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Brazil, the OECD and the Decline of Banking Secrecy

Greater pressure on public sector budgets, motivated by factors such as increased demand for goods and services by the population (partially a by-product of materialism), but also stemming from the misuse of public funds and aggressive international competition, is a feature of the world economy today. This fact is echoed in governmental search for additional revenue. A natural and non-traumatic means of obtaining additional funds by not increasing tax burden is the detection of amounts that are undeclared and invested in international financial markets by a country's citizens.

It was following this logic that after dialogue with European countries the United States passed FATCA (the Foreign Account Tax Compliance Act). This regulation imposes on financial institutions and similar entities outside the United States (FFIs) the obligation to report accounts held by American citizens, under penalty of otherwise suffering retention of up to 30% on payments from U.S. sources. The mechanics as to related data exchange were set forth in the Intergovernmental Agreement (IGA) executed between Brazil and the United States on September 23, 2014.

In a second act to the same drama, in April 2009 member countries of the Organization for Economic Cooperation and Development (OECD) approved a revised text of the preexisting multilateral Convention on Mutual Administrative Assistance in Tax Matters ("the Convention"). Said convention, first drafted in 1988, now accepts the adhesion of external members to its original group, and was ready for signature in June 2011. Brazil was a signatory to the document, which is now pending ratification by the National Congress, as formally solicited by Executive Branch Communication N. 270/2014. Once ratified and published by legislative decree the Convention will come into force in Brazil.

Article 6 of the Convention provides for automatic exchange of tax information as may be agreed between the signatory parties. This rule is moderated, however, by Article 21 of the Convention, under which individual rights and safeguards cannot be disregarded in the application of the Convention, including as respects professional secrecy.

Banking secrecy is in fact a modality of professional secrecy, which according to Complementary Law N. 105/2001 (the Banking Secrecy Law) is subject to a limited number of exceptions, all provided for by the law. The subject bound to secrecy is not the financial institution alone: banking information remains subject to confidentiality when transferred to the Fiscal Authority. It is on the constitutional protection of privacy and private life, provided for in the Constitution, that lies the foundation of banking secrecy. What is sought to be safeguarded, in other words, is not merely the information being held by the financial institution but information which disclosure could cause harm to intimacy and privacy. Therefore it does not stand to reason that just because said information is divulged to the Fiscal Authority it then becomes freely accessible by any third party, including foreign country fiscal authorities. For this reason, thus, such exchange of information would only be permissible if the Banking Secrecy Law was amended.

Anticipating said legislative change, the OECD foresaw the execution between the fiscal authorities of cooperating counties of an ancillary instrument, the Competent Authority Agreement. This Agreement specifies the details of the obligation to exchange information.

Accompanying the Competent Authority Agreement as an annex, the Common Reporting Standard calls on financial institutions of each country to audit pre-existing and future accounts so as to determine the residence of the account holder. Also to be detected and reported is the end "controlling person" in the case of accounts held by a non-financial institution entity holding passive investments (Passive NFE), a concept that includes companies established in low tax countries, trusts and foundations. Such information should be reported by financial institutions to the authorities in their countries for transfer to the country of residence of the account holder or Passive NFE controller.

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The information to be exchanged will cover deposit accounts, custodial accounts and insurance policies that have the potential for financial return, as well as other similar types of income. Individual accounts already existing on the date of adoption of the rules will be subject to a simplified review process for detection of the reported residence address, should the account balance not exceed US$ 1,000,000.00. Individual accounts exceeding this amount are subject to electronic records search and also paper search should the electronic search not reveal sufficient information, as well as confirmation of the information by a client relations manager. Company accounts, by way of comparison, are subject to review only when their balance exceeds US$ 250,000.00.

The ownership analysis of accounts under the OECD model is much more rigorous than that required under FACTA and IGA. In the latter, accounts held in the United States by companies or custodians domiciled outside Brazil are not communicated to the Brazilian authorities even though the end controlling person is a Brazilian resident. Under the broader reaching scope of the OECD, these shields are disregarded.

Important steps have yet to be made before the OECD rules can take effect in Brazil: ratification by the National Congress and publication in Brazil of the Convention, signed by the country in 2011; revision of the Banking Secrecy Law permitting the relay of banking information by the Brazilian tax authorities to foreign authorities; and the execution of the Competent Authority Agreement, including its accompanying document, the Common Reporting Standard.

These are labor-intensive steps, including from a political point of view, but which Brazil has committed to take quickly via its endorsement of The Declaration on Automatic Exchange of Information in Tax Matters adopted at the OECD's annual Ministerial Council Meeting in Paris on May 6, 2014. Ratification of the Convention is being treated as a matter of urgency in the National Congress and, as announced by the press, the government's forecast is that the new detection system should begin to operate as from 2018.

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