

Viktoria Wöhrer

Data Protection and  
Taxpayers' Rights:  
Challenges Created by  
Automatic Exchange  
of Information

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European and International  
Tax Law and Policy Series



# Data Protection and Taxpayers' Rights: Challenges Created by Automatic Exchange of Information

## Why this book?

In the last decade, there have been major developments in the areas of the exchange of tax information and data protection. Technological developments have facilitated the processing of personal data and led to more efficient tax administration and tax enforcement, as well as a substantial increase in the volume of personal data processing. This book provides a comprehensive overview of the main developments, as well as the structure and content of the various instruments for exchange of information. In particular, the exchange of information under double taxation treaties, TIEAs, the CoE/OECD Convention on Mutual Administrative Assistance in Tax Matters and EU directives is addressed. The scope and procedure of recently adopted automatic exchange of financial account information, tax rulings and CbC reporting are laid down in a detailed manner.

In the area of data protection, the General Data Protection Regulation was adopted in 2016 and entered into force on 25 May 2018. It replaces the Data Protection Directive and further harmonizes data protection in the European Union. What is more, the ECJ has stressed the importance of data protection in some high-profile cases. This book examines the most important existing data protection guarantees in the European Union. The analyses in this book of article 8 of the ECHR, article 8 of the CFR, the DPD and the GDPR focus on the level of data protection and the specific guarantees recognized by the European Court of Human Rights and the Court of Justice of the European Union, in particular those aspects that could be critical when it comes to the exchange of information in tax matters.

This book analyses whether the scope of exchange of information is in line with the data protection requirements in the European Union and how exchange of information provisions have to be designed in order to be compliant with EU data protection guarantees.

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## Preface

In the last decade, there have been major developments in the areas of exchange of tax information and data protection. Technological developments have facilitated the processing of personal data and have led to more efficient tax administration and tax enforcement as well as a substantial increase of the volume of personal data processing. In the area of exchange of information, automatic exchange of financial account information, tax rulings, country-by-country reports and reportable cross-border arrangements have been and are being introduced in the European Union and on a global level. In addition, public country-by-country reporting is currently being discussed.

In the area of data protection, the General Data Protection Regulation was adopted on 27 April 2016 after four years of negotiations and entered into force on 25 May 2018. It replaces the Data Protection Directive and provides for further harmonization of data protection in the European Union. What is more, the ECJ has stressed the importance of data protection in some high-profile cases. In *Digital Rights Ireland* (Joined Cases C-293/12 and C-594/12), the ECJ declared the Data Retention Directive invalid and, in *Schrems* (Case C-362/14), the ECJ held that data processing on the basis of the Safe Harbour Agreement that the European Union had concluded with the United States was not in line with EU data protection safeguards. We can thus observe an expansion of both data protection and exchange of information. These two fields of law, however, are not always easy to align with each other.

This book provides a comprehensive analysis of the global developments of exchange of information instruments, the developments of data protection provisions in the European Union, and their interplay. In this context, it aims at answering two overriding questions. First, it is examined whether the scope of information that has to be automatically collected and exchanged due to recently introduced exchange of information provisions is compatible with data protection in the European Union. Second, the procedure for gathering the necessary data for exchange of information and forwarding it to tax authorities of other jurisdictions is examined. It is analysed how exchange of information provisions have to be designed in order to be compliant with EU data protection guarantees.

The doctoral study that led to this book was written during my time as a research and teaching associate at the Christian Doppler Laboratory for “Transparency in International Taxation” established at the Institute

for Austrian and International Tax Law in Vienna at the University of Economics and Business Administration. I would especially like to thank the supervisor of my thesis, Univ.-Prof. Dr DDr. h. c. Michael Lang for his support throughout the whole project. My sincere gratitude also goes to Univ.-Prof. Dr Alexander Rust for accepting the role as my second supervisor and for sharing his knowledge with me. Special thanks moreover to Univ.-Prof. MMag. Dr Josef Schuch and Univ.-Prof. Dr Claus Staringer for kindly agreeing to be members of my doctoral committee. In addition, I would also like to take the opportunity to thank all of my colleagues at the Institute who assisted me during the writing of my thesis in the course of numerous discussions that took place on various occasions. In particular, I would like to thank Dr Karoline Spies for reading large parts of my manuscript and providing me with invaluable comments and suggestions for improvement.

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Viktoria Wöhrer  
Vienna, February 2018

## Introduction

Exchange of information has always been an important issue to be considered in the area of international taxation as it is a necessary tool for tax administrations to get information on income that their taxpayers earn abroad. In the last years, however, there has been a tremendous development of exchange of information provisions. When reading tax news, one has the impression that transparency in international taxation has been steadily expanding – more and more information has to be disclosed and is exchanged across borders. Almost every week, new agreements dealing with exchange of information are signed. The current focus on transparency also becomes apparent when looking at the BEPS Action Plan; one of the three key pillars of the Action Plan is “improving transparency as well as certainty”.<sup>1</sup> In addition, the G20 also supports an increasing scope of tax transparency and exchange of information and has stressed that they will continue to support international tax cooperation and, in particular, an effective and widespread implementation of the internationally agreed standards on tax transparency.<sup>2</sup> Within the European Union, the European Commission has highlighted tax transparency by listing it as one of the five key actions for a fair and efficient corporate tax system in the European Union.<sup>3</sup> The increasing exchange of information has also been driven forward by technical developments – the storage density and power of microchips has been doubling every 1.5 to 2 years for decades<sup>4</sup> – which has made it possible to store a huge amount of information. Furthermore, technological developments have made it easier to produce, edit, disseminate, and store data and have thereby enabled an increasing scope of data processing.<sup>5</sup>

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1. See OECD/G20, *Addressing the Tax Challenges of the Digital Economy – Action 1: Final Report* p. 3 (OECD 2015), International Organizations’ Documentation IBFD [hereinafter *Action 1 Final Report* (2015)].

2. See e.g. G20, *Leaders’ Communique Hangzhou Summit*, 4-5 Sept. 2016, para. 19 [hereinafter *G20 Leaders’ Communique Hangzhou Summit 2016*]; G20, *Leaders’ Declaration: Shaping an interconnected world*, G20 Germany 2017, Hamburg, 7-8 July 2017, p. 7 f [hereinafter *G20 Leaders’ Declaration Hamburg 2017*].

3. See European Commission, *A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action*, COM(2015) 302 final (17 June 2015), EU Law IBFD.

4. See G.E. Moore, *Cramming more components onto integrated circuits*, 86 Proceedings of the IEEE 1, p. 82 (1998); J. Markoff, *Smaller, Faster, Cheaper, Over: The Future of Computer Chips*, New York Times (26 Sept. 2015).

5. See O. Lynskey, *The Foundations of EU Data Protection Law* p. 2 (Oxford 2015).

Even though exchange of information for tax purposes is generally considered as being a necessary tool to combat tax avoidance and tax evasion, the developments in the area of exchange of information have also been criticized for not having sufficiently taken into account the protection of personal tax data.<sup>6</sup> With regard to automatic exchange of financial account information, Philip Baker stated, “[t]his overriding requirement of compliance with data protection law seems to have been very largely overlooked in constructing the CRS/DAC system” and that it is “almost inevitable that challenges to the CRS/DAC system will be mounted based upon a failure to protect privacy and data protection rights”.<sup>7</sup> This statement represents the criticism on the scope of exchange of information and shall be taken as a starting point to examine whether the new developments in the area of exchange of information take sufficient account of taxpayers’ rights. In particular, the focus of this book should be the question of whether the scope of exchange of information is still in line with the data protection provisions in Europe.

In order to analyse whether the scope of exchange of information complies with data protection safeguards, it is necessary to first look at the exact scope of exchange of information. In the last decade, information that is relevant for tax assessment has not only been exchanged on request but also spontaneous and automatic exchange of information has become more popular. However, is automatic exchange of information really a new thing or has it just received more media attention recently because of the UBS scandal and the Panama Papers? Chapters 3 and 4 are dedicated for walking through the development of exchange of information provisions in the numerous instruments for exchange of information and have the aim of giving a comprehensive overview over the scope of information that has to be provided to the tax administrations of other countries. Thereby, especially the question of whether legal possibilities for exchange of information have also substantially been expanded or, rather, whether it is an increasing use of existing legal frameworks and media attention that makes exchange of information such a popular topic today should be answered. Besides exchange of information, there are also additional forms of administrative cooperation available such as, for example, simultaneous controls or the presence of foreign officials. This contribution, however, should be limited to assessing the exchange of information provisions. Similarly, the possibilities for cross-border exchange of information for tax purposes under anti-money laundering legislation would also go beyond the scope of this book and

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6. See M. Scharper, *Data Protection Rights and Tax Information Exchange in the European Union: An Uneasy Combination*, 23 MJ 3, p. 530 (2016).

7. P. Baker, *CRS/DAC, FATCA and the GDPR*, BTR 3, p. 252 (2016).

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will not be addressed in detail. Whereas exchange of tax information usually takes place among tax administrations of different countries, within the European Union, it has even been proposed to require certain companies to make specific tax relevant information available to the public.

After establishing the exact scope of exchange of information, the next chapter will deal with the question of how to strike a balance between the necessity to exchange information for assessing taxes and taxpayers' rights. On the one hand, all exchange of information measures have the legitimate aim of ensuring an effective taxation of income. The expanding scope of exchange of information opens additional doors for tax administrations to control whether the taxpayers file tax returns with the right amount of income. At first sight, it seems just and fair that there is sufficient control to make sure that everyone pays the right amount of taxes. The UBS scandal and the Panama Papers have been catching the attention of the media and the public and have led to a call for more transparency.

Even though it is difficult at first glance to oppose this demand, widening the scope and nature of information exchange might also have the potential to infringe taxpayers' rights. Taxpayers are obliged to disclose the circumstances of their private and business lives that are relevant to their tax liability to the tax authorities. Information that is relevant for computing the amount of taxes that must be paid is information that most taxpayers would not want to be publicly known or accessed by unjustified persons.<sup>8</sup> Therefore, it is necessary to control and analyse the limits of the amount of information that tax authorities are allowed to access and store; as with information becoming more easily accessible, the risk that this information is misused is also increasing.<sup>9</sup> It is necessary to strike a balance between increasing transparency for controlling taxpayers and ensuring that personal tax related data is not misused by controlling data storage and access to this data.

In the last decade, one could have the impression that the focus has been on the efficiency of the rules for exchange of information and their global acceptance by countries. The legal positions of the persons involved, on

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8. Of course, this is dependent on the political culture in a certain country. Whereas in most countries tax information is subject to official secrecy, in some countries – for example, in Finland – tax data is publicly available to a certain extent.

9. ECJ, Opinion of Advocate General Saugmandsgaard Øe, 19 July 2016, Joined Cases C-203/15 and C-698/15, *Tele2 Sverige AB v. Post- och telestyrelsen and Secretary of State for the Home Department v. Tom Watson and Others (Tele2 Sverige AB)*, ECLI:EU:C:2016:572, paras. 1 ff.

the contrary, have remained a lesser concern. The fifth chapter will present possible problems that taxpayers may face in the process of exchange of information. It shall be analysed whether there are valid grounds to also take into account the position of the taxpayer when tax information is exchanged between tax authorities of different countries and whether there are already sufficient safeguards protecting taxpayers' rights in exchange of information procedures.

If the conclusion can be drawn in chapter 5 that there are valid grounds to give attention to taxpayers' rights in the process of exchanging information for tax purposes, the next chapters shall analyse the data protection provisions in Europe, analyse their scope, and deal with the question of whether the taxpayer could rely on data protection in order to oppose bulk exchange of information if too much data is exchanged or to ask for procedural rights. So far, data protection rights have not been given much attention by legislators when expanding the provisions for exchange of information.<sup>10</sup> Chapter 6 will give an overview of data protection instruments and their relevance for the area of exchange of information. The following chapter 7 will comprehensively analyse to what extent these data protection rules may influence the interpretation and limit the scope of exchange of information between tax authorities, and whether the exchange of information instruments are compatible with data protection safeguards.

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10. Scharper, *supra* n. 6, at p. 515.

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## Chapter 2

### Why Do We Need Information Exchange?

Exchange of information for tax purposes is necessary “to secure the effective suppression of tax evasion”.<sup>11</sup> Information exchange gives the resident state the possibility to know the amount of income of its taxpayers, which is the first step to enforcing its tax law. Most countries have two different kinds of personal income tax liability differentiating between residents and non-residents. Due to the worldwide-income principle, the income of private persons is, in general, taxable in the state of residence of the individual regardless of whether it is sourced in the country of residence or abroad.<sup>12</sup> This is referred to as “personal jurisdiction”. In contrast, non-residents have no physical presence, i.e. neither a domicile nor their habitual abode, in the country. Thus, only income that is territorially connected to the country, i.e. income sourced in the country, is subject to taxation in that country. This is referred to as “territorial jurisdiction”.

If part of the worldwide income of residents in a country is also taxed abroad, they can receive a tax credit or have this income exempt on the basis of double tax treaties or unilateral provisions that allow for a relief from double taxation. However, to include all of the worldwide income in the tax base of the home country, the home country needs information about this income. To properly enforce worldwide taxation, the home country needs to obtain information on assets or income located abroad. Of course, when the income is not subject to third-party reporting, the taxpayer usually has an obligation to self-assess his worldwide income and report it on his tax return.<sup>13</sup> This requires the taxpayer to report its tax liabilities “on the basis of legal positions that [he] reasonably and in good faith believes to be correct”.<sup>14</sup> However, if the taxpayer evades taxes by not stating his foreign income, it can be difficult for the tax authorities to know whether the taxpayer receives income from sources in other countries without

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11. League of Nations, *Double Taxation and Tax Evasion Document - Report and Resolutions submitted by the Technical Experts to the Financial Committee - F.212*, p. 26 (Geneva, Feb. 1925) [hereinafter *DTTE Document F. 212* (1925)].

12. See K. Vogel & A. Rust, *Introduction*, in *Klaus Vogel on Double Taxation Conventions* para. 2 (E. Reimer & A. Rust eds., 4th ed., Kluwer 2015). The United States for example taxes not only the worldwide income of its residents but also of its citizens.

13. See e.g. P. Baker & P. Pistone, *General Report*, in *The Practical Protection of Taxpayers' Fundamental Rights* p. 27 (IFA Cahiers vol. 100B, 2015), Online Books IBFD.

14. M. Doran, *Tax Penalties and Tax Compliance*, 46 Harv. J. on Legis., p. 111 (2009).

information exchange. Opportunities for tax evasion are increased when low-tax jurisdictions do not share information with foreign tax authorities. Exchange of information and cooperation between tax authorities of different jurisdictions should provide the tools to identify taxpayers that are not compliant and are committing a criminal offence by not disclosing all of their worldwide income.<sup>15</sup>

Tax evasion in the European Union has been estimated to cost the EU Member States approximately EUR 860 billion per year.<sup>16</sup> On a global level, Zucman has estimated that around 6% of individuals' net financial wealth – amounting to about USD 4.5 trillion – is unrecorded and held in tax havens.<sup>17</sup> In order to fight offshore tax evasion, it is essential for home jurisdictions to know about income generated outside of the resident state. Investments made, held and managed through financial institutions abroad could easily remain untaxed if no information exchange or alternative instrument to ensure taxation is in place.<sup>18</sup> Especially in cases where two countries agree on adopting a tax treaty that provides for the exemption method, it is essential that those two countries exchange information with each other. Otherwise, the tax treaty without exchange of information may lead to increased double non-taxation. It could be the case that the source state is prevented from taxing and, at the same time, the residence state does not tax the particular income because it does not have enough information about the existence and amount of income generated by the taxpayer.<sup>19</sup>

Furthermore, the integration and globalization of economies as well as an increased mobility of taxpayers and a higher number of cross-border

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15. See e.g. European Commission, Communication from the Commission to the European Parliament and the Council, An Action Plan to strengthen the fight against tax fraud and tax evasion, COM(2012) 722 final (6 Dec. 2012), EU Law IBFD [hereinafter COM(2012) 722 final]; European Commission, Communication from the Commission to the European Parliament and the Council on tax transparency to fight tax evasion and avoidance, COM(2015) 136 final (18 Mar. 2015), EU Law IBFD [hereinafter COM(2015) 136 final]; European Commission, Communication on further measures to enhance transparency and the fight against tax evasion and avoidance, COM(2016) 451 final (5 July 2016), EU Law IBFD [hereinafter COM(2016) 451 final]; A.J. Cockfield, *Big Data and Tax Haven Secrecy*, 18 Florida Tax Review 8, p. 488 (2016); S. Kuhn, *Counting the costs of transparency compliance*, 83 ASA 11/12, p. 795 (2014/2015).

16. See R. Murphy, *Closing the European Gap*, A Report for Group of the Progressive Alliance of Socialists & Democrats in the European Parliament, Tax Research LLP, p. 2 (2012).

17. G. Zucman, *The Missing Wealth of Nations: Are Europe and the U.S. net Debtors or net Creditors*, 128 The Quarterly Journal of Economics 3, p. 1342 (2013).

18. OECD, *Standard for Automatic Exchange of Financial Account Information in Tax Matters* p. 9 (OECD 2014) [hereinafter CRS].

19. League of Nations, *DTTE Document F. 212* (1925), *supra* n. 11, at p. 23 [4083] f.

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transactions are factors which have increased the relevance of exchange of information.<sup>20</sup> In the last decades, the world became more international – it is easier for taxpayers to choose where they want to be active and earn their profits. Even though there are still some obstacles, e.g. language issues, individuals can choose rather freely where they want to work, shop, invest their financial capital, or allocate the production activities of the enterprises they control. At the time when tax systems were developed, the situation was different. Trade among countries was very much controlled and limited by high tariffs and physical restrictions to the movement of goods. Capital movements were forbidden or greatly controlled. Most enterprises and individuals operated and earned their income largely within the borders of one country.<sup>21</sup> Therefore, in the past, the information that was needed to assess taxes correctly could mostly be obtained within the country of residence, and co-operation with tax authorities of other countries was necessary only in exceptional situations. In today’s integrated economy where it is rather easy for everybody to earn income abroad, exchange of information is necessary to provide tax authorities in cross-border situations with possibilities to investigate whether a taxpayer has been complying with tax obligations that are equivalent to those available in a purely domestic situation. Pistone, therefore, has argued that “a national benchmark should be the starting point for a mechanism that secures the effectiveness of tax auditing”.<sup>22</sup>

With rising cross-border activities, exchange of information between tax authorities is becoming more and more important. Especially income from mobile assets and financial instruments can easily and without high costs be transferred to other states. Consequently, one area where tax evasion has been widespread is taxation of capital income. Without cross-border exchange of information, it is easy for a single taxpayer to avoid taxes on interest income by just opening a bank account in a foreign country (which has no information exchange with the home country). High-net-worth clients have attempted to escape the tax liability in their residence states by creating vertiginous asset holding structures involving numerous jurisdictions and foreign tax systems that provide for a low or no tax burden

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20. Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, OJ 2011, L 64/1 (2011); see also C. Sacchetto, *Exchange of Information, Tax Crimes and Legal Protection*, in *Financial Crisis and Single Market* p. 55 (L. Salvini & G. Melis eds., Discendo Agitur 2012); P. Gyöngyi Végh, *Towards a Better Exchange of Information*, 42 Eur. Taxn. 9, p. 394 (2002), Journals IBFD.

21. See e.g. V. Tanzi, *Globalization, Tax Competition and the Future of Tax Systems*, IMF Working Paper No. 96/141, p. 4 et seq. (1996).

22. P. Pistone, *Exchange of Information and Rubik Agreements: The Perspective of an EU Academic*, 67 Bull. Intl. Taxn. 4/5, p. 217 (2013), Journals IBFD.

on mobile income and capital. It became feasible to estimate the scale of evaded taxes by offshore accounts when whistle-blower Bradley Birkenfeld informed the US Internal Revenue Service (IRS) about the tax cheats of UBS clients.<sup>23</sup> The pressures on governments and international organizations to combat this phenomenon grew exponentially. The magnitude of lost tax revenues has encouraged governments to intensify their work against tax evasion and tax avoidance.

The decreasing trust in the institutional framework and fairness of the tax systems also played an important role in encouraging international efforts to tackle dishonest behaviour undertaken by both financial institutions and taxpayers. Limited exchange of information opens up opportunities for tax avoidance and tax evasion by some taxpayers which is not only negative for a country's budget but also leads to an unfair distribution of the burden of public expenditure. In order to make up for the tax revenue that is lacking due to tax evasion, the burden for those taxpayers complying with the laws must be higher.<sup>24</sup> In such a situation, there are some individuals and companies paying a very low amount of taxes and others that are contributing more. This not only seems unfair from a morale standpoint but also provides tax evaders with a comparative advantage in a competitive market. For the creation of a level playing field between taxpayers and companies active in only one country and those which are acting internationally across borders, it is necessary to have an effective exchange of information system in place.

Exchange of information, therefore, is essential for tax matters in a globalized world. The increasing digitalization has led to more and more information (big data) being available. In order to ensure tax compliance, new legislation has been adopted to provide tax administrations with access to more data about the residents and citizens of their country. This data can not only be used for an audit of a specific taxpayer. Tax administrations are increasingly implementing data analytics which allows “developing sophisticated risk profiles, analysing trends, flagging potential audit issues and identifying higher-risk cases for deeper investigation and cutting off avenues for fraud before they even occur”.<sup>25</sup>

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23. See B. Birkenfeld, *Inside the Cartel: Bradley Birkenfeld*, 27 *World Policy Journal* 1, p. 10 (2010).

24. League of Nations, *Double Taxation and Tax Evasion: Report - Document C. 216. M. 85*, p. 23 (London, 12 Apr. 1927) [hereinafter *DTTE Report C. 216 M. 85* (1927)].

25. C. Edery, *Big Data Serving Tax Compliance*, in *Data-Driven Tax Administration* p. 49 (IOTA Intra-European Organisation of Tax Administrations 2016).

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Interestingly, the United Nations Committee on Economic, Social and Cultural Rights has recently issued a comment on state obligations under the International Covenant on Economic, Social and Cultural Rights (ICESCR)<sup>26</sup> where it is argued that the parties – 165 jurisdictions, inter alia all European jurisdictions – under that multinational treaty are required to take necessary steps against tax avoidance and tax evasion. The ICESCR protects, inter alia, the right to health, the right to education, and the right to an adequate standard of living. In order to ensure an effective protection of these rights, the parties have “to take necessary steps, to the maximum of their available resources, to facilitate and promote the enjoyment of Covenant rights, and, in certain cases, to directly provide goods and services essential to such enjoyment”.<sup>27</sup> The participating jurisdictions are required to enforce progressive tax schemes in order to mobilize the resources necessary for fulfilling their obligation to ensure the protection of economic, social and cultural rights. However, the participating jurisdictions do not only have to guarantee these rights within their own territory. The parties to the Covenant have to work towards achieving “the full realization of the rights recognized” also outside their national territory.

As “excessive protection to bank secrecy and permissive rules on corporate tax may affect the ability of States where economic activities are taking place to meet their obligation to mobilize the maximum available resources for the implementation of economic, social and cultural rights”, the UN Committee on Economic, Social and Cultural Rights argues that “States should combat transfer pricing practices and deepen international tax cooperation, and explore the possibility to tax multinational groups of companies as single firms”.<sup>28</sup> Taking these considerations into account, it can be argued that a broad scope of exchange of information, also including in respect of developing countries, is not only desirable from a tax policy perspective but is also required under a multilateral treaty.

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26. United Nations, *International Covenant on Economic, Social and Cultural Rights (ICESCR)* (16 Dec. 1966).

27. United Nations, Committee on Economic, Social and Cultural Rights, *General Comment No. 24 on State Obligations under the International Covenant on Economic, Social and Cultural Rights in the Context of Business Activities*, E/C.12/GC/24 (23 June 2017), para. 23.

28. *Id.*, at para. 24.

## Contact

IBFD Head Office  
Rietlandpark 301  
1019 DW Amsterdam  
P.O. Box 20237  
1000 HE Amsterdam  
The Netherlands

**Tel.:** +31-20-554 0100 (GMT+1)

**Email:** [info@ibfd.org](mailto:info@ibfd.org)

**Web:** [www.ibfd.org](http://www.ibfd.org)



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