The automatic exchange of information era

Moving towards global tax transparency

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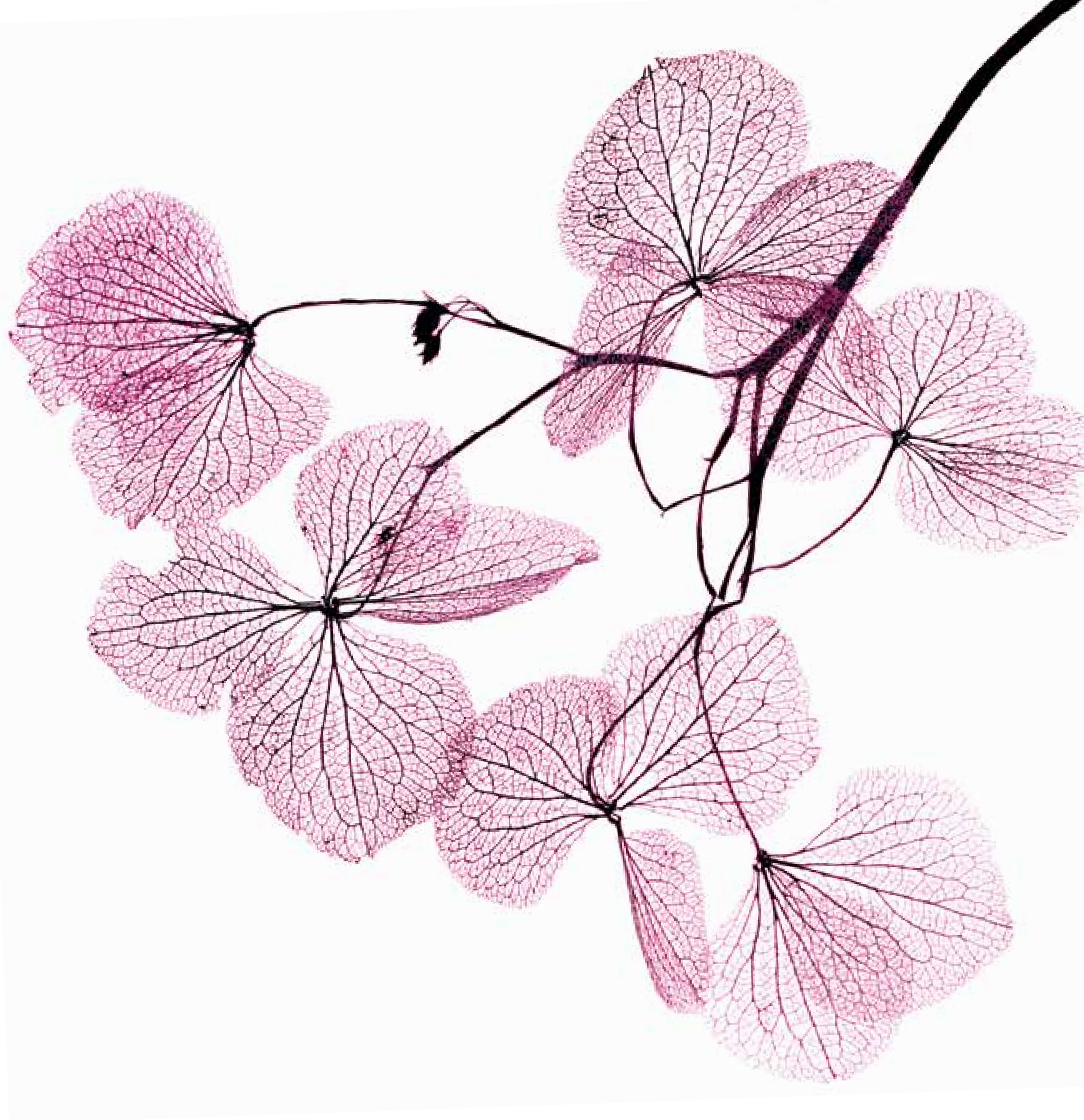
Aiming to reduce tax evasion, the automatic exchange of information is increasingly becoming the standard system of exchange between tax authorities, with a rapidly growing number of countries participating in initiatives such as the OECD Common Reporting Standard. Financial intermediaries (in a broad sense, so not just banks but also including funds, insurance and non-supervised investment structures) worldwide need to implement pre-existing automatic exchange of information frameworks (such as under the FATCA Intergovernmental Agreements), and anticipate upcoming additional exchange of information obligations (such as under the OECD Common Reporting Standard).



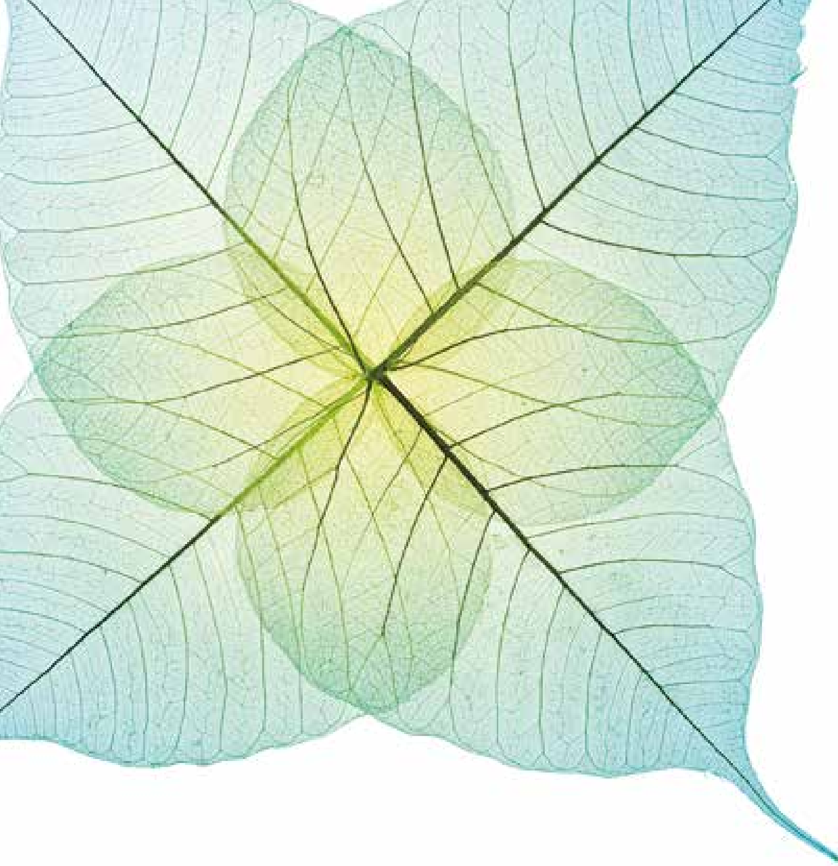
This article will first outline the global context of rapidly evolving initiatives, then focus on the impact of these changes in Luxembourg.

Global context

Until a few years ago, the automatic exchange of information outlook was relatively poor:

- Exchange of information on demand (according to OECD principles, and generally laid down in double taxation treaties) was considered to be the standard system of exchange between tax authorities. Such exchange of information on demand requires a series of stringent conditions to be met before a treaty partner can be obliged to provide information on a taxpayer in their jurisdiction. Depending on local law, the holder of information and/or the taxpayer may also be able to initiate legal proceedings against such a request
- The automatic exchange of information was limited to the scope of the EU Savings Directive (in force since 2005), which requires the automatic exchange of information between EU tax authorities (with certain non-EU countries and Dependent and Associated Territories of EU member states applying similar or equivalent rules). However, this directive has a very limited scope of application; only the cross-border payment of interest income (as well as distributions and redemptions in certain types of fund) is affected. Additionally, certain banking secrecy jurisdictions (such as Austria, Luxembourg and initially Belgium) were allowed to temporarily apply an anonymous savings withholding tax regime instead

In 2010, the OECD used the publication of grey lists to make a concerted push to convince banking secrecy jurisdictions (who until then made reservations under their double taxation treaties as to the application of this type of exchange) and other 'non-cooperative' jurisdictions to accept exchange of information on demand provisions and amend their double taxation treaties accordingly. As a result, a series of countries (including Switzerland, Luxembourg and Belgium) agreed additional protocols to their double taxation treaties to allow such exchanges and to be taken off the OECD's grey list (as being listed may trigger anti-abuse provisions and other measures leading to adverse tax consequences for businesses).



More recently there has been a shift towards tax transparency, with the automatic exchange of information chosen as the standard. This shift was accelerated significantly by the financial crisis and by the U.S. Foreign Account Tax Compliance Act (FATCA):

- In its standard version, FATCA is a regime allowing the IRS to obtain information from financial intermediaries (not just banks but also funds, certain insurance companies and certain non-supervised investment structures) on the identity of U.S. Persons, the financial assets they hold and their investment income. Financial intermediaries that fail to comply with these reporting obligations (or clients of those financial intermediaries who fail to provide sufficient information to the intermediary to be classified correctly for FATCA purposes) may be subject to a punitive 30% FATCA withholding tax on their direct (and at a later stage, indirect) sources of U.S. income
- In view of pre-existing political pressure within the EU (and among the G20 countries) to move to the automatic exchange of information, five EU member states negotiated a framework agreement with the U.S. in order to impose FATCA obligations based on the automatic exchange of information via local tax authorities (known as the Intergovernmental Agreements or IGAs) Meanwhile, a second model of IGA is available whereby automatically exchanged information is still sent directly via the IRS
- The IGA concept has proven to be a success as a large number of countries worldwide have signed (or are in the process of negotiating) an IGA with the U.S.
- In addition, the amended EU Savings Directive was adopted this year by the European Council following a long negotiation process that began in 2008. With a view to closing loopholes in the current EU Savings Directive, the new version will have a significantly expanded scope of application and will be applicable as from 1 January 2017
- Elsewhere, and as a result of, among other things, an initiative led by the 'Big 5' EU member states (Germany, France, the UK, Italy and Spain), the OECD has released a global standard for the exchange of information. Dubbed the Common Reporting Standard or CRS, it was endorsed by the G20 in February 2014, an event followed by a statement issued by 44 jurisdictions wishing to be 'early adopters' (aiming for its application as from 2016). The 'Big 5' EU member states wish to formally sign the CRS at the Global Forum meeting in October 2014 in Berlin, together with all early adopters wishing to do so. As it stands, the OECD Convention on Mutual Administrative Assistance in Tax Matters has been signed by more than 60 jurisdictions, including Luxembourg and Switzerland
- Finally, the EU Administrative Cooperation Directive will (in various phases) enter into force as from 2015, imposing requirements including the automatic exchange of information between tax authorities within the EU on salaries, pensions, director's fees, insurance and real estate. It is the European Commission's intention to extend the scope of application of this directive to all types of financial income

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The automatic exchange of information is consequently heading towards:

- A virtually global automatic exchange of information system
- A wide range of data exchanged on all types of financial income
- Different, yet partly overlapping frameworks that at some point will need to be integrated into a single standard. It may well be that the CRS developed by the OECD will at some point 'absorb' the EU Savings Directive

Focus on Luxembourg

Luxembourg also recently made a shift towards full participation in the automatic exchange of information. The government's decision to negotiate an IGA with the US triggered a kind of domino effect:

- Luxembourg decided to conclude an IGA Model I with the U.S., which basically establishes an automatic exchange of information regime between Luxembourg financial institutions (banks, funds, certain insurance companies and certain non-supervised investment structures) and the Luxembourg tax authorities on U.S. Persons. The Luxembourg tax authorities will forward this information to the IRS
- Having accepted the automatic exchange of information with the U.S., Luxembourg also took (or in practice, had to take) steps to discontinue the 35% savings withholding tax under the EU Savings Directive. Luxembourg will apply the automatic exchange of information under the EU Savings Directive as from 1 January 2015 (provided draft law no. 6668 in this respect is adopted)
- Although Luxembourg is currently not one of the 44 early adopters of the Common Reporting Standard, it is a signatory to the (protocol of the) OECD Convention on Mutual Administrative Assistance in Tax Matters, and will consequently also participate in the automatic exchange of information based on the CRS at some point
- As Luxembourg and Austria abandoned their opposition to the amended EU Savings Directive and it was then adopted by the EU Council this year, its broadened scope of application will apply as from 1 January 2017 (including through the automatic exchange of information, since—as mentioned above—Luxembourg will discontinue the savings withholding tax as from 2015)

Industry impact in Luxembourg

It is clear that the banking, fund and insurance industry, as well as certain non-supervised investment structures need to follow these developments closely to ensure timely implementation of the automatic exchange of information obligations.

Indeed, financial intermediaries in general need to do more than simply implement (or continue implementing) the Luxembourg FATCA IGA, leading to important changes to procedures and IT systems. Those intermediaries are also likely to be impacted by related developments, triggering procedural and IT system changes as well. These include:

- The switch to be made under the current EU Savings Directive from a savings withholding system to the automatic exchange of information on 1 January 2015
- More significant changes to be made as to the substantially broadened scope of application of the amended EU Savings Directive, applicable as from 1 January 2017
- The Common Reporting Standard, which may significantly extend automatic exchange of information obligations to a much larger number of countries, based on similar (yet not identical) mechanics as those applicable under the FATCA IGA. An additional complication is that the exact implementation date is not yet known, and a harmonisation move may lead to the absorption of the (amended) EU Savings Directive by the CRS at some point in the future (before or after the implementation date of the amended EU Savings Directive)

Apart from the above-mentioned financial intermediaries, service providers need to adapt their service offerings to be able to deal with an increased specialised demand for assistance in this area.

It is clear that these developments need to be monitored closely in order to limit implementation costs, and to allow synergies between these related developments to be exploited where possible.