of differences in national tax systems. At the same time, the increased need to take into account data protection issues in relation to citizens has brought these issues to the fore in the tax context. The aim of safeguarding fiscal objectives related to the collection of general government funds may be in tension with data protection in relation to the taxpayer or a third party. In the EU, data protection issues have acquired greater significance since the entry into force of the General Data Protection Regulation[26] (GDPR). In general, the importance of information and its processing in the taxation process can be seen as emphasized. The taxation process is increasingly concerned with the processing and management of information connected to taxation.[27]

5. Financial institutions, reporting requirements and data protection

[24] According to C. Alley and D. Bentley (586-587) simplicity has also been highlighted in at least the following outlines of the criteria for a good tax system: Report of the Royal Commission on Taxation (Carter Report) Vol 2, The use of the tax system to achieve economic and social objectives (1966); Australian Taxation Committee (Asprey) 1976; The Meade Report 1978; A Report of a Committee Chaired by O'Brien M H (O'Brien Report), 1st Report of the Commission on Taxation – Direct Taxation (1982); ICAEW Tax Faculty 1999 and The American Institute of Certified Public Accountants, Inc Tax Policy (AICPA) Concept Statement 1 Guiding Principles of Good Tax Policy; A Framework for Evaluating Tax Proposals (2001).

[25] An example of the possibility for interpretation is provided by the main benefit test in Annex IV of DAC6.

[26] Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) [2016] OJ L119/1.

[27] As early as 2001, the American Institute for Certified Accountants (AICPA) also identified information security as one of the criteria for a good tax system in 'Tax Policy Concept Statement 1: Guiding principles of good tax policy: A framework for evaluating tax proposals'.

During the last few decades bank secrecy has had to give way to a greater extent than before in the face of greater rights afforded to tax authorities to acquire data.[28] Traditionally the obligation to give information to tax authorities has varied from one country to another as well as the impact of the international exchange of information. Even in countries where the tax administration has had comprehensive access to information, increasing international exchange of information has had a significant effect on the confidentiality of client information and the administrative burden caused by obligatory data transfer.[29]

It seems to be the case that the more global exchange of information occurs, the greater the risk of breaches of confidentiality, privacy and secrecy provisions or even abuses in respect of the use of data obtained, especially regarding business secrets. It should be borne in mind that business secrets are a significant precondition to conduct a business and, therefore, also an unconditional element under Article 16 of the Charter of Fundamental Rights of the European Union and are protected as property under Article 17 of the Charter. Business secrets are also protected under Article 17(4) of DAC and under Article 26(3)(c) of the OECD Model Convention.[30] From the perspective of the legitimacy of tax systems it is essential that the obligatory transfer of information related to business secrets is well justified and necessary in accordance with the relevant regulation.

The CJEU's case law indicate that the different forms of international tax information exchange can be seen to be in the public interest. Under Article 23(1)(e) of the GDPR both the EU and its Member States may restrict the scope of their obligations and rights in relation to information exchange when it is necessary and proportionate to safeguard taxation matters. The role and status of the tax authorities are highlighted in the preamble of the GDPR, recital 31 of which notes that personal data are disclosed in accordance with a legal obligation for the exercise of their official mission, such as tax and customs authorities should not be regarded as recipients if they receive personal data which are necessary to carry out a particular inquiry in the general interest, in accordance with Union or Member State law.

One must also recognize the starting points, such as 'lawfulness, fairness and transparency' and the purpose limitation laid down in Article 5(1) of the GDPR,[31] which provides that the personal data must be adequate, relevant and limited to what is necessary in relation to the purposes for which they are processed ('data minimization').[32] Therefore, the data can be obtained only if it is necessary in relation to the purposes for which it is processed. Furthermore, the tax purpose is underlined in DAC, Article 20(2) of which provides that

[28] The development can be seen also in article 26(5) of the OECD Model Convention, which states as follows: 'In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution…' See also Godfrey and others 2016, 173.
[29] International Working Group on Administrative Burdens, 'The Standard Cost Model: A Framework for Defining and Quantifying Administrative Burdens for Businesses,' 2004.
[30] OECD, Commentary on Art. 26 OECD MC, No. 19.2.
[31] Article 5(1) of the GPDR provides as follows: 1. Personal data shall be: (a) processed lawfully, fairly and in a transparent manner in relation to the data subject); (b) collected for specified, explicit and legitimate purposes and not further processed in a manner that is incompatible with those purposes; further processing for archiving purposes in the public interest, scientific or historical research purposes or statistical purposes shall, in accordance with Article 89(1), not be considered to be incompatible with the initial purposes (purpose limitation).
[32] Pistone has suggested that it may be preferable to grant tax authorities direct access to such information. From the perspective of data protection of the financial institutions and their customers, his suggestion can be seen problematic. See P. Pistone, 40.

requests for information should include at least, inter alia, the tax purpose for which the information is sought.

Therefore, it is important to highlight the significance of the utilization of the data collected pursuant to DAC. The data must be used in a taxation process. It cannot be collected simply for potential later use. The Commission's reports to date indicate that the data has either been inadequately utilized or not utilized at all.[33] All the data collection should be justified in terms of its necessity in order for the goals of the tax system to be achieved.[34] The data may have both a direct and an indirect impact on taxation, which should be noted in the evaluation. Among other things, the exchange of information can help to improve the authorities' risk management and prevent tax fraud.[35]

From the perspective of the principle of proportionality the focus has been on the requirements of the need to collect data. Article 26 of the OECD Model Convention and Article 1(1) of DAC specify that the data collected must have foreseeable relevance to the taxation. DAC stipulates that 'the Member States shall cooperate with each other with a view to exchanging information that is foreseeably relevant to the administration and enforcement of the domestic laws'. Difficulties may arise in presenting the proof of relevance as well as in achieving constitutional justification on the basis of proportionality especially where the scope of the data collection and exchange involved is massive.[36]

The Finnish Supreme Administrative Court (*Korkein hallinto oikeus*, KHO) ruling KHO 2020:8 offers an example of the emphasis placed on the significance of data protection and the principle of proportionality.[37] Although it did not deal with the automatic exchange of information, the scope of the data request relates to similar characteristics and brought questions of proportionality into play.

The KHO's ruling notes that the Finnish Tax Administration had requested a wide variety of data from the taxpayer. The request extended to information on the company's clients and was only partly based on the tax audit on the company and mainly on the comparison data audit. Section 21 of the VML concerns comparison data audits and, as noted above, states that a tax audit can also be performed for the express purpose of collecting information that can later be used in the taxation of another taxpayer.

The ruling also notes that the request included a listing of all the clients of the company in order to be used for the comparison data audit. Referring to the GDPR, the Court held that

---

[33] Evaluation of Administrative Cooperation in Direct Taxation, Final Report 9-24. Also De Troyer reminds that the efficiency of information exchange depends on the capacity of the Member States to use the bulk information received. I. De Troyer 486.

[34] Article 25(4) of DAC (DAC2) provides that collected data shall not be retained longer than necessary to achieve the DAC's purposes.

[35] Evaluation of Administrative Cooperation in Direct taxation, European Commission 2019, 45.

[36] R. Seer and S. Kargitta 507.

[37] FI: KHO, 30 Dec. 2020, 2020:8.

this request was not legitimate. The request made by the Finnish Tax Administration was accordingly denied.[38]

The listing presented by the Finnish Tax Administration had included besides the request on the identification of all the clients also a request for a wide range of economic information on them.

The Court's reasoning emphasized that the GDPR had entered into force in all EU Member States on 25 May 2018. Collection of the data of an identified bank's clients entails processing the personal data covered by the GDPR. Enforcement of the request was possible under the law after the date mentioned above to the extent permitted under the GDPR.[39]

The Court also referred to the principle of proportionality and to recital 31 of the GDPR, which states that 'requests for disclosure sent by the public authorities should always be in writing, reasoned and occasional and should not concern the entirety of a filing system or lead to the interconnection of filing systems. The processing of personal data by those public authorities should comply with the applicable data-protection rules according to the purposes of the processing.'

Therefore, the reasoning of the Court's ruling stated that the request was not limited only to those clients whose data could be presumed to be relevant for the tax assessment. The request was not in line with the principle of proportionality and recital 31 if it involved transferring the data of an entire (client) register.

This ruling makes it clear that the effect of the GDPR has to be taken into account. Therefore, requests made by tax authorities must now be formulated in a different manner from the pre-GDPR era. Nonetheless, interesting and open-ended questions relating to the acceptability of such formulations will continue to present themselves.

6 Conclusions

Traditionally the criteria for a good tax system have been observed only from the perspectives of a taxpayer or a tax recipient. However, the taxing procedures and taxation as a whole rely more and more on the information received from third parties, especially financial institutions. The responsibility of financial institutions to report the data required for the international exchange of information on their clients calls for a new approach to the criteria for a good tax system. The data protection rules discussed above place limits on the scope of the requests that may be made by tax authorities and the on the ways in which data

[38] The KHO referred especially to the time-consuming process and to Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) [2016] OJ L119/1, and Articles 5 and 6 of the GDPR.

[39] The case itself had some unique characteristics relating to misinterpretation, in time-consuming proceedings that began in 2013. The KHO had given a ruling on the first stage of the proceedings, in which it stated that the written request made by the Finnish Tax Administration to present material for the purposes of a comparison data audit was an appealable decision. On this, see KHO, 30 August 2016, 2016 T 3593 and J. Lindgren, 448.

may be processed by them. The criteria for a good tax system require that these limits be expressed more clearly.

Ehrke-Rabel notes that only third parties in possession of data or information that the tax authorities need can contribute to tax transparency. Therefore, third parties need to be in a specific relationship with the taxpayer and need to be trusted by the tax administration. She mentions that these classical intermediaries (e.g. banks and other financial institutions) are in a certain way ‘controlled’ by the state in fields of law other than taxation. According to Ehrke-Rabel, since this kind of intermediary is traditionally bound by specific professional ethics and legal liability, its compliance with legal obligations, such as third-party reporting, is presumed to be at a high level.[40]

In general, a good tax system guarantees a taxpayer rights in a proactive and legitimate manner, where the criteria applied ensure effective administrative procedure and a reliable and multiple-stage system of appeal. From the perspective of this research, it has to be emphasized that these procedures and rights should be provided regardless of the taxpayer’s former conduct. For example, a taxpayer should still have the right to be heard at all the stages of appeal even if he or she had previously been involved in a tax avoidance scheme. For tax recipients a good tax system means effective taxation and tax collection, which ensures legitimate fiscal revenue.[41]

The increasing role of third party information raises the question of and the growing need to establish criteria as to how parties, that have reporting obligations should be taken into account when designing good tax systems in the future. In evaluating the criteria of a good tax system from the perspective of the provision of third party information, the focus should be on the data, its handling and its usage. It is important to those who are required to report that questions as to the quantity, availability and compatibility of the data, as well the applicable data protection issues, are clearly defined and answered. A good and efficient system should ensure that the tax authority may only request data that is needed and actually used in order for the tax authority to carry out its work and tax assessment. This issue, which is essentially one of foreseeability, relates also to the fact that the exchange of information conducted by an EU Member State for tax purposes is covered by the GDPR.

When calculating a tax system’s efficiency and the total costs of the tax services, control and collection, the costs attributable to the reporting and the gathering of other third party information should be taken into account. Assessment of the tax system’s efficiency should not be based on private parties – such as financial institutions – that are not involved in the relationship between the taxpayer and the tax recipient or responsible for payment of the taxes in question. It is likely that the data systems being developed will allow client data to be collected and delivered to the tax authority at low or no extra cost. However, the system and its future development should not lean only on this consideration.

Third party information obligations and costs that are not really attributable to a financial institution’s business cause an obvious problem when compared to the objectives of a good tax system. A more transparent arrangement should be achieved. The division of the (extra)

[40] T. Ehrke-Rabel 79-80.

[41] The recent discussion and calculation of the tax gap also relates to the evaluation of this approach. On this, see also Article 26(5) of the OECD Model Convention, which provides that banking information shall not be regarded as secret.

costs between the taxpayer and the tax recipient in accordance with the matching principle and the principle of proportionality could offer one acceptable approach by which to resolve this issue.

Finally, the possible effects of third party information requirements that are unintentional in nature must be taken into consideration. The structure and practical applicability of information exchange systems should not lead to an administrative burden and extra costs being caused to financial institutions or other responsible actors in the process. If the applicable regulations may have effects on the market or only on some institutions, this could lead to undesirable outcomes. Increased reporting requirements may cause structural changes or arbitrage aimed at avoiding the burden and even the outsourcing of these burdensome activities. Greater market concentration and forms of banking that fall outside the scope of the applicable regulation represent other undesirable consequences that might arise.

What constitutes a good tax system and what costs and other resources are involved in meeting the need to obtain third party information, while also respecting proportionality and taking account of possible compensation for the extra costs, are relevant questions. The ongoing and fast development of financial products, if it continues, throws up the issue of these products falling outside recognized methods of tax treatment. This should not be an incentive for the use of unregulated ways of running businesses or conducting banking. Further research is needed on these topics, particularly on such issues as the use of cryptocurrencies, the lack of internationally harmonized definitions, and traceability and tax assessment.[42]

Bibliography

Alexander K, *Principles of Banking Regulation,* Cambridge University Press, 2019

Armour J, Awrey D, Davies P, Enriques L, Gordon J.N., Mayer C, and Payne J, *Principles of Financial Regulation*, Oxford University Press, 2016

AICPA, *Guiding Principles of Good Tax policy.* A Framework Evaluation for Tax Purposes, Tax policy Concept Statement, March 2001

Alley, D & Bentley B, *A remodelling Adam Smith´s tax design principles,* Bond University Law Faculty Publications, 2005

R. Biebel & J. Voje, *Exchange of information: issues, use and collaboration EU report,* Volume 105B, Studies on International Fiscal Law by the International Fiscal Association 2020, pp. 247-277.

[42] See e.g. T. Falcão & A. Lara Yaffar 246; and R. Biebel & J. Voje 275.

De Troyer I, *Administrative cooperation and recovery of taxes*, Handbook of the European Union Taxation Law. Edited Edited by Christiana HJI Panayi, Werner Haslehner, Edoardo Traversa, Edward Elgar Publishing, 2020, pp. 474-488

T. Ehrke-Rabel, *Third Parties as Supplementary Sources of Tax Transparency, EATLP Thematic Report2018*, in *Tax Transparency*, (F. Yavaslar & J. Hey eds. IBFD 2019), Books IBFD, pp. 67-95.

European Commission, *First Report of the Commission AEFI expert group on the implementation of Directive 2014/107/EU for automatic exchange of financial account information*, March 2015

European Parliament, *The Role of the Financial Sector in Tax Planning*, Study for TAXE 2 Special Committee, 2016

European Commission, *Evalution of Administrative cooperation in Direct Taxation*, Final Report, 2019

Finér L and Tokola *A, The Revolution in Automatic Exchange of Information; How is the Information Used an What are the Effects*, (Volume 71), Bulletin for International Taxation 2017

Godfrey G, Newcomb D, Burke B, Chen G, Schmidt N, Stadler E, Coucouni D, Johston W and Boss Walter H.; *Bank Confidentiality – A dying Duty But Not Dead Yet?,* Business Law International, Vol 17 No 3, 2016

International Monetary Fund, *A Fair and Substantial Contribution by Financial Sector*, Final Report for G-20, June 2010

T. Falcão & A. Lara Yaffar, *Exchange of information: issues, use and collaboration, General report*, Volume 105B, Studies on International Fiscal Law by the International Fiscal Association 2020, pp. 195-246

B. Kuijper, T. Cameron & Z. Szatmari, *Technology-Enabled Tax Compliance*, OECD International, Bulletin for International Taxation. October 2020, p. 583-597.

J. Lindgren, *EATLP National Report Finland 2019,* in *Tax Procedures*, (P. Pistone ed. IBFD 2020), Books IBFD, pp. 435-465.

P. Pistone, EATLP *General Report 2019*, in *Tax Procedures*, (P. Pistone ed. IBFD 2020), Books IBFD, pp. 3-111.

OECD, *Study into the Role of Tax Intermediaries,* 2008

OECD, *Building Transparent Tax Compliance by Banks,* 2009

OECD, *Framework for a Voluntary Code of Conduct for Banks and Revenue Bodies*, Sixth meeting of the OECD Forum on Tax Administration, Istanbul, 15-16 September 2010

OECD, *What is a "Competitive Tax System*, Taxation Working papers No 2, Stephen Matthews, 2011

OECD, *Mandatory Disclosure Rules*, Action 12, Final Report, 2015

OECD, Model Tax Convention on Income and on Capital: Condensed Version 2017

S. Maria Ronco, *Data Protection in Direct Tax Matters and Developments from the EU Standpoint*: The Case of Automatic Exchange of Information, International Tax Studies, Issue 4-2020, p. 6.

Seer R and Kargitta S, *Exchange of information and cooperation in direct taxation,* Handbook of the European Union Taxation Law, Edited by Christiana HJI Panayi, Werner Haslehner, Edoardo Traversa, Edward Elgar Publishing, 2020, pp. 489-510