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Diving into the Muddy Waters of Tax Transparency: Part One

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This first article of a two-part series gives an overview of past and upcoming tax transparency initiatives, with a focus on the EU, the U.K. and Asia. This first part will look at the current status of these initiatives and in particular at developments in the EU. Part two will focus on the U.K. and Asia.

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In the aftermath of the 2008 financial crisis, states were left in serious budgetary distress and were looking to increase their fiscal revenues so as to sustain growth, infrastructure and internal development projects, amongst other things. The working premise was that while globalization generated opportunities to increase global wealth, it also resulted in increased risks, notably from a revenue loss perspective. To address this risk, better tax transparency and information exchange for tax purposes were seen as key to ensuring that taxpayers would have no safe haven in which to hide their income and assets, and would pay the right amount of tax in the right place.

These tax transparency initiatives led at European and international levels were deeply influenced by the leaks that took place in Luxembourg, Panama and in the Bahamas, to name but a few. These initiatives also ran in parallel with double tax treaty renegotiation which introduced, in those treaties that were renegotiated, an exchange of information clause.

Global Achievements Towards More Tax Transparency

Mutual Administrative Assistance in Tax Matters

At international level, the Convention on Mutual Administrative Assistance in Tax Matters, which was developed jointly by the OECD and the Council of

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Europe in 1988, was amended by a Protocol in 2010. This amendment aligned the Convention to the international standard on exchange of information upon request. It was further opened to all countries, in particular to ensure that developing countries could benefit from the new, more transparent environment. The amended Convention was opened for signature on June 1, 2011. This initiative was undertaken in parallel with DAC 1 at European Union ("EU") level (see below).

The Action Plan against Base Erosion and Profit Shifting

In June 2012, the G-20 leaders commissioned the OECD to develop an action plan to prevent base erosion and profit shifting ("BEPS"), i.e., tax planning strategies used by multinational companies that exploit the gaps and mismatches between tax rules amongst various countries.

This action plan was presented and endorsed in 2013 at the G-20 summit in St. Petersburg, Russia, and constituted the very first milestone of the BEPS project. This project resulted in 15 Actions, released on October 5, 2015, and agreed at the G-20 Antalya meeting in November 2015 , which are designed to be implemented either domestically or through tax treaty provisions.

Common Reporting Standard

The Common Reporting Standard ("CRS") is a regulation initiated by the OECD in 2014, aiming at preventing tax evasion and leading to a global automatic exchange of information between CRS-participating jurisdictions. The CRS was implemented at EU level through the Directive on Administrative Cooperation in 2014 (Directive 2014/107/EU), known as "DAC 2" (see below). While the exchange of information amongst EU countries is regulated by DAC 2, the automatic exchange of financial information with non-EU countries is ruled by the CRS multilateral competent authority agreement. To date, this agreement has been signed by a significant number of jurisdictions. Many jurisdictions commit to exchange information by the end of 2017, and for some, by the end of 2018.

From a practical point of view, the CRS requires financial institutions located in a CRS jurisdiction to (i) identify customers who are resident in another CRS jurisdiction, and (ii) report financial accounts held with financial institutions in one CRS jurisdiction, directly or indirectly, by account holders that are tax residents in another CRS jurisdiction.

Country-by-Country Reporting

The BEPS reports that were issued in October 2015 notably cover some recommendations (Action 13 of the BEPS Action Plan) on transfer pricing documentation and country-by-country reporting ("CbC" reporting). The CbC reporting imposes an obligation on companies that are required to prepare consolidated financial statements and that have a turnover in excess of 750 million euros (approx. $880 million) on a consolidated basis to prepare and file a CbC report. When subject to a CbC reporting obligation, multinationals have to indicate their turnover, their results before tax, their tax liability, their share capital, the number of employees, etc. In addition, a list of all entities which are part of the group will have to be disclosed. A multilateral instrument—the multilateral competent authority agreement on the exchange of CbC reports—was signed in January 2016 amongst 31 initial participating jurisdictions. As at July 6, 2017, 65 jurisdictions had signed the agreement.

These international initiatives have already forced multinational groups to think about implementing a real strategy when it comes to the communication of their fiscal affairs. It also puts a burden on these groups to be adequately equipped so as to collect the information that is, and will be, needed in order to prepare the required reports.

With the historical context now established, tax transparency measures in the EU are considered below. (Measures in the U.K. and Asia will be considered in part two of this article.)

EU Tax Transparency Measures

The international initiatives briefly explained above have received a lot of traction from Europe. As part of the anti-tax avoidance package, the European Commission has been very active in introducing new tax transparency measures over the past years.

First Directive on Administrative Cooperation (DAC 1)

DAC 1, which was adopted in February 2011, replaced the 1977 Directive and was the first significant milestone in EU tax transparency. It laid down the foundations of exchange of information at EU level by establishing all the necessary procedures for better cooperation between tax administrations in the EU, such as exchanges of information, whether upon request, spontaneously or automatically, together with participation in administrative enquiries, simultaneous controls and notifications of tax decisions. DAC 1 also provided for the necessary practical tools, such as a secure electronic system for the information exchange.

The by-default type of exchange of information set out by DAC 1 is the exchange of information upon request, according to which a requested authority is required to communicate foreseeably relevant information that has been requested by a requiring authority. The information as requested has to be provided to the requiring authority within six months. However, where the competent authority is already in possession of the requested information, such information has to be provided within two months.

DAC 1 further imposed an automatic exchange of information where the following products were concerned:

- income from employment;
- director's fees;
- certain life insurance products;
- pensions; and
- real estate ownership and income.

Finally, DAC 1 introduced a spontaneous exchange of information according to which the competent authority of a Member State is required to exchange in-

formation if there are grounds to believe that there would otherwise be a loss of tax revenue in another Member State.

Second Directive on Administrative Cooperation (DAC 2)

DAC 2 extended the scope of DAC 1 by bringing certain types of financial information within the scope of the automatic exchange of information with effect from January 1, 2017. This financial information consists of interest, dividends and similar types of income, gross proceeds from the sale of financial assets and other income, as well as account balances. As such, DAC 2 broadly implemented into EU law the CRS introduced by the OECD in 2014.

Third Directive on Administrative Cooperation (DAC 3)

In the aftermath of the so-called LuxLeaks, Council Directive 2015/2376 of December 8, 2015 amended DAC 2 in order to extend—once again—the scope of automatic exchange in order to impose an automatic exchange of information on cross-border tax rulings and advance tax agreements granted to corporate taxpayers.

Fourth Directive on Administrative Cooperation (DAC 4)

Six months after the adoption of DAC 3, the scope of automatic exchange of information at EU level was extended yet again. Council Directive 2016/881 of May 25, 2016 (DAC 4) implemented the conclusions reached globally on CbC reporting as part of the BEPS project at EU level. DAC 4 introduced a mandatory automatic exchange of CbC reports at EU level. The rules provided by DAC 4 mirror the ones defined in the BEPS Action 13 report: the obligation to file CbC reports is only applicable to companies obligated to prepare consolidated financial statements and that have a turnover in excess of 750 million euros on a consolidated basis, etc.

What's Next?

When reviewing the tax transparency measures taken so far, one can easily notice that not only the frequency of new or rather amending legal instruments has increased over the past years, but more fundamentally, these amendments have broadened the scope of exchange and have, in addition, increased the circumstances under which information must be exchanged. Today, mandatory automatic exchange of information has definitively become the new norm. What we are also witnessing is a gradual shift from rather confidential disclosure of information to and amongst tax authorities, to a more public disclosure of some taxpayers' corporate tax affairs.

Proposals by European Commission

The first illustration of this tendency was the proposal released by the European Commission in April 2016 to amend an EU accounting directive of 2013 regarding the disclosure of income tax information by certain undertakings and branches. What this proposal sets out is a kind of upgrade from the existing CbC reporting in order to make it public. In other words, the taxpayers targeted by this proposal are the same as the ones targeted under DAC 4, i.e., European multinational enterprises or non-European multinationals that have specific undertakings or branches in the EU which have a consolidated net turnover exceeding 750 million euros. The proposal introduces an obligation for such entities to make income tax information available on their website, including a brief description of the nature of their activities, the number of employees, the amount of net turnover including that with related parties, amount of profit or loss before tax, the amount of income tax accrued, the amount of income tax paid as well as the amount of accumulated earnings. All this information will have to be broken down per EU Member State.

So far, this has remained at proposal stage and the timing for adoption and implementation into local law remains uncertain. However, some steps were taken on July 4, 2017 to relaunch this initiative, which have further been echoed in European Commission President Juncker's State of the Union speech in September 2017. This proposal is not technically new, as it has already been introduced to a great extent for banks, which are regulated under the Capital Requirements Directive IV. In addition, there is strong public pressure, in addition to political will, to ensure that this proposal becomes a directive. Therefore, one should assume that it will become a reporting norm in the coming years.

Even though the achievements for increased tax transparency at EU level are already visible, and even though the proposal on public CbC reporting has not yet become a directive, the EU Commission continues to issue new proposals.

On June 21, 2017, a proposal for a Council directive that aims at amending DAC 4 (and as such, is already referred to as "DAC 5") by setting new transparency rules for intermediaries that design or sell potentially aggressive tax schemes was released. While the proposal is mainly targeted at so-called tax shelters, it is so widely drafted that it could in fact cover entirely routine tax planning. The proposal aims to provide tax authorities with information about these schemes so that they can review intermediaries' activities, thereby increasing effectiveness in tackling aggressive tax planning. The information obtained by the tax authorities of one Member State would then be exchanged with all other EU Member States. According to the proposal, intermediaries will be required to report any cross-border arrangement that contains one or more characteristics that might indicate that the arrangement is set up to avoid paying taxes. The definition of an applicable cross-border arrangement is not subject to any requirement that there be a tax impact on at least two jurisdictions, which therefore results in an extremely broad scope of what may constitute a "cross-border arrangement".

The definition of "intermediaries" is also very broad and may include those consulting firms, banks, lawyers, tax advisers, accountants, etc. which help their clients to set up structures in order to optimize their tax bills. The new reporting requirements are expected to enter into force on January 1, 2019, with Member States required to exchange information every three months thereafter. Finally, the proposed rules require cross-border arrangements to be reported within five days of the first step of implementa-

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tion. This unrealistic time constraint seems to be materially impossible to comply with. Jean-Claude Juncker has also expressed a strong political will to have this proposal adopted in the course of 2018.

Stance of the Commission

As a conclusion to these EU initiatives, we have seen that the European Commission is taking a rather aggressive stance on tax reporting obligations as they constitute the premise on which tax transparency should be achieved. However, having so many instruments on the table—some of which could be considered as poorly drafted—may in fact create a level of uncertainty for taxpayers, and ultimately this approach will not meet the goals which these initiatives are expected to achieve. Rather, it would be safer to test existing tools that are currently available, as these are likely to be adequate provided they are well implemented.

While one may wonder as to the probability of these new proposals becoming law, it is within the realm of possibility that they will become EU law in the near future, either under the current form or somewhat slightly changed. The reason for this is that very strong public and political pressure to do so exists, and there is doubt that any country will fight against these proposals, especially because on the surface they only add a reporting obligation. On this basis, multinationals and other operators active in several countries should now clearly factor the possibility that their fiscal affairs may be disclosed into their global strategy. They should also be keenly aware that, in any case, a greater investment in internal reporting functions will be needed from now on.

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