EUROPEAN COMMISSION PROPOSES NEW ADVISOR DISCLOSURE OBLIGATION FOR AGGRESSIVE TAX PLANNING

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In the current context of tax transparency, fair and effective taxation, and global tax good governance, the European Commission (the "Commission") recently pushed existing disclosure obligations one step further. On June 21, 2017, it published a proposal for a Council Directive (the "Proposal") amending Directive 2011/16/EU dealing with automatic exchange of information in the field of taxation (the "Directive").[1] The Proposal requires certain intermediaries, including tax lawyers, to report certain potentially aggressive tax arrangements.

The Proposal comes in the context of B.E.P.S. Action Plan 12 (Disclosure of Aggressive Tax Planning) and the fact that certain financial intermediaries and tax advisors – as revealed again by last year's Panama Papers scandal – presumably assisted clients in hiding wealth in offshore jurisdictions.

In the press release announcing the proposal, the Commission's Pierre Moscovici stated:[2]

> We are continuing to ramp up our tax transparency agenda. Today, we are setting our sights on the professionals who promote tax abuse. Tax administrations should have the information they need to thwart aggressive tax planning schemes. Our proposal will provide more certainty for those intermediaries who respect the spirit and the letter of our laws and make life very difficult for those that do not. Our work for fairer taxation throughout Europe continues to advance.

Currently, E.U. Member States are not required to exchange information when they are made aware of tax avoidance or tax evasion plans. The Proposal aims at changing this by scrutinizing intermediaries (such as lawyers, accountants, and bankers) and requiring them to disclose potentially aggressive tax planning arrangements that contain a cross-border element. This disclosure would be done by a timely automatic exchange of information. According to the Commission, only uniform action would provide the appropriate level of disclosure to prevent abusive tax planning involving intermediaries. Consequently, the scope of existing automatic exchange of information between tax authorities must be extended.

At the E.U. level, Ireland, Portugal, and the U.K. already have mandatory disclosure rules in place.

In an attempt to keep compliance costs as low as possible, only the minimum necessary framework for disclosure will be established. The Commission cites the

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1 Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements.

2 European Commission, "Commission Forges Ahead on New Transparency Rules for tax planning intermediaries," news release, June 21, 2017.

following examples:

- The rules set out clear reporting responsibilities to avoid double reporting.
- The common rules are limited to addressing potentially aggressive tax planning schemes with a cross-border element within the E.U.
- There will be no publication requirement of the reported tax schemes, only automatic exchange between Member States.
- Penalties for non-compliance will be established under the provisions that implement the Directive into national law and will remain under the sovereign control of Member States.

Member States will retain jurisdiction to decide how to pursue cases of illegitimate arrangements, but the exchange of information will be automatic.[3] The first reports would be due by March 31, 2019.[4]

POTENTIALLY AGGRESSIVE TAX PLANS

Since tax planning evolves, the Commission chose not to define what constitutes a potentially aggressive tax arrangement. Instead, it identified certain hallmarks of potentially aggressive tax plans. These hallmarks describe aspects of transactions that present a strong indication of tax avoidance or abuse. If a hallmark exists, the plan must be reported to the tax authorities.[5]

Annex IV[6] lists five types of hallmarks (with the two first only taken into consideration if the plan meets the "main benefit test" discussed below):

"[T]he Commission chose not to define what constitutes a potentially aggressive tax arrangement. Instead, it identified certain hallmarks."

- **Generic Hallmarks**. These hallmarks include (i) arrangements entered into to take advantage of confidentiality; (ii) arrangements under which intermediaries are entitled to a fee linked to the tax advantage provided for by the arrangement, or to the absence thereof; and (iii) arrangements that are based on the use of standardized forms that need not be adapted to every single taxpayer.[7]
- **Specific Hallmarks Which May Be Linked to the Main Benefit Test**. These include (i) arrangements triggering the use of losses, (ii) arrangements converting the nature of an income flow from ordinary to another low-taxed category, and (iii) certain circular transactions that result in offsetting certain income flows.[8]
- **Specific Hallmarks Related to Cross-Border Transactions**. These hallmarks include (i) arrangements that entail a deductible payment made to a recipient that will not be taxed on receipt, (ii) depreciation deductions taken in

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3 Proposed new article 25a of the Directive.

4 New Article 8aaa.4 added to Section II of Chapter II of the Directive.

5 Article 1(b) of the Proposal, as amending Article 3 point 19 of the Directive.

6 Article 1(b) of the Proposal, as amending Article 3 point 20 of the Directive.

7 Annex IV (A) of the Proposal.

8 Annex IV (B) of the Proposal.

more than one jurisdiction on the same asset, (iii) items of income for which more than one taxpayer can claim double-taxation relief, and (iv) arrangements containing transfers of assets to other jurisdictions that reduce the amount payable in consideration of the assets.[9]

- **Specific Hallmarks Concerning Automatic Exchange of Information Agreements in the E.U.** This category targets arrangements circumventing automatic exchanges of information, resulting in unreported income in the taxpayer's country of residence.[10]

- **Specific Hallmarks Concerning Transfer Pricing**. These include arrangements that do not conform to the arm's length principle or the O.E.C.D.'s transfer pricing guidelines. They also include arrangements that fall within the scope of existing automatic exchange of information provisions concerning advance cross-border rulings but that are not reported or exchanged.[11]

"The 'generic hallmarks' and the 'specific hallmarks which may be linked to the main benefit test' are taken into account only when the main benefit of an arrangement is to obtain a tax advantage."

The "generic hallmarks" and the "specific hallmarks which may be linked to the main benefit test" are taken into account only when the main benefit of an arrangement is to obtain a tax advantage (the "main benefit test"). This occurs:

> * * * if it can be established that the advantage is the outcome which one may expect to derive from such an arrangement, or series of arrangements, including through taking advantage of the specific way that the arrangement or series of arrangements are structured.

Plans that exemplify the various hallmarks include the following:[12]

- Plans that involve a cross-border payment to a recipient resident in a no-tax jurisdiction
- Plans that involve a jurisdiction with inadequate or weakly enforced anti-money laundering legislation
- Plans that are set up to avoid reporting income as required under E.U. transparency rules
- Plans that circumvent E.U. information exchange requirements for tax rulings
- Plans that have a direct correlation between the fee charged by the intermediary and the tax savings from the arrangement
- Plans that result in depreciation deductions to be claimed on the same asset in more than one country
- Plans that enable the same income to benefit from tax relief in more than one jurisdiction
- Plans that do not respect E.U. or international transfer pricing guidelines

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9 Annex IV (C) of the Proposal.

10 Annex IV (D) of the Proposal.

11 Annex IV (E) of the Proposal.

12 European Commission, "Questions and Answers on New Tax Transparency Rules for Intermediaries," June 21, 2017.

INTERMEDIARIES AND DISCLOSURE

Intermediaries are responsible for reporting a potentially aggressive plan, if they designed, marketed, organized, or managed the transaction while providing tax-related services. In addition, in order to be an "intermediary," an advisor must have a contact with the E.U. This means that the advisor must meet at least one of the following criteria:[13]

- Incorporated in, and/or governed by the laws of, a Member State
- Resident, for tax purposes, in a Member State
- Registered with a professional association related to legal, taxation, or consultancy services in at least one Member State
- Based in at least one Member State from where the person exercises their profession or provides legal, taxation, or consultancy services

Intermediaries can be individuals or legal entities, including entities that have no legal personality.

In certain circumstances, the obligation to report is shifted to the taxpayer. This will occur when (i) the intermediary is not able to disclose the information because of a privilege enjoyed by the taxpayer, such as the attorney-client privilege of confidentiality; (ii) the intermediary has no European presence; or (iii) the plan is designed in-house. In any such fact pattern, the disclosure obligation shifts to the taxpayer.[14] When this shift occurs due to a privileged situation, the intermediary must inform the taxpayer of this shift in responsibility.[15]

TIMING OF DISCLOSURE

In order to effectively deter implementation of aggressive tax plans, the disclosure obligation must be made at an early stage, ideally prior to implementation of a disclosed plan.

The required timing varies depending on who is subject to the disclosure obligation:

- If the intermediary must report the plan, the reporting must be made within five days, beginning on the day after the plan becomes available to a taxpayer for implementation or the first step in a series of arrangements has been implemented.[16]
- If the reporting obligation is shifted to the taxpayer, the disclosure must occur within five days, beginning on the day after the reportable plan, or the first step in a series of arrangements, has been implemented.[17]

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[13] Article 1(b) of the Proposal, as amending Article 3 point 21 of the Directive.

[14] Proposed new Article 8aaa.2 added to Section II of Chapter II of the Directive.

[15] *Id.*

[16] *Id.*

[17] *Id.*

EXCHANGED INFORMATION

The disclosure will be made using the common communication network developed at the E.U. level. To ensure a standardized disclosure obligation throughout the E.U., a standard form would be created.[18]

The items of information that are expected to be exchanged include the following:[19]

- The identification of intermediaries and taxpayers, which should include the name, country of tax residence, taxpayer identification number, and (where appropriate) persons associated with the intermediary or taxpayer
- Details of the hallmarks that make the cross-border arrangement reportable
- A summary of the content of the reportable cross-border arrangement, which should include a reference to the name by which the arrangement is commonly known and a description of the relevant business activities or arrangements, excluding (i) disclosure of a commercial, industrial, or professional secret, or of a commercial process or (ii) disclosure that is contrary to public policy
- The date of implementation of the arrangement or the date of commencement of the first step in a series of such arrangements
- The national tax provisions that enable the tax advantage
- The value of the transaction
- The other Member States that are affected by the plan
- The names and identifying information of any person in another Member State that is likely to be affected by the reportable cross-border arrangement or series of such arrangements

CONCLUSION

Sophisticated corporations understand that a business transaction originating in the tax department or at a meeting with outside tax advisors can suffer from the appearance of an absence of economic substance, as the steps are laid out by tax advisors and not business people. The Proposal adopts that approach.

In principle, it is one thing to give tax advice regarding a plan that is taking place for operational reasons and another for a tax advisor to orchestrate the entire transaction. In practice, no one yet knows where the line will be drawn between an aggressive tax plan and an acceptable tax plan where the advice explains two choices for implementation: one that yields higher taxes and one that achieves greater tax savings.

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18 Proposed new Article 20(5) of the Directive.

19 Proposed new Article 8aaa.6 added to Section II of Chapter II of the Directive.