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Reporting taxation

Analysing loopholes in the EU’s automatic exchange of information and how to close them

Executive Summary

The European Union (EU) has been making improvements to its legal frameworks relating to the collection and exchange of relevant information to help tackle illicit financial flows related to tax evasion and tax avoidance and in order to identify money associated with crime. Given the existence of flaws in the first version of the Directive on Administrative Cooperation (DAC 1), the EU has been working on amendments to the Directive in order to broaden its scope, increase the number of cases that trigger the need for the collection and exchange of information and improve the mechanisms and timeframe for those exchanges. Global initiatives, especially the enactment of the US Foreign Account Tax Compliance Act (FATCA) have also influenced and accelerated the process.

The first revision led to DAC 2 and refers to the adoption of the OECD’s Common Reporting Standard (CRS) for the automatic exchange of information relating to financial accounts (e.g. information about foreign bank accounts). Automatic exchanges under the CRS and DAC 2 only started to take place in 2017 (or in 2018 for Austria). As a result, there are no reports about its effectiveness. However, many potential loopholes or shortcomings identified in the CRS are also present in DAC 2 (which is almost a copy of the CRS). First of all, neither framework ensures that all countries, especially financial centres, will take part in the CRS or in DAC 2. For example, there are no sanctions for financial centres or tax havens (e.g. in the US) that fail to exchange all the relevant information with EU countries or for those that exchange information only with selected countries or who sign only bilateral agreements (instead of the multilateral one). Secondly, tax havens may facilitate avoidance mechanisms by offering golden visas and residency via investment schemes so that individuals’ banking information is sent to the “wrong” authority (the country issuing the golden visa). These schemes allow individuals to obtain residency or citizenship in exchange for money without needing to actually emigrate to those countries. This is exacerbated when these jurisdictions (e.g. many British overseas territories) choose voluntary secrecy (to send, but not to receive any information from other countries). Thirdly, DAC 2 has not broadened the scope of the CRS. The result of this is that there are still many types of financial institutions and financial accounts or types of non-financial assets that are not covered by either framework. Moreover, in principle information exchanged under DAC 2 cannot be used by authorities for non-tax purposes (e.g. to tackle corruption or money laundering).

In order to address these shortcomings, the EU Commission should revise DAC 2 and oblige all financial centres and tax havens to exchange all relevant information with EU countries and with all countries, especially developing countries or, in the event that they do not do that, impose sanctions. Enhanced due diligence should apply to jurisdictions offering golden visas, residency and citizenship via investment schemes, or who are choosing voluntary secrecy or who are not yet taking part in the CRS (in the case of developing countries, technical assistance should be provided to help them join the CRS as soon as possible). EU countries should establish regulations making it explicit that entities issuing, trading or exchanging crypto-currencies are covered by the CRS/DAC 2. Moreover, the EU should incorporate, as soon as possible, the new OECD mandatory disclosure rules for schemes circumventing the CRS or hiding the beneficial owner of accounts. The EU should also improve the sanctions and incentives proposed by the OECD for cases of non-compliance with these disclosure rules (e.g. by adding whistleblower protection). Lastly and most importantly, in order to track compliance and the effectiveness of DAC 2 and the CRS, EU countries should publish statistics. These statistics would not breach any confidentiality requirements or lead to any extra cost being incurred. They would show how much money is held in each country, classified by the country of residence of the account holders (so that developing countries unable to join the CRS may find out basic information about their residents' foreign accounts). Statistics would also help identify avoidance schemes. For example, they could show how many accounts (and how much money) are "legally" not being reported ("legally" because they fall outside the scope of the CRS/DAC 2). By checking whether the number and values of these "legally unreported" accounts increased, it would be possible to identify avoidance schemes. Statistics could also reveal the use of golden visas or movements of money that are attempting to avoid reporting (e.g. if Germans start moving their money from France to Serbia or if they start opening bank accounts using golden visas or other residency via investment schemes).

Importantly, "automatic" exchanges of information will not replace exchanges "upon request" within the EU (based on DAC 1) or with non-EU countries (based on international agreements). Instead, both methods of exchange of information complement each other. Authorities receiving information automatically may use that data to make a specific request or a group request to another country to obtain more details.

The second revision of the EU Directive, which led to DAC 3, refers to the automatic exchange of information on crossborder tax rulings and advance price agreements (APAs). This is related to secret tax agreements resulting in tax avoidance by multinationals such as those described in the "LuxLeaks" scandal in Luxembourg. DAC 3 is an improvement by comparison with DAC 1 given that DAC 1 only covered spontaneous exchanges of such rulings based on EU countries' discretion. It is also an improvement compared to the OECD's BEPS Action 5, which covers compulsory spontaneous exchange of information only to countries related to the tax ruling. The improvements that appear in DAC 3 refer to the means of exchanging information. While it refers to "automatic" exchanges, the framework is actually better: each EU country issuing a relevant tax ruling will have to upload it to a central depositary, which will be directly accessible by any other EU country.

DAC 3, however, is not free of loopholes. First of all, it covers only corporate taxpayers but not natural persons (even though high net worth individuals could equally be engaging in secret tax agreements). Secondly, it covers only rulings related to crossborder transactions, but not necessarily rulings benefitting a multinational company as a whole (not related to a specific cross-border transaction). Thirdly and most importantly, information will not be public, even though the information exchanged will not include any trade or commercial secrets. The lack of public access is inconsistent with the fact that many countries - including EU countries - are already publishing summary information on tax rulings for free.

For this reason, the EU should revise DAC 3 and close the loopholes referring to natural person taxpayers and rulings benefitting a multinational (beyond a specific crossborder transaction) and require publication of all exchanged information or at least an anonymised summary of the ruling, but indicating the industry sector of the taxpayer. EU countries should also publish statistics on those rulings that fall outside the scope (e.g. natural persons or excluded old rulings below a given threshold). EU countries should ensure that they have international agreements with all developing countries so that they may spontaneously share information on tax rulings with them pursuant to BEPS Action 5.

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Contact person

František Nejedlý

Advisor on Budgets

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