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Position Paper of the German Association of Tax Advisers (DStV) regarding the proposed OECD Mandatory Disclosure Rules for Addressing CRS Avoidance Arrangements and Offshore Structures

In the preceding months, multiple leaks such as the Panama Papers and Paradise Papers have shown that cross-border tax planning models enabled global undertakings to channel billions of euros in tax revenues away from the European Union and its Member States. In doing so, law firms specializing in international tax planning fed into a market where specially designed "products" are offered to undertakings with the aim of reducing their overall tax burden. In developing their products, law firms search for loopholes in the international tax system, on which basis turnovers and profits can be shifted until almost no tax must be paid.

The OECD Model Rules giving rise to this public consultation focus on arrangements that are designed to avoid reporting under the OECD Common Reporting Standards (CRS). Thus, the defining feature of the arrangement is unlikely to be its tax consequences per se, but rather the way the arrangement can be used to circumvent CRS reporting obligations and undermine financial institutions due diligence procedures. It therefore, nevertheless, has an indirect impact on taxation and tax advisers *qua* intermediaries.

Preliminary remarks

The CRS, the BEPS 12 Action Plan Report and the Model Rules giving rise to this consultation rightfully acknowledge that the true reasons for aggressive tax planning, the design of opaque offshore structures or CRS avoidance arrangements are the diversities between national regulations. For example, states use their tax systems to compete against each other by raising attractiveness for the economy, thereby motivating profit shifting resulting in undue distortions of competition. The construction of taxation schemes or reporting avoidance arrangements only exists because national laws are not coordinated. The EU Commission and the OECD have recognized this and seek for global solutions to this problem within the BEPS project.

The DStV firmly supports all reasonable national and international efforts to curb tax evasion and comparable practices if they progressively reduce the differences in tax systems or between reporting obligations between States. For this reason, we welcom the OECD, G20 and G7 initiative which led to the creation of the Common Reporting Standard (CRS) for the automatic exchange of financial account information.

The discussion draft for model “Mandatory Disclosure Rules for Addressing CRS Avoidance Arrangments and Offshore Structures” is therefore in our view a necessary and welcome addition to increase the robustness of the CRS regime. The insights about tax arrangements, employed by individuals and international corporations, are capable of undermining trust and fairness in our societies in general, and threaten the integrity of our tax systems. The OECD Model Rules can provide tax administrations with intelligence on the design and supply of CRS avoidance arrangements and offshore structures. At the same time, we need to keep in mind that mandatory disclosure obligations need to be justified and proportionate, since they are facie in breach of the principles of privacy and confidentiality, for example guaranteed by Article 8 of the European Convention of Human Rights.

It should be noted that over 99.9% of tax accountants and taxpayers are not involved in CRS avoidance arrangements or the design of opaque offshore structures. This is demonstrated, for example, by the results of a study prepared by the Greens in the European Parliament. In the study *"Usual Suspects? - Co-conspirators in the business of tax dodging”* the largest tax data leaks in recent years, the offshore leaks, the Panama Papers and the Bahamas Leaks, are evaluated (see study commissioned by The Greens/EFA in the European Parliament: "Usual Suspects? - Co-conspirators in the business of tax dodging"). This evaluation has shown that intermediaries designing critical tax arrangements or offshore structures are barely active in

Germany. Germany does not rank among the world or European TOP 10 countries (see the aforementioned study, Figure 2, page 8, and Figure 5, page 10). Rather, the German share accounts for only 2.99% of the intermediaries involved in such models in the EU. Furthermore, the study reveals that German small and medium-sized law firms are not listed as relevant intermediaries within the scope of the study.

It is thus important that **any kind of international regulation on disclosure requirements affecting the profession of tax advisers is carried out with great caution and carefulness in order to not overburden small and medium sized firms**.

The DStV therefore emphatically notes that the expedient idea of drafting a model regulation for mandatory disclosure rules needs to keep the important societal functions of tax advisers in mind. Only a negliglible minority of tax advisors engage in harmful practices, and burdening the vast majority of upright professionals with excessive red tape or treating them as suspects would undermine the effectiveness, sustainability and acceptability of the measure at hand.

In this regard, the DStV emphasizes that:

Disclosure requirements cannot affect either the core of the professional ethics of tax advisers (i.e. confidentiality), the nature and substance of the professional regulation of tax advisers within their national context (i.e. alter the socio-economic role of a profession) or the capacity of the profession to deliver high quality services to its clients (i.e. by an increase of workload as a consequence of an unbridled disclosure obligation). For this reason,

1. **the subject matter of the disclosure obligation must be clearly determined and precisely formulated. In this regard, specific hallmarks should be preferred over generic hallmarks. By this, unnecessary disclosing of information is prevented. Intermediaries or other reporting entities are not overly burdened by the uncertainty of what needs to be disclosed.**

2. **The subject matter of the CRS Avoidance Arrangements and Opaque Offshore Structures as well as the persons required to disclose (and under what circumstances) must be specified clearly and with legal certainty. This**

also includes the point of time when disclosure has to be made (i.e. feasible). Differences in the implementation in national law will automatically lead to legal uncertainty and undermine transparency.

3. The OECD Model Rules must give sufficient margin to the national legislator to align the specificities of the national professional regulations with the OECD disclosure requirements. Only this can guarantee that the OECD Model Rules have no negative impact on the exercise of the liberal professions that characterize intermediaries.

Comments on selected provisions

Section 3(1) in conj. with 3(5) pt. 1, 2 and 4 – The definition of intermediary

Intermediary is defined as "promoter" - persons who are responsible for the design or marketing of an Offshore Structure or a CRS Avoidance Arrangement – or as a "Service Provider" – a person that is responsible for the design, marketing, implementation or organization of the structure or arrangement.

The fact that the definition of intermediary goes beyond tax adviser and focusses of the nature of the activity instead is favorable to the DStV. Especially since the disclosure obligation relates to structures or organizations that are preferably designed, marketed, implemented or organized by financial advisors or investment advisers or lawyers (see. Para 64).

It is however unclear, if the intermediary must be member of a profession in the state in which it is active. Tax advisor is a regulated profession and comes with a protected title. **It should be clarified that the trigger for the disclosure obligation is the activity pursued**. Acting under a title (regulated profession) only shall not be a decisive criterion.

Moreover, there is need to clarify if the personal scope covers companies or undertakings acting as intermediaries. At the current stage the reference is made to "persons". Does this refer to natural persons only or does it include legal persons as well. This must be further clarified for the sake of legal certainty.

At para. 64 the explanation defines the intermediary as a “local intermediary” providing its services through a “branch”. In the light of the current era of digitalisation this criterion of “physical presence” seems outdated. Services, such as consulting or advisory services, do not per se require physical presence in the country where the service is delivered. Where must disclosure be made if the service provide does not offer the service via a branch but online? Thus, **the definition of “branch” should be more specific or deleted**.

<u>Section 3(3) – The determination of the start of and the period for disclosure</u>

Under the Model Rules, States are required to have a very short notification deadline for intermediaries. The information should be provided to the tax authority within 15 working days. The moment of time for this notification period is triggered in two situations:

- Where the person has designed the structure or arrangement and/or has begun marketing it (i.e. making it available for implementation) to other potential intermediaries or Reportable Taxpayers.
- Where the intermediary provides relevant services in respect of the structure or arrangement to a client or Reportable Taxpayer in circumstances where the Intermediary can reasonably be expected to know that the structure is an Offshore Structure and one of the benefits of the arrangement is the circumvention of CRS reporting.

These two situations can arise at different times in respect of the same structure or arrangement. Although “the filing date should be as soon as is practicable after the obligation to disclose has been triggered”, it is clear from the wording of the Model rules that the period for disclosure remains 15 working days. Irrespective of the point of time the disclosure obligation is triggered. While the DStV acknowledges the necessity to trigger the notification period in different points of time, depending on the activity pursued or service offered, inevitably, this will cause more workload for intermediaries and service providers.

For this reason, the DStV is of the opinion that a deadline of 15 days is unreasonably short. It is true that the necessary information is already available to the intermediary and the reportable taxpayer when arrangements or structures are made available or implemented. Nevertheless, the necessary information to be submitted by intermediaries or reportable taxpayers must be prepared, collected and reviewed before transmission to the tax authorities. The pure mass of information to be checked and reviewed can require more time than 15 working days to guarantee a full and complete disclosure of information under the Model Rules. This is due to, for example, the anonymization of information involving third parties, checking against self-incrimination or to ensure timely correspondence with other promoters or intermediaries involved in the same arrangements or structures (i.e. Chapter 4 exempts intermediaries from being required to disclose exactly the same information twice in respect of the same arrangement to the same tax authority).

The DStV therefore proposes to extend the deadline to **one month**.

Additional remark:

Currently it is unclear from the Model Rules how "having been made available" must be interpreted.

From our understanding a CRS Avoidance Arrangement or Offshore Structure will be treated as having been "made available" for implementation at the time the material design elements of the arrangement or structure have been completed and communicated to a client or Reportable Taxpayer. While the DStV welcomes the fact that the rules on disclosure have no retrospective effect, i.e. are only triggered after the service is provided to the client or Reportable Taxpayer or comes to the knowledge of the intermediary. It remains unclear if this includes cases where an CRS Avoidance Arrangement or Offshore Structure is communicated but not applied and turned into practice? Here, the DStV emphasizes that **further clarification is highly demanded to provide appropriate safeguards for intermediaries or promoters**.

<u>Section 4(1) pt. 1 - Information to be disclosed to the public authorities</u>

The last sentence of Chapter 4(1) determines that the intermediary must disclose the information "to the extent such information is within the Intermediary's knowledge, possession or control".

"Intermediaries knowledge, possession or control" are broad notions and must be further clarified, regarding, for example, the point of time the information comes to the intermediary's knowledge, possession or control. The definition of “their knowledge” is unclear. What is the scope? When does an intermediary have knowledge? Is suspicion sufficient? Likewise, the terms “possession or control” needs clarification. Does possession or control only exist where the possession or control is exercised materially over the information (i.e. hardcopy or digital copy)?

The Model Rules propose that the information will be treated as within a person’s control if it “can be obtained by asking for it”. The threshold of “being obtainable by asking for it” leaves a wide margin of interpretation and creates unnecessary uncertainty for intermediaries and Reportable Taxpayers. For example, how should an intermediary proceed if the information is not communicated upon asking for it?

An intermediary cannot be expected to go beyond the requirements of the applicable professional standards and existing know-your-customer rules when collecting and reporting information under the Model Rules. Thus, the DStV strongly reminds the OECD to ensure a **high level of legal certainty by avoiding generic and broad requirements** being imposed on intermediaries.

Section 1 and 2 - Hallmarks

The description of the arrangements that are required to be disclosed is an essential aspect of the proposed Model Rules. To that end, the OECD draft contains the so called “hallmarks” set out in Chapter I and II. Hallmarks act as filters which specify the features of arrangements of interest for the tax administration under the Model Rules at hand. They can be divided in two categories: “generic hallmarks” and “specific hallmarks”. Bearing in mind that hallmarks define what constitutes a reportable arrangement, these essential features must be well-defined, clear and concise so as to maximize the legal certainty within which intermediaries and Reportable Taxpayers exercise their disclosure duties.

Generic Hallmark - Avoidance Arrangements

Chapter I sets out the “generic hallmarks”, which are intended to capture concomitant circumstances of arrangements which are designed to circumvent, marketed as, or have the effect of bypassing the CRS. They do not define specific legal characteristics of the arrangements in question. Innovative arrangements with legal features unkown to the administration would not be identifyable through a list of such features. By capturing arrangements due to the concomitant circumstances, the “generic hallmarks” therefore act as the primary tool of the Model Rules to provide tax administrations with intelligence about innovative avoidance arrangements. Invertedly, by providing tax administrations with input about the avoidance strategies employed, the information gathered from arrangements to be disclosed under the “generic hallmarks” can be expected to inform legislative change. The “generic hallmarks” therefore act as a catalyst for legal policy.

Unlike comparable proposed regimes for tax matters, such as the OECD BEPS Action 12: Final Report Mandatory Disclosure Rules, or the European Commission’s proposal for the mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (COM(2017) 335 final and its Annex 1), **the “generic hallmarks” in the discussion draft are not mediated by any filter**.

However, filters ensure that a regulation does not include unnecessary or irrelevant cases. Overinclusion can lead to excessive compliance costs, particularly for smaller entities, undermine the willingness of obliged parties to comply with an otherwise sensible regulation and can cause preventive overreporting, which strains the resources of authorities and hinders them from identifying relevant cases for preventive regulation. Thus, the DStV strongly advises the OECD Model Rules **to include a main benefit test**.

In the case of the BEPS Action 12 Final Report and COM(2017) 335 a main benefit test acts as such a filter. It ensures that business decisions which reduce the tax rate as a side effect do not fall under the scope of the reporting requirement. In the case at hand, an implicit main benefit test can be included in the definition of CRS Avoidance Arrangement (p.8) as follows:

***[…] is any Arrangement for which it is reasonable to conclude that it is designed to, or marketed as circumventing CRS Legislation or exploiting an absence thereof.*”**

For example, this would remove business decisions which are not primarily targeted at, or marketed as CRS avoidance arrangements, but which as a secondary effect remove a transaction from the scope of CRS reporting.

Alternatively, the BEPS Action 12 Final Report contemplates **a de-minimis filter** (p. 38-39) to prevent overdisclosure, ensure the usefulness of the information attained and reduce the compliance cost for both the private sector and tax administrations. The de-minimis filter is discarded in the BEPS Action 12 Final Report, because of the pre-condition based on a main benefit test. However, since no main benefit test is included in the Model Rules, a de-minimis can be implemented to mediate the broad scope of the "generic hallmarks" and thereby reduce the risk of overinclusion. To ensure that the de-minimis filter would not be used to circumvent CRS obligations systematically, it would suffice to suspend its application for "specific hallmarks".

Specific Hallmark – Offshore structures

The "specific hallmarks" in Chapter II on the other hand list legal features, such as offshore structures, for which it is reasonable to conclude that they undermine or exploit weaknesses in the due diligence procedures under the CRS. These structures must be disclosed.

The specific hallmarks under the Model Rules allow tax authorities to target arrangements which are known to be used for CRS avoidance. Unlike the "general hallmarks", the specific hallmarks therefore do not target innovative arrangements, but arrangements which have already been identified by the tax administration, at least in their relevant characteristics.

Since the "specific hallmarks" build on the prior information available to the respective tax administration, the DStV suggestes **to heed the OECD BEPS 12 2015 Final Report principles, whereby the States define country specific hallmarks together with a list of excluded tax regimes and outcomes that are not required to be disclosed**. This would prevent the overinclusion of arrangements and build on the intelligence available to the respective tax administration. Additionally, this ensures the usefulness of the information attained and simultaneously reduces the compliance cost for both the private sector and tax administrations.

Section 4(3) – Avoidance of double disclosure

In order to avoid duplicate disclosure in respect of the same arrangement in the same jurisdiction, Chapter 4(3) of the Model Rules provides that the intermediary "shall not be required to disclose any information on an arrangement that has previously been disclosed to that tax authority by that intermediary or another intermediary".

The obligation to report certain information either on intermediaries or tax payers includes additional work. The adoption of a potentially broad information obligation must be prevented. While the DStV – in principle – welcomes the effort to minimize additional workload for intermediaries, the road taken under Chapter 4(3) seems to be flawed and not sufficient in attaining this goal.

For example, under the Model Rules two unrelated entities can be obliged to disclose information to the tax authorities. These intermediaries can be established in two countries and have no relation whatsoever. How does the 3.1(b) exception be applied in practice and ensure no additional workload for intermediaries? How is control ensured? How does this affect liability, where, for example, one intermediary communicates that the information has been disclosed, but in fact has not been? This **uncertainty gives room for abuse and thus needs further clarification**.

It should be noted that many firms that are considered as intermediaries under the proposal consist of only one professional and a few employees. The proposal is studded with such vague legal concepts. Here, **more legal certainty must be ensured to minimize the practical workload of intermediaries and to avoid disputes with the tax authorities and the risk of being penalised for a failure to report.** The Model Rules should give due account to this fact.

Section 4(2) – Protection of professional secrecy

The DStV welcomes the fact that the proposal recognises and seeks to protect the information exchanged between legal counsel and client, if the national regulations of a certain profession cover the information by professional secrecy (confidentiality). We emphasis, that in the light of transparency – the objective the Model Rules seek to attain - it is not relevant who provides the information to the tax authorities, but only that the relevant information is disclosed. The **DStV strongly emphasises that the relationship between the intermediary and his client should not unnecessarily been intervened with**, so as to infringe the rule of law at national level or disproportionately burden the intermediary.

The tax consultant is an independent body within tax law. Advice given on tax matters is a legal advice and the associated professional tasks serve the tax law, an important common good. The tax adviser has a prominent societal function in certain societies. The purpose of the professional confidentiality principle is to ensure an open and trustful relationship and communication between the client and his legal adviser.

The exemption to the disclosure obligation granted to intermediaries under Chapter 4(2) does not touch upon this specific feature of the legal relationship. By exempting the intermediary from the disclosure obligation if national law protects the principle of professional secrecy ensures that the core of the professional ethics and the trust between the adviser and client is maintained. In Germany, for example, this is the case for lawyers, accountants and tax advisers.

However, the DStV is of the opinion that the wording of Section 4(2)(2) point 1 can be misleading by covering information under the professional secrecy principle that emerges from "communications [which] are produced for the purpose of seeking or providing legal advice or used in existing or contemplated legal proceedings and protected from disclosure under domestic law". This **can be misleading** if, for example, other information that is not produced for purposes referred to before is not covered by professional secrecy. This is problematical under German law, where the principle of confidentiality covers all communication between adviser and client. A breach of which can be sanctioned by criminal law. Thus, the **DStV strongly advises that the principle of professional secrecy should be subject to its definition by law. Moreover, it must cover all communication and information exchanged by adviser and client (confidentiality).**

In the light of the foregoing, the **DStV supports that the disclosure obligation shifts to the reportable taxpayer where the intermediary is covered by a principle of professional secrecy** and, hence, is legally prevented from making a disclosure of information to third parties.

However, in this light, the DStV is **strongly against** an anonymous notification which is required by Section 4(2)(2) pt. (a), whereunder the intermediary is required to file a written notification to the responsible tax authority that he holds "information on a CRS Avoidance Arrangement or Offshore Structure that is not required to be disclosed" due to the exemption thereunder. An anonymous notification, although it does not disclose the personal information of the taxpayer involved, clearly violates the confidentiality principle entrusted to the intermediary (i.e. Parteiverrat). By making a notification to the relevant tax authority, irrespective of being anonymous or not, the confidentiality principle is negated.

Moreover, since the disclosure obligation shifts to the Reportable Taxpayer under Section 4(2)(2) pt. (b) where the waiver is triggered, there is no practical need for an additional notification by the intermediary. Rather, the DStV emphasis the disproportionality of this requirement, i.e. by overburdening intermediaries. The DStV wants to emphasise that the objective of the Model Rules is transparency. Transparency is attained either, by disclosure through the intermediary or by disclosure of the Reportable taxpayer. Any additional disclosure requirement or notification obligation is superfluous, violates the professional secrecy between adviser and client and clearly goes beyond what is strictly necessary to attain the objective of transparency. **In the light of the foregoing, the DStV strongly advises to delete the notification requirement under Section 4(2)(2) pt.(a)**.

Instead the OECD should further elaborate on the information obligation of the intermediary vis-à-vis the Reportable Taxpayer. It is important that the Model Rules clearly define to what extent the information obligation shifts from the intermediary to the Reportable Taxpayer. Currently, it remains unclear from the Model Rules when the intermediary has fulfilled its information obligation under Chapter 4(4) vis-à-vis the Reportable Taxpayer regarding the shift of the disclosure obligation. Is a formal information sufficient or must the intermediary accompany his client? Here, the **Model Rules must provide further clarification of the scope of the information obligation of the intermediary towards the Reportable Taxpayer**.

Also, **questions of liability must be clarified**. How and to what extent does the intermediary incur liability, if the information obligation is not pursued, pursued incorrectly, incomplete, late or false?

<u>Coherence with the EU Commission Proposal (COM(2017) 335 final)</u>

On a final note, the DStV wants to stress the importance of coherence among international and European initiatives when it comes to disclosure obligations that have an impact on the tax adviser profession.

Although the OECD Disclosure Rules for Addressing CRS Avoidance Arrangements and Offshore Structures and the EU Commissions proposal on the mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (COM(2017) 335 final) are not identical, they overlap on multiple aspects. Amongst others, for example, both legal instruments seek to impose disclosure or notification obligations on intermediaries and in particular tax advisers. The legislator wishes to enhance the transparency concerning cross-border tax planning or, in the case of the Model Rules, concerning the use of avoidance arrangements or offshore structures through which private entities avert reporting obligations vis-à-vis national tax authorities.

The DStV wishes to bring to the OECD’s attention that coherence of the procedural aspects affecting tax advisers under both instruments cannot be ignored or dealt with in isolation. Coherence of the two instruments must a central objective towards their finalisation. The OECD and the EU Commission must work closely to align and adjust their rules to the largest degree possible. The **aversion of unnecessary workload imputed to tax advisers or intermediaries must be ensured at all stages**.

Without asking, we will be happy to provide further information or explanation if needed.

Kind regards,

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