AmCham EU
SPEAKING FOR AMERICAN BUSINESS IN EUROPE

Our position

AmCham EU's position on the proposed tax transparency rules for intermediaries

AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate US investment in Europe totalled more than €2 trillion in 2016, directly supports more than 4.5 million jobs in Europe, and generates billions of euros annually in income, trade and research and development.

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Executive summary

The American Chamber of Commerce to the European Union (AmCham EU) supports the overarching principle of full transparency between taxpayers, advisers and tax authorities regarding transactions that they have undertaken. AmCham EU is supportive of the European Union (EU)'s action in these areas, in particular the disclosure and exchange to governments of country-by-country reports between tax authorities within the EU.

AmCham EU believes in the desirable end-goal of increased transparency in an environment of cooperative compliance. Where taxpayers and tax authorities work together under cooperative compliance relationships, this gives tax authorities the information they require, and taxpayers the certainty they desire.

However, we do not believe that the Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (the proposal) is a step toward this goal. Several elements of the proposal could undermine it by placing a disproportionate compliance burden on businesses and advisers whilst swamping tax authorities with reports of 'false positives' where there was no tax avoided. We are particularly concerned that, given the options outlined in the Commission's consultation in this area, the most laborious option for taxpayers and intermediaries has been selected. We are disappointed that a code of conduct, or individual Member State regimes (with information exchange between Member States) was not selected, at least as a starting point with a much lower compliance burden.

While the overall structure of the regime (i.e. identification of transactions via hallmarks) is broadly in line with international best practices and existing EU unilateral regimes, the cross-border nature of the Directive requires changes for it to be fully aligned. In particular, lists of excluded territories and transactions (or a combination of both) should be developed. The hallmarks and reportable transactions are much more broadly drawn than existing EU domestic regimes, and will cover a significant volume of transactions. Combined with the definition of 'intermediary' (which would include a tax team employed by one company providing advice to another intra-group company), this would mean that many transactions that do not rely on external advisers and do not have a tax avoidance motive will be reportable. This would include many 'ordinary course of business' transactions with no tax motive.

The introduction of any such regime will increase the cost of doing business in the EU relative to other international investment locations without such rules. However, we understand the importance of giving tax authorities the information they need to protect their tax bases. If such rules are to be introduced, it should be done in a way that improves transparency and avoids creating an obligation to report 'ordinary course of business' transactions and advice. There is no need to place disproportionate administrative burden on responsible taxpayers seeking advice on the tax implications of transactions, on responsible advisers providing it, or on tax authorities administering the tax systems.

An extension to the reporting timeline and much greater specificity in defining 'in scope' transactions could achieve both the objectives of the proposal and reduce the compliance burden on tax administrations, taxpayers, and advisers. Additionally, provisions to limit double reporting would give welcome relief without running contrary to the objectives of the proposal.

In this paper, we set out further details on AmCham EU's concerns, as well as some principles to assess the practicality and usefulness of individual hallmarks.

Coherence

International and pan-European coherence

AmCham EU welcomes the elements of the proposal that adhere to the international consensus already agreed by the EU as part of the OECD's Base Erosion and Profit Shifting (BEPS) project, specifically the BEPS Action 12 Final Report (the Action 12 Report)[1].

However, the proposal contains additional complexity that is not advocated in the Action 12 Report. In particular, paragraph 240 of the Action 12 Report recommends that hallmarks are designed at a jurisdictional level that are specifically targeted to identify 'concerning outcomes', and that a list of excluded tax regimes and outcomes that are not required to be disclosed is also provided.

As the European Commission's proposal deviates from this approach, AmCham EU is concerned that it does not meet the principle of subsidiarity as laid out in Article 5 of the Treaty on the Functioning of the European Union (TFEU). Our suggestions below regarding specific hallmarks would therefore be best interpreted by individual Member States, in a new proposal drawn up in line with the OECD's recommendations. Under such a regime, we would expect intermediaries to have to report in their own country, rather than where the client is (subject to the double reporting compliance burden being eased – see below). If, however, the proposal is to remain in its current structure, these suggestions are also applicable to hallmarks designed at EU level.

In addition, we note that the proposal places the hallmarks in an Annex to the Directive. This Annex could purportedly be amended by the European Commission under Article 290 TFEU. However, Article 290 concerns amendment or supplementation of non-essential elements of legislative acts. The hallmarks are clearly an essential element of such a Directive, and should therefore only be changed through unanimous agreement of the European Council under Article 115 TFEU.

Scope, target, and purpose

Mandatory disclosure obligations are in breach of the principles of privacy and confidentiality as guaranteed by Article 8 of the European Convention of Human Rights, unless justified and proportionate. Article 5 TFEU also confirms that legislation should be limited to that which is necessary to achieve the objectives of TFEU. We are concerned that the proposal is not proportionate; rather it far exceeds what is required to meet the stated objective of dissuading intermediaries from designing and marketing tax avoidance schemes. This also raises the similar question of whether it places disproportionate restrictions on the free movement of capital.

In particular, rules would be disproportionate (and potentially harmful to a broader objective of ensuring tax compliance) if they undermine the ability of taxpayers to seek advice on the tax implications of transactions from third parties or even their own internal tax functions[2]. A clear distinction needs to be acknowledged between tax advice provided in the ordinary course of business, and marketed 'schemes' that have been provided by third parties. As it stands, the proposal does not provide specificity around definitions and has an over-broad collection of hallmarks which do not distinguish between such cases.

We are seriously concerned that the proposals would impact the ability of taxpayers to have unfettered access to professional advice. The proposals not only suggest that potentially sensitive information should be shared with the tax authorities in the Member States which may be impacted by tax planning, but with all Member States' tax authorities in situations where hallmarks are met, even if the triggering was inadvertent and had no tax impact, or if the transactions did not proceed.

The perverse result could be that the taxpayer community will be prevented from obtaining advice from responsible advisors (including advice properly highlighting risks), and instead be forced to either seek advice from less reputable practitioners or be faced with uncertainty. The UK disclosure of tax avoidance schemes

[1] http://www.oecd-ilibrary.org/taxation/mandatory-disclosure-rules-action-12-2015-final-report_9789264241442-en;jsessionid=1sp2pkn82s206.x-oecd-live-02

[2] The definition of 'intermediary' is drawn so broadly that it would likely include an entity within a multinational group that employees the group's tax function and thus cover 'ordinary course of business' advice between internal tax specialists and management/other group companies.

(DOTAS) regime has several restrictions in scope (for example, the benign test, the non-advisor test, the ignorance test, and a focus through definitions on ensuring that only 'schemes' are reportable).

Aside from fear of disclosure and penalty liability, a separate aspect of the problem concerns conflicts of interest between advisors and their clients. For example, an advisor will be incentivised to recommend against actions that have even a small chance of engaging a hallmark, even if, on the balance of probabilities, the hallmark does not apply. The potential for such conflicts will of itself tend to cause advisors to feel obliged to decline an instruction from the outset, having regard to professional rules of ethical conduct.

Similarly, where multiple advisers are simultaneously engaged (either as members of a global network, or contracted individually by a client), the incentives for non-EU advisers will be to withhold information from EU advisers on the non-EU tax consequences, or steps, of a transaction (i.e. to limit the scope of the advice that would be performed in the EU and thus limit the opportunity for the EU adviser to report). This could easily be normalised and extend to non-reportable transactions, because the referring advisers will not be based in the EU and thus less likely to feel confident in applying the rules. Ultimately, this will weaken the quality of the advice that EU advisers are able to give.

A taxpayer would not implement a 'tax avoidance scheme' without having undertaken a full analysis of the global tax consequences. However, taxpayers may undertake other transactions without a full analysis of the tax consequences, particularly where tax is expected to be immaterial and there is a commercial necessity to move quickly. The result is that the reporting deadline would most likely be breached where a taxpayer has undertaken a transaction without any motive to avoid (or even minimise) tax. The introduction of a motive condition (see below) and a relaxation of the reporting deadlines (also below) would help to counter these perverse outcomes.

Given the very wide definition of reportable transactions, if the obligation to file the information falls on the taxpayer where no intermediary is involved, this will impose an excessive burden on businesses operating in the EU and will cause many of the difficulties identified in this paper to spill over to mainstream business activities for which no intermediary is even considered.

The wide definition of 'intermediaries' extends beyond the traditional adviser and also poses concerns. Care needs to be taken to not impose obligations which cannot be fulfilled because the intermediary does not have and has no right of access to the information. Banks and other financial intermediaries purely providing banking services on standard terms should not cross the line into the provider becoming an 'intermediary' for the purposes of the Directive and this should be clarified.

As a practical matter, AmCham EU also questions whether the proposal will be of any benefit at all in the fight against tax evasion, and therefore does not believe 'intermediaries' should be described as such. There would be no incentive for the small number of advisers and taxpayers who are already breaching the law to disclose their activities. Such individuals may even seek to apply the *Nemo Tenetur* principle in their defence. The rules will therefore hit the most compliant taxpayers the hardest.

Hallmarks

AmCham EU welcomes the use of defined hallmarks as a methodology for identifying 'in scope' transactions. Indeed, this is in line with international best practice as endorsed by the OECD. However, the list of hallmarks must strike an appropriate balance. We respect the fact that if the hallmarks are too narrow, then taxpayers and advisers may find ways to circumvent them. However, if the hallmarks are too broad, they will require reporting of transactions to which there is no risk to revenue collection. This would place a disproportionate compliance burden on all businesses, and the volume of reports could frustrate the objective of allowing tax authorities to assess risks and react in a timely manner to close down loopholes where necessary.

At a time where both businesses and tax authorities are grappling with scarce resources, there are efficiency gains for both parties in investing the time upfront to design hallmarks that will reduce the number of 'false positives' that tax authorities will receive, if this can be done in a way that ensures transactions are reported where they could potentially pose risk to revenue collection.

As noted above, we consider that Member States should design their own hallmarks. However, whether designed by individual Member States or at EU level, the following principles (which are described in more detail below) could be applied to the design of hallmarks to ensure these objectives are met with a significantly lower compliance burden.

- A tax avoidance motive should be a pre-requisite (the motive condition).
- Transactions in scope should be replicable and marketable (the scheme condition).
- Transactions in scope should be intra-group transactions only (the reasonable knowledge condition).
- The hallmarks should differentiate between transactions that are undertaken frequently and in the ordinary course of business, and those which are indicative of tax planning (the targeting condition).
- Transactions for which tax mismatches are already neutered should not require reporting (the compliance condition).
- The hallmarks should be legal under EU law (the legality condition).

The motive condition

In order to be consistent with the objective of dissuading intermediaries from designing and marketing arrangements specifically to avoid tax, an overarching motive condition should need to be satisfied for all hallmarks. Peculiarly, the proposal acknowledges that such a main benefit condition is required for some, but not all hallmarks. While we would favour a 'motive test' to a 'main benefits test', either test, if appropriately drafted and applying to all hallmarks, would be beneficial in reducing the volume of unnecessary disclosures.

While we do not accept that all transactions with tax motivations are, in the proposal's words, 'aggressive' (a term that we consider to be subjective and unhelpful), by any definition we would expect that the main intention of the taxpayer to avoid tax is a prerequisite for a transaction to be deemed so. We therefore see no reason that the specific hallmarks should not also require such a condition in order to limit the volume of reports that would otherwise need to be filed where there was no motive to avoid tax. Without this amendment, taxpayers would be required to implement systems that analyse each and every transaction that they undertake, which (given the volume of transactions that businesses undertake) is neither practical nor useful to the aims of the proposal.

A motive condition is not of itself sufficient to limit the compliance burden that would otherwise arise if the hallmarks themselves are not sufficiently well targeted, so such a condition should be included in addition to the other amendments we propose.

The scheme condition

In order to meet the ultimate objective of dissuading intermediaries designing and marketing 'aggressive tax planning arrangements', rather than covering 'ordinary course of business' tax advice, the hallmarks should have an additional overarching condition that they should only apply where the transactions form part of an overall scheme or arrangement that is replicable and marketable/promoted.

The reasonable knowledge condition

Taxpayers should not be required to identify the tax implications on third parties of a transaction. Taxpayers have no legal right to see a third party's tax returns, so unless the third party is willing to share these with the taxpayer, there is no way of knowing how a receipt will be treated for tax purposes. Typically, such information would not be available until at least one year after the transaction, which extends far beyond the reporting deadline. Even then, the third parties' tax returns could be falsified, or amended/reassessed by a tax authority.

Accordingly, an overarching condition should be that only intra-group transactions should be within scope of the hallmarks.

The targeting condition

Several of the proposed hallmarks would apply to a very large volume of transactions, and therefore do not clearly distinguish between those transactions that are undertaken for tax avoidance, and those that are undertaken in the ordinary course of business. Greater detail on the precise meaning of these hallmarks may assist.

While, in such circumstances, the main benefits test could not be met in any case (if it were to be applied to all hallmarks), it is unclear why these taxpayers should be required to assess and document the applicability (which is not an insignificant compliance burden) where there is no chance of the hallmark ever being met. For example:

- Hallmark A3 fails to recognise that standard documentation is used for many transactions in the ordinary course of business. Pro formas are essential to allow businesses to efficiently undertake routine transactions in line with the law, without having to re-write bespoke forms and documentation where there is no business benefit to doing so. In particular, industry standard forms enhance the soundness and efficiency of financial systems.
- Hallmark B3 fails to recognise that circular transactions involving round tripping of funds are common and essential to comply with various company secretarial and legal requirements, particularly regarding company financing.

If, rather, the objective is specifically to identify where taxpayers or advisers have deliberately managed to circumvent the intentions of poorly worded legislation, this could be better served by the motive test described above than one which focuses on all deductible payments (which covers most expenses incurred by companies).

The compliance condition

Several of the hallmarks are unnecessary on the basis that the EU already has directives in place that would neuter any tax advantage that could ever accrue. If the objective is rather to target those companies evading taxes by not following the law, it is unclear why they would be compelled to report their own illicit acts (this may also contravene the *Nemo Tenetur* principle). The result is therefore an increase in the compliance burden only of those companies who are already following the law that negates any potential tax advantage.

While, in such circumstances, the main benefits test could not be met in any case (if it were applied to all hallmarks), it is unclear why these taxpayers should be required to assess and document the applicability (which is not an insignificant compliance burden) where there is no chance of the hallmark ever being met. For example:

- Hallmarks C1(a), C1(e), C2, C3, and C4 should not result in a tax saving where the Member State has implemented the provisions of ATAD2. In particular, Hallmark C3 should not pose policy concerns if the second recipient of double tax relief would otherwise be taxing the same income that has already been taxed multiple times (e.g. worldwide tax systems such as the US).
- Hallmark E1 should never be triggered because all EU Member States apply and recognise the merits of the OECD Transfer Pricing Guidelines[3]. While different Member States (and the Commission) may take different interpretations of what an 'arm's length' price is, it would not be correct to say that a taxpayer has undertaken arrangements that do not conform with it in such instances.
- Hallmark E2 only applies to transactions that should have been reported and exchanged under the Directive on Administrative Cooperation, so would never be reportable unless the Member State has not correctly implemented the Directive.

[3] http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/company_tax_study_en.pdf

The legality condition

To avoid potential legal challenges and confusion, as well as limiting the scope to those transactions for which tax authorities cannot make appropriate changes to the law to circumvent any perceived abuse, hallmarks should only cover transactions where the European Court of Justice has not already ruled on their legality. Hallmarks B1, C1(b), C1(c), and C1(d) may not be compliant in this regard, and further legal analysis is encouraged to assess whether they therefore would be useful to tax authorities.

In particular, hallmark B1 conflicts with a fundamental principle of the Single Market (and objective of the Commission's ongoing Common Consolidated Corporate Tax Base project) that taxpayers in the EU should have the right to offset economic losses suffered in one Member State with economic profits accrued in another.

By imposing that a third country must have a 'minimum corporate tax rate', Hallmark C1(b)(ii) may exceed the limits of EU competence and infringe on the free movement of capital. In addition, Hallmark C1(b)(ii) would create unpredictability for businesses because the average of EU corporate tax rates can change from year to year.

Administrative concerns

Reporting deadline

We do not believe it is achievable to fully analyse whether a transaction falls within scope of the regime, document it, and complete the extensive form within a five day period. While we appreciate that the five-day period mirrors existing domestic regimes, typically such regimes focus only on one country's tax base, and in such cases it is still a significant effort for trained tax professionals in that country to fully identify and analyse the transactions' tax implications, undertake internal review, and meet the reporting deadlines.

In a cross-border scenario, several additional complications will arise. Firstly, the hallmarks of the cross-border regime proposed are much broader (as they are targeting a number of different countries' concerns simultaneously). Secondly, taxpayers and advisers may not have the requisite in-house expertise to analyse foreign tax implications, and accordingly will need to rely on their networks or advisers to provide assurance on this. It will not be possible to undertake such broad and international analysis within a five-day period, and even where additional resource is allocated, it will not always be within the control of taxpayers and advisers to guarantee that foreign analysis is available in the timeframe.

The reporting period seems particularly harsh when the information will only be shared quarterly between tax authorities. Given the complexities in compliance described above, it is particularly hard to justify such a short time-frame if the penalties for not reporting are purposefully 'dissuasive' (which we assume to mean 'penal').

Additionally, it is unclear why a taxpayer should be required to analyse and report transactions that they have no intention of entering into, simply because an adviser has told them that the option is available.

A 30-day reporting period, following the date that the first leg of any transaction (or series of transactions) has commenced would be more appropriate and still meet the proposal's objectives.

Entry into force

In addition to the ongoing compliance burden once the rules are in place, taxpayers and advisers will need time to train staff and develop systems to enable them to identify reportable transactions. This is particularly true for advisers who may rely on networks of firms to provide foreign analysis, most of whom will not be based in the EU). This will be a considerable investment and take time.

We therefore recommend that additional time should be given between the implementation in individual Member States and the entry into force, to allow taxpayers and advisers to ensure that systems are in place to enable them to comply.

The proposal to impose the reporting requirement in advance of legislation, i.e. from the date of political agreement (Art 8aaa(5) as inserted by Article 1(2)) puts intermediaries in the impossible situation of being obliged to comply with laws before they are proposed and passed by Member States' Parliaments.

Other

We are concerned that there seems to be no provisions to limit the compliance burden around double reporting. Where a transaction is already known to have been reported (either by a related party of the taxpayer or intermediary) in another Member State, there should be no need for it to be reported again. In addition (and especially given the overly broad hallmarks and the extensive range of transactions that will fall within them), it would be useful if taxpayers and intermediaries were absolved from reporting where similar transactions had already been reported. This could be achieved equitably if tax authorities were required to periodically publish anonymised summaries of transactions meeting the hallmarks of which they had already been notified.