8 March 2018
EBF_031284

EBF COMMENTS ON THE PROPOSED DIRECTIVE ON MANDATORY DISCLOSURES (DAC6)

LEGAL UNCERTAINTY – NEED FOR ACTUAL KNOWLEDGE TEST

The model rules require an Intermediary (or taxpayer who benefits from the arrangement) to disclose certain relevant information to its tax administration. The definition of "Intermediary" also covers Financial Institutions that are necessarily involved in all financial transactions. It would be helpful if the definition is amended in such a way that it is clear that a bank in the normal course of its banking business does not fall under the definition of "Intermediary". Only in situations where a bank itself would "design, market, organize or make available for implementation a reportable cross-border arrangement" it should fall under the definition of an "intermediary".

In all cases greater clarity should be provided that a bank providing of routine banking services without greater involvement or knowledge of the planning, will not cause the bank to be considered a Service Provider.

Because subjective tests cannot efficiently be operationalized by financial institutions, the EBF recommends, at least for Reporting Financial Institutions that have implemented CRS reporting and done the required CRS due diligence: An actual knowledge standard (akin to knowledge of relationship manager); or a dominant purpose test.

In the case of Service Providers, it would be logical if this actual knowledge standard is only applicable in situations where there is "relationship manager" in CRS. If there is no relationship manager, the Reporting Financial Institution is deemed not to set up the scheme (i.e. design, marketing, implementing or managing).

DIFFICULTIES TO APPLY THE SCHEME IN PRACTICE

A major concern is that the contemplated scheme would be very challenging to implement in practice if financial institutions have to carry out granular investigations, potentially with retroactive effects.

The use of hallmarks is a good approach to identify reportable arrangements. However, they are currently very widely defined. They would need to be better targeted in order to be more objectively and consistently applied. That should be the case for example with the following definitions: "Arrangement for which it is reasonable to conclude that it is designed to, marketed as [or has the effect of] circumventing CRS Legislation…" / "structure for which it is reasonable to conclude that it is designed to have, marketed as having [or has] the effect of allowing a natural person to be the Beneficial Owner of a

Passive Offshore Vehicle while obscuring such person's Beneficial Ownership or creating the appearance that such person is not Beneficial Owner".

Loose or wide hallmarks will encourage protective reporting (e.g. as defence against penalties) increasing the volume unnecessarily and leading to duplicative. This will take time and effort for both intermediaries and tax administrations to process and in this later respect will delay action being taken by Governments.

More can be done to prevent duplicative reporting, which is in no one's interest. If a report has been made in one country, it should be explicitly clear that it is not also required in any others. For duplicative reporting to be diminished when applying DAC6, the text of the 5th Compromise draft of DAC6 would need to be clarified (Article 8aaa, 3)

- To distinguish more clearly between intermediaries that respectively designed, marketed, agreed or managed the implementation of the arrangement, if this is to determine which intermediary has the primary obligation to report; and

- To define, and ensure the effective existence of, "proof" that information has already been filed by another intermediary (e.g. by obliging Member States' competent authorities to issue a DAC6-defined acknowledgement of receipt of the required information with respect to the arrangement, which could serve as "proof" for any other relevant party that disclosure has occurred, albeit without constituting an acceptance or approval of the arrangement itself by the competent authority).

Too much discretion is left to the Commission, which is entitled to amend the hallmarks by way of delegated acts. New and/or amended hallmarks should only become effective after a sufficiently long consultation period and new rules may only enter into force after a sufficiently long adjustment period.

As to the notion of tax residence is to be inferred by Financial Institutions for CRS purposes by applying the CRS due diligence procedures, it is necessary under certain circumstances to communicate the same information to different countries under the CRS. The proposed mandatory disclosure rules might well exacerbate this issue.

We understand that the clawback period until 15 July 2014 is retrospective. Retrospective application of legislation is impossible for intermediaries. In practice, the retrospective identification of behaviours or arrangements cannot be achieved.

Note that more clarity will also be required with respect to reporting deadlines. In the DAC6 5th Compromise text, for example, what exactly is to be understood by "the day [...] the reportable cross-border arrangement is made available to that relevant taxpayer", "the day the reportable cross-border arrangement is ready for implementation by the relevant taxpayer" and "the day when the first step in its implementation has been made with respect to the relevant taxpayer"?

A PREMATURE INITIATIVE

In the EBF's view, if the adoption of an EU mandatory disclosure scheme proved to be necessary, then the details of such scheme should be elaborated based on an in-depth analysis of all the relevant data, in close consultation with industry experts who could help authorities better understand business transactions and structures, identify actual avoidance issues and formulate specific and targeted measures where necessary.

As regards to the specific MDR elaborated by the OECD regarding CRS avoidance arrangements, it should be borne in mind that the CRS implementation is still currently in its initial phase with only early adopters having exchanged information for the first time in September 2017, while the other participating jurisdictions (more than 50) have not yet exchanged any information. Comprehensive reviews of all financial accounts have been and are still being carried out by financial institutions in 2016, 2017 and 2018 (non-early adopters) in order to determine the tax residency of their clients and to eventually identify reportable accounts. A fully-fledged reporting including entities and their controlling persons will only take place at the end of the two years review phase of preexisting accounts. At this early stage of implementation, the proposed OECD MDR scheme therefore appears to be premature since any allegations of loopholes in the CRS framework can only be the result of preliminary observations. A holistic assessment of the 2017 CRS data should take place prior to the adoption of such MDR scheme.

THE KEY CHALLENGE IS A GLOBAL LEVEL PLAYING FIELD

In addition, the network of CRS exchange relationships is still in the process of being expanded. Under such circumstances, the Global Forum has not yet launched its peer review process. In our opinion, the key factors for achieving the CRS's goals are, on one hand, that the global standard is implemented on a broad scale and, on the other hand, that the CRS rules are consistently implemented (i.e. global level playing field). We understand that Governments want to address the CRS avoidance via non-CRS jurisdictions, but we find it paradoxical that to close the gaps in global implementation, pressure and additional obligations will be put on those stakeholders (ie financial institutions) who are CRS-compliant. Hence weakening the incentives for a global implementation of the CRS.

ADDITIONAL LAYER OF REPORTING

It should be borne in mind that the practical implementation of the CRS has been one of the biggest and most complex tax projects to date, both financially and organizationally, for tax administrations and financial institutions alike. IT systems had to be substantially expanded, extensive data collection processes were implemented, reporting systems were set up, compliance processes had to be redefined and employees comprehensively trained. With its very broad scope, the CRS has resulted in the setting-up of a comprehensive and unprecedented system for the automatic exchange of financial account information. We are concerned that the MDR might require additional due diligence at the level of financial institutions, irrespective of whether or not they are involved in reportable arrangements.

One of our fundamental concerns with MDR and DAC6 is that potential loopholes and inefficiencies of the CRS will not be treated in the CRS itself but in another framework, adding a new layer of reporting, with a different scope of application and using a different language, resulting in overreporting and multiple reporting. It may sound tempting to receive too much information, but the reality is that it suppresses Governments' ability to act.

We have difficulties to understand that the use of accounts which are specifically excluded by the CRS from the scope of reporting will be caught under the MDR and DAC6. The CRS has defined certain accounts as excluded from the definition of "Financial Accounts" (see Sec. VIII.C.17 CRS "Excluded Accounts"), which effectively makes them "non-reportable accounts". Excluding these accounts from the definition of "Financial Accounts" was agreed upon by the OECD and its member states. It seems contradictory to consider an arrangement to transfer funds into such an "Excluded Account" as circumventing the CRS legislation. Even more so, if the advice from a bank to invest in e.g. a retirement or pension account (as defined in Sec. VIII.C.17.a CRS), which would require the transfer of funds from a CRS-reportable depository account into a non-reportable "Excluded Account", would qualify as a CRS Avoidance Arrangement.

We are also concerned that the meaning of "Passive Offshore Vehicle" under the MDR is not aligned with the CRS-definition of "Passive NFE". As set out in Sec. 1.2, a "Passive Offshore Vehicle" does not carry on a substantive economic activity that is supported by staff, equipment, assets and premises. It is unlikely, that every entity that qualifies for an Active NFE-Status (as described in the CRS) is going to meet these requirements (e.g. a NFE liquidating its assets might not carry on a substantive economic activity that is supported by staff or equipment). The CRS stipulates that only Controlling Persons of a Passive NFE (as defined in the CRS) qualify as Reportable Person; thus, Controlling Persons of an Active NFE are not subject to CRS-reporting. Regarding a potential risk of avoiding CRS-Reporting, the disclosure of an Active NFE (as defined in the CRS) as an Offshore Structure under the MDR would not mitigate such risk, since CRS-reporting is not required (and technically not possible) with respect to Controlling Persons of an Active NFE (as defined in the CRS). Therefore, an entity that qualifies for an Active NFE-Status under the CRS should not be considered as an Offshore Structure, irrespective of its ownership structure.

EBF RECOMMENDATIONS

Many stakeholders have commented the OECD MDR and share the EBF concerns (see https://www.oecd.org/tax/beps/public-comments-mandatory-disclosure-rules-for-CRS-avoidance-arrangements-offshore-structures.pdf).

The EBF therefore calls on the Council to reconsider the scope of application of the proposed Directive and to clarify that providing routine banking services (e.g. maintaining a financial account for a customer) without any additional involvement in structuring, does not make the bank an "intermediary" under DAC6.