Automatic exchange of information and data protection rules: friends or foes?

By Carole HEIN, Director & Georges WANTZ, Managing Director, Deloitte

Since the 2008 financial crisis, two regulatory trends have notably emerged. On the one hand, transparency is being enhanced through increasing reporting requirements (tax or regulatory) and "substance-over-form" rules, notably seen in IFRS or CRR.[1], and on the other, there is a willingness to protect data of investors and customers.

In that respect, the collaboration between states in general and tax authorities in particular has been enhanced.

1 – The continual enhancement of the scope of the automatic exchange of information …

The concept of automatic exchange of information was first introduced with the EU Savings Directive,[2] which allowed stakeholders to report interest from savings in the account holders' state of residence or to apply withholding tax. This evolved from encouraging the majority of actors to choose the exchange of information option to making it mandatory.

EU Member States have continued to expand the scope of the automatic exchange of information by amending the EU directive on administrative cooperation (DAC). They automatically exchange information on employment income, pension income, directors' fees.

On 28 March 2014, Luxembourg concluded an intergovernmental agreement with the US tax authorities to apply FATCA[3], which enables the automatic exchange of information between US tax authorities and other tax authorities around the world.[4] This kind of exchange has also been extended across the globe via the CRS[5]. In 2016, the EU Savings Directive was then repealed considering the development in connection with CRS.

According to the FATCA and CRS regulations, Luxembourg reporting financial institutions, which include banks, investment funds and life insurance companies, must collect data on their account holders and certain controlling persons and identify whether they are reportable. Regarding these reportable accounts, they must then automatically and annually exchange the relevant personal data (their name, address, tax identification number, etc.) and financial information to the Luxembourg tax authorities, who subsequently transmit this information to the relevant foreign tax authorities.

During the Luxembourg Presidency of the Council of the European Union, member states also reached a unanimous agreement to exchange advance tax agreements. This involved a significant update, DAC 3,[6] which organizes the automatic exchange of information in the European Union (besides the OECD requirements based on Action 5 of BEPS[7]), and through Luxembourg form 777E that needs to be filed with a ruling request to the Luxembourg tax authorities.

These rules were then complemented by the transposition of DAC 4,[8] which introduced a new transfer pricing documentation requirement called country-by-country reporting (CbCR) that requires the sharing of key information on group companies that meet certain criteria.

Cooperation between authorities was expanded by the EU Directive 2015/849/EU on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and the EU Directive 2016/2258/EU as regards access to anti-money-laundering information by tax authorities ("the AML Directives"). The CSSF[9] Circular 17/650, which was complemented by CSSF Circular 20/744, was then issued to provide guidelines and more details on professionals' duties regarding tax crimes. These regulations require professionals to promptly notify the Luxembourg Financial Intelligence Unit (FIU) on their own initiative if they know, suspect or have reasonable grounds to suspect that a primary tax offense is either taking place, has occurred or was attempted. Concerned professionals were recently reminded of this obligation in a Circular dated 29 July 2021. This rule which increases the cooperation between authorities and exchange of information is an exception to paragraph 22 of the Loi Générale des Impôts (AO) because it allows the communication of personal information that is normally covered by tax secrecy.

Since 1 January 2021, market players must also report information regarding reportable cross-border arrangements. Based on the transposition of DAC 6,[10] cross-border arrangements with certain cumulative criteria or features that could indicate the risk of tax avoidance must be reported to tax authorities who, in turn, must exchange this information with other EU member states.

Finally, DAC 7[11] requires platform operators to report information on income earned by sellers on their platforms, and member states to automatically exchange this information. It aims to enable local tax authorities to identify income earned through digital platforms and determine the relevant tax obligations. DAC 7 must be transposed at the latest by 31 January 2022 and applies as from 1 January 2023. Despite DAC 7 not yet applying in national law, its little sister, DAC 8, is already under discussion and will concern crypto assets and cryptocurrency.

Since DAC was introduced in 2011, the automatic exchange of information has been significantly enlarged to include more and more personal data, which could challenge a fundamental right—data protection.

2 – …requires a data protection framework

In parallel to these data exchange evolutions in the European Union, the Member States have made the protection of personal data a fundamental European right on 1 December 2009 (Article 8 of the European Charter of Fundamental Rights), legally binding through the Treaty of Lisbon and the EU legislator has renewed its legal framework through the General Data Protection Regulation (GDPR), which has applied since 25 May 2018 and compels member states to apply a similar approach to data protection.

As a result, data protection must be considered in every area of our society; therefore, it is no surprise that some legislations on the automatic exchange of information include specific data protection requirements.

Indeed, even if a reporting financial institution must share certain data with the tax authorities, it must also comply with data protection requirements. In this respect, Luxembourg reporting financial institutions, being data controllers within the GDPR's meaning, are required to notify any concerned individual that their data is being collected and processed under the FATCA Law of 24 July 2015 and the CRS Law of 18 December 2015. They must also notify that this data may be reported to the Luxembourg tax authorities that could, in turn, transmit this data to the relevant foreign tax authorities. Luxembourg reporting financial institutions must also notify their individual clients that, among others, they have a right to access the information reported to the Luxembourg tax authorities and to rectify this information if necessary.

Generally, this notification can be included in account opening or subscription forms, the general terms of business or any other legal document such as a fund prospectus.

The relevant data must not be stored for longer than required to apply the Luxembourg FATCA and CRS law or any other applicable statute of limitation, and it cannot be easily reused for a different purpose (the principle of purpose limitation).

In the DAC 7 text that must be transposed by 31 January 2022 at the latest, data protection is also covered, as the rules linked to GDPR are clearly included as a reminder of good practice.

3 – How can you reconcile both measures?

At first glance, data protection regulations and automatic exchange of information regulations seem contradictory.[12] However, if we analyze the perimeters and goals of the aforementioned regulations, two major points emerge.

First, the GDPR is not in conflict with the automatic exchange of information, as both regulations can be properly and simultaneously applied. There are reminders of and specific provisions regarding data protection in automatic exchange laws, to prevent market players from using one part of the regulations to try to avoid the application of others.

Second, proper governance, specifically tax governance, can reconcile both measures, allowing market players to comply with these regulations.

While governance has been on the agenda for some time, it has increasingly become crucial based on evolving tax legislation and the importance of managing risks linked to tax aspects, including financial and reputational risks. This is why tax authorities are increasingly expecting Luxembourg actors to have precise and good processes and policies/documentation in place to tackle different requirements, which allows market players to prove their tax compliance. This also enables Luxembourg to maintain its position as a "good student" in the transposition and application of European Union and worldwide regulations.

In this respect, compliance officers hold a key function—and due to the job's ever-expanding perimeters, we are seeing new and more specific roles emerge. This includes the Data Protection Officer (DPO) function, which will help organizations achieve the right compliance level for all regulations.

1) Capital Requirements Regulations.
2) Council Directive 2003/48/EC of 3 June 2003.
3) Foreign Account Tax Compliance Act.
4) Luxembourg approved FATCA through the law dated 24 July 2015.
5) "Common Reporting Standard".
6) Council Directive (EU) 2015/2376 of 8 December 2015 amended Council Directive 2011/16/EU.
7) Base Erosion and Profit Shifting.
8) European Council Directive 2016/881 of 25 May 2016.
9) CSSF: Commission de supervision du secteur financier.
10) EU 2018/822 dated 15 June 2018.
11) EU Directive 2021/514/EU dated 22 March 2021.
12) FATCA and CRS are currently being legally challenged in court.

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