European Banking Federation

Ref.: EBF_003351
25.07.2013

EBF COMMENTS ON OECD & COMMISSION'S QUESTIONS ON AUTOMATIC EXCHANGE OF INFORMATION

I. PRELIMINARY REMARKS

A. NEED TO KNOW THE "BIG PICTURE" BEFORE ANSWERING OECD AND COMMISSION'S QUESTIONS

The European Banking Federation (EBF) welcomes the consultation process on Automatic Exchange of Information (AEOI) which was launched in June 2013 respectively by the OECD and the Commission, based on questionnaires, with the aim to better understand some of the operational and practical issues at stake.

We would like to point out that this exercise can only be fully carried out if the OECD and the Commission provide the "big picture", since answers to most of the questions raised depend on the general framework. The EBF therefore calls for a clear steer about what the standard will be for and about its scope. In particular, it should be clarified whether such standard would only include a schema for reporting or would also extend to the transmission methodology and/or due diligence requirements. Particular attention should be paid to the overarching questions on how to ascertain tax residency and what kind of proof will be required, bearing in mind that indicia searches such as citizenship under FATCA do not work well in a residence-based system where territories are in close proximity. Failing details of the big picture, we are able at this point in time to provide only general comments and to answer only some of the OECD and Commission's questions.

The questions are referred to hereinafter as "OECD questions" (followed by question's number) and "EC questions" depending on whether they pertain to the questionnaire presented by the OECD or by the Commission. We intend to provide further inputs when we know the details of the general framework.

EBF a.i.s.b.l
Avenue des Arts 56, B-1000 Brussels
+32 (0)2 508 37 11 Phone
+32 (0)2 511 23 28 Fax
www.ebf-fbe.eu

B. NEED TO COORDINATE INITIATIVES AND MODELS

A number of projects relating to the exchange of information are currently in the pipe-line:

- The OECD project for a multilateral approach to AEOI;
- FATCA and related Inter-Governmental Agreements (IGAs);
- EU proposed Review Savings Directive (EUSD);
- EU proposed Review Directive on Administrative Cooperation (DAC);
- The EU-G5 Pilot Initiative;
- Reporting aspects of the initiatives to streamline Treaty benefits related procedures (see below under "E")

While the EBF acknowledges that tackling tax evasion is necessary and high on the political agenda, it is concerned that the myriad of initiatives and their divergent features create a "cacophony" which may result in inconsistencies and un-level playing field. For instance, we note that in the EU the Commission envisions the reporting of capital gains under DAC, going far beyond the FATCA requirements.

Furthermore, these initiatives are developed with a plethora of literature which makes it difficult to monitor and may turn to be counter-productive.

These competing and potentially conflicting projects and their surrounding complexity may place tax administrations and financial intermediaries in a difficult position. It is therefore crucial to avoid unnecessary burdens and duplicative systems which are particularly costly. It is also advisable to promote simple solutions when it is possible. If Governments want to rely more extensively on financial intermediaries to tackle tax evasion, they must reach consensus on clear and consistent rules, with which financial intermediaries and tax administrations can comply in a cost-efficient way. We would therefore urge Governments, the OECD and the Commission to coordinate their efforts on AEOI so as to be able to come up with a single standard, which is not too complex to implement and administer.

EC Question 10: Do you support the approach taken by the OECD? (Part 1 of the answer)

The EBF considers the OECD as being the appropriate body to develop a common standard. Given its experience in the EU context, and more specifically with the EU Savings Directive, the Commission could bring valuable inputs. We therefore recommend the OECD and the Commission to work together in a consistent, constructive and convergent way. The OECD would be in charge of developing a common standard and a minimum data set, while the Commission would endorse it in its territory for intra-Community reporting. That would also be the global standard for information exchange between a Member State and a third country.

Despite its agreement on the OECD objective of standardization at global level, the EBF believes that national specificities should not be ignored. Therefore, jurisdictions should be left with a certain leeway in determining the level of standardization they want to implement e.g. as regards the format in which Financial Institutions report to their own competent authorities. If, in this respect, host country's tax authorities decide to accept the use of domestic formats for reporting by financial intermediaries, this would imply that those tax authorities would be charged with converting the domestic standard-based data into the internationally accepted schema.

Notwithstanding this, flexibility is also required so as to enable Financial Institutions, in particular the affiliates of a group with worldwide operations, to report to their own authorities using the OECD schema.

Within the EU, there will be a need to ensure that tax authorities of Member States do not confuse the scope and features of the global reporting with any domestic reporting system. Any misunderstanding would potentially lead to unjustified fraud suspicions concerning foreign investments.

We are particularly concerned about who will do the reconciliation between data reported according to local rules (even if standardized) and what the client declares in his residence country. The reconciliation complexities will be created by any difference in scope between a possible future multilateral reporting, notably the residence country reporting, and the material scope of the domestic tax law. In fact, a recent study from the European Policy Forum on the Savings Directive (http://www.epfltd.org/images/Taxing%20Savings%20Sensibly.pdf) shows (see n° 19 onwards) that data exchanged are barely used, because they do not fit to the income tax rules. There is further an increasing number of evidence that national tax inspectors are misled by the information received from abroad and immediately presume, in case of discrepancies, a fraudulent behavior. This leads to an important amount of useless administrative exchanges between tax administrations, taxpayers and financial intermediaries. Some consider that one way to address this issue would consist in adapting domestic taxable bases to the AEOI. Others believe it should be the other way round, i.e. the reporting should be formatted according to the residence country's income tax rules. The EBF believes neither is realistic or desirable. However, we would like to emphasize that tax administrations should issue detailed guidance to inform their inspectors of what information they get from the AEOI and how they should use it. The issuance of such guidance is crucial to avoid massive erroneous suspicions.

EC Question 3: What, if any, elements of the pilot initiative do you see as potentially burdensome for EU financial institutions? Would it be any less burdensome, from the perspective of EU financial institutions, if the pilot initiative envisaged by 17 Member States were to be implemented in any other way?

The EU-G5 pilot initiative is very confusing and appears at first sight as being a mere political announcement with no concrete substance. There is not enough detail published yet regarding this initiative and its possible implications to enable us to properly evaluate this EC question 3. Our major concern about this initiative results from its potential to lead to duplications of requirements. In addition, we would like to point out that the reference to FATCA as a benchmark is questionable given that many of the FATCA requirements (e.g. indicia searches) do not work well in an EU context.

C. CAN US FATCA BE CONSIDERED AS A BENCHMARK IN A MULTILATERAL CONTEXT?

EC Question 10: Do you support the approach taken by the OECD? (Part 2 of the answer)

US FATCA can be used as a starting point to develop a reporting standard in a multilateral context. The FATCA schema (reporting side of it) presents the advantage of being nearly complete.

However, US FATCA requires high volumes of information to be reported, while a more risk-based approach could be more efficient and less burdensome. Some aspects of FATCA are very US-centric and not appropriate for a multilateral context (e.g. due diligence incl. indicia searches) and for the EU context (e.g. current local FI exception). The US FATCA is particularly burdensome and overly complex notably as regards customer due diligence. In this respect it is an example of what should be avoided at multilateral and Intra-Community levels. For example thresholds were introduced in FATCA and IGAs to trigger enhanced due diligence, and whilst such may be appropriate to ensure enhanced screening of customer information to capture the citizenship of financial account holders, such information, and therefore screening, should not be required in a residency based tax compliance system. We would anticipate that in a multilateral context resident countries matching systems would identify inaccuracies relative to an account holders declared tax residence.

We would like to emphasize that banks do not provide tax advice. Any requirement imposed on financial institutions to implement an AEOI in a multilateral or Intra-Community context must therefore be based on simple rules, concepts and tools and cannot require financial institutions to do tax determinations.

D. Need for a Holistic, “Big bang” approach

OECD Question 18: Are there other factors that would make reporting in a multilateral context easier or more difficult?

The various initiatives regarding AEOI, in particular FATCA, have been a moving target over the last couple of years.

It is time for Governments to favor a holistic approach, i.e. it is crucial that a significant number of countries are on board prior to the launch of a multilateral approach to AEOI. The worst-case scenario would be to develop a system with a limited number of participating countries joining progressively. This would imply numerous, burdensome and costly upgrades for financial institutions and would require Financial Institutions to approach clients multiple times to determine their residence. A unique starting date is a must-have for business. In this respect it is even questionable whether the implementation of FATCA, which has just been postponed, should not be aligned on the entry into force of such global AEOI and postponed accordingly. The “big-bang approach” would help avoiding too many changes or upgrades.

The US FATCA experience also shows that sufficient time must be granted to financial institutions to put in place systems and procedures in the field of exchange of information. Financial institutions would need sufficient lead-time - 18 months to 3 years - starting once the final rules are known. The recent postponement of many of the FATCA requirements proves that it is extremely difficult for all parties to work when the implementation period is not sufficient.

In addition aligning TRACE - see below under (E) - with the multilateral AEOI could be enhanced if governments agreed that a financial institution could not, as envisaged in the TRACE cross border tax relief system, operate as an authorized intermediary (AI) unless the financial institution’s residence country participates in multilateral AEOI.

EC Question 4: Is the timeline included in the proposal feasible for EU financial institutions?

We have been working on FATCA for more than 3 years before reaching an acceptable level of understanding of the implementation issues. This shows that the proposed timeline for implementing the Review Directive on Administrative Cooperation (DAC), whose scope is different and in some respects significantly wider and still needs to be clarified, is totally unrealistic.

E. Need to put TRACE back on the Agenda

In 2006 the OECD's CFA created the Informal Consultative Group (ICG) on the Taxation of Collective Investment Vehicles (CIVs). The ICG was asked to report on:

- Technical issues relating to the granting of treaty benefits with respect to the income of CIVs; and
- Possible improvements to current procedures for claiming treaty benefits by all cross border portfolio investors.

The resulting output was the Tax Relief and Compliance Enhancement (TRACE) project aimed at finalizing the documentation and developing the IT solutions to support the system, and in January this year the CFA endorsed the TRACE Implementation Package (IP).

Meanwhile following the EU Commission's adoption of the "Recommendation on Withholding Tax Relief Procedures, COM (2009) 7924 final" in October 2009, which follows from the FISCO Report (2010), the Commission formed the Tax Barriers Business Advisory Group (T-BAG) whose output was a report published in May this year outlining a solution framework to address issues around withholding tax and refund collection.

What was clear from both is that in order to reduce implementation costs for all stakeholders work to align TRACE with emerging reporting regimes such as FATCA was essential.

Both initiatives start with the acknowledgment that, in practice, claiming withholding tax relief under Double Taxation Agreements and/or a country's domestic tax laws is often cumbersome and time and resource intensive for governments, financial institutions, and foreign portfolio investors. As a result, end investors often are effectively forced to forego the tax relief due to them. This has adverse effects, not only on the investor, but also on the source country (due to its reduced ability to attract investment) and the residence country (due to its lack of information about the income of its resident or the excessive foreign tax credits it may end up having to give).

Source country governments who continue to operate tax reclaim systems will continue to bear the costs associated with such a system, such as the stamping and certification of tax reclaim forms and processing refund payments, reconciling information reporting.

Information aligning the implementation of a multilateral information exchange system with TRACE would reduce, and in some instances eliminate, many of these costs.

Implementation costs of an exchange of information system will require Governments to invest significantly in systems, but also make significant legislative changes.

If the elements necessary to implement TRACE are not built into the final solution from the outset, the natural result will be a resistance to reopening that design effort at a later date. Significant efficiencies could be achieved for both business and governments by aligning implementation covering both multilateral information exchange and TRACE simultaneously.

This means taking into account the information requirements of both residence and source countries, but also building on the design solutions such as due diligence, self-certification, reportable information, liability and the need for consistency that were, well documented, and for the most part resolved when building the TRACE solution. It would seem therefore that implementation of multilateral information exchange would not be delayed by the added focus.

The introduction of new residence country reporting requirements is a good opportunity to also introduce the proposed withholding tax relief system at the same time. This would not only improve the client's net return on their investments and grant him what he is due, but will also partly compensate the costs for financial institutions that will have to put in place systems and procedures for a multilateral information exchange.

The OECD's Trace report as well as the EU T-BAG report include several proposals to harmonize and simplify withholding tax relief procedures.

F. NEED TO TAKE DATA PROTECTION INTO CONSIDERATION

OECD Question 18: Are there other factors that would make reporting in a multilateral context easier or more difficult?

Data privacy rules need to be taken into account and amended as the case may be, as well as be aligned to future proofing. With respect to EU data privacy rules, it should be made clear that the states themselves have to comply with these rules as they themselves will be the "controllers" under EU law.

II. FINANCIAL AND NON-FINANCIAL ENTITIES

G. Entity Classification – Trusts and Partnerships

EC Question 17: What is your opinion on including also the following entities in the scope of reportable taxpayers: partnerships, non-publicly traded corporations and trusts (with a list of exemptions)?

There is currently a lack of globally accepted terminology regarding entity classification and this would need to be addressed.

EUSD presently does not align with FATCA classifications.

The scope of financial intermediaries who have to report should be limited to a positive list of entities drawn from those FATF Recommendations which define financial institutions. The inclusion of other entities into the financial intermediary category (e.g. paying agents upon receipt under EUSD) is unnecessarily overly complex for those generally small actors and may result in duplicative reporting.

In the absence of guidance on trusts and partnerships, we would recommend that the look-through approach under US FATCA is not applied and that the reporting is limited to income received by the trust or partnership. The idea of a central Ultimate Beneficial Owner ("UBO")-register, which financial institutions could access, should be considered by states.

With regard to the identification of trusts different KYC/AML standards are in use in different jurisdictions. In the absence of clear guidance for tax reporting purposes, these KYC/AML standards should not be relevant for the reporting. If the reporting would only be based on these different AML standards, then there would be no level playing field on the one hand, and a potential for loopholes on the other hand.

H. Exceptions carving out certain low-risk entities

OECD Questions 5-6-7: Is it correct that in a multilateral context, an approach where every country would specify a list of different exceptions for low risk entities by reference to its domestic law would be difficult for financial institutions to operate? Assuming this is the case, could certain categories be defined generically and still be administrable by and provide sufficient certainty to financial institutions? If so, which categories do you think could be/could not be defined generically in a way that would be administrable, and how would you see the process working?

As a general preliminary comment on the carve-out of low-risk entities, we consider that the generic approach in the latest Model Annex II is useful but not sufficient. It should be complemented with a per-country domestic list of low-risk entities, for example along the lines of the initial version of Annex II to the Model 1 IGA. We would need to give this further consideration before providing detailed answers on questions 5, 6 and 7 raised by the OECD in its questionnaire of June 2013.

What must be avoided at all costs are subjective tests and that is the reason why reliance on generic definitions is not satisfactory enough. Certain determinations are very complex especially when dealing with foreign entities. It should be borne in mind that financial institutions do not provide tax advice and cannot play the role of tax lawyers. It is therefore necessary that they can rely on simple tools such as official lists. States are indeed in the best position to ascertain which entities are low-risk and can be excluded.

I. Thresholds and local bank exception

OECD Question 2: Assuming a system that requires reporting not just of U.S. accountholders but also accountholders from a large number of other jurisdictions, what would be the implication for business of eliminating threshold amounts? Please consider this question from the perspective of (…) <u>excluded financial institutions</u>. (…)

The rules on local banks are helpful as a concept to eliminate excessive administrative burden, but it is not clear how they can operate in a multilateral/European context.

OECD Question 4: Do the answers depend on which threshold is being discussed (e.g. pre-existing accounts, individual accounts versus entity accounts, thresholds for cash value insurance)

There is a need to model thresholds on FATCA IGA to ensure a consistent application of thresholds. Their application should be optional for FIs to ensure a maximum flexibility.

III. REPORTABLE ACCOUNTHOLDERS

J. Financial Account

EC Question 13: Do you think it is appropriate to exclude from the definition of "Financial Account" any equity or debt interest in an investment entity if they are regularly traded on an established securities market? Please bear in mind that if the securities representing that equity or debt interest in an investment entity are held in a custodial account, there would be no exemption.

Yes, it is appropriate as this rule is overly complex. In addition, the treatment of equity and debt interest as accounts will lead in any way to distortions between legal forms of companies, as such interest is not always presented by a security and consequently not held in deposit. Think only on smaller forms of capital companies, such as s.àr.l. and GmbH, as well as partnerships, where the only manifestation of interest held is often exclusively contained in a contract (statutes).

OECD Question 17: Are there other aspects of the definitions or due diligence procedures that raise issues that are particular to reporting in a multilateral context?

The US FATCA concept of "Relationship Manager" is particularly burdensome for financial institutions. It may make sense in a system where citizenship is searched but not in a system around tax residency. Such a concept is clearly to be avoided in a multilateral information exchange.

K. Thresholds and Exceptions carving out certain accounts

The use of thresholds is subject to debate within the financial services industry. The answer to the questions on the use of thresholds varies a lot depending on the type of industry, type of activity, line of business, clientele, and on whether it concerns new or pre-existing accounts.

While thresholds diminish the amounts of accounts to be reviewed and help financial institutions to deal with commercial aspects (especially when the overwhelming majority of a financial institution's clients are local tax residents and present no cross-border implications), they require additional procedures and increase complexity.

This topic will therefore require more analysis and discussions with the business once the "big picture" is clarified by the OECD.

We would like to point out that under FATCA, the use of thresholds is optional. We should assume that the use of thresholds would also be optional in a multilateral context. Another key point is that thresholds would need to be calculated based on assets (like FATCA) and not on income.

OECD Question 1: Do you intend to apply a threshold, where it is available, for purposes of reporting U.S. accountholders in connection with FATCA Model 1 IGA reporting? Why or why not?

The thresholds are in the main used flexibly depending on the business divisions e.g. mass market retail banks will apply the thresholds to reduce the number of accounts to be remediated. However private banks or smaller banks, where customer volumes are smaller, may choose not to apply the thresholds instead choosing to remediate all accounts and avoid monitoring accounts in future.

L. Individual accountholder identification and due diligence requirements – pre-existing and new account relationships – Self-certification

OECD Question 9: What are the cost implications of reviewing the existing customer database for reportable account holders with respect to multiple residence countries and what aspects of due diligence affect costs the most (e.g., does the length of the look-back period affect costs, and if so, how)?

Operationally, there is no reason for a financial institution to record multiple residences on files. However, we would capture a residence for EUSD reporting purposes or QI treaty relief.

OECD Question 10: Would financial institutions prefer countries (if possible) to introduce a comprehensive domestic reporting regime from the beginning, perhaps as an option?? (i.e., instead of requiring reporting with respect to residents of a few countries, require reporting (or customer due diligence) with respect to all non-resident accountholders or those of countries with which exchange relationships exist)?

If Governments were to introduce a comprehensive domestic reporting regime, then they should make sure it is consistent with the OECD model.

OECD Question 11: Could financial institutions review all accounts to identify the residence country when they review the account base for FATCA purposes, whether or not resident/citizen of the United States? Would the absence of thresholds in this context make a difference in that regard?

No, there may be many accounts grandfathered when EUSD was introduced where residence data was not held and were not remediated. When reviewing accounts for US FATCA we are looking for specific US indicia as defined in the IGA, generally via electronic search, we would not be looking for non US search terms and classifying customers on the basis of these additional terms. This list of additional search terms would be extensive to cover all the member states of the EU and rules would have to be created to deal with conflicting indicia. For example, a customer who was born in France, lives in Germany but works in Luxembourg where the bank account is maintained We believe that a presumption rule would be required to enable classification of residence as the same as where the account is maintained except if there is evidence of a connection to another territory. In cases where a connection is identified, this should be cured by a self certification or certification of tax residence from the tax authority. Where this is not cured then the presumption is that the person is resident in the other territory.

OECD Question 14: In the multilateral context, it is less clear how an indicia approach would work: while indicia of citizenship (such as place of birth) could be eliminated, a question to be addressed is how to deal with cases in which the various indicia with respect to a particular account are inconsistent (e.g. a phone number in one country, address in another and a standing order to transfer funds to a third country). How often do you think you would be confronted with conflicting indicia, if such an approach were applied in a multilateral context?

We would like indicia search to be avoided, as we believe this would lead to many false positives and many conflicting indicia. This is a burdensome aspect of FATCA.

While it is helpful to determine citizenship, e.g. place of birth (for US taxation purposes), it is less helpful for determining residence in an EU context.

OECD Question 15: From a business perspective, what would be a workable approach to deal with such cases? For pre-existing accounts would self-certification be a workable option in such cases? Are there situations for new accounts in which it would not be feasible to obtain a self-certification regarding tax residence?
EC Question 16: Do you think it is appropriate, in a multilateral context, to rely extensively on self-certification for due diligence purposes?

As regards pre-existing accounts, after an electronic search, if there is no conflicting evidence regarding the residence, presumption rules should apply, i.e. additional documentary evidence, e.g. self-certification, would only be required in marginal cases. For new accounts, self-certification would be an option to determine the relevant tax residence in cases of doubt (e.g. addresses in different countries).

IV. REPORTABLE PAYMENTS

M. Scope – Insurance products

EC Question 14: How do you see the definition of insurance product covered by the FATCA Model 1 compare with the definitions of insurance product which are covered by the amending proposal to the EUSD? Do you see any difference?

The insurance product definition within the amending proposal is far wider than envisaged under FATCA which is restricted to insurance products which have a Cash Value. As a consequence the number of FIs required to report is significantly larger and the scope of this reporting is greater.

N. Amounts to report - Capital gains *versus* Gross sales proceeds – Account balances

The calculation of capital gains is very complex (LIFO, FIFO, absence of acquisition prices etc). This is the reason why reporting of capital gains which was initially envisioned under FATCA has been dropped in favor of gross proceeds only. Although less onerous to provide, reporting of gross proceeds is however only an indication of a disposal in most cases and may be misleading for tax authorities in jurisdictions where other exemptions and elections must be taken into consideration.

O. Availability of information

EC Question 2: Would EU financial institutions in all Member States be obliged to report to their tax administrations the information required in the proposal, as a result of the implementation of FATCA agreements? If not, what particular problems would exist?

The proposed Review DAC has been extended based on the assumption that FIs would start to collect information for FATCA purposes. However, the extension includes Capital Gains reporting which is a more onerous requirement than envisaged by FATCA.

For FIs in a FATCA-Model 1 country, this assumption is correct in respect to persons identified as US persons. It should be noted, that FATCA-Model 2 does not provide for similar reporting to the national tax administration. In any case, the implementation of a FATCA-Agreement (both FATCA-Model 1 and FATCA-Model 2) does not by itself result in an obligation for EU-FIs to report FATCA-specific information in respect to Non-US persons, and thus the information required in the proposal is not readily available.

V. OTHER QUESTIONS SPECIFIC TO US FATCA AND IGA

P. FATCA Schema for reporting and transmission methodologies

EC Question 8: Do you have any comments on the IT system (i.e. FATCA schema; schema user guide; transmission method) currently being developed to implement FATCA?

There are still a number of issues and uncertainties that need to be clarified as regards the FATCA schema in order for financial institutions to be able to use it. It is crucial for efficient and useful reporting to happen that guidance be completed (please see the EBF follow-up letter to BIAC).

Q. FFI Registration

EC Question 9: Do you have any comments on the FATCA registration process and/or on the GIIN?

Due to the postponement of the start of FATCA registration (new date August 19, 2013) and the pending relevant guidelines, a final evaluation of the FATCA registration process is not possible at the present time.

VI. OTHER QUESTIONS SPECIFIC TO EU DIRECTIVE ON ADMINISTRATIVE COOPERATION (DAC) AND EUSD

R. General comments on Review DAC

EC Question 1: Would you like to comment on any specific aspects of the Commission's proposal?

<u>**We note that the proposed DAC revision aims at the reporting of capital gains. This proposal must absolutely be dropped.**</u> The calculation of capital gains is extremely complex (LIFO, FIFO, absence of acquisition prices etc). This is the reason why reporting of capital gains which was initially envisioned under FATCA has been dropped in favor of gross proceeds only. Although less onerous to provide, reporting of gross proceeds is however only an indication of a disposal in most cases and may be misleading for tax authorities in jurisdictions where other exemptions and elections must be taken into consideration.

<u>**In addition, it would take years of discussions between states to implement the reporting of capital gains.**</u>

In the absence of detailed information and explanatory guidance on how the proposal would affect EU financial institutions and how it has to be implemented and in view of the ongoing discussions on OECD-, G20- and the G5-level in regard to a global standard on automatic exchange of information, commenting on specific aspects of the proposal seems premature. In our view the proposed timeline is quite precipitous.

Therefore it is neither realistic nor possible to implement an automatic information exchange system as envisaged by the EC within the proposed timeline (starting from January 1, 2015 regarding taxable periods as from January 1, 2014).

<u>Adviser in charge</u>: Roger Kaiser