Deutsche Bank
Research

Research Briefing
European integration

And yet they do move

EU extending exchange of information for tax purposes – new OECD standard to be finalised by September

June 5, 2014

Author
Frank Zipfel
+49 69 910-31890
frank.zipfel@db.com

Editor
Barbara Böttcher

Deutsche Bank AG
Deutsche Bank Research
Frankfurt am Main
Germany
E-mail: marketing.dbr@db.com
Fax: +49 69 910-31877

www.dbresearch.com

DB Research Management
Ralf Hoffmann

Following tough negotiations in March the Council of Ministers adopted a proposal to extend the European Union's Savings Taxation Directive. It is to be transposed into national law by 2016 but only take effect from 2017. This means that all the EU member countries will see the scope of exchange of information broadened – in terms of both "entities" addressed and "definition of savings income". Thanks to EU agreements to be negotiated with five European third countries (Switzerland, Liechtenstein, Andorra, San Marino and Monaco) on equivalent measures by end-2014, automatic exchange of information is also to be extended to these countries. Given the developments at the international level, the negotiations are very likely to be brought to a successful conclusion.

Moreover, on the basis of the existing revised Administrative Cooperation Directive, further types of income and capital are to become subject to automatic exchange of information from 2015. On top of this, as part of the proposal tabled in June 2013 to further extend the Administrative Cooperation Directive there is a call not only for mandatory automatic exchange of information regarding numerous other types of income (such as dividends and capital gains), but also account balances. With the amendment to be adopted by year-end, the current version of this directive already contains aspects deriving partly from the implementation of the US FATCA legislation and partly from aspects required by the new OECD standard. In the longer term it could subsume the provisions of the Savings Taxation Directive.

In February, the OECD presented a new standard for the global implementation of automatic exchange of information. This is to be supplemented by September 2014 with a detailed commentary as well as technical solutions. The OECD efforts have strongly accelerated developments in the EU. The standard is much more comprehensive than the rules set out in the framework of the updated Savings Taxation Directive, but also goes further than the existing proposal to extend the Administrative Cooperation Directive. Therefore, expect the proposal to still have to be adapted to the OECD standard.

The progress in establishing automatic exchange of information was virtually impossible to envisage one and a half years ago. However, the current schedule is very optimistic. But given the international developments over the past year it may be assumed that nothing will be able to stop the march of automatic exchange of information even beyond the EU's borders on a medium-term horizon. It remains to be seen to what extent it will actually be possible to coordinate the multitude of international initiatives with one another and ensure adequate data protection.

Overview of developments since summer 2013 | 1

- May 2013: European Commission is given mandate to negotiate with five European third countries* on tax agreements which are intended to broaden the base of savings taxation and automatic exchange of information.
- June 2013: Commission submits draft to extend the Administrative Cooperation Directive, which provides for a significant extension of automatic exchange of information.
- September 2013: G20 advocates among other things that automatic exchange of information becomes a global standard.
- November 2013: Commission tables draft legislation to amend Parent-Subsidiary Directive which is mainly meant to prevent double non-taxation by means of improper structuring (e.g. via so-called hybrid bonds).
- December 2013: European Council expects adoption of legislation to extend Savings Taxation Directive by March 2014.
- February 13, 2014: OECD presents new standard on exchange of information.
- February 23, 2014: G20 finance ministers welcome and support the new standard, mandating the OECD to table a detailed commentary and technical solutions for the standard.
- March 11, 2014: European Commission presents ECOFIN and European Council with progress report on negotiations with five European third countries on extending exchange of information.
- March 19, 2014: 44 countries (including 23 EU members such as DE, IT, FR, NL and UK) commit in a joint statement to acting as early adopters of automatic exchange of information and pledge to do so by the end of 2017 if possible.
- March 21, 2014: Luxembourg and Austria abandon their resistance to automatic exchange of information at European Council meeting.
- March 24, 2014: Council formally adopts extended Savings Taxation Directive. Directive in force from 2017.
- July 1, 2014: FATCA reporting obligation for banks comes into force.
- By September 2014: Conclusion of work on automatic exchange of information at OECD level and confirmation by G20.
- End-2014: Target for conclusion of negotiations with third countries and adoption of Administrative Cooperation Directive.

* Switzerland, Liechtenstein, Monaco, Andorra and San Marino

International cooperation remains very dynamic

The rapidity with which (automatic) exchange of information in tax matters is being extended at both the EU and international levels has continued apace in 2014. Following tough negotiations, the Council of Ministers formally adopted the proposal to extend the European Union's Savings Taxation Directive[1] on March 24.[2] At times it had looked as if Austria and Luxembourg had wanted to further delay its adoption after all. Still, the directive is not required to be transposed into national law by 2015 but only from the beginning of 2016. It is not to take effect until 2017, though.

Several factors paved the way for this development. Besides the international pressure from US (FATCA), G20 and OECD efforts on exchange of information in tax matters, the ongoing negotiations between the Commission and five European third countries obviously also played a part.[3] By end-February there had already been two negotiating rounds in which all five countries had indicated their willingness in principle to extend the existing agreements with the EU to include automatic exchange of information in compliance with the new OECD standard.[4] The wording of the agreements is to be finalised by the end of 2014.

Thanks to the adoption of the proposal to extend the Savings Taxation Directive, another important stepping-stone towards comprehensive, universal automatic exchange of information has been laid at the EU level. This goes hand in hand with a final paradigm shift away from taxation at source (or withholding taxes) towards automatic exchange of information (AEI). However, this does not rule out the possibility that at the national level – i.e. for tax residents who maintain depository and custodial accounts at domestic banks – a final withholding tax may continue to be imposed even if foreign income is generated there too. In this way, for instance, tax residents of Germany can continue to enjoy the benefits of the final withholding tax on investment income – including, say, the simplified tax procedure for both taxpayers and financial authorities as well as an internationally competitive tax rate.

The developments at EU level will increasingly be shaped and accompanied by global efforts to establish far-reaching automatic exchange of information. In February, the OECD unveiled – as announced – global standards[5] to implement this automatic procedure. By September these are to be supplemented with a detailed commentary and technical solutions and then tabled as one "complete package".[6] In parallel, 44 countries – including not only the large EU members but also a number of "offshore centres" – issued a joint statement in March in which they committed to early adoption of automatic exchange of information on the basis of the new OECD standard.[7] Depending on a given account (balance), automatic exchange of information is to be launched in either September 2017 or 2018. This target date is anything but modest.

---

[1] See COM (2008) 727.
[2] See Council (2014). The political breakthrough was already achieved at the European Council meeting on March 20.
[3] See COM (2014a). Third countries: Switzerland, Liechtenstein, Monaco, Andorra and San Marino.
[4] See COM (2014a).
[5] See OECD (2014a). The OECD had been given the respective mandate by the G8 and the G20.
[6] On May 6, the 34 OECD countries plus 13 other countries pledged to implement the OECD standard and thus introduce automatic exchange of information on this basis. See OECD (2014d).
[7] See OECD (2014b). In so doing, they embraced the initiative of the so-called G5 for a pilot project on automatic exchange of information based on the FATCA model of April 2013.

OECD efforts have speeded up developments in the EU significantly

OECD standard much more broadly based than Savings Taxation Directive

The new OECD standard on automatic exchange of information is much more broadly based than the rules of the Savings Taxation Directive – even if one takes into consideration the recently adopted extension of the directive. This is not very surprising considering that the extension proposal dated back to 2008. Fundamentally, the OECD standard provides that countries collect information from "their" financial institutions on an annual basis and exchange it with other countries.[8] The standard sets out in uniform and relatively abstract terms exactly what information has to be exchanged, which financial institutions have to report it, which types of account and which entities (natural and legal persons) are affected, and which obligations of due diligence are incumbent on the financial institutions.

The standard consists of two components. The first is known as the CRS (Common Reporting Standard). It contains the reporting and due diligence rules for financial institutions. This has to be transposed into national law.[9] The second is known as the CAA (Competent Authority Agreement), which contains the detailed rules for the exchange of information. This can be implemented under existing rules such as the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, or bilaterally in double taxation agreements (Article 26 of OECD Model Agreement).

Fundamentally, OECD standard will cover all types of investment income

To minimise the latitude for taxpayers to circumvent the reporting duty by switching assets into other types of investment or legal entity the OECD defines both the scope of financial information and type of account holder as well as the financial institutions subject to reporting requirements in the broadest terms possible. Financial information thus embraces all types of investment income (i.e. interest, dividends, income from certain types of life insurance products or similar income and all other types of income from assets held in an account), but also account balances and (gross) sales proceeds linked to custodial accounts in which financial assets are held. Financial institutions are defined in such general terms that not only banks and asset managers but also brokers and certain types of insurance company, for instance, fall into this category.[10] Account information comprises not only accounts of natural persons but also of other entities or legal persons such as trustees or foundations. In the wording of the OECD standard, the reporting financial institutions are required to take a "look through"[11] approach to determine the ultimate, effective (or individual) owner, as far as this is possible – in so doing, recourse is to be taken to existing rules such as anti-money-laundering procedures.

Objective is to determine ultimate economic owner

[8] For more on this and what follows see OECD (2014a) and OECD (2014c).
[9] The CRS is strongly based on the general agreements and international treaties which the US has already reached with many countries to implement the FATCA standard and which provide for reciprocal obligations on exchange of information (Model I IGA). Unlike FATCA, the OECD model takes a multilateral approach which provides for a truly reciprocal automatic exchange of information and no longer contains US-specific factors and conditions. For example, the standard does not focus on citizenship. In the case of FATCA the European banks are required to report information on a broad spectrum of investment income accruing to US citizens, such as interest, dividends, (gross) sales proceeds from financial assets, and derivatives. Up to now, however, US banks have only been required to report deposit interest paid to natural persons in the US.
[10] For details see OECD (2014a), p. 29ff.
[11] This refers particularly to passive units.

Banking secrecy for non-residents of the EU is virtually history

By 2017 at the latest, automatic exchange of information will be the standard for non-residents (for tax purposes) in all the EU member countries – i.e. including Luxembourg and Austria.[12] Beyond the EU countries, the reach of the Savings Taxation Directive will be extended by bilateral agreements between the member states and Britain's and the Netherlands' dependent and associated territories. Furthermore, it will be extended to the countries already mentioned in the context of the EU agreements to be hammered out by end-2014 with the five European third countries of Switzerland, Liechtenstein, Andorra, San Marino and Monaco. Given developments at the OECD level and the negotiating rounds to date, the talks are very likely to be brought to a successful conclusion.

Successful conclusion to negotiations with third countries likely

The upshot is that the Savings Taxation Directive already provides a basis for reporting not only interest payments on debt claims, sales proceeds on debt claims and income from certain investment funds, but also all income from investment funds and life insurance products that are substantially similar to debt claims. Also included is income from innovative financial products similar to debt claims. In this context, of course not only natural persons but also legal persons, such as foundations or trusts, are required to exchange data. Moreover, the paying agent must also verify who is the actual economic owner of interest income. In this way, both the definition of savings income is considerably extended as is the scope of entities subject to the reporting obligations.

Already adopted directives will lead to significant extension of exchange of information

From 2015 the revised Administrative Cooperation Directive already adopted in 2011 will add five further categories of income and capital to automatic exchange of information: income from employment, director fees, pensions, life insurance products not covered by the Union's other legal instruments, and ownership of and income from immovable property (e.g. rents). The prerequisite for this, however, is that the information in the respective country is already available – it is only in such cases that the obligation to exchange data will be applicable.[13]

On top of this, as part of the proposal tabled in June 2013 to further extend the Administrative Cooperation Directive[14] there is a call for mandatory automatic exchange of information also for dividends and capital gains as well as all other income with respect to assets held in a financial account. Among other things, account balances would have to be reported too. The current Administrative Cooperation Directive already contains aspects deriving partly from the implementation of the US FATCA legislation and partly from aspects required by the new OECD standard. Therefore, in the longer term the Savings Taxation Directive could be merged into the Administrative Cooperation Directive.

---

[12] For more on this and what follows see Council (2014a), Council (2014b), COM (2014a) and COM (2014b).
[13] For more details see Administrative Cooperation Directive (2011) and Zipfel, Frank (2013).
[14] See COM (2013) 348 final.

Roadmap for establishment of automatic exchange of information 2

Automatic exchange of information			
	Instrument	Status	Next step
EU	Administrative Cooperation Directive 2011	Adopted	Extended exchange of information from 2015
EU	Proposal to extend Administrative Cooperation Directive 2013	In Council	To be adopted by year-end (?!)
EU	Extended Savings Taxation Directive	Adopted March 2014	Extended exchange of information from 2017
EU	Bilateral agreements with third countries	Under negotiation since end of 2013	Under negotiation – target for conclusion by end-2014
Global	Global OECD standard for automatic exchange of information	OECD debate Standard published in March 2014	Conclusion and adoption of complete package by September 2014 (G20), subsequently bilateral implementation required (by 2017?!)

Source: Com (2014a)

How will the OECD standard be implemented in the EU?

OECD and G20 negotiations have more or less "overtaken" developments at EU level

Actually, the proposal to extend the Administrative Cooperation Directive was expected to be adopted by the Council of Ministers back in late 2013, and exchange of information on this basis to take effect from 2015. However, that has not happened yet. This is mainly attributable to two factors. For one, the negotiations demanded by Austria and Luxembourg to reach agreements with five important European third countries did not really take off until late 2013. For another, the developments in the OECD and G20 since H2 2013 have accelerated to such a degree that they have more or less "overtaken" the talks at EU level. Why is this so important for implementation in the EU?

Taxation Directive would have to be adapted to OECD standard

After the OECD standard was unveiled in February 2014 it emerged that the proposal to amend the Administrative Cooperation Directive would not go far enough to meet that standard. This applies a fortiori to the Savings Taxation Directive: the directive will, in principle, become obsolete as soon as the OECD standard is in place since the former is much narrower in scope. Moreover, given the differing approaches[15], the problem will be caused by the conflicts that arise between the Savings Taxation Directive and the OECD standard. While, for example, interest savings are defined very precisely in the Savings Taxation Directive, and there are also detailed lists specifying the affected "entities", the OECD standard does not require this since it is worded in much more general

[15] This primarily applies to the way in which income and the reporting entities are defined.

and abstract terms.[16] This would bring about precisely what is to be avoided according to all political statements: differing standards existing in parallel, as this is contradictory to efficient, uniform and consistent implementation of automatic exchange of information – from the standpoint of the financial authorities, financial institutions and paying agents.

Administrative Cooperation Directive needs amending for implementation of OECD standard

Therefore, it now looks as if the proposal to revise the Administrative Cooperation Directive is to be adapted to the OECD standard – assuming this proposal is implemented in the Administrative Cooperation Directive framework. Since the OECD's "complete package" itself is not meant to be finalised until this coming September, it is very doubtful whether the draft directive can still be amended in the course of the year in a way that meets the requirements of the OECD standard and subsequently still be adopted by the Council of Ministers by year-end. To achieve this, the negotiations with third countries would also have to be stepped up in parallel – here, too, the existing proposal fails to provide an adequate negotiating basis.

Technically, the new OECD standard will initially be nothing other than a model for information and double taxation agreements. This means that in practice, despite the uniform standard, exchange of information must generally be arranged bilaterally between countries – and in the best case multilaterally between several countries – via an additional new agreement. The actual exchange of information can ultimately only be conducted on a bilateral basis, though. Against this backdrop, the year 2017 may be considered more than ambitious as the starting point for exchange of information. At the very least the EU countries could prescribe binding use of the standard via a directive, but this also requires a certain time lead – if for nothing else than to create the technical prerequisites. The example of FATCA shows how long such a process can last.

Big tax data – flood of data set to swamp tax administrations

Exchange of information generates deluge of data – not linked with automatic deduction at source

A uniform, coordinated system of exchange of information in tax matters can help to avoid competitive disadvantages for investors and companies alike, since distorting effects of taxation on capital allocation which are also caused by tax evasion can be mitigated. However, to do so the tax authorities must also be able to handle the deluge of data. The example of escalating numbers of people voluntarily turning themselves in for tax evasion[17] in Germany shows that corresponding technical and staffing prerequisites have to be met to be able to deal with the information sensibly. Because exchange of information does not automatically mean tax is withheld at the source, it is ultimately up to the tax authorities to carry out the taxation procedure, i.e. make active use of the data in the proceedings. However, withholding a flat tax at source remains possible at the national level, i.e. for tax residents, as this greatly simplifies matters for the tax authorities and taxpayers alike.

Data protection is critical element of OECD standard

A crucial point in implementation will be the issue of data protection. The comprehensive exchange of information targeted by the standard involves the global exchange of huge volumes of sensitive data. True, data protection clauses are fundamentally a constituent part of the standard. However, more precise stipulations will not be available until September 2014 in the complete package. Incidentally, the data protection issue leaves a backdoor open. A blanket clause provides that whenever a country determines that its respective contracting partner fails to fulfil its commitments – explicit reference is made to

[16] The story is similar for the Administrative Cooperation Directive. Here, for example, capital gains are defined more precisely. The OECD standard takes a different approach here, too – (gross) sales proceeds from financial assets are described there in very general terms.
[17] See SZ (2014).

compliance with data security in this context – the exchange of information can be stopped with immediate effect.

Conclusion

March of automatic exchange of information can no longer be stopped

In conclusion it is important to note that the progress made towards establishing automatic exchange of information would have been nearly inconceivable just one and a half years ago. Ultimately, the US was the catalyst with FATCA. It remains to be seen to what extent it will actually be possible to coordinate the multitude of international initiatives with one another and ensure adequate data protection. It is undoubtedly correct from a political standpoint to use the existing window of opportunity to establish automatic exchange of information around the world if possible. While the tentative schedule is overly optimistic, it may be assumed that nothing will be able to stop the march of automatic exchange of information even beyond the EU's borders on a medium-term horizon.

Frank Zipfel (+49 69 910-31890, frank.zipfel@db.com)

Selected literature

Administrative Cooperation Directive (2011). Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC.

COM (2013). 348 final of 12.6.2013. Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation.

COM (2014a). Enhancement of the EU Savings Directive, Technical Briefing. 24 March 2014.

COM (2014b). MEMO/14/172 EU savings taxation rules and savings agreements with third countries: frequently asked questions. 10 March 2014.

Council (2014a). Press release 8100/14, 3307th Council meeting on 24 March 2014, and Press release 7524/14.

Council (2014b). Council Directive 2014/48/EU of 24 March 2014 amending Directive 2003/48/EC on taxation of savings income in the form of interest payments.

OECD (2014a). Standard for Automatic Exchange of Financial Account Information, Common Reporting Standard.

OECD (2014b). Joint Statement by the early adopters group. 19 March 2014. http://www.oecd.org/tax/transparency/AEOIjointstatement.pdf.

OECD (2014c). Automatic Exchange of Financial Account Information. Background Information Brief, Update, 13 February 2014.

OECD (2014d). Declaration on automatic exchange of information in tax matters. Adopted on 6 May 2014. http://www.oecd.org/mcm/MCM-2014-Declaration-Tax.pdf.

SZ (2014). Zahl der Selbstanzeigen steigt rasant. Süddeutsche Zeitung. 15 April 2014.

Zipfel, Frank (2013). Savings Tax, Administrative Cooperation & Co.

© Copyright 2014. Deutsche Bank AG, Deutsche Bank Research, 60262 Frankfurt am Main, Germany. All rights reserved. When quoting please cite "Deutsche Bank Research".
The above information does not constitute the provision of investment, legal or tax advice. Any views expressed reflect the current views of the author, which do not necessarily correspond to the opinions of Deutsche Bank AG or its affiliates. Opinions expressed may change without notice. Opinions expressed may differ from views set out in other documents, including research, published by Deutsche Bank. The above information is provided for informational purposes only and without any obligation, whether contractual or otherwise. No warranty or representation is made as to the correctness, completeness and accuracy of the information given or the assessments made.
In Germany this information is approved and/or communicated by Deutsche Bank AG Frankfurt, authorised by Bundesanstalt für Finanzdienstleistungs-aufsicht. In the United Kingdom this information is approved and/or communicated by Deutsche Bank AG London, a member of the London Stock Exchange regulated by the Financial Services Authority for the conduct of investment business in the UK. This information is distributed in Hong Kong by Deutsche Bank AG, Hong Kong Branch, in Korea by Deutsche Securities Korea Co. and in Singapore by Deutsche Bank AG, Singapore Branch. In Japan this information is approved and/or distributed by Deutsche Securities Limited, Tokyo Branch. In Australia, retail clients should obtain a copy of a Product Disclosure Statement (PDS) relating to any financial product referred to in this report and consider the PDS before making any decision about whether to acquire the product.

Internet/E-mail: ISSN 2193-5963