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European Union alert

ECOFIN reaches agreement on tax intermediaries directive / revises noncooperative jurisdiction list

On 13 March 2018, EU finance ministers reached political agreement on the tax intermediaries directive proposed by the European Commission on 21 June 2017 that would require mandatory reporting by tax intermediaries and the automatic exchange of information by the tax authorities of member states for certain cross-border arrangements in relation to individuals, companies and other entities.

The directive, which takes the form of an amendment to the Directive for Administrative Cooperation (DAC), is part of the efforts to tackle tax abuse and ensure fairer taxation in the EU, and broadly reflects the elements of action 12 of the BEPS project on the mandatory disclosure of potentially aggressive tax planning arrangements.

The directive will provide EU tax authorities with information about such schemes by requiring intermediaries, such as tax advisors, accountants, banks and lawyers, who design and promote tax planning schemes for their clients, to report to the tax authorities in the country in which they are resident any cross-border tax planning arrangement they design or promote that contains specific broadly defined criteria ("hallmarks"). That EU member state then will share the information with all other member states on a quarterly basis. Penalties will be imposed on intermediaries that do not comply with the transparency measures.

If the taxpayer develops the arrangement in-house, or is advised by a non-EU adviser, or if legal professional privilege applies, the taxpayer must notify the tax authorities directly.

The directive will be formally adopted during the next EU council meeting on 25 May 2018, and once adopted generally will apply as from 1 July 2020, with limited retroactive effect.

In addition to reaching agreement on the mandatory disclosure scheme, the council also revised the EU’s list of noncooperative jurisdictions to take into account recent commitments made by listed jurisdictions and an assessment of jurisdictions for which no listing decision had yet been taken. In this respect, Bahrain, the Marshall Islands and Saint Lucia have been removed from the list. However, the Bahamas, Saint Kitts & Nevis and the US Virgin Islands have been added to the noncooperative jurisdiction list because they failed to make commitments at a high political level in response to the EU's concerns. Anguilla, Antigua and Barbuda, the British Virgin Islands and Dominica have been added to the “gray list.”

Key features of tax intermediaries’ directive

Reportable cross-border arrangements

A “cross-border arrangement" under the directive is an arrangement that involves more than one EU member state or a member state and a third country where at least one of the following conditions is fulfilled:

- Not all participants are resident for tax purposes in the same jurisdiction;
- One or more of the participants is simultaneously resident for tax purposes in more than one jurisdiction;
- One or more of the participants carries on a business in another jurisdiction through a permanent establishment (PE) in that jurisdiction and the arrangement forms part or all of the business of that PE;
- One or more of the participants carries on an activity in another jurisdiction without being resident for tax purposes or creating a PE in that jurisdiction; and
- The arrangement has a possible impact on the automatic exchange of information or the identification of beneficial ownership.

A "reportable cross-border arrangement" is one that contains at least one of the designated “hallmarks,” i.e. criteria that indicate a potential risk for tax avoidance (see below).

The directive covers arrangements involving all types of direct tax, including corporate, personal, capital gains and inheritance tax.

Intermediaries

The draft directive defines an “intermediary” as any person that designs, markets, organizes, makes available for implementation or manages the implementation of a reportable cross-border arrangement. Significantly, the definition will extend to a person that *knows or could be reasonably expected to know* that he/she has undertaken to provide, directly or indirectly, the designing, marketing, organizing, making available for implementation or managing of the implementation of a reportable arrangement.

To be subject to the reporting rules, an intermediary also must: (i) be resident in a member state; (ii) provide the services through a PE in a member state; (iii) be incorporated in or governed by the laws of a member state; or (iv) be registered with a professional association related to legal, taxation or consultancy services in a member state.

If there are several intermediaries involved in a reportable arrangement, each intermediary will have to report it to the relevant tax authorities, unless they can prove that the same information already has been reported.

If the intermediaries are covered by local rules relating to legal professional privilege or if no tax intermediary is involved in a covered arrangement (i.e. either the reportable arrangements were developed in-house or all intermediaries are based outside the EU), the reporting obligation will fall on the relevant taxpayer, subject to the same deadlines as apply to tax intermediaries.

Hallmarks of reportable arrangements

An arrangement will have to be reported if it features at least one of the indicators or "hallmarks" outlined in Annex IV of the draft directive. The final hallmarks are narrower than those proposed in the European Commission's original draft directive, but still are broad in scope.

Certain hallmarks would be subject to a “main benefit test,” which would be satisfied if it can be established that the main benefit or one of the main benefits a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage. The following are some of the hallmarks that would be linked to the main benefit test:

- Generic hallmarks, including the existence of confidentiality clauses, contingent fees and standardized structures that would require limited customization for implementation;
- Specific hallmarks relating to the transfer of losses or conversion of income into other categories of revenue that are taxed at a lower level or are exempt from tax (e.g. capital gains, gifts); and
- Certain hallmarks relating to cross-border transactions, such as transactions involving a jurisdiction that does not impose corporate tax or imposes corporate tax at the rate of zero or almost zero, or where a payment benefits from a full exemption from tax or from a preferential regime in the jurisdiction where the recipient is established for tax purposes. (The proposed hallmark aimed at reporting cross-border transactions with jurisdictions that impose corporate tax at a statutory rate lower than 35% of the average statutory corporate tax rate in EU was rejected, and is not included in the final draft.)

Other hallmarks not subject to the main benefit test would include:

- Deductions for the same depreciation or relief from double taxation claimed in more than one jurisdiction;
- Hallmarks relating to transactions that aim at circumventing existing obligations on exchange of information or on beneficial ownership; and
- Hallmarks concerning transfer pricing and relating to arrangements involving an intragroup cross-border transfer of functions, risks, and/or assets, if the transfer is estimated to reduce the earnings before interest and taxes of the transferor by 50% or more during the three-year period after the transfer.

Reporting and exchange of information

Tax intermediaries will have to report arrangements that fall within the scope of the directive within 30 days after the arrangement is made available for implementation / ready for implementation or the first step in the implementation has taken place (although in certain situations, the intermediary will be required to submit a report every three months). Where an intermediary (or taxpayer) is required to submit information on covered arrangements with the competent authorities of more than one member state, the information must be filed with one member state according to a specified hierarchy.

Information on the arrangement would include:

- Identification of the intermediaries and relevant taxpayers, including their names, dates and place of birth (in case of an individual), residence for tax purposes, taxpayer identification numbers and, where appropriate, persons that are associated enterprises of the relevant taxpayer;
- Details of the hallmarks that make the cross-border arrangement reportable;
- Summary of the arrangement, including a reference to the name by which it is commonly known (if any) and a general description of the relevant business activities or arrangements, without leading to the disclosure of business secrets or processes that would be contrary to public policy;
- Date the first step in implementing the arrangement was or will be made;
- Details of the member state provisions that form the basis of the arrangement;
- Value of the arrangement;
- Identification of the member state of the relevant taxpayer(s) and any other member states that are likely to be concerned by the arrangement, as well as any other person likely to be affected by the arrangement including to which member state(s) that person is linked.

Member state tax authorities will be required to exchange information automatically about the reportable cross-border arrangement within one month from the end of the quarter in which the information was filed, with the first exchanges to take place by 31 October 2020. The quarterly exchanges, made through a centralized EU database, should help to ensure that potentially aggressive tax planning arrangements are brought to the attention of the tax authorities before the schemes are implemented.

Effective date

The directive will apply as from 1 July 2020, and member states will have until 31 December 2019 to transpose it into their national laws and regulations.

It should be noted that arrangements, the first step of which is implemented between the date the directive enters into force and its effective date, would have to be reported by 31 August 2020.

Comments

The directive is expected to enter into force by early July 2018 (i.e. 20 days after publication of the directive in the official journal of the EU). Taxpayers and intermediaries should closely monitor this date to capture all potentially reportable cross-border arrangements, as well as the transposition and implementation process at the EU member state level.

Contacts

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