# The European Union's Mandatory Disclosure Regime

## A roundtable discussion

June 2018

# The European Union's Mandatory Disclosure Regime

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Welcome

On 25 May 2018, the Council of the European Union formally adopted the Directive amending Directive 2011/16/EU with respect to mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (the Directive). The content of the adopted Directive corresponds to that agreed by the Economic and Financial Affairs Council of the European Union (ECOFIN) on 13 March 2018.

The Directive, which will now take effect on 25 June 2018[1], will require "intermediaries" such as tax advisors, accountants and lawyers that design and/or promote tax planning arrangements to report transactions and arrangements that are considered by the EU to be potentially aggressive.

If there are no intermediaries that can report, the obligation will shift to the taxpayers.

Given the breadth of the transactions and arrangements covered, relevant reporting obligations will very likely result for both companies headquartered in Europe and for non-European companies with activities in Europe. Determining if there is a reportable cross-border arrangement raises complex technical and procedural issues for multinational companies and their advisors.

Our roundtable panel discuss the new provisions and how they may impact your business, including:

- Background and timeline
- Details of the mandatory disclosure requirements, including the purpose of the reporting, what arrangements are reportable, when reporting must be made and what happens with reported information
- Implications of reporting/failure to report
- The need for tracking and reporting systems and procedures

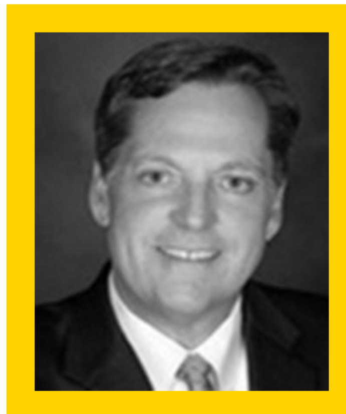
The roundtable discussion occurred in April 2018, prior to formal adoption of the Directive.

1. *EU publishes Directive on new mandatory transparency rules for intermediaries and taxpayers*, EY Global Tax Alert, 5 June 2018. https://www.ey.com/gl/en/services/tax/international-tax/alert--eu-publishes-directive-on-new-mandatory-transparency-rules-for-intermediaries-and-taxpayers

# Roundtable participants

Jano Bustos

Jano Bustos leads the BEPS desk in the EY Global Desk Network in New York. Before joining EY, Jano worked at the Spanish Ministry of Finance where, among other roles, he was a delegate to several of the OECD working parties and was part of the group of ad hoc tax experts to the United Nations.



Tom Ralph

Tom is a US native, but resident in Munich, Germany, where he is a member of EY's United States transfer pricing desk.

Stephanie Lamb

Stephanie is one of the leaders of our Financial Services practice.

Rienk Kamphuis
Rienk is one of the leaders of our Tax Technology and Transformation practice.

Moderator: Marlies de Ruiter
Marlies de Ruiter is the EY Global International Tax Services Policy Leader, based in the Netherlands. Marlies has broad experience with international tax policy, and specifically with BEPS, and was previously the Head of the Tax Treaty, Transfer Pricing and Financial Transactions Division of the OECD's Centre for Tax Policy and Administration. Under her leadership, the OECD developed 7 of the 15 BEPS actions, including the actions on tax treaties and transfer pricing.

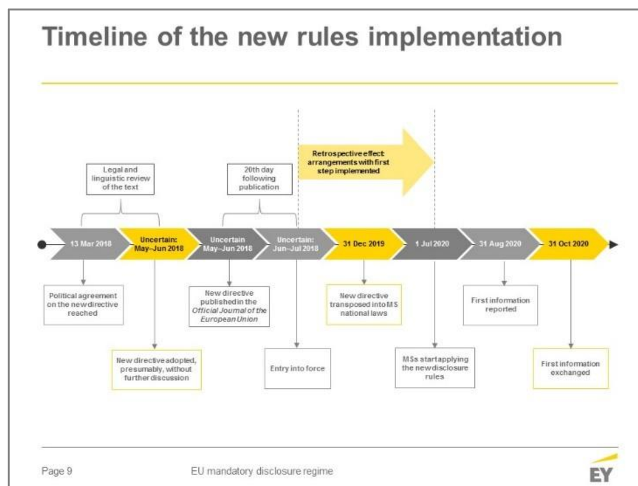
# The European Union's Mandatory Disclosure Regime: rationale for the new rules

Marlies de Ruiter: On March 13, the EU Council reached agreement that so called tax intermediaries – which in their press release they summarized as tax advisors, accountants and lawyers – need to report, and again I use the words that the EU uses in its press release "schemes that are considered potentially aggressive." The agreement of the Council was on a draft Directive that itself would amend EU Directive 2011/16/EU which involves administrative cooperation in the field of taxation.

As we will cover in our discussion today, a more thorough read of the Directive, however, makes it clear that the term intermediaries is quite broad, potentially including banks and trusts. This obligation to report will shift to taxpayers themselves if there is no (EU) intermediary that is obliged to report. Also, we will see that the net to catch what is considered aggressive cross-border tax planning is cast rather wide. Moreover, once the report has been made, it will automatically be shared between all tax authorities in the EU.

The broad scope is consistent with the aim of the Directive, which is to tackle what the EU sees as aggressive cross-border tax planning. The Directive achieves that in two different ways: first, by providing tax authorities with information about the types of tax arrangements that are being used, but also by trying to create a behavioral change via a deterrent for taxpayers to engage in behaviors that could draw the attention of the tax authorities once reported. Of course, the first question to ask with new rules, in particular rules like these which will impact compliance processes at the core, is when they will start to have an impact.

Stephanie, even though reporting isn't required until 2020 – my understanding is that the application of the rules is imminent. Is that right?




Stephanie Lamb: That's right, yes; because the Directive asks EU Member States to give retrospective effect to the rules when they implement them. Let me explain what that means; On 13 March 2018, political agreement was reached on the text of the Directive, and the Directive was adopted by the Council of the European Union on 25 May 2018. It enters into effect 20 days after its official publication, which means on 25 June 2018. Member States will translate the Directive into national legislation before the end of 2019, and the legislation will have to take effect as of July 2020. However, as I said there is the obligation to create a retrospective effect for any reportable cross-border arrangements of which the first step was implemented after entry into force of the Directive and before July 1st 2020.

Reporting will have to take place before 31 August 2020 and, after that, the first exchanges of this information will take place in October 2020. Given the steps that must be taken between not now and its official adoption, we therefore expect that the scope of this Directive will include reportable cross-border arrangements implemented as of June or July this year.

Once it is established that there is a reportable cross-border arrangement, then the next thing to establish is who needs to report – an intermediary or, if there is no intermediary that is obliged to report, the taxpayer.

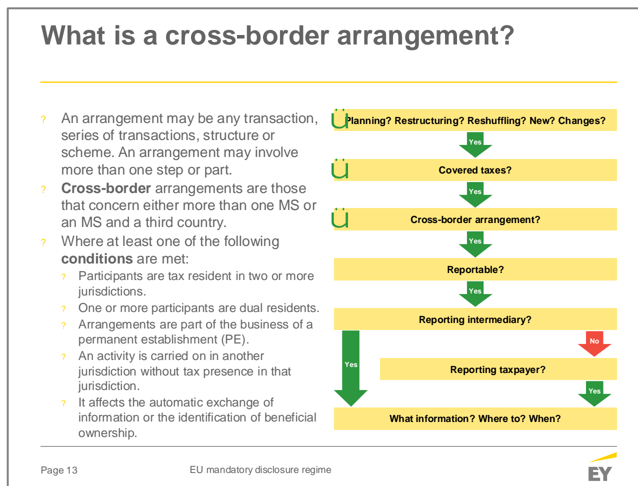
Marlies: So it's going to be crucially important to be able to identify these reportable cross-border arrangements as of July or so this year and penalties will apply to situations of non-compliance. In order to understand what needs to be reported and who needs to report, let's first take a look at the overview of the process.

As you see, the whole process starts from the indication that something may be changing in the tax environment, or the entrepreneurial or even personal environment of a person, if this may have tax consequences. This person may be an individual or an entity. Such a change may be a planning activity that is, for example, needed because of new market developments, a restructuring of activities or reshuffling of entities or the creation of new contracts and transactions. From there, the first question is whether the taxes that may be implied are in scope of the Directive. If they are, then whether the change leads to a cross-border arrangement needs to be assessed and, if it does, whether that arrangement is reportable because it meets one or more of the predefined hallmarks. Once it is established that there is a reportable cross-border arrangement, then the next thing to establish is who needs to report – an intermediary or, if there is no intermediary that is obliged to report, the taxpayer. Finally when it is established who needs to report, then the next questions are what information needs to be reported when and where.

Moving back to the first step of the process, the first question to ask is what taxes are covered. Stephanie, can you shed some light on that?

Stephanie: The existing Directive, into which the new rules are being added, is one that relates to all taxes, but specifically excludes many indirect taxes. So, income tax, corporate tax, capital gains tax, registration duties, local taxes, real estate taxes, and wealth or inheritance taxes are all within the scope; however, indirect taxes such as VAT, customs and excise duties are not. Also social security contributions and fees for certificates, etc. and dues of a contractual nature are excluded.

Marlies: So that limits the application more or less to direct taxes, which is also confirmed by the press release accompanying the new Directive. The next question is whether the change may lead to a cross-border arrangement. Tom, what is a cross-border arrangement, according to the Directive?




Tom Ralph: First, I would like to note that many of the concepts that we will be diving into now, even when further defined, are vague and require interpretation. The interpretation by the governments that will be needed once governments introduce these rules into their domestic legislation is not yet available, and will likely only be produced sometime next year. Also, countries may deviate from the Directive and be stricter, for example, including domestic arrangements in their requirements. But at this moment we can only work with information we have, and as mentioned, due to the retrospective effect that is required, we will need to start collecting the cross-border reportable arrangements which are subject to the Directive as of the coming June or July.

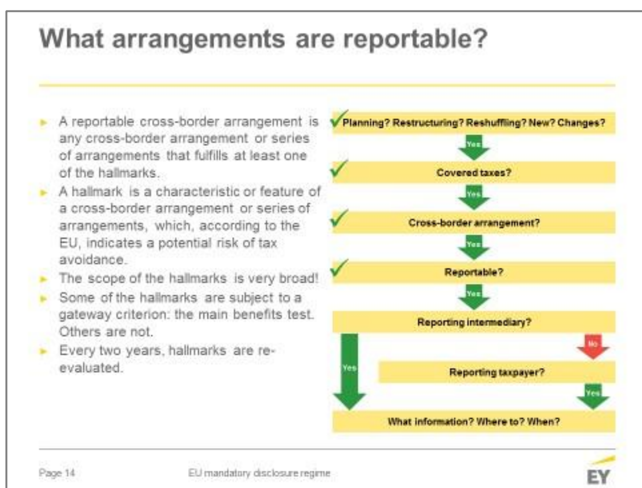
The first relevant question on cross-border arrangements is what exactly is an arrangement? An arrangement can consist of more than one step or part, according to the Directive. No further explanation is given, however. Looking at the accompanying publications, but also at the way that EU countries that have already implemented mandatory disclosure rules have interpreted the term, such as the UK, an arrangement may be anything from a transaction to a series of transactions, a structure or a scheme.

It could actually mean that if a sale of goods is considered an activity, or traveling to an EU country for business purposes is considered an activity, that such activities are a cross-border arrangement and may be caught as a reportable arrangement if one of the hallmarks is met.

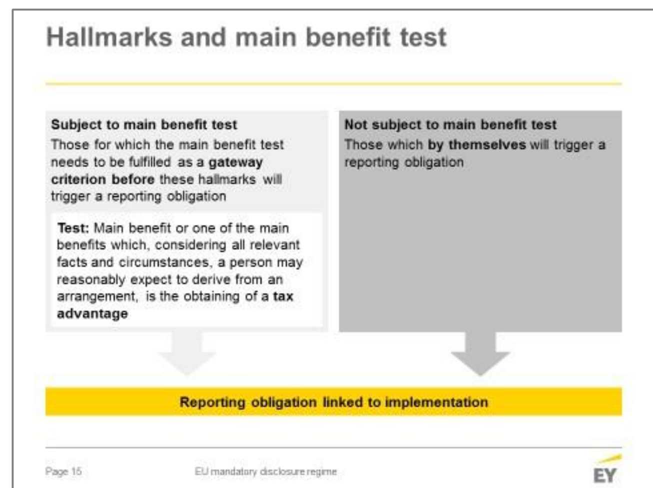
Such an arrangement is regarded as a cross-border arrangement when it concerns either more than one of the EU Member States or a Member State and a third country. So transactions between Australia and China are out of scope. To be of concern to one or more Member State, one of the conditions on the image on page 6 needs to be met. Any arrangement that involves participants from more than one country will be captured. And, as you see, these participants do not necessarily have to be associated enterprises. So that condition is quite easily met in a cross-border situation. The other conditions are more specific, and require either a participant that is a dual resident or has a permanent establishment, or – and I find this quite far reaching – concerns a situation where a participant carries on an activity in another jurisdiction without being tax resident or creating a permanent establishment.

This last one is extremely wide in scope. It could actually mean that if a sale of goods is considered an activity, or traveling to an EU country for business purposes is considered an activity, that such activities are a cross-border arrangement and may be caught as a reportable arrangement if one of the hallmarks is met. The key question then, is whether and which hallmarks may be met in these situations. Also, arrangements that may have an impact on automatic exchange of information or the identification of beneficial ownership are captured.

Marlies: Tom, that means that the definition of cross-border arrangement may capture many situations, such as for example, a professor traveling to another country to give a lecture, or an employee of a small or medium-sized enterprise traveling to another EU country to explore the possibility in that market by participating in an industry fair. The key will then be whether this is a reportable cross-border arrangement. What makes such a cross-border arrangement reportable?



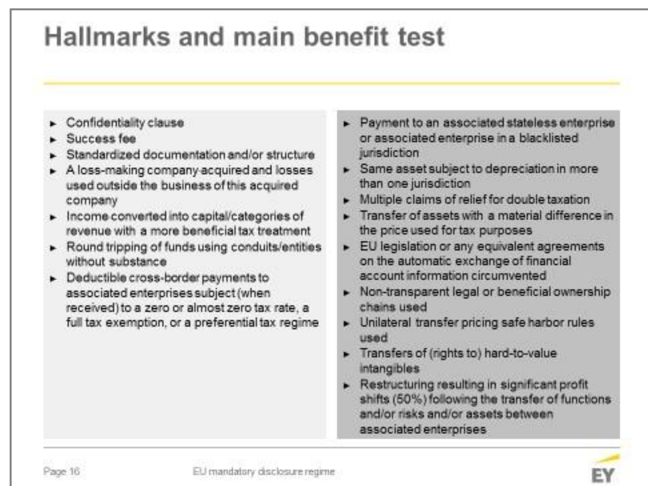

Tom: Cross-border arrangements are only subject to reporting when they meet one of the hallmarks listed in the Directive. These hallmarks reflect characteristics of arrangements that are deemed to create potential risks of tax avoidance. These hallmarks are not carved in stone, and they may change over time; indeed, they are scheduled to be reviewed every two years. When looking at the hallmarks, it is also important to recognize that some of them are subject to a gateway criterion, known as the main benefits test, and some are not.




The main benefits test resembles the main purpose test that you may know from your country's general anti-avoidance rules, or from the principal purpose test that the OECD has developed. However, as it only relates to the benefit created by the "tax advantage" and not to the purpose behind the arrangement, it also seems to be intended to be broader than the main purpose test. Besides that, it seems that it is intended to be more objective, looking at the weighting of the expected tax advantage compared to other expected advantages. A problem here is that it is not defined what the tax advantage is or when a tax advantage is considered to be derived. What is the starting point or the counterfactual from where the assessment begins? The only sliver of explanation is given by the wording that is added for the category C hallmarks, which are subject to the main benefit test. Here, it is indicated that taxation at a zero or almost zero corporate tax rate, the applicability of a full exemption or taxation in the context of a preferential regime by themselves are not sufficient to conclude there is a main benefit. This implies that a counterfactual first needs to be defined before it can be assessed whether a tax benefit was derived. This counterfactual could, for example, be the arrangement, or series of transactions, as it would likely be constructed if no tax would be imposed. This would for example mean that a commercial activity of a company in a zero tax country by itself would not lead to reporting.

> Such [confidentiality] clauses are quite commonly posed by intermediaries giving tax advice. EY changed its approach globally following the introduction of mandatory disclosure rules in the US and no longer poses such conditions. The introduction of mandatory disclosure rules in Europe may have similar effects on the engagement conditions on tax advice in the EU.

Marlies: Thanks, Tom. So the hallmarks play an important role in the determination of whether a cross-border arrangement will be reportable. Will the professor or the SME that we mentioned before indeed have to report their arrangements?




The thumbnail above reflects all the hallmarks. As you see, the hallmarks illustrate how broad the scope is that the EU has identified. The first box relates to hallmarks for which the main purpose test functions as a gateway criterion. The hallmarks indicated in the second box will trigger a reporting requirement by themselves. As it takes too much time to discuss all hallmarks in detail, we will discuss some now, but not all. The image gives you an indication of the many elements that are captured.

The confidentiality hallmark is something that taxpayers may want to pay special attention to. Such clauses are quite commonly posed by intermediaries giving tax advice. EY changed its approach globally following the introduction of mandatory disclosure rules in the US and does not pose such conditions anymore. The introduction of mandatory disclosure rules in Europe may have similar effects on the engagement conditions on tax advice in the EU.

Jano, the confidentiality hallmark looks at the formal agreement between the client and the intermediary. Many others look at triggers that are closely connected to the amount of tax to be paid. Can you give a couple of examples?

Jano Bustos: Thanks, Marlies. Let me briefly describe some of the so called "specific hallmarks related to cross-border transactions" included in letter C. paragraph 1 of the Annex of the Directive that we mentioned before. As we said, some of these hallmarks require the "main benefit test" to apply, while others don't.

A common element to these hallmarks is that they all relate to arrangements that involve deductible payments between associated enterprises. Therefore, not all cross-border payments are included, but only the ones that are deductible.

Also, these payments need to be made between associated parties as defined in the Directive. The payments don't need to be between EU Member States, and payments involving third countries are also covered.

Once we have a payment that meets these conditions, basically being a deductible payment between related parties, the hallmark then looks into the tax consequences of the payment for the recipient. Here, the Directive is clearly looking into situations where a deduction or non- or low-inclusion situation may occur for all or part of the income associated to such deductible payment.

The first case we have is when the recipient is not resident for tax purposes in any jurisdiction. That could occur, for example, when transparent entities are involved in a transaction. This hallmark does not require the main benefit test to be met, so the mere fact of a deductible payment being paid to such transparent entities would trigger the reporting obligation.

Two other hallmarks look into the characteristics of the jurisdiction where the recipient of the payment is established:

- First, we have payments to jurisdictions that do not impose any corporate tax or imposes corporate rate at a rate of zero or almost zero. This hallmark seems to refer to the statutory rate of that jurisdiction and not the effective rate to make this determination. In this case, the main benefit test needs to be met.
- Second is a hallmark that looks into the jurisdiction where the recipient is resident is the one that refers to non-cooperative jurisdictions included in the OECD or EU lists, the so-called black lists. The EU published its list last year. In this case, there is no requirement to also meet the main benefit test and the hallmark will apply automatically.

The other two hallmarks included in letter C.1 of the annex do not refer to specific tax features of the jurisdiction of the recipient, but rather the taxation of the payment itself. In both cases, the main benefit test needs to be met. It is important to note that the Directive makes clear that, in the context of the application of these specific hallmarks, the presence of the conditions set out in them – which in this case is the low taxation in the hands of the recipient – cannot alone be a reason for concluding that an arrangement satisfies the main benefit test.

The use of the word “undermine” seems to introduce an element of intent and subjectivity, which will likely require guidance in order to understand where the bar is set and enable the filtering of arrangements which are purely commercial (i.e., they might result in no CRS reporting but that is simply the outcome of a commercial arrangement rather than something that is used for the purpose of avoiding CRS reporting for improper purposes).

The first case would is that of payments benefiting from a full exemption in the recipients' hands. The other case would be that of payments benefiting from a “preferential tax regime.” Any preferential regime (such a regime does not necessarily need to be harmful) would be covered. Therefore, even those tax regimes (such as patent boxes) that meet the recommendations of the OECD under the BEPS project will fall within the scope of the hallmark. In order for a regime to be considered preferential, it must offer some form of tax preference in comparison with the general principles of taxation in the relevant country.

Marlies: Let's move to the area of financial services and beneficial ownership. Stephanie, can you tell us something about the hallmarks on exchange of financial account information and unclear beneficial ownership structures?

**Hallmark D.1 on automatic exchange of information**

- Hallmark is targeted at “arrangements” that **may have the effect** of undermining the reporting obligations under a common reporting standard (CRS).
- Specific examples of arrangements are included; however, this is not an exhaustive list.
- The introduction to the proposed changes to the new directive makes reference to the work undertaken by the Organisation for Economic Co-operation and Development (OECD) on the Model Mandatory Disclosure Rules (MMDR) for addressing CRS avoidance arrangements and opaque structures and cites the MMDR and its commentary as a source of illustration and interpretation for hallmark D.1:
  - There are slight differences in the drafting of the specific hallmarks between hallmark D.1 in the new directive, and the MMDR, however, substantively covers the same scenarios.
  - This helpfully brings in examples of the application of the specific hallmarks.
- Financial institutions will need to consider whether they fall within the broad definition of intermediary and whether they are involved in arrangements that fall within hallmark D.1.

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Stephanie: These particular hallmarks are targeted at “arrangements” that may have the effect of undermining reporting obligations under the common reporting standard (CRS)

On the face of it, this is a very broad requirement, as it does not necessarily need to have had the effect but simply “may” have the effect of undermining the CRS. The use of the word “undermine” seems to introduce an element of intent and subjectivity, which will likely require guidance in order to understand where the bar is set and enable the filtering of arrangements which are purely commercial (i.e., they might result in no CRS reporting but that is simply the outcome of a commercial arrangement rather than something that is used for the purpose of avoiding CRS reporting for improper purposes).

The introduction to the proposed changes to the Directive makes reference to the work undertaken by the OECD on the Model Mandatory Disclosure Rules for Addressing CRS Avoidance Arrangements and Opaque Structures (“MMDR”) and cites the MMDR and its Commentary as a source of illustration and interpretation for Hallmark D.1

In terms of understanding what these rules mean for financial institutions, the first thing to consider is that the definition of “intermediary” is broad and not only includes persons responsible for the design or marketing of arrangements, but also any persons who provide services, assistance or advice relating to the design, marketing or organization of the arrangement where they know or could reasonably be expected to know the person was involved in such an arrangement.

That definition would not generally be expected to capture financial institutions when carrying out routine banking transactions (i.e., money transfer, custody, etc.) because the nature of the information readily available to them would typically not meet the “reasonably be expected to know” standard.

Financial institutions will need to consider the services they offer, however, especially whether there are instances in which they are in possession of knowledge (using the objective standard), which would mean they should know their services cause them to be an intermediary with an obligation to disclose.

Financial institutions may also need to consider undertaking risk assessments to identify areas of their business where such arrangements might exist.

**Hallmark D.2 on non-transparency**

- Hallmark is targeted at arrangements with non-transparent legal or beneficial ownership chains that meet all of the following conditions:
  - Include entities without any economic substance
  - Include entities for which their residence does not match the beneficial ownership of their assets
  - Where the beneficial owners are made unidentifiable
- MMDR contains a similar rule on disclosure of “opaque offshore structures” and provides some commentary on what is meant by lack of transparency.
- This hallmark is largely mechanical and can catch any ownership arrangements that meet the conditions.

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The US offers taxpayers the ability to depart from the arm's-length standard and charge only costs for certain services that are generally administrative or low value in nature. The use of the services cost method is attracting more attention lately because the use of it may help mitigate the impact of the new base erosion anti-abuse Tax (BEAT) measure that was introduced a few months ago in the US.

The D2 hallmark is largely mechanical and is aimed at the reporting of non-transparent legal or beneficial ownership chains. It applies to any arrangements that meet certain conditions, regardless of the purpose or effect of those arrangements. An arrangement is caught if it involves a non-transparent legal or beneficial ownership chain and also uses persons, legal arrangements or structures that meet the three conditions reflected on the image.

The MMDR has a fuller definition of an opaque offshore structure and an exclusion for institutional investors (meaning regulated and government investors).

The MMDR refers to the Financial Action Task Force transparency requirements as a test of whether a jurisdiction is sufficiently transparent.

Marlies: This moves us to the E hallmarks on transfer pricing. Tom, can you illustrate what the reporting obligations relating to transfer pricing will be?

**Specific hallmarks related to transfer pricing (E.1)**

- Unilateral safe harbor rules are used:
  - Do all transactions with Brazil-related parties need to be disclosed?
    - Minimum statutory gross profit margin required when applying the resale price method, for the import of goods, services or rights, ranging from 20% to 40% depending on the company's industry
    - Minimum profitability threshold and a cap on intercompany export transactions
    - Deductibility of interest expense limited by reference to London Interbank Offered Rate (LIBOR) plus an annual spread
  - What about transactions with US-related parties where the services cost method is used?
    - The services cost method is an elective, specified transfer pricing method for which "covered services" can be charged out at cost.

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Tom: The first specific hallmark related to transfer pricing involves the use of unilateral safe harbor rules. Some countries, such as Brazil and the US (at least for some services transactions) have transfer pricing rules that do not follow OECD norms and instead compensate related parties by using specified fixed margins depending on the industry. For example, Brazil generally requires the use of the resale price method, with respect to the importation of goods, services or rights. Under this method, the Brazilian entity must earn specified minimum statutory gross profit margins ranging from 20% to 40% depending on the company's industry.

Similarly for exported products or services, the Brazilian entity must earn a minimum of a specified, fixed statutory profit margin. Finally, Brazil limits the deductions of interest expense that Brazilian entities pay interest to foreign-related parties by reference to LIBOR plus an annual spread.

The US offers taxpayers the ability to depart from the arm's-length standard and charge only costs for certain services that are generally administrative or low value in nature. The use of the services cost method is attracting more attention lately because the use of it may help mitigate the impact of the new base erosion anti-abuse tax (BEAT) measure that was introduced a few months ago in the US.

Presumably, related-party transactions with Brazil that use the statutory minimum profit margins or statutory interest rates, would need to be disclosed. Similarly, transactions with US related-parties that use the services cost method would also need to be disclosed. These are just two examples of transactions with third countries that would need to be disclosed. Many similar unilateral safe harbors exist. Even though these transactions clearly pose the risk of charging prices that are not arm's-length, you can question whether all of these pose a relevant tax risk. Mostly safe harbors are introduced to create simplified approaches for relatively routine, low transfer pricing risk, transactions. It is a pity that now the all transactions falling within the scope of this hallmark are potentially painted as tax avoidance practices, in particular at a time when simplification is so badly needed.

**Specific hallmarks related to transfer pricing (E.2)**

- Transactions involving hard-to-value intangibles:
  - Pharma research and development (R&D)
  - Software development
  - Business processes or market information
- Transactions involving restructurings that result in significant profit shifts following the transfer of functions and/or risks and/or assets between jurisdictions

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Tom: Taxpayers will also need to disclose information regarding transactions involving intangibles that are hard-to-value – perhaps because of the lack of comparables or due to difficulties in predicting at the time of transfer the level of ultimate success of the intangible). Although the transfer of the IP may be made for non tax reasons, the new mandatory disclosure rules require these types of transactions to be disclosed. How will the governments use this information? Will they look at all these kinds of transactions as nefarious? Time will tell, but it is advisable to ensure that you have a robust functional analysis, economic analysis, and documentation for all reportable transactions.

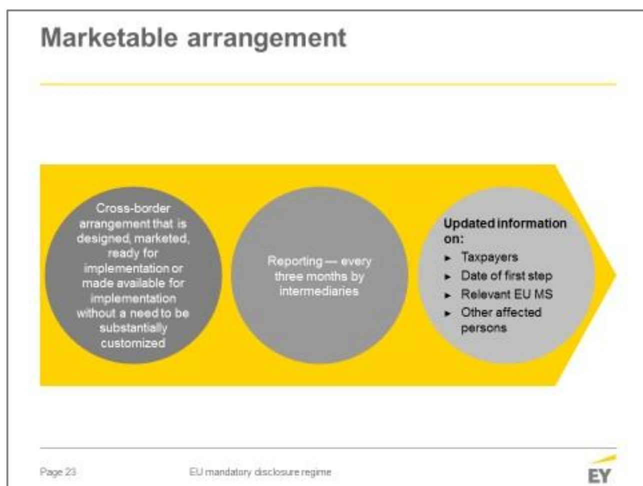
Transactions involving restructurings that result in significant profit shifts following the transfer of functions, risks and/or assets between jurisdictions must also be reported.

Transactions involving restructurings that result in significant profit shifts following the transfer of functions, risks and/or assets between jurisdictions must also be reported. Take the simple example of converting from a full-fledged distributor into a "risk-less" distributor. Consider the example in which a multinational enterprise group (MNE group) holds trade names and other similar IP in Company A and long-term supplier contracts in Company B. After the MNE group acquires a full-fledged distributor, the MNE group transfers the acquired corporation's trade name and similar IP to Company A and the acquired corporation's long-term supplier contracts to Company B, consistent with its corporate strategy for operating.

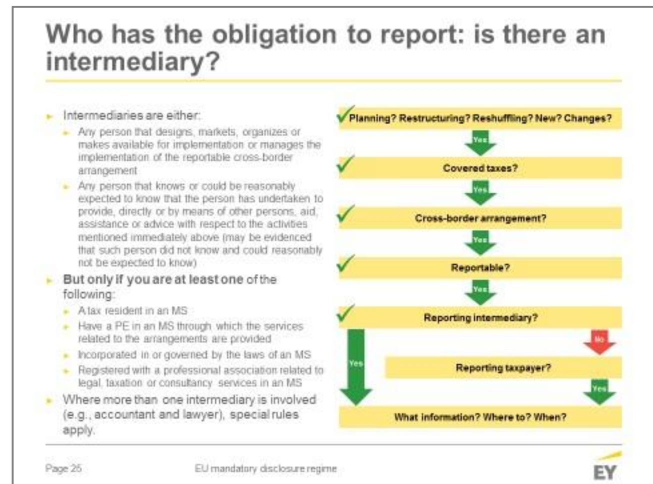
This example may seem familiar to you because it is an example from the OECD Transfer Pricing Guidelines on Restructuring. The OECD Transfer Pricing Guidelines instruct us that such a restructuring would be respected. Nonetheless, the new mandatory disclosure rules require that such transactions be disclosed, even if an exit tax is paid.

Again, it is unclear how governments will use the information they receive under the new rules, so it is critical to ensure that the conduct of the parties is consistent with the form of the restructuring and that the economic analysis is strong. The new mandatory disclosure rules imply that taxpayers must be even more proactive in performing functional and economic analyses and documenting their transactions.

Marlies: For many of these transactions, there may not even be an intermediary involved and we should realize that the potential impact on taxpayers themselves may be extensive. But, it seems that the lecture by the professor and the visit to the industry fair are not covered by the hallmarks, even though they were identified as cross-border arrangements.




One thing to note for completeness is that, besides individual reportable cross-border arrangements, intermediaries will face separate reporting obligations on marketable arrangements. The image to the left and below indicates what marketable arrangements are and reflects the specific information that must be reported every three months.

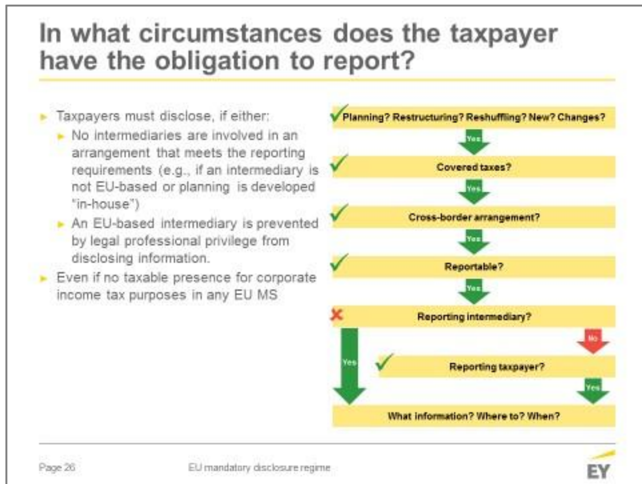



That moves us to the "Who needs to report" question. The first port of call is the intermediary. Jano, who are regarded to be intermediaries and when will these intermediaries have to report?

Jano: The primary responsibility to report arrangements that fall within the so-called hallmarks rests with an intermediary. The definition of an intermediary in the top half of the above image is somewhat broad, covering those who design, market or knowingly provide advice in relation to a reportable arrangement. So it is certainly wide enough to cover most situations where an intermediary provides tax advice. But from what we know at present, it should not catch situations where the intermediary role is solely one of tax compliance, or financial statement audit.

For an intermediary to have a reporting obligation, they must also have nexus to the EU. That means that, for example, an intermediary outside the EU will not have a reporting obligation – though if it has subcontracted part of the advice to an EU-based intermediary, that EU-based intermediary may have to report. When there is no EU intermediary involved, the obligation to report will shift to the taxpayer. With that, these new rules will directly and indirectly also impact the companies or individuals to which the arrangements relate.

It is very important to note that there are certain situations in which the reporting obligation falls on the taxpayer. Those would, for instance, be where a transaction or a planning idea is developed and implemented "in-house" or an advisor is outside the EU so there is no intermediary in the meaning of the new rules.




It is very important to note that there are certain situations in which the reporting obligation falls on the taxpayer. Those would, for instance, be where a transaction or a planning idea is developed and implemented "in-house" or an advisor is outside the EU, so there is no intermediary in the meaning of the new rules, or in a case where the relationship between advisor and client is protected by legal professional privilege.

That might well be the case, for instance, in those countries where the intermediary is a law firm, rather than an accountancy practice. In those latter cases, though, the intermediary will still need to be able to identify arrangements that fall within the Directive, as the Directive requires them to inform a taxpayer of their disclosure obligations, and the intermediary will need to document in its files that it has informed the client.

One final word on legal professional privilege; some similar broader concepts and obligations exist in various countries. Typically, we refer to these as professional secrecy. The Directive is phrased quite narrowly and so it will be interesting to see what happens (and whether the reporting exemption will apply also to professional secrecy) when national governments put this into local law.

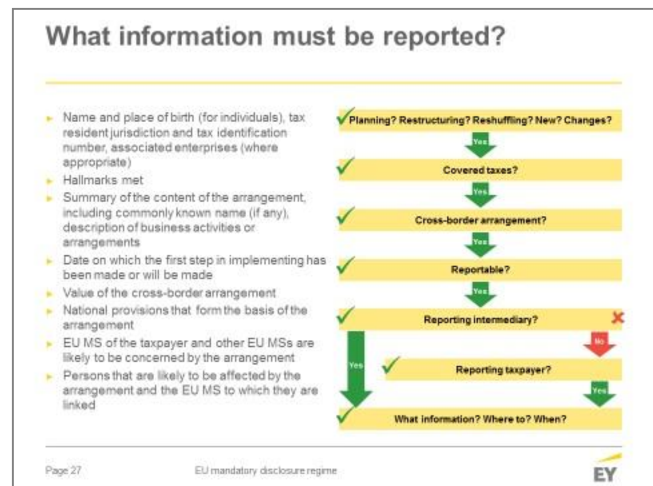
Marlies: Jano, a question that I have is whether a taxpayer is considered an intermediary or whether the term is separately distinguishable from the intermediary?

Jano: The taxpayer is not an "intermediary" and that's an important distinction. I mentioned earlier that intermediaries only need to report if they have nexus to the EU. Where the obligation to report rests with the taxpayer, on the other hand, that EU nexus requirement does not apply.

Marlies: So if someone in the United States – let's say a US law firm – advises on a cross-EU transaction to a US taxpayer and that transaction otherwise meets all the requirements for reporting, then the US lawyer is excused, but the US taxpayer needs to report? That can be interesting.

Jano: Yes, that is the way that the wording seems to read. We will need to see what the domestic legislation will look like, of course. But if a US corporation does not report in these circumstances it seems that it will be non-compliant.

Marlies: Thanks Jano. Now that we've spent some time on the triggers for reporting, let's take a look at what information the intermediary (or the taxpayer) has to provide to the tax authority. Rienk, can you take us through that?




Rienk: One thing you will notice straight away is that the identity of the taxpayer is part of the required information. So this is not just about giving the tax authority visibility on the arrangement, but also the identity of the client involved in the arrangement.

The arrangement must be described, together with the hallmarks that are triggered. There is also a requirement to identify the "value of the arrangement." At this point, it is not clear what is meant by this.

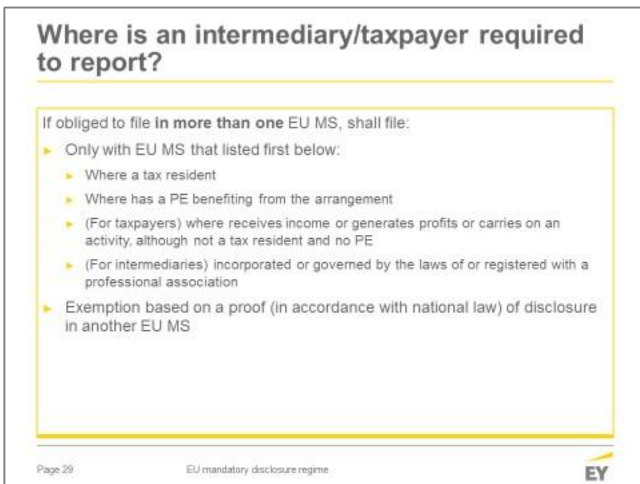
Another key feature of this EU regime is that the reports are automatically exchanged, on a quarterly basis, among the Member State governments.

Let's turn to the timing of when these disclosures have to be made. Essentially, there is a 30-day window from any of the trigger dates set out on this image on page 12. Arrangements captured by the retrospective effect will have to be reported between July 1st and August 31st 2020. These same timeframes apply to taxpayers, where such obligation to report sits with them. At this stage, the EU has provided no interpretative guidance on this, or indeed on anything else in the Directive.

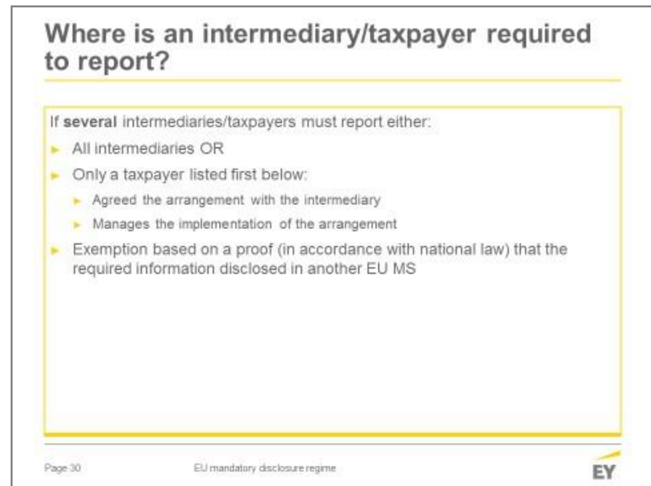
Marlies: I am still not sure what is meant by "made available for implementation." Does it, for example, require a detailed step plan? I know it is perceived to be unclear, but can we turn to other interpretation sources to see whether they are helpful. Stephanie, can, for example, the UK explanations on their disclosure rules be helpful?

Stephanie: The UK has had a domestic disclosure regime for some years, and that phrase "made available" does indeed feature in the UK rules. It is worth noting that the UK tax authority has published substantial guidance on its regime, almost 200 pages, and we have to hope that either the EU or Member States will do likewise with this Directive, given the many uncertainties we are facing. In a UK context, "made available" means that all the elements necessary for the implementation of the scheme are in place and a communication has been made to a client suggesting they enter into it.

Marlies: Now we know what needs to be reported, who needs to report and when reporting needs to take place, the next question is where the report needs to be filed. Jano, is there any guidance on this question?




Jano: The image above gives the order of reporting if the intermediary or taxpayer needs to report in several Member States, for example, because it has a taxable presence in multiple countries, such as in its country of residence and in a PE country. In principle, reporting per taxpayer or intermediary will therefore only take place in one Member State.




The image above provides a second interpretation. It gives the order of reporting when multiple intermediaries or taxpayers have to report on the same reportable cross-border arrangement. For taxpayers, the reporting obligation is relatively clearly narrowed down to one taxpayer, as long as the other taxpayers provide proof that reporting has taken place. However, for intermediaries, the guidance is a bit ambiguous. It is indicated that in principle all intermediaries have to report. However, it is also indicated that reporting does not have to take place if it is proven that reporting has taken place according to the domestic legislation of the Member State of the reporter. It is not entirely clear whether this only covers the situation where intermediaries are in the same country, or also covers situations where the intermediaries are in different countries, although that interpretation would mean that many duplications would be prevented.

Marlies: The possibility to ensure reporting by one central intermediary does seem efficient. Let's look at what happens with the information once it has been provided. Different from individual national mandatory disclosure regimes, the information reported will be exchanged on the basis of this Directive. Tom, can you explain how that will work?

It is important to note that this is not an advance ruling or clearance regime. The Directive explicitly states that just because a tax authority does not react to information disclosed, it should not be assumed that they accept the arrangements are acceptable.

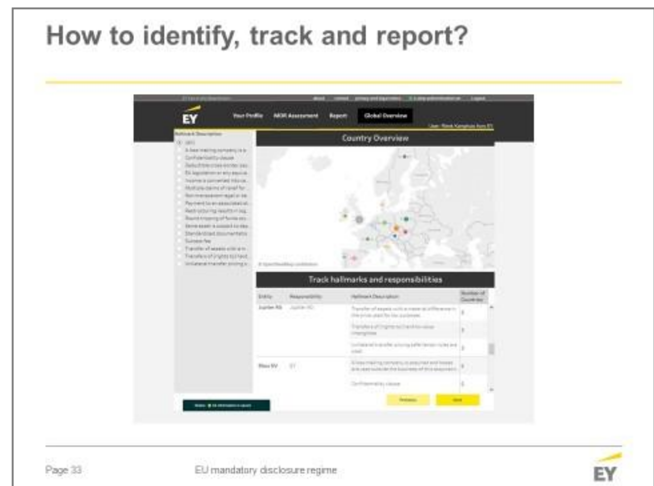
Tom: Another key feature of this EU regime is that the reports are automatically exchanged, on a quarterly basis, among the Member State governments. This exchange will start in October 2020. The exchange will also capture the cross-border arrangements that are captured by the retrospective effect of the Directive.

It is important to note that this is not an advance ruling or clearance regime. The Directive explicitly states that just because a tax authority does not react to information disclosed, it should not be assumed that they accept the arrangements are acceptable.

Marlies: The Directive also asks member states to introduce penalties. What might these look like?

Tom: The penalties have been left to national governments to set, with the Directive simply guiding governments that the penalties should be effective, proportionate and dissuasive. Apart from penalties, of course, non-compliance will lead to significant reputational risk.

Marlies: Thanks, Tom. We now have a good overview of what the Directive will require. Looking at the scope of the reporting obligations, it seems that intermediaries and taxpayers can use some help in identifying, tagging, storing and tracking the reportable cross-border arrangements that they will have to identify as of June and July this year. Rienk, can technology help?



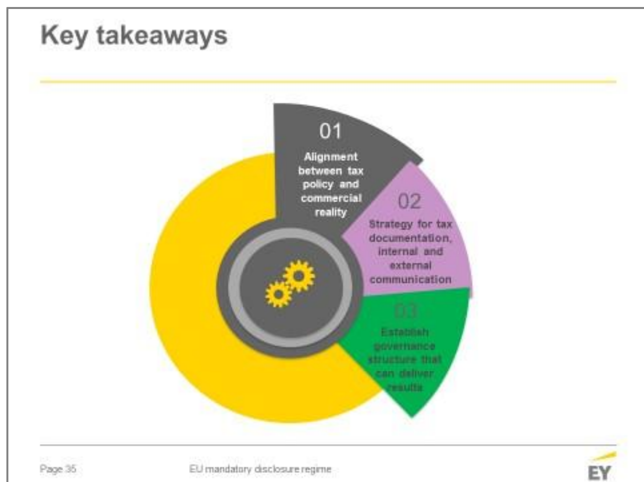

Rienk: Of course. Even though there are a lot of questions about the scope and the detailed implications, we are looking into developing a tool specifically for these new developments. The purpose of the tool could, for instance, be to provide our clients direction on whether and what information needs to be disclosed, by whom and to which tax authority, and – if a company is using multiple intermediaries – to keep track of which information is shared by whom and whether all required disclosures have been made.

Ideally it would have dashboards – such as, for instance, the mock up that we show you here on the thumbnail above – that inform you which intermediary is responsible for disclosure or the company itself. Also, we would like to clearly distinguish the hallmarks in each report so that – prior to submission – we can revisit and review the reports for insights that will no doubt develop over the next two years as this Directive is being implemented.

It should also be noted that in most countries providing content to the tax authorities requires specialized secure data transmission protocols. And that is not necessarily easy or cheap, as we have seen from the country-by-country reporting.

I would like to stress the fact that this new Directive will become relevant for intermediaries and taxpayers as of June or July this year, given the retrospective effect required.

Given the complexity and increased compliance burden of these developments, we intend to put some serious effort into creating a methodology that our clients can easily access and that will help them manage their own reporting obligations, as well as to create a level of oversight over the reporting obligations of the intermediaries that are their service providers.

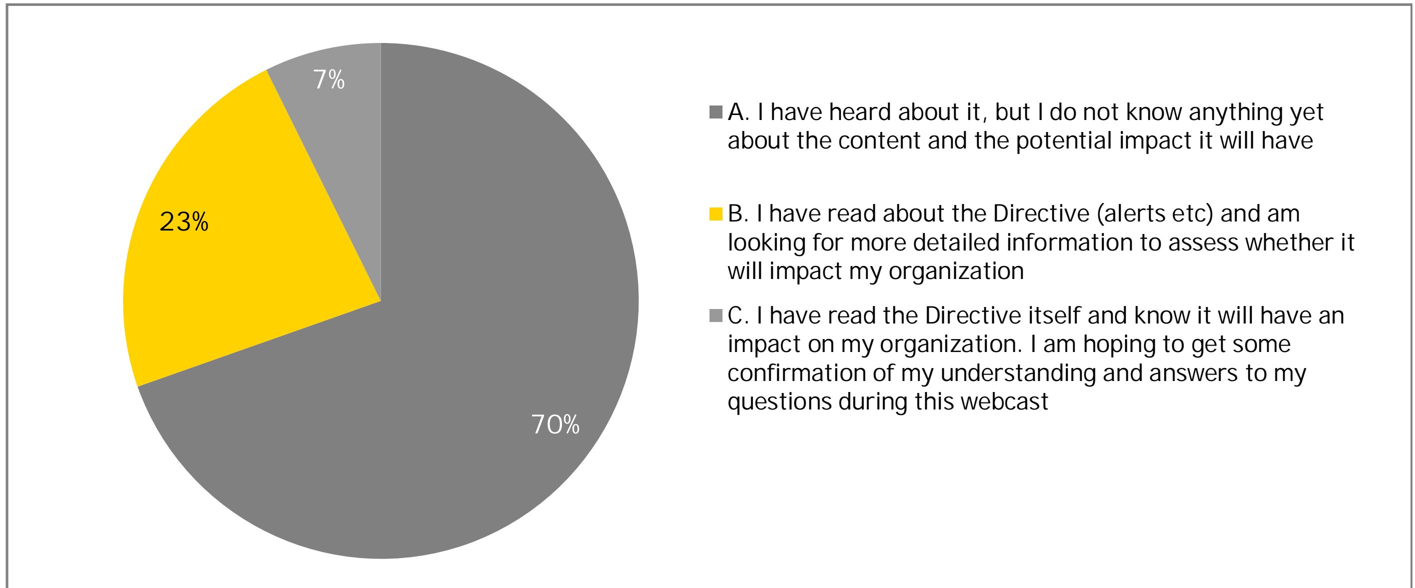



That brings us to the final part of the webcast. I would like to close off with two short takeaways:

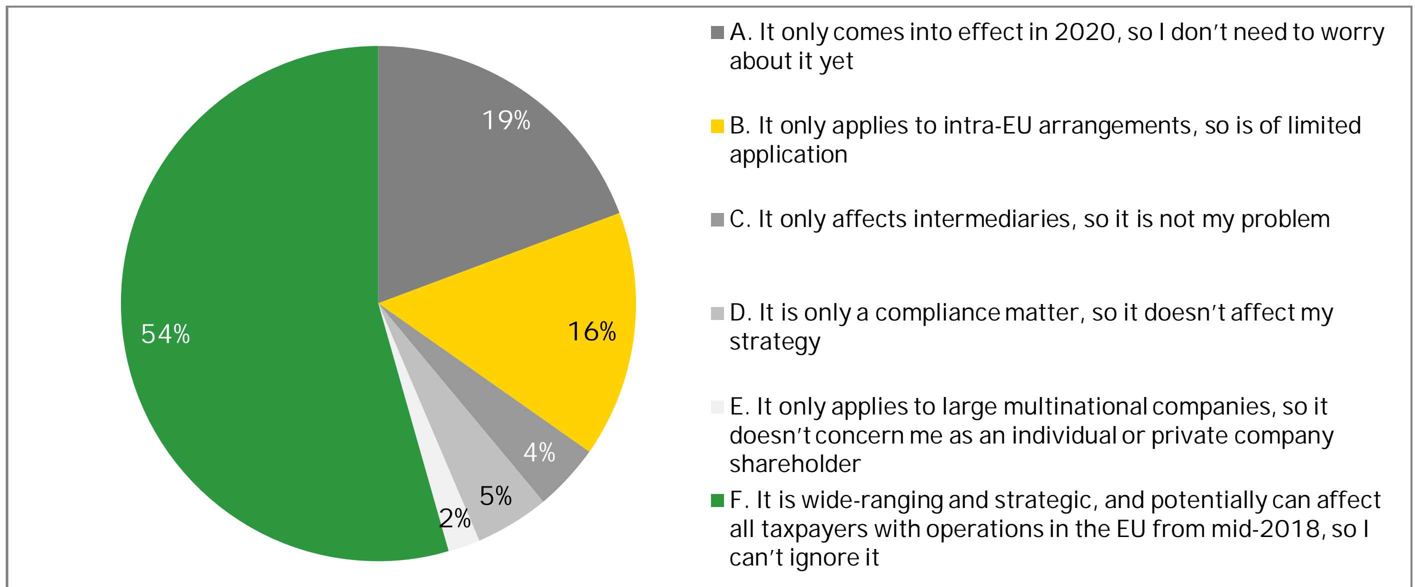
1. First, as we have seen, the rules will have a relevant impact on the transparency environment. But it is not the only change that will have impact on transparency. We had a webcast on this new environment in September last year, which you still can view. This new era of transparency will have an important impact on the alignment of a company's tax policy with their commercial activities, on designing and retaining tax documentation, on communication with stakeholders and on a company's governance structure.
2. And second, I would like to stress the fact that this new Directive will become relevant for intermediaries and taxpayers as of June or July this year, given the retrospective effect required.

## The voice of business: views from around 500 EY clients in April 2018

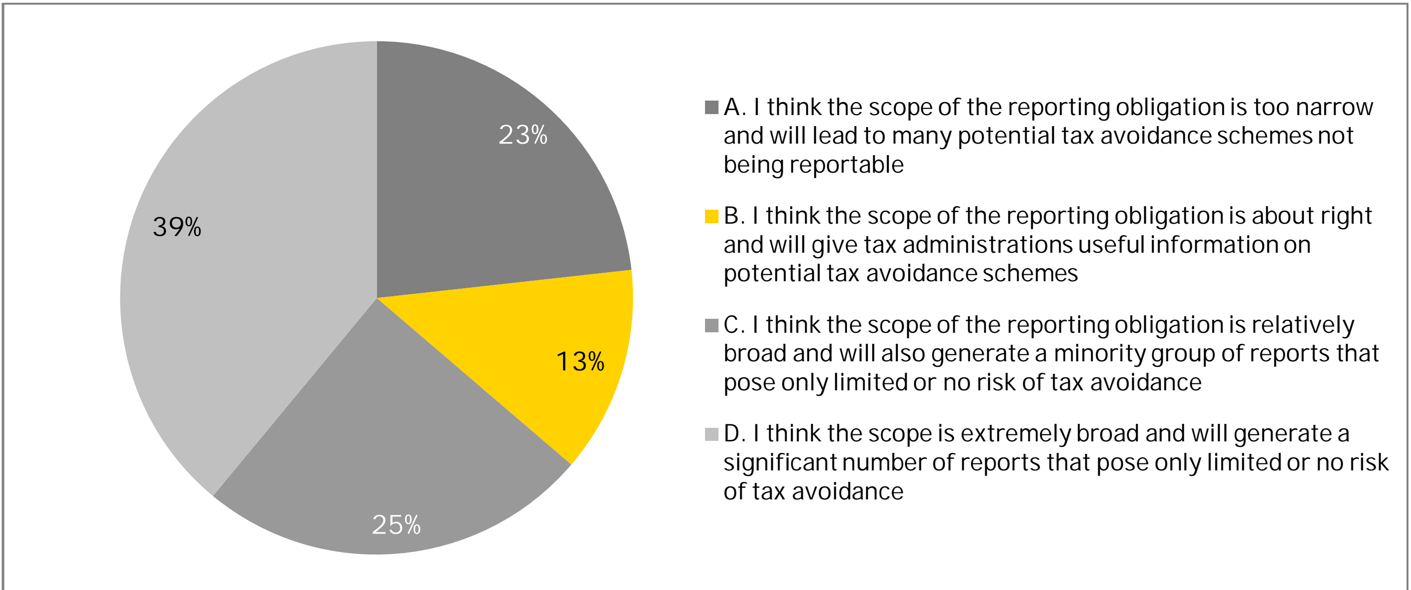
1. What is your current understanding of the content and impact of the MDR Directive?



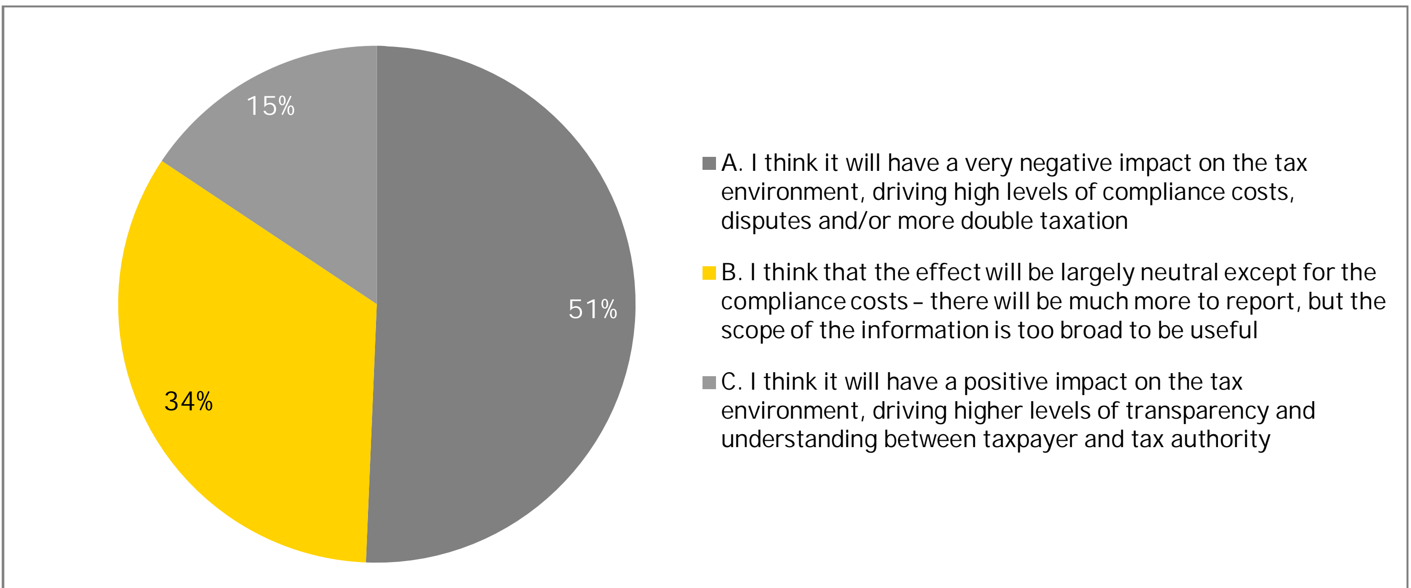

2. What is your initial reaction to the MDR Directive?



3. Which of the following statements most closely matches your expectations regarding the scope of the reports that tax administrations will be receiving?




4. What impact will the MDR Directive have on the tax environment?



# Notes

# Notes

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