FINAL REPORT & ADDENDUM	REF: 0120454/1/039949PRM.LSE
FEASIBILITY STUDY ON A STANDARDISED "RELIEF AT SOURCE" SYSTEM IMPLEMENTING THE PRINCIPLES OF THE FISCO RECOMMENDATION	

AUTHOR:	ISSUE DATE:
PwC EU Services (1)	3-JUN-2013

European Commission

Taxation and Customs Union DG

SUBJECT: Feasibility Study on a Standardised "Relief at Source" System Implementing the Principles of the FISCO Recommendation

Final report & Addendum

SPECIFIC CONTRACTS **SC03: TAXUD/2010/DE/103**
SC04: TAXUD/2011/DE/129

STATUS: Approved

1 "PwC" is the brand under which member firms of PricewaterhouseCoopers International Limited (PwCIL) operate and provide services. Together, these member firms form the PwC network. Each member firm in the network is a separate and independent legal entity and does not act as an agent for PwCIL or any other member firm. PwCIL does not provide any services to clients. PwCIL is not responsible or liable for the acts or omissions of any of its member firms, nor can it control the exercise of their professional judgment or bind them in any way.

PwC EU Services
Europees Economisch Samenwerkingsverband/Groupement Européen d'Intérêt Economique/
European Economic Interest Grouping
Maatschappelijke zetel/Siège social/Registered office: Woluwe Garden, Woluwedal 18,
B-1932 Sint-Stevens-Woluwe
T: +32 (0)2 710 4211, F: +32 (0)2 710 4299, www.pwc.com
BTW/TVA BE 0872.793.825 / RPR Brussel - RPM Bruxelles / INGBE16 3101 8056 4374 - BIC BBRUBEBB

TABLE OF CONTENTS

* *

*

TABLES

* *

*

FIGURES

* *

*

European Commission

Taxation and Customs Union DG

SUBJECT: Feasibility Study on a Standardised "Relief at Source" System Implementing the Principles of the FISCO Recommendation

Final report

STUDY OVERVIEW

This report highlights the main findings and conclusions arising from the feasibility study on a standardised relief at source system implementing the principles of the FISCO recommendation.

By way of an introduction, Chapter 2 sets the scene for the study and provides sufficient basic tax theory to enable the interested reader to understand the main issues in the report and put them into perspective considering the fast-moving international exchange of information environment.

It provides a high-level description of the double taxation generally arising on cross-border securities income payments (WHT in the SC followed by another tax charge in the RC) and the mitigation measures provided for in DTTs (relief at source or refund of WHT by the SC; exemption or tax credit in the RC).

Chapter 3 provides an overview of the objectives, scope and main assumptions and constraints. It also presents the structure of the report as well as the reference and applicable documents, acronyms and definitions that are used in the report. Finally, it presents the assumptions applying to the study and the selected cases assessed throughout the study: Cross-Border Scenario, Reversed Cross-Border Scenario and Triangular Scenario.

Chapter 4 describes the governing principles of the two contemplated Models and is aimed at paving the way for the comparison between them. The AIC Model should be regarded as a variation of the SC Model, the main differences between these two Models being the communication channels and other few principles linked to the first one. It ends by describing the operating Models considering the various flows applicable to each: the TRI flow and the cash flow (common to both Models) and the exchange of information flows (different between the two Models).

Chapter 5 details the interactions between the contemplated Models and the EU and international administrative cooperation framework. The Administrative Cooperation, Recovery and Savings Directives and other international cooperation instruments are analysed.

Chapter 6 aims at analysing the European legal tools available for putting the contemplated Models in place within the EU and, if appropriate, with third countries.

Chapter 7 gives an overview of the possible data protection concerns that could arise from the SC and AIC Models, as both entail the collection and cross-border exchange of personal (tax) information regarding individuals by financial intermediaries and tax administrations.

Chapter 8 focuses on the effectiveness of the two Models and their ability to ensure tax compliance by Investors, from both an RC and SC perspective.

Chapter 9 presents the conclusions of the fraud analysis. Both Models as they currently stand provide tax administrations of SCs and RCs with the opportunity to combat some of the fraud risks existing in the current situation.

Chapter 10 presents the IT part of the feasibility study which compares the AIC and SC Model from an IT architecture perspective.

Chapter 11 identifies the costs and benefits that the SC and AIC Models have compared to the current situation, and the advantages and disadvantages of one Model compared to the other. These questions were raised for each stakeholder: MSs, the financial sector, Investors and the EU budget.

Chapter 12 develops a high-level implementation plan based on the results from the previous phases. This implementation plan describes a suggested methodology and the various stages and phases, as well as provides an estimate in terms of timing for the implementation taking into account the various interdependencies.

Chapter 13 is the concluding chapter of this study which provides an overview table of the advantages and disadvantages of both Models.

* *

*

CHAPTER 1 INTRODUCTION

This chapter provides an overview of the objectives, scope and main assumptions and constraints. It also presents the structure of the report as well as the reference and applicable documents, acronyms and definitions that are used in the report.

* * *

1.1 DOCUMENT PURPOSE AND SCOPE

This final report presents the findings, conclusions and recommendations of the feasibility study on a standardised relief at source system that the European Commission's Directorate-General for Taxation and Customs Union (DG TAXUD) has commissioned to PwC. The objective is to present the main outcomes of the analysis conducted.

1.2 CONTEXT

This final report is part of the work that DG TAXUD decided to carry out to follow up to the European Commission Recommendation on Withholding Tax Relief Procedures of 19 October 2009 (2). Although we hope that this final report will be helpful to the European Commission in deciding how to best follow-up to the work in this area, it has to be stressed that this final report is without prejudice of any decisions that the European Commission may take. The European Commission has not decided yet whether or not to launch any initiative in this area.

1.3 DEVIATION FROM TEMPO

There is no major deviation from TEMPO (3) in this report. The only deviations were justified by readability considerations. Some schemas representing the models included in Appendices 4, 5, 6 and 7 are available in A3 format as they are not readable under an A4 format. The complexity of these models as well justified the use of various colours to highlight the different steps.

1.4 ASSUMPTION AND CONSTRAINTS

This feasibility study compares two Models implementing a standardised relief at source system: the SC and the AIC Models. The context of the development of these Models and their structuring principles are set out in the current final report. However, general knowledge of the EU framework in terms of exchange of information and legal tools and practices is needed to have a good understanding of the various problems raised. In addition, familiarity with the FISCO/TRACE work (4) is required to have an in-depth understanding of both Models and be able to place them in their historical context.

1.5 STRUCTURE

The final report is made of **13 chapters** besides the executive summary and the study overview. They are organised as follows:

- **The present chapter** presents the characteristics of the document, including an overview of its structure;

2 C(2009)7924 of 19.10.2009
3 See list of abbreviations under heading "Terminology"
4 See Chapter 2

- **Chapter 2** presents the main concepts in terms of WHT and DTT, and the international context of the feasibility study;
- **Chapter 3** presents the scope and an overview of the study, its structure and identifies the relevant scenarios that will be assessed throughout the study;
- **Chapter 4** presents the governing principles of both models, highlighting the main differences between these and provides an operational description of each model including the various tasks performed by the different stakeholders;
- **Chapter 5** analyses the interaction of each Model with the administrative cooperation framework at EU and international level;
- **Chapter 6** presents the legal instruments available to implement one or the other Model;
- **Chapter 7** presents the data protection analysis and is aimed at highlighting the possible data protection concerns taking into account the Data Protection Directive;
- **Chapter 8** analyses both Models looking at their effectiveness and their ability to ensure tax compliance of the investors;
- **Chapter 9** analyses the ability of each model to fight against fraud;
- **Chapter 10** presents the IT analysis. It evaluates the architecture to support the information exchange in a standardised relief at source system under both Models, suggests a way forward to implement the needed IT solution and compares the AIC and SC Models with a view to identifying the preferred model from an IT perspective;
- **Chapter 11** presents the costs and benefits analysis, looking at the costs and the benefits that the SC Model and the AIC Model would have compared with the current situation, and the advantages and disadvantages of one Model compared with the other;
- **Chapter 12** develops a high-level implementation plan, suggesting a methodology and defining the various stages and phases to implement a relief at source system, as well as provides an estimate of what seems to be realistic in terms of timing;
- **Chapter 13** presents the overall conclusions of the feasibility study.

1.6 TERMINOLOGY

This section provides the list of all abbreviations, acronyms and definitions used in the document.

1.6.1 ABBREVIATIONS AND ACRONYMS

ABBREVIATIONS/ ACRONYM	TERM
AI	Authorised Intermediary
AIC	Authorised Intermediary Country
AIIN	Authorised Intermediary Identification Number
AH	Account Holder
Art. / Arts.	Article / Articles
BPMN	Business Process Modelling Notation
CBA	Cost-Benefit Analysis
CCN	Common Communication Network between EU MSs' Tax Administrations
CFA	Committee on Fiscal Affairs (Organisation for Economic Cooperation and Development)
CI	Contractual Intermediary
CIV	Collective Investment Vehicle
CoR	Certificate of Residence
DAC	Directive on Administrative Cooperation (Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC)
DAH	Direct Account Holder
DG MARKT	Directorate General Internal Market and Services (European Commission)
DG TAXUD	Directorate General Taxation and Customs Union (European Commission)
DTT	Double Tax Treaty
EI	Excluded Intermediary
EUSD	European Union Savings Directive
FATCA	Foreign Account Tax Compliance Act (US legislation)
FDAP	Fixed, Determinable, Annual, Periodical
FI	Financial Institution
FFI	Foreign Financial Institution
FISCO	European Commission's Clearing and Settlement Fiscal Compliance ("FISCO") expert group
FTE	Full-Time Equivalent
GDP	Gross Domestic Product
IAH	Indirect Account Holder
ICG	Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors (Organisation for Economic Cooperation and Development)
IEC	International Electrotechnical Commission
IF	Interface (5)
IMF	International Monetary Fund

5 This abbreviation will only be used within the IT analysis; it will not be used as a standard abbreviation.

ABBREVIATIONS/ ACRONYM	TERM
INV	Investor
IO	Information object (5)
IRS	US Internal Revenue Service
ISD	Investor Self-Declaration
ISMS	Information Security Management System
ISO	International Organisation for Standardisation
ITF	IT functionality (5)
KYC	Know Your Customer
LAC	Logical application component
LTC	Logical technology component
MS	Member State
OECD	Organisation for Economic Cooperation and Development
PQP	Project Quality Plan
PS	Platform service
QA	Quality Assurance
QC	Quality Control
QI	Qualified Intermediary (US legislation)
RaS	Relief at source (5)
RC	Residence Country
RFC	Request for clarification (5)
RFI	Request for information
RP	Reportable Payment
SC	Source Country
SCM	Standard Cost Model
T-BAG	Tax Barriers Business Advisory Group of the European Commission
TA	Tax Administration
TEMPO	TAXUD Electronic Management of Projects Online
TFEU	Treaty on the Functioning of the European Union
TIEA	Tax Information Exchange Agreement
TIN	Taxpayer Identification Number
TOGAF	The Open Group Architecture Framework
TRACE	Treaty Relief and Compliance Enhancement Group of the OECD
TRI	Tax Rate Information
UC	Use case
UCI	Undertakings for Collective Investment
UCITS	Undertakings for Collective Investment in Transferable Securities
VAT	Value Added Tax
WA	Withholding Agent
WAC	Withholding Agent Country
WHT	Withholding Tax

Table 1: Abbreviations and Acronyms

1.6.2 DEFINITIONS

TERM	DEFINITION
Authorised Intermediary	Any Intermediary that is recognised by the Competent Authority (on a contractual or another legal basis) as an Authorised Intermediary and is therefore authorised, under certain terms and conditions, to claim WHT relief on securities income on behalf of its Investors and on a pooled basis.
Account Holder	Any person that is a Direct Account Holder or an Indirect Account Holder and with respect to which the AI acts as an Authorised Intermediary
Authorised Intermediary Identification Number	A unique combination of numbers assigned by the Source Country to an Authorised Intermediary
Contractual Intermediary	Any Intermediary that is neither an Excluded Intermediary with respect to the Source Country nor acting as an Authorised Intermediary and with respect to which the AI has received a valid Intermediary Declaration (original or copy) for Contractual Intermediaries • Certifying that the Intermediary is subject to Know Your Customer Rules (except to the extent that it is an Intermediary only by reason of being a Fiscally Transparent Entity) with respect to the Account Holders for which claims are made through the AI; • Authorising the disclosure of the declaration to relevant tax administrations in accordance with its terms; and • Agreeing to specified procedures for the recovery of under-withheld tax.
Competent Authority	Competent Authority has broadly the same meaning irrespective of the international exchange of information instrument (e.g. DTT, Directive on Administrative Cooperation, Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters): According to the OECD Model Tax Convention, the term "Competent Authority" recognises that in some OECD member countries the execution of DTTs does not exclusively fall within the competence of the highest tax authorities; some matters are reserved or may be delegated to other authorities. Each Contracting State can thus designate one or more authorities as being competent (Commentaries on Art. 3 of the OECD Model Tax Convention). For the purposes of the Directive on Administrative Cooperation, the term "Competent Authority of a MS" means the authority which has been designated

TERM	DEFINITION
	as such by that MS (Art. 3.1 of the Directive on Administrative Cooperation). The same applies in Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters.
Covered Payment	In general (6), any payment of dividends or interest arising in the Source Country received by the AI with respect to an account that has been designated by the AI in as one for which it is acting in its capacity as an Authorised Intermediary.
Direct Account Holder	Any person (including another Intermediary) who has an account directly with an Authorised Intermediary
Excluded Intermediary	An Intermediary that has been designated as such by the Competent Authority
Fiscally Transparent Entity	An entity or arrangement with respect to which, under applicable tax treaties or the domestic law of the Source Country, the partners, beneficiaries or similar persons are treated for tax purposes as the owners of the income received by the entity or arrangement
Indirect Account Holder	Any person who receives amounts that have been paid through an Authorised Intermediary but who does not have a direct account relationship with the Authorised Intermediary. For example, a person that has an account with a foreign Intermediary which, in turn, is a Direct Account Holder of the AI is an Indirect Account Holder. A person is an Indirect Account Holder even if there are multiple tiers of Intermediaries (each of which would also be a Direct or Indirect Account Holder of the Authorised Intermediary) between the person and the Authorised Intermediary. If a Fiscally Transparent Entity acts as an Intermediary under these Procedures by making claims on behalf of its partners, beneficiaries, or similar persons, each such partner, beneficiary or similar person shall be treated as an Account Holder.
Information object	Any data sets or reports used as input and/or output during a process steps. They can be generated, used or processed by IT functionalities.
Interface	A tool and concept that refers to a point of interaction between two IT functionalities or logical components. Interfaces are used to exchange information objects between IT functionalities or logical components.

6 Except to the extent modified by the agreement concluded by the AI and the SC.

TERM	DEFINITION
Investor	Any person that receives a Covered Payment and that is not acting as an Intermediary with respect to that Covered Payment
Investor Self-Declaration	The certification, in one of the forms set out, provided by an Account Holder to an Intermediary, • Certifying that the Account Holder is the beneficial owner of the income to be paid or credited to the account(s) to which the certification relates; • Providing certain additional information relevant to determining the appropriate rate of withholding to be applied to the income to be received; • Authorising the disclosure of the declaration to relevant tax administrations in accordance with its terms; and • Agreeing to specified procedures for the recovery of under-withheld tax.
IT functionality	A certain functionality provided by an IT system. IT functionalities are used to describe the software capabilities of a logical application component.
Know Your Customer	Customer due diligence and record-keeping requirements relating to the opening and maintenance of accounts with financial services firms that are based on the relevant principles established by the Financial Action Task Force, including in particular Recommendations 4-11 of the 40 Recommendations relating to measures to prevent money laundering and terrorist financing and the 9 Special Recommendations relating to terrorist financing as they relate to financial institutions (found at www.fatf-gafi.org)
Logical application component	A product and technology neutral description of an IT component which resembles a part of an IT system. It provides information objects and IT functionalities to the user or other IT systems.
Logical technology component	A product and technology neutral description of an IT component which resembles a part of an IT infrastructure. It provides platform services to other IT systems.
Payer	Any person that makes a Covered Payment, directly or indirectly, to an Authorised Intermediary
Platform service	A certain functionality provided by an IT infrastructure component. Platform services are used to describe the software capabilities of a logical technology component.

TERM	DEFINITION
Reportable Payment	In general (7), any Covered Payment, but only to the extent that the Covered Payment • Is paid directly, or indirectly through one or more Contractual Intermediaries, to another Authorised Intermediary acting in its capacity as an Authorised Intermediary; or • If not so paid, is either: – Paid, directly or indirectly, to a person who is a resident of the Source Country for tax purposes; or – A payment that qualifies for a reduction or exemption from withholding tax in accordance with Double Tax Treaties.
Residence Country (8)	Country where the investor has its tax residence
Source Country (8)	The country from which dividends and interest payments arise
Standard Transmission Format	A unique combination of letters or numbers, however described, assigned by a country or other taxing authority to its residents and used to identify the residents in the course of collecting taxes
Tax Rate Information	Pooled information provided by an Authorised Intermediary to a Payer regarding the withholding rate to be applied to a payment
Withholding Agent	The person who is required, under the laws of the Source Country, to withhold tax on a Cover Payment and remit it to the Source Country. The term includes an Authorised Intermediary that has also been authorised to assume withholding responsibility

Table 2: List of definitions

7 Except to the extent modified by the agreement concluded by the AI and the SC.
8 Note that these definitions will have to be refined and detailed according to the legal aspects they cover.

1.7 DOCUMENT CONVENTION

This section provides the details of the convention used in the various flowcharts included in the report. The flowcharts have been drawn following the Business Process Modelling Notation.

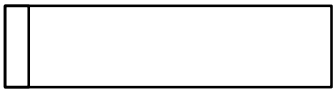
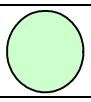
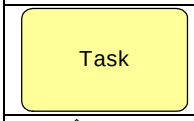
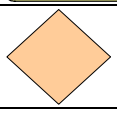
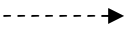
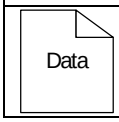
BPMN NOTATION	BPMN ELEMENT NAME	DESCRIPTION
	Pool	A pool represents a participant in a process. It acts as a "graphical container" used for partitioning a set of activities from other pools.
	Start Event	Event that indicates the start of the process activities.
	End Event	Event that indicates the end of the process activities.
	Task	Indicates atomic activity within the process, i.e. task which cannot be broken down to a finer level of detail.
	Gateway	Decision box or gateway, used to control the process flow, i.e. to decide whether the process flow must follow one direction or another.
	Sequence Flow	Used to show the order in which activities are performed.
	Association	Used to associate information (e.g. a Data Object) to an Event, an Activity or a Gateway. An Association can be directional (arrow) or not.
	Data Object	Represents a document (spreadsheet, form, reference manual, etc.) or a database.

Table 3: Notation followed in the flowcharts' document

1.8 REFERENCE, APPLICABLE DOCUMENTS AND SPECIFIC STANDARDS

Reference and applicable documents can be found in Appendix 29.

* *

*

CHAPTER 2 BACKGROUND

The objective of this chapter is to set the scene of the study and enable the interested reader, whatever his or her professional background, to have sufficient basic tax theory to understand the main issues of this report, and put it into perspective considering the quickly moving international exchange of information environment. To reach its informative objective, this chapter is necessarily simplifying and does not claim to be exhaustive.

This chapter starts with a high-level description of the double taxation generally arising upon cross-border securities income payments (WHT in the SC, followed by another tax charge in the RC) and the mitigation measures provided for in DTTs (relief at source or refund of WHT by the SC; tax credit in the RC).

The main principles included in the FISCO Recommendation, which is aimed at "generalising" relief at source, as opposed to refund procedures, and at making these procedures more efficient are then detailed. In particular, it is recalled that, in order to ensure proper operation of a generalised relief at source system, exchange of information should be organised both towards the SC (to ensure correct application of the DTT rates) and towards the RC (to ensure compliance).

The two different collection and exchange of information paradigms (collection and exchange of information by the SC or by the AIC) are introduced to the reader for the first time.

These two paradigms are analysed from various angles in the following chapters of this report. At this stage, however, it is important to include the question of the application of DTT reliefs and the correlative exchange of information between countries in a broader context. To this end, this chapter covers a range of cross-border exchange of information initiatives: the QI regime, the Savings Directive regime, the OECD work (including the ICG Report), FATCA, the Directive on Administrative Cooperation, Art. 26 of the OECD Model Tax Convention, the OECD/Council of Europe Multilateral Convention on Mutual Assistance in Tax Matters, and the Rubik agreements..

* * *

2.1 WITHHOLDING TAX AND DOUBLE TAX TREATIES

1. **Withholding Tax around the World.** The vast majority of countries around the world apply WHT on securities income (basically dividends and interest). The WHT is deducted either by the Issuer of the securities or by a Financial Intermediary (FI) that is involved in the payment of the income, a so-called Withholding Agent (WA).

In many cases taxing rights are shared between the SC and the RC pursuant to a DTT. In most of the DTTs, the SC (i.e. the country where the Issuer of the securities is established) is entitled to tax part of the movable income paid (dividends or interest). This taxation normally takes the form of a WHT. On the other hand, the RC (i.e. the country where the Investor is established/resident) keeps its right to tax the income collected by the Investor according to its local income tax rules.

In order to mitigate, as much as possible, the double taxation (a first taxation in the SC, a second taxation in the RC), most of the DTTs provide for two mechanisms, being one in the SC and the other in the RC.

- It is generally provided that the SC will cap the WHT it applies to the income paid (i.e. a maximum rate). In theory, the SC can either provide for a relief at source (i.e. a reduction of the WHT rate directly upon payment of the movable income to the Investor) or a refund method (i.e. where the Investor is entitled to a refund equal to the difference between the tax rate provided for in the internal tax legislation of the SC and the DTT rate);
- In the RC, the double taxation is in principle mitigated by applying a tax credit with respect to the income collected by the Investor.

Non-resident Investors may often be entitled to a lower WHT rate or even an exemption from tax in the SC, compared to the tax rate provided for in the internal tax legislation of the SC.

In practice, the application of such reduced WHT rate or exemption often takes the form of a so-called "refund procedure", whereby the WHT is first applied and then refunded. The timing for the refund can be very long and the procedures very burdensome, which leads to inefficiencies (the beneficial owner of the income bearing the cost of the timing difference to the benefit of the SC).

In addition, the procedures to claim treaty benefits are often complicated and vary considerably among countries so that most portfolio Investors just cannot afford to seek the application of the rights they are in principle entitled to.

2. **The Giovannini Group and the FISCO Group.** The Giovannini Group of financial market experts identified 15 barriers to the integration of EU securities post-trading systems in a report of 2001, "*Cross-border clearing and settlement arrangements in the European Union"*, and 2003, "*Second Report on EU Clearing and Settlement"(*9*).*

9 http://ec.europa.eu/economy_finance/eu/integrating/giovanni_group/index_en.htm

The second Giovannini Report recommended, *inter alia*, that all financial intermediaries established within the EU should be allowed to offer withholding agent services in all of the MSs to ensure a level playing field between local and foreign intermediaries (Barrier 11).

The EU Clearing and Settlement Fiscal Compliance Experts' Group ("FISCO") that was created in March 2005 following the Communication "*Clearing and Settlement in the European Union – The way forward"* had as one of its key objectives the resolution of Giovannini Barrier 11 (10).

The FISCO Group published two reports: "*Fact-Finding Study on Fiscal Compliance Procedures Related to Clearing and Settlement within the EU"* was issued in 2006 and *"Solutions to Fiscal Compliance Barriers Related to Post-Trading within the EU"* was issued in 2007.

As indicated in those reports, the granting of WHT relief at source rather than through a refund procedure would be a major step towards simplification of WHT procedures.

3. **The FISCO Recommendation.** On 19 October 2009, further to the work of the FISCO Group, the European Commission adopted a Recommendation on Withholding Tax Relief Procedures (11). The aim of the FISCO Recommendation, which was a joint initiative of the Directorate Generals for Taxation and Customs Union and for Internal Market Services, is to make it easier for an Investor that is resident in one EU MS to claim WHT relief on securities income received from another MS. In broad terms, the FISCO Recommendation formulates proposals for improving the way tax administrations could grant relief from WHTs at source rather than apply refund procedures.

The suggested approach is to use an AI system whereby MS allow (foreign) FIs to claim relief from WHT on behalf of their Investors and on a pooled basis (Information Agent - IA). MSs are also encouraged to allow IAs, if they wish to do so, to take primary withholding responsibility (i.e. effectively collect the WHT and pay it to the SC) therefore acting as Withholding Agents (WA).

To counter-balance the risk of tax fraud/evasion arising from the pooling of information, AIs would be required, under this system, to report investors' detailed information to the SC. Moreover, this information is expected to be provided also to the RC. In such a way the SC would be in a position to check whether the WHT relief has been correctly granted and the RC would be able to confirm to the SC whether an investor who purported to be tax resident in that country is effectively resident therein for tax purpose. Moreover, this would enable the RC to check whether that investor has declared and paid the tax due in his/her RC on cross-border securities income that are subject to reporting.

Under this simplified system, AIs would claim WHT relief based on an Investor-Self Declaration (ISD) which would replace Certificates of Residence (CoR).

10 http://ec.europa.eu/internal_market/financial-markets/clearing/compliance_en.htm

11 C(2009)7924 of 19.10.2009. More information can be found at the following link: http://ec.europa.eu/taxation_customs/taxation/personal_tax/taxation_securities/index_en.htm

It should be noted that the Model outlined in the Recommendation is not described in details and is limited to a number of basic principles broadly corresponding to the approach being taken by the OECD in its TRACE work, which is exhaustively defined in the Implementation Package. The latter is inspired broadly by the QI system implemented by the US.

More in details, the Commission's Recommendation encouraged Source (Member) States to implement some simplification elements in order to ease the application of the DTT WHT rates (either in the framework of a refund or of a relief at source). These elements can be summarised as follows:

- **Relief at Source (Paragraph 3).** Application of reliefs at source instead of refund procedures;
- **Standardised and Quick Refund Procedures (Paragraph 4).** Where, in exceptional cases, tax relief at source is not feasible, source MSs are invited to set up standardised and quick refund procedures:
  - Authorisation of FIs to submit refund claims on behalf of their Investors;
  - Use of a single contact point for the introduction and handling of all the refund claims and publication of the relevant information on refund procedures on a website, in at least one language customary in the sphere of international finance;
  - Use of common formats for refund claims which would be able to be filed electronically;
  - Refunding in a reasonable period of time and normally, at least, within 6 months of receipt of the refund claim by the relevant tax administration, provided that all necessary information is available;
- **Role of Information and Withholding Agents (Paragraph 5).** Where there is a custody chain involving several FIs:
  - The Reporting Agent closest to the Investor should verify whether the Investor is entitled to tax relief and should store the documentation received;
  - The Reporting Agent closest to the Investor should report Investor specific information to the source MS either on an annual basis or upon request;
  - Each Reporting Agent in the custody chain should pass pooled WHT rate information to the next Reporting Agent in the chain so as to reach the WA; and
  - The WA should apply WHT relief at source on the basis of the pooled WHT rate information received;
- **Conditions for Financial Intermediaries (Paragraph 6).** Source MSs are invited to lay down proportionate and non-discriminatory conditions and obligations in order for a Financial Intermediary to be authorised to act as a Reporting Agent or even WA;

- **Documentation Proving Entitlement to Tax Relief (Paragraph 7).** Source MSs are invited to allow alternative proofs of the Investor's entitlement to tax relief to Certificates of Residence issued by the residence MS (e.g. self-certification by the beneficial owner);

- **Information and Documentation in Electronic Format (Paragraph 8).** Source MSs are invited to allow Reporting Agents and WAs to transmit and archive information and documentation by electronic means;

- **Supervision (Paragraph 9).** MSs are invited to set up procedures to investigate the compliance of Reporting Agents and WAs with obligations created in accordance with this Recommendation. This could include single or joint audits by the tax administration of the source MS and/or the tax administration of the MS where the information or Withholding Agent is located/established or audits by Independent Reviewers;

- **New Communication Channels (Paragraph 10).** In addition, to ensure proper operation of this system and the validity of the information exchanged, the Recommendation suggests that new channels of communication should be created and/or existing channels adapted where appropriate. For instance, it might be envisaged to leverage on already existing EU communication channels, such as those set in place further to the implementation of the Savings Directive.

4. **Follow-up to the FISCO Recommendation.** To follow-up on the FISCO recommendation, the European Commission has set up two working groups:

- **The FISCALIS Project Group.** This group, which has been set up by DG TAXUD under the FISCALIS programme, is made up of representatives of a limited number of MSs which volunteered to participate (12) (the *"FISCALIS Project Group"*). Its mandate is to work on concrete ways to implement the principles outlined in the FISCO Recommendation. The FISCALIS Project Group was also responsible for cooperating with PwC in carrying out the feasibility study;

- **The T-BAG.** The Tax Barriers Business Advisory Group (*"T-BAG"*) has been established by DG MARKT and includes representatives from business. Its mandate is to update the European Commission on the current state of WHT relief procedures in the MSs as well as to advise it on how to implement in practice the principles outlined in the FISCO Recommendation from a business perspective.

5. **The OECD TRACE Work.** The principles outlined in the FISCO Recommendation largely correspond to the approach being taken by the OECD in the "Treaty Relief and Compliance Enhancement" – TRACE project (13). This work led to the release, in February 2010, of draft documentation to be used for cross-border tax claims (the "Implementation Package") (14). As far as information reporting/exchange is concerned, the Implementation

12 The MSs participating in the Project Group are as follows: Austria, Belgium, the Czech Republic, Germany, Greece, Ireland, Italy, Malta, the Netherlands, Spain and the United Kingdom.

13 http://www.oecd.org/ctp/taxtreaties/aboutthetracegroup.htm

14 http://www.oecd.org/tax/taxtreaties/oecdreleasesdraftdocumentationforcross-bordertaxclaims.htm

Package requires an AI that wants to claim benefits not just to pass pooled information up the chain of intermediaries, but also to report, directly to the SC, on an annual basis, investor-specific information regarding the beneficial owner of the income. The SC would, once it receives the information, be expected to provide it to the investor's RC via automatic exchange of information programmes. Ideally, the RC would notify the SC reasonably soon thereafter if the investor who purports to be a resident of the RC is, in fact, not so. The AI would also be required to provide to the SC information on its clients who are residents therein and are not, therefore, claiming DTT relief.

2.2 INTERNATIONAL CONTEXT

6. **The Need for (Exchange of) Information.** The question of the application of DTT reliefs and the correlative exchange of information between countries must be included in a broader context.

"In today's globalised economy [...] effective information exchange is essential for countries to maintain sovereignty over the application and enforcement of their tax laws and to ensure the correct application of [DTTs]. Given that an increasing number of taxpayers are engaging in cross border activity, tax authorities need an effective legal mechanism for obtaining information from their treaty partners to ensure compliance with the tax laws. While taxpayers can operate in a global world relatively unconstrained by national borders, tax authorities must respect these borders in carrying out their functions. Exchange of information provisions offer a legal framework for co-operating across borders without violating the sovereignty of other countries or the rights of taxpayers" (15).

In this respect, most countries started to take into account the loss of earnings resulting from the tax fraud/evasion and the poor exchange of information between them as from 2000.

7. **Exchange of Information v. Anonymous WHT.** It appears nowadays that there is a broad consensus about the fact that FIs should, where appropriate, play a role of tax intermediaries in cross-border transactions (16). There are basically two ways in which

15 http://www.oecd.org/tax/oecdreleasesnewprovisionsforexchangeofinformationbetweentaxauthorities.htm

16 Beyond FATCA: An Evolutionary Moment for the International Tax System, Itai Grinberg, Draft of January 27, 2012, Abstract: *"The international tax system is in the midst of a novel contest between information reporting and anonymous withholding models for ensuring that states have the ability to tax offshore accounts. (...) Four incongruent initiatives of the European Union, the OECD, Switzerland, and the United States together represent an emerging international regime in which financial institutions act to facilitate countries' ability to tax their residents' offshore accounts. The growing consensus that financial institutions should act as "tax intermediaries" cross-border represents a remarkable shift in international norms that has yet to be recognized in the literature. What remains is a contest as to how financial institutions should serve as tax intermediaries cross-border, and for which countries. (...) The eventual triumph of an information reporting model over an anonymous withholding model is key to (1) allowing for the taxation of principal, (2) ensuring that most countries are included in the benefit of financial institutions serving as tax intermediaries cross-border, and (3) encouraging taxpayer engagement with the polity and supporting sovereign policy flexibility, especially in emerging and developing economies."* The author is Associate Professor, Georgetown University Law Center. Until the summer of 2011, the author served in the Office of International Tax Counsel at the United States Department of the Treasury. In that capacity he

(domestic and/or foreign) FIs could play such role: either as (foreign) WA or as (foreign) Reporting Agents:

- **WHT.** When a FI acts as a WA, it generally collects the tax on behalf of the SC ("classic" WHT) but it can also be the case that taxes are collected, by way of an anonymous WHT, on behalf of the RC (e.g. in the framework of the Savings Directive, during a transitional period and in lieu of automatic information exchange; in the framework of the Rubik project – cf. Appendix 1). The latter system is often applied in countries where some restrictions still exist (e.g. within the EU in Austria and Luxembourg, outside the EU in Switzerland);

- **Exchange of Information.** When a FI acts as a Reporting Agent, its main duty is to collect the relevant elements of information required by the taxing authority. Again, such taxing authority can either be the SC (e.g. the QI regime) or the RC (e.g. the Savings Directive as it is commonly applied).

The current trend is towards more exchange of information across borders, although some specific projects/agreements still provide for anonymous WHT. In this respect, Appendix 1 briefly presents the various initiatives taken in Europe, in the US and at the OECD level (including, but not limited to, the QI regime, the Savings Directive, some OECD works, FATCA and Rubik agreements).

In the framework of this study, the main question is "how", in the context of a simplified WHT relief at source system, the international exchange of information should be organised both towards the SC (to ensure correct application of the DTT rates) and towards the RC (to ensure correct income tax treatment) with specific consideration to the channels used in this respect.

In this regard, the study covers the assessment of two main Models that, in the remainder of this document, are referred to as the "AIC Model" and the "SC Model". In a nutshell, these two Models can be described as follows:

- **AIC Model.** The AI closest to the beneficial owner reports the information to the MS where it is established, which then passes the information automatically to both source and residence MSs (called the "AIC Model" as the cross-border information flows passes through the AIC);

- **SC Model.** The AI closest to the beneficial owner reports the information to the source MS, which then provides this information automatically to the residence MSs (called the "SC Model").

* *

*

was substantially involved in FATCA from its inception, and also represented the United States at the OECD and at the Global Forum on Transparency and Exchange of Information for Tax Purposes.

CHAPTER 3 SCOPE, OVERVIEW AND ASSUMPTIONS OF THE STUDY

This chapter first presents the overall scope of the study, being the comparison between the AIC Model and the SC Model from various perspectives: tax compliance, fraud, interactions with EU legal framework and DTTs, legal, IT and Cost Benefit.

The second section of this chapter describes the assumptions applying to the study and the third section highlights the relevant scenarios that will be assessed through the study.

* * *

3.1 SCOPE AND OVERVIEW

8. **Assessment of Two Models.** With respect to the flow of the Investor-specific information to the tax administrations of the source and residence MSs, many different approaches could have been explored.

Nevertheless, the European Commission has decided, for practical reasons, to limit the scope of this study to the assessment of two most likely Models that, in the remainder of this document, are referred to as the "SC Model" and the "AIC Model". In a nutshell and limiting the description to the information communication channels, these two Models can be described as follows:

- **SC Model.** The AI closest to the beneficial owner reports the information to the source MS, which then provides this information automatically to the residence MSs. It is the result of the OECD works described above, in particular the ICG report and the draft Implementation Package.

- **AIC Model.** The AI closest to the beneficial owner reports the information to the MS where it is established, which then passes the information automatically to both source and residence MSs. The AIC Model was initially inspired by the FISCO Recommendation and by the Savings Directive routing system for information reporting/exchange. Considering that no detailed description of the "AIC Model" existed at the beginning of the study (the exchange of information via the AIC being the only existing feature), it has been developed from scratch. In doing so we have worked on the assumption that the AIC Model would be broadly based on the same governing principles as the SC Model, unless the adoption of different communication channels for information reporting/exchange as well as the fact that it would be applied in an EU context would justify or require some further variations. It should be noted that the AIC Model has been defined only for the purpose of conducting this feasibility study. No definitive decision has been taken by the European Commission in this respect.

9. **Multifold Comparison – Overview of the Study.** The comparison between the SC Model and the AIC Model considers several aspects. . The comparison encompasses: an analysis in terms of interaction with the EU and International Administrative Cooperation framework; an analysis from a legal perspective (i.e. legal tools available in the EU to implement the proposed system and data protection issues); an analysis of tax compliance, fraud (i.e. including an assessment of the risks of tax fraud and the identification/evaluation of mitigation measures to tackle identified risks), effectiveness and simplification. The Study also looks at the IT issues linked to the implementation of the proposed system and includes a cost/benefit analysis. Finally, it provides guidelines for a high-level implementation plan.

3.2 ASSUMPTIONS

10. **Preliminary remark.** The study is based on the following simplifying assumptions. These assumptions have been chosen taking into account the objective of the study, which is to assess the feasibility of the contemplated Models (SC Model and AIC Model).

11. **Focus on Information Flows.** The key factor differentiating the Models is the information flow scheme. The study therefore takes as a starting point, and essentially focuses on, the information flows provided for in both Models.

This notion includes all information flows between FIs (i.e. the pooled information), between FIs and MSs' tax administrations (i.e. information reporting) and between MSs' tax administrations (i.e. information exchange). It also includes the transmission of validations and correction reports as well as the transmission of feedback reports between MSs.

The study, however, also formulates some recommendations on other aspects as far as the analysis demonstrates that the adoption of the AIC Model for information reporting would require/justify changes to other elements of the system as described in the Implementation Package.

12. **The OECD Model Tax Convention as a Starting Point.** When referring to DTTs, the study only considers the OECD Model Tax Convention.

This pragmatic approach has been agreed upon given the fact that the assessment of a wide range of DTTs would probably not have influenced the choice between the AIC Model and the SC Model. A particularity in a given DTT would indeed most probably have the same consequences (in terms of checks, exceptions, etc. to be put in place) regardless of the Model applied.

Before any of the two Models is implemented, each DTT should in principle be submitted to an analysis that considers both countries in turn as SC and RC. Such analysis should cover the treaty rates (interest and dividends) and any conditional exemptions, but it could also cover the following issues, which might all be relevant when applying for, and checking the application of, a reduced WHT rate: definition of person (Arts. 1-3 of the OECD Model Tax Convention); definition of resident (Art. 4); definition of permanent establishment; definition of beneficial owner; Triangular Scenario (payment of income by an establishment); definition of dividend/interest; possible application of anti-abuse provisions such as limitation on benefits clause, etc.

As regards the OECD Model Tax Convention, a choice had to be made as to the most appropriate version, considering the DTTs currently in force (as the OECD Model Tax Convention and its commentaries have evolved over time). Considering the limited changes in the relevant Articles of the OECD Model Tax Convention itself, the analysis is based on the last OECD Model Tax Convention available and its commentaries (July 2010) with, however, some reservations as regards the tax treatment of CIVs mentioned in these commentaries.

13. **No Analysis of Recovery Measures.** The study does not analyse in depth the possible recovery processes in cases of tax fraud/evasion and/or mistakes (wrong application to be corrected by means of a recovery measure) nor the Recovery Directive (apart from the interactions between each Model and said Directive and the value/importance of this Directive for the functioning of the system).

14. **No In-Depth Tax Analysis of the Existing Situation.** The existing situation in the SCs in general is deemed inefficient and too burdensome for portfolio Investors to be able to seek the application of the rights they are in principle entitled to pursuant to the applicable DTTs. As a result, the study essentially focuses on the assessment and the comparison of the AIC and SC Models, without analysing the existing situation in detail.

The existing situation is nevertheless assessed, in the framework of the cost-benefit analysis (Chapter 11), from a high-level perspective as far as it is necessary to identify the benefits and the constraints that the various actors, and especially the tax administrations of the MSs, would face if one, none or both Models were implemented.

15. **Only Double Tax Treaty Relief**. The Recommendation suggests possible ways for MSs to improve their procedures for granting WHT relief on cross-border securities income earned by EU Investors pursuant to DTTs and domestic law.

The study nevertheless only covers the application of WHT relief based on DTTs, keeping in mind that domestic law WHT reliefs could also be applied to any of both Models provided that the domestic law requirements can indeed be fulfilled with the elements of information expected to be exchanged (e.g. domestic WHT exemption subject to a mere residence criterion).

16. **Treatment of CIVs.** The treatment of CIVs is complex and varies from DTT to DTT and country to country (treaty access or not, transparency or not) and most DTTs do not (yet) lay down specific regimes with respect to CIVs. Nevertheless, CIVs are major Investors/operators in the European market and thus cannot be left aside in this study.

Assuming the study should not analyse in depth the different tax treatments that MSs could apply to CIVs and should be limited to an assessment of how the standardised relief at source system could work when investments are made via CIVs, a pragmatic approach has been followed based on two of the four alternatives proposed by the OECD (bearing in mind that the treatment of CIVs could basically be the same under both the AIC Model and the SC Model):

- If a CIV (irrespective of its legal form e.g. company, pension fund, partnership, trust, etc.) is entitled to treaty benefits in its own right, then it should be able to complete an ISD on its own behalf and provide it to the FI that holds securities on behalf of the CIV;

- Those entities that are not entitled to treaty benefits in their own right would be included in the definition of "intermediary". Accordingly, provided that such entities are authorised by the relevant SC, it could be treated as an AI and make claims on behalf of each of its individual Investors on a pooled basis. Of course, the SC could choose not to enter into

such an agreement, in which case the entity would be required to provide, to the payer, ISDs relating to each of its beneficiaries.

17. **Treatment of Insurance Companies.** The assumption has been taken that, in the countries covered by the study, life insurance products (e.g. unit-linked and non-unit linked life insurance products) are not considered transparent from a tax perspective. In other words, insurance companies are considered as the beneficial owners of the income arising from their portfolio investments, irrespective of whether or not the investments in question relate to representative assets, and will thus be entitled to complete an ISD on their own behalf and provide it to the FI that holds the securities.

18. **Definition and Level of Information Required.** As the main focus of the study is the analysis of the channels of information used to exchange information towards the RCs and the SCs, the definition and level of information required are out of scope. These elements have indeed already been considered in the Implementation Package and both the AIC Model and the SC Model are similar on that point.

The level of information described in the Implementation Package is thus used as a basis for the study. The study therefore considers the following elements of information as a minimum that has to be exchanged:

- The name, address and Authorised Intermediary Identification Number (AIIN);
- The name, address and Taxpayer Identification Number (TIN) of the Account Holder (or other form of information or combination of information (e.g. address and date of birth) used by a country or other taxing authority to identify its residents for the purposes of collecting taxes) and country of residence in the case of an Account Holder that is not an AI; and
- Information regarding the amount of a Reportable Payment, the date on which it was paid or credited to the Account Holder, details of the securities in respect of which the payment was made, and amount of tax withheld from the Reportable Payment.

Nevertheless, in the framework of the fraud analysis, the study addresses the question whether other elements of information could be relevant for the fight against fraud and tax evasion. In this perspective, the level of information exchanged in the context of the Savings Directive is also analysed.

19. **No Statistical Study.** A statistical analysis has not been performed as it would have required the participation of a large sample of Investors and representatives from the financial sector.

3.3 SELECTION OF THE RELEVANT SCENARIOS

20. **Four Assumptions**. Appendix 2 presents four assumptions aimed at simplifying the identification of relevant cases for the study. These assumptions disregard the following elements/situations:

- Involvement of CIs;
- Situations where WAs are not located in the SCs;
- Situations where SCs and RCs are located outside the EU (17); and
- Purely internal situations.

21. **Twelve Cases.** The application of the simplifying assumptions has narrowed down the number of possible cases to twelve. The remaining cases are described below in order of complexity:

- Cross-Border Scenario;
- Reversed Cross-Border Scenario;
- Triangular Scenario.

3.3.1 CROSS-BORDER SCENARIO

22. **AIC is RC.** In the first selected kind of scenarios, the Issuer is located in the same country as the WA, namely X being located either inside or outside the EU, whereas the AI is located in the same country as the Investor, namely Y being located either inside or outside the EU. This situation is called the "Cross-Border Scenario".

This is probably the most classic case of cross-border investments, i.e. a taxpayer investing in foreign securities through its local bank.

3.3.2 REVERSED CROSS-BORDER SCENARIO

23. **WA and AI in SC.** In the second kind of scenarios, it has been taken into account that the Issuer, the WA and the AI could be located in the same country, namely X being located either inside or outside the EU. The Investor would still be located in a different country, namely Y being located either inside or outside the EU. This situation is called the "Reversed Cross-Border Scenario" as the AI is established in the same country as the Issuer of the security.

For example, this situation could occur in the case of a taxpayer who used to live in a country X (with local investments made through a local bank) and moved to a country Y (while remaining client of the same bank).

3.3.3 TRIANGULAR SCENARIO

24. **WA in SC.** In the third selected kind of scenarios, the Issuer is considered to be located in the same country as the WA (either inside or outside the EU), while the AI and the Investor

17 As mentioned above, the situation where SCs and RCS are located outside the EU is excluded from the scope of the current study. However, the study explores how to extend the withholding relief at source system to third countries so that they could also participate in the system.

are located in different countries. This situation is called the "Triangular Scenario" as three countries are involved in the routing of information.

Hence, the first kind of scenarios in scope is as follows. As mentioned above, the Issuer and the WA are always located in the same country, namely X being located either inside or outside the EU. The AI is not located in the same country as the Issuer and the WA. In this case, the AI has been placed in country Y, being located either inside or outside the EU. The Investor is located neither in the same country as the AI nor in the same country as the Issuer and the WA. In this case, the Investor has been placed in the country Z, being located either inside or outside the EU.

This situation could arise, for example, in the case of a taxpayer who used to live in a country X (with local and foreign investments made through a local bank) and moved to a country Y (while remaining client of the same bank).

This scenario is the most complex one (and in some instances, cover the difficulties of the two other scenarios) but it nevertheless occurs frequently in practice since it covers the situation of a taxpayer investing in a portfolio of securities from various origins in a bank account held abroad, which is a situation typically sensitive in terms of tax fraud and tax compliance.

* *

*

CHAPTER 4 GOVERNING PRINCIPLES AND DESCRIPTION OF THE OPERATING MODELS

This chapter describes the governing principles of the two Models under examination, as they are currently defined. The AIC Model is based on the principles of the SC Model, which are outlined in the Implementation Package, with one major difference, being the communication channels to be used to report information to the SC and the RC.

However, in our view, the use of different communication channels as well as the fact that the AIC Model would be applied in an EU context, would require some additional variations to its governing principles, in order to ensure the coherence of this Model. It includes the implementation of the AIC Model via common binding rules, the recognition process and effects and, the involvement of the AIC in the audit procedure.

Each principle is an alternative to a similar principle of the SC Model that should be analysed. These alternatives are highlighted and explained in this section.

The AIC Model, as defined in this section, is therefore a variation of the SC Model analysed in the study, given that it is based on the SC Model, but presents some differences in terms of communication channels and other related elements. It has to be stressed that the AIC Model has been defined only for the purposes of conducting this study. Therefore its main governing principles, as outlined in this study, are still subject to change, should the European Commission decide to table any proposal in this area.

The first section includes a short description of the various persons/entities identified according to their functionality in one or both Models.

The following sections then describe the governing principles of both Models. The principles covered relate to the AI (recognition, audit and liability), the routing (outward flows, feedback loops and cooperation between countries), the reporting (content and timing), the Investor identification and adjustments of under- and over-withholding.

The final section presents a description of the operating models. It considers the various flows applicable to each: the TRI flow and the cash flow (common to both Models) and the exchange of information flows (different between the two Models).

The activities are very much similar from one Model to another as these Models are both based on the OECD work and on the Implementation Package.

* * *

4.1 INTRODUCTION

25. **Introduction.** This section gives a broad overview of the main relevant governing principles applicable to both the SC Model and the AIC Model, taking into account their twofold objectives: granting relief at source in the SC and ensuring compliance in the RC via exchange of information.

26. **Definition of the AIC Model.** Unlike the SC Model, whose governing principles are described in details in the Implementation Package, the AIC Model was not fully defined when we started working on this feasibility study. Therefore, in order to conduct the feasibility study, and solely for this purpose, we had to develop it. The starting point was that the AIC Model is based on the SC Model, with a major variation represented by the communication channels to be used to report information to the SC and the RC. In particular, under the AIC Model, AIs would report investors' information to the tax administrations of the MS where they are established, which would, in turn, exchange this information with both the SC and the RC. This principle concerning the routing of information is based on the current Savings Directive (each AI communicates with its own tax administration) and is also mentioned in the FISCO Recommendation (18).

This difference requires, in our view, some additional variations, which have been defined for the purposes of conducting this feasibility study. They are as follows:

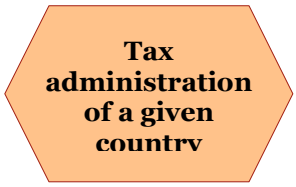
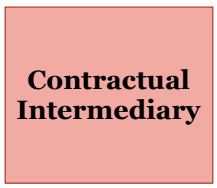
- Implementation of the AIC Model via common binding rules;
- Recognition process and effects; and,
- Involvement of the AIC in the audit procedure.

The AIC Model, as defined in this section, is therefore a variation of the SC Model analysed in the study, given that it is based on the SC Model, but presents some differences in terms of communication channels and other related elements. It has to be stressed that the AIC Model has been defined only for the purposes of conducting this study. Therefore its main governing principles, as outlined in this study, are still subject to change, should the European Commission decide to table any proposal in this area.

18 Paragraph 10(2) of the FISCO Recommendation invites MSs to explore the scope offered by the Recommendation itself for implementing new, non-burdensome, channels of information exchange aimed at providing both the source MSs and the residence MSs with investor-specific information and states that this could be modelled on procedures drawn up under Community legislation, particularly Directive 2003/48/EC.

27. **Functional Entities.** In order to describe the principles governing the AIC and SC Models, the following persons/entities can be differentiated according to their functionality in one or both Models.

Most of the below definitions are simplified definitions of those listed in the Implementation Package.

ENTITIES	DESCRIPTION
	Any person (19) that receives a Covered Payment (20) and that is not acting as an Intermediary with respect to that Covered Payment
	Any Intermediary that is treated as an AI and acts in its capacity as an AI (21)
	Entity having the primary withholding responsibilities
	Issuer of the security and debtor of the movable income (generally interest and dividends)
	Referred to below as "Source Country" (SC), "Residence Country" (RC) or "Authorised Intermediary's Country" (AIC), as the case may be
	Any Intermediary that is neither an Excluded Intermediary nor acting as an AI and with respect to which the AI has received a valid Intermediary Declaration for Contractual Intermediaries, • Certifying that the Intermediary is subject to Know Your

19 As mentioned in the assumptions, the purpose of the study is not to address specific questions around the definitions of the terms "person" (Articles 1-3 of the OECD Model Tax Convention), "resident" (Article 4) or "beneficial owner". We will thus consider the investor as being treaty entitled and being the beneficial owner of the movable income payments.

20 Meaning, here, any payment of dividends or interest arising in the SC received by the AI with respect to an account that has been designated by the AI as one for which it is acting in its capacity as an AI.

21 In the present case, acting as Reporting Agent only (not as a Withholding Agent).

ENTITIES	DESCRIPTION
	Customer Rules (except to the extent that it is an Intermediary only by reason of being a Fiscally Transparent Entity) with respect to the Account Holders for which claims are made through the AI; • Authorising the disclosure of the declaration to relevant tax administrations in accordance with its terms; and • Agreeing to specified procedures for the recovery of under-withheld tax. (This entity is not mentioned in the FISCO Recommendation but is included in the Implementation Package)
Excluded Intermediary	An Intermediary that has been designated as such by the Competent Authority (This entity is not mentioned in the Recommendation but is included in the Implementation Package)

Table 4: Functional entities

4.2 AUTHORISED INTERMEDIARY

4.2.1 RECOGNITION

28. **Authorised Intermediary.** Both Models are based on the concept of "Authorised Intermediary", i.e. a FI that is authorised by the SC, under certain terms and conditions, to apply for treaty relief at source (or a refund) on behalf of its clients and on a pooled basis.

- **SC Model: Contractual (Bilateral Agreement).** The intermediary has the opportunity to participate in the system or to remain outside. If the intermediary decides to participate, it will do so on a "bilateral basis" by entering into contracts with each of the respective SCs in which it wants to act as an "Authorised" Intermediary. The template of contract provided for in the Implementation Package leaves some room for negotiation as regards its content and the SC keeps the possibility to modify some of its elements;

- **AIC Model: Authorisation (Multilateral Recognition).** The intermediary has also the opportunity to participate in the system or to remain outside. However, if an intermediary decides to participate in the relief at source Model provided by the EU framework, it will benefit from the AI status and bear the AI requirements for all the MSs ("all or nothing" approach). The intermediary willing to participate in the relief at source system and benefit from the AI status should therefore enter into the framework of the EU regulation multilaterally negotiated between MSs. The criteria to become an AI would be common across the EU (inserted in a specific piece of legislation) and the recognition would be given by the AIC through an administrative procedure. Another possibility could be to

also involve the SC in the recognition process (e.g. by providing that it may/should cooperate with the AIC).

4.2.2 AUDIT

29. **SC Model.** The ICG Report and the Implementation Package describe the principles applicable in order to ensure compliance of the FIs with their obligations under the SC Model. These principles cover three main areas:

- The independent reviewer's report;
- The oversight rights of the Competent Authorities;
- The designation as an EI.

30. **Independent Reviewer's Report.**

- **Independent Reviewers.** According to the Implementation Package, to the extent possible under their laws, governments should develop a process by which at least initial fact-finding would be conducted by an approved independent reviewer.
- **Reviews Already Undertaken.** The work of the independent reviewer should build, when relevant, on reviews already undertaken for other regulatory purposes, in order to avoid duplication of effort.
- **Compliance Reviews.** Compliance reviews should focus on:
  - Whether the intermediary has in place appropriate training and procedures;
  - The processing of Covered Payments (including application of WHT);
  - The documentation provided by the Investor to support the claim in a representative sample of accounts;
  - The reporting to the SC;
- **Access to Information.** The Independent Reviewer shall have access to all relevant records of the AI for purposes of completing its Report, including information regarding specific Account Holders receiving Covered Payments.
- **Standardisation.** The independent reviewers could provide to multiple SCs a single report based upon agreed procedures. Such an arrangement would alleviate the prospect of intermediaries having to deal with multiple reviews, standardise compliance arrangements and minimise costs (as a single review would cover multiple SCs).
- **Consolidated Review.** A consolidated review of the AI is possible, so long as:
  - The members of the group making up the AI operate with uniform practices and procedures and shared systems for performing the functions being reviewed; and

- Those practices and procedures and shared systems are subject to uniform monitoring and control.

- **Designation of the Independent Reviewer:**

  - **Proposition by the AI.** The AI shall propose to the Competent Authority an initial Independent Reviewer that is subject to laws, regulations or rules that impose sanctions for failure to exercise its independence and to perform the review competently;

  - **Approval by the Competent Authority.** The Competent Authority may, however, revoke its acceptance of the Independent Reviewer proposed if it reasonably believes that the reviewer designated is not independent or cannot perform an effective review. The AI shall then propose a substitute, which will be approved or rejected by the Competent Authority.

- **Timing and Filing of Independent Reviewer's Report.** An independent reviewer's report would be issued in the following circumstances and according to the following timing:

  - **First Full Calendar Year of AI Status.** For the first full calendar year that the AI has in effect an agreement with any country pursuant to which it acts as an AI;

  - **Upon Request:**

    - **At Most Every Three Years.** Thereafter, only upon request by any Competent Authority under any such agreement, which shall be no more often than every three years;

    - **Upon Request for Good Cause.** Unless a Competent Authority has good cause for requesting a more frequent Independent Review, including:

      > that a prior review of the AI has indicated a significant failure by the AI to meet its obligations; and/or

      > the risk of default;

  - **Under-Withholding: Mandatory Intermediate Years Review.** If the Independent Reviewer's Report identifies material failures by the AI to meet its obligations, the years between the last reviewed year and the year subject to the Independent Reviewer's Report shall also be subject to review, but only if the AI would be liable for any claim for under-withholding by the Competent Authority with respect to such year.

31. **Competent Authority's Oversight Rights.**

- **Access to AI's Documentation.** Governments should not give up their right to see information held by intermediaries regarding beneficial owners. In particular,

governments would have the right to review Investor-specific beneficial ownership information to the extent necessary to confirm the results of the initial fact-finding report;

- **Spot Checks.** The Competent Authority can request information regarding a certain percentage or number of Account Holders receiving a specific Covered Payment. At the same time, other information held by the AI with respect to the relevant Account Holders could also be examined, such as KYC rules information, and information on the underlying transaction on the basis of which the Account Holder has acquired the relevant securities (22);

- **Expansive Reviews.** The Competent Authority may also pursue a more expansive examination of the AI's operations and procedures;

- **Access to Independent Reviewer's Work Papers and Reports.** The Competent Authority shall have access to the Independent Reviewer's work papers and reports;

- **On Site Review.** Reviews may take place at the offices of the AI, subject to any required consent obtained from the AIC's Competent Authority and in accordance with any bilateral or other agreements between the two countries.

32. **Designation as an Excluded Intermediary.** The Competent Authority (of an SC) may, at its discretion, determine that information provided by a specific Intermediary is by definition unreliable.

Such determination should be based on:

- Objective evidence that information provided by the Intermediary in connection with these Procedures (whether with respect to the SC or another country) has repeatedly been unreliable or incorrect and that such information has resulted in material under-withholding of tax that has not been promptly corrected, or paid by the Intermediary; or

- In the case of a CI, the Intermediary's failure to fulfil significant procedural obligations.

Upon making such determination, the Competent Authority shall designate the Intermediary as an EI and shall add such Intermediary to the list maintained by the Competent Authority. Such designation shall take effect immediately and the Intermediary so designated shall immediately cease to make any claims for reductions in the rate of WHT to be applied to Covered Payments. The Intermediary shall remain on such list unless it becomes an AI, subject to these Procedures, with respect to the SC, or unless the Competent Authority otherwise determines that the Intermediary should be removed from the list.

Such designation shall, at the request of the AI, be treated as an event of default to which the resolution process applies. However, in such case, the initial meeting generally will take place within 15 days of such designation:

22 For instance, spot checks could cover the anti-abuse clause contained in DTTs (limitation on benefits clause, anti-treaty-shopping clauses, etc.), the qualification of the income, specific conditions, etc.

- If a satisfactory resolution is reached, the Competent Authority may suspend the designation so long as the AI complies with the terms of such resolution;
- If a satisfactory solution is not reached or the AI fails to comply with such resolution, the designation of the AI as an EI shall become effective.

In addition, if the Competent Authority terminates the agreement for cause in accordance with the resolution process, the AI shall thereafter be treated as an EI for a period of five years, unless the Competent Authority earlier agrees,

- That an AI may treat it as a CI; or
- That the Intermediary may act as an AI.

33. **AIC Model.** The AIC Model follows the SC Model, yet with the following differences:

- **Designation of the Independent Reviewer.** The criteria for the designation of an independent reviewer would be common across the EU (inserted in a specific piece of legislation) and a single independent reviewer would be designated for a given AI;
- **Independent Reviewer's Report: Every Three Years.** An independent reviewer's report would be issued every three years;
- **Competent Authority's Oversight Rights: Joint Audits.** Controls of the AI could be initiated by the AIC, on its own initiative or upon request of the SC and/or RC. Simultaneous controls, presence in administrative offices, participation in administrative enquiries by foreign agents (e.g. official of the SC and the RC) and, more in general, the use of all administrative cooperation tools offered by the Directive on Administrative Cooperation would be favoured (in order to avoid duplicative audits for the same AI). When a tax administration of a given country would express the wish that a given AI is audited, the tax administrations of the other countries concerned (SCs, RCs and/or AIC) would be invited to join the audit process. The results of the audits so carried out would be valid for the tax administrations of the countries having participated in the joint audit, but also against tax administrations of the countries not having participated in the joint audit (whatever their capacity as SCs, RCs or AIC for a given AI);
- **Designation as an Excluded Intermediary.** The Competent Authority (of the AIC or of an SC ([23])) may, at its discretion, determine that information provided by a specific intermediary is by definition unreliable under the same conditions as in the SC Model. If the decision came from an SC, then the designation as an EI would only apply to income sourced in such SC; if the decision came from the AIC (probably in more severe cases), then the designation as an EI would apply to every SC. As in the SC Model, a resolution

23 If a RC has reasons to believe that an AI is not compliant with the requirements of the AIC Model, it could also decide to sanction this AI. However, the only sanction being to terminate the agreement between the RC and the AI, the RC would therefore act as a SC. So, the RC is not mentioned as it will have to act as SC to sanction the AI (and terminate the agreement of the AI).

process would apply leading either to suspension of the designation as an EI or to an effective designation as an EI for five years.

4.2.3 LIABILITY

34. **Liability of the AI v. the SC.** In the case of the proposed Models, the intermediary that is closest to the beneficial owner is in the best position to determine whether the information that has been provided by the Investor is correct, and therefore whether the Investor in fact is entitled to treaty benefits.

As a result, both Models (24) (the AIC Model following the SC Model on that point) provide that the AI is liable for any under-withholding for any Account Holder which is a DAH or an IAH holding its securities via one or more CIs, unless one of these intermediaries is an AI acting as such. The liability of the AI will remain, even if the AI complied with all the procedures and guidelines defined in the Model.

The various procedures impose on the AI some specific checks and at the same time authorise the AI to rely on some sources (e.g. it is considered that the AI can rely on the information provided by a CI unless the AI should be considered to know or, based on industry standards, to have reasons to know that such information is unreliable or incorrect). However, the purpose of all these procedures is to improve the security of the system and decrease the risk of under-withholding, but not to decrease the liability of the AI.

As a result, if an AI having applied all the required procedures is deemed to have under-withheld (the AI acting as a WA) or to have caused under-withholding (other cases) on a securities income, it will be liable for the tax amount to be assessed by the SC.

Afterwards, it is up to the AI to take all the relevant actions to recover this amount from its counterpart (DAH or FI being not an AI). It is up to the AI to include this liability in the contractual relations with its clients.

35. **Liability of Other Intermediaries v. the SC.** Accordingly, other intermediaries more remote from the Investor in the chain of intermediaries should in most cases not be held liable for errors made by the intermediary closest to the Investor with respect to that Investor's eligibility for treaty benefits. Since the function of those intermediaries is essentially limited to accurately passing on TRI provided by lower-tier intermediaries, their liability should be limited, as a practical matter, to errors that they themselves make with respect to such processing.

36. **Contractual Liability v. Tax Liability.** The type of liability the AI has to bear (basically a contractual liability or something different) is not clearly defined in the ICG report and the draft Implementation Package as, according to the Implementation Package, each SC will need to consider how best to achieve that result in the context of its own legal framework. For

24 We refer in this respect to the agreement called "procedures regarding the operation of the Financial Intermediary as an AI" as currently existing in the draft Implementation Package.

example, some countries may need to provide that the annual reporting forms constitute a "tax return" under the SC's domestic law.

As a result, although the chain of liabilities is clearly defined, the nature of the liability to be borne by the AI vis-à-vis the SC is not a defined principle.

37. **Liability of the AI v. the RC.** Moreover, both Models being initially focused on the possibility to have relief at source according to the DTTs on a pooled basis, they do not address the question of the liability of the AI vis-à-vis the RC.

As a result, the nature of the liability to be borne by the AI vis-à-vis the RC, if any, is not a defined principle.

4.3 INFORMATION CHANNELS (ROUTING)

4.3.1 OUTWARD FLOWS

38. **Three Main Flows.** The application of the relief at source and exchange of information according to both the SC Model and the AIC Model is based on three main flows:

- **Cash Flow.** A cash flow (from the Issuer to the Investor and the SC);
- **Pooled Information (TRI)** ([25])**.** A flow of information required to apply the treaty relief at source (it concerns the flows of information between all the FIs in the chain from the Investor till the WA);
- **Detailed Information.** Exchange of information flows enabling (1) the SC to check the correct application of the WHT pursuant to the relevant DTTs and (2) the RC to ensure the correct application of the income tax legislation applicable to the Investor.

39. **Detailed v. Pooled Information** ([26])**.** As you can see, there are two different flows of information in each of the two Models.

40. **Pooled Information.** On the one hand, AIs are allowed to claim, on behalf of their clients that are portfolio Investors, the application of treaty relief at source in the SC (reduction or exemption of WHT) based on "pooled" information, i.e. information that does not identify specific Investors by name but characterises a group of Investors as having attributes that entitle them to a particular treaty rate. This pooled information needs to be available to the WA to allow the WA to withhold the proper amount of tax.

Businesswise, the main benefit from providing pooled information regarding the beneficial owner of the income (Investor) is that Investor-specific information is maintained by the AI with the most direct account relationship with the beneficial owner and not passed up the chain of intermediaries (the AI acts as a filter of information towards the chain of intermediaries). This way, the AI does not pass any proprietary customer information to

25 Tax Rate Information (as opposed to the detailed or Investor-specific information)
26 Implementation Package, p. 10 and pp. 152-153

potential competitors (i.e. the other intermediaries, including the WA). As a result, the WA can of course only pass pooled information to the SC.

The flow of information required to apply the treaty relief at source and the cash flow can be illustrated as follows:

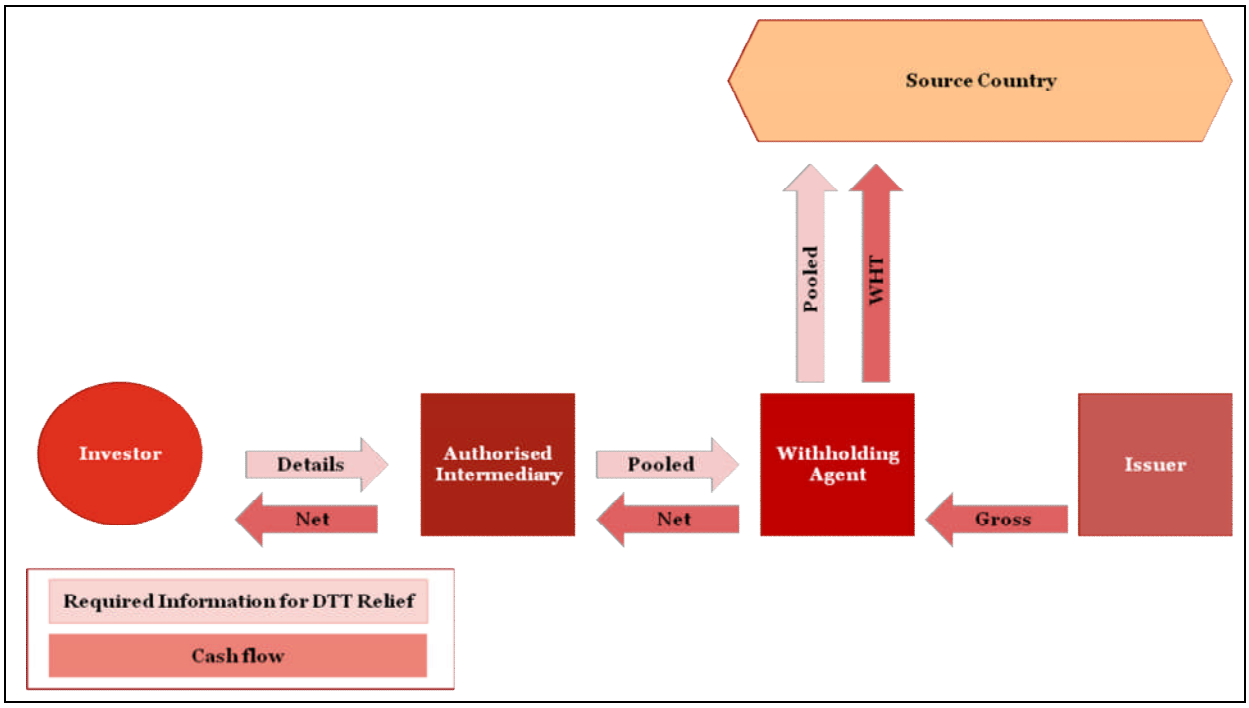


Figure 1: Required Information for DTT Relief at Source and Cash Flow

41. **Detailed Information (Routing).** However, any SC willing to grant WHT relief at source based on the pooled information will require in exchange to be provided with Investor-specific information to check whether such relief was appropriate.

Both the SC and AIC Models tend to allow the SC to confirm that the treaty benefits provided were actually owed, while allowing the RC of the Investor to double-check the amount of movable income mentioned in the Investor's tax return.

The method used by both Models to reach these objectives is different, however. As a result, the third flow mentioned above (provision of Investor-specific information to the tax administrations of the SC and of the RC) is the main difference between the two Models and the main subject of this study.

42. **SC Model Exchange of Information Flows.** The SC Model provides that the AI should provide the detailed information directly to the tax administrations of the SC (27). The SC should then pass that information to the tax administrations of the various RCs. This can be illustrated as follows.

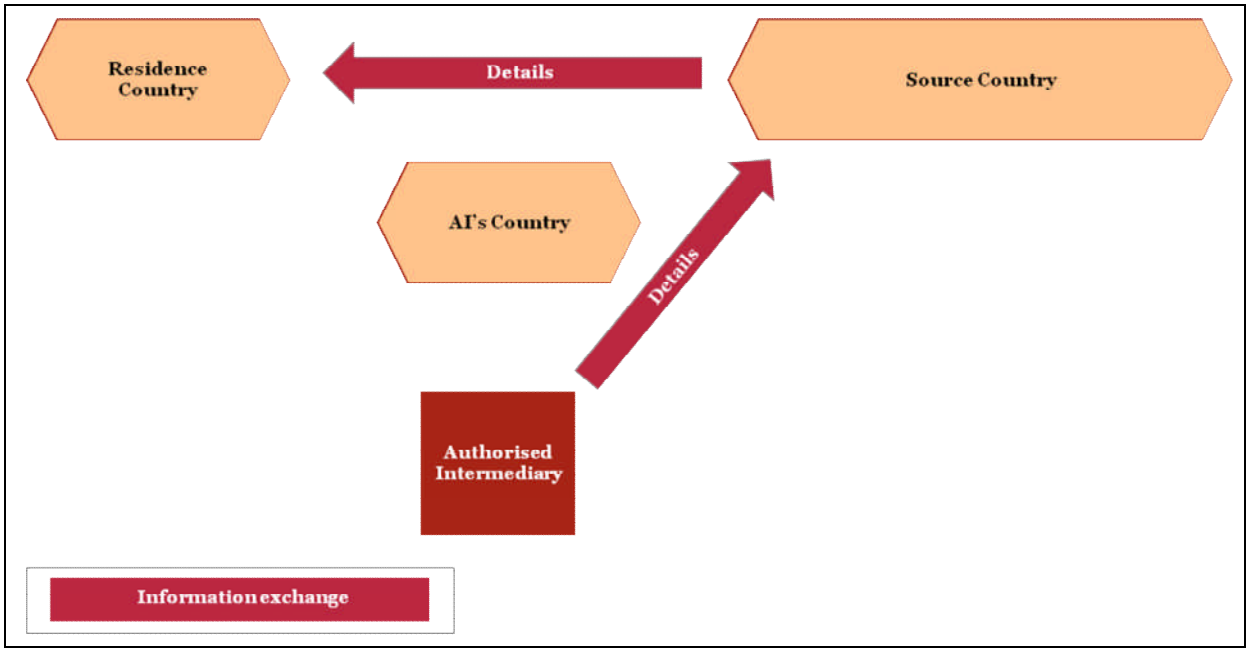


Figure 2: Routing SC Model Exchange of Information Flows

43. **AIC Model Exchange of Information Flows**. On the other hand, the AIC Model provides that the AI should provide the Investor-specific information to the tax administrations of the country in which it is established (AIC). The AIC should then pass that information to the different SCs, but also to the different RCs. This can be illustrated as follows.

27 Note that, according to the Implementation Package, this provision of information to the SC would not only be applicable in case of DTT application, but also when the Investor resides in the SC (i.e. situations where SC = RC). This situation is illustrated later on in the report under Chapter 7 (Data Protection Analysis).

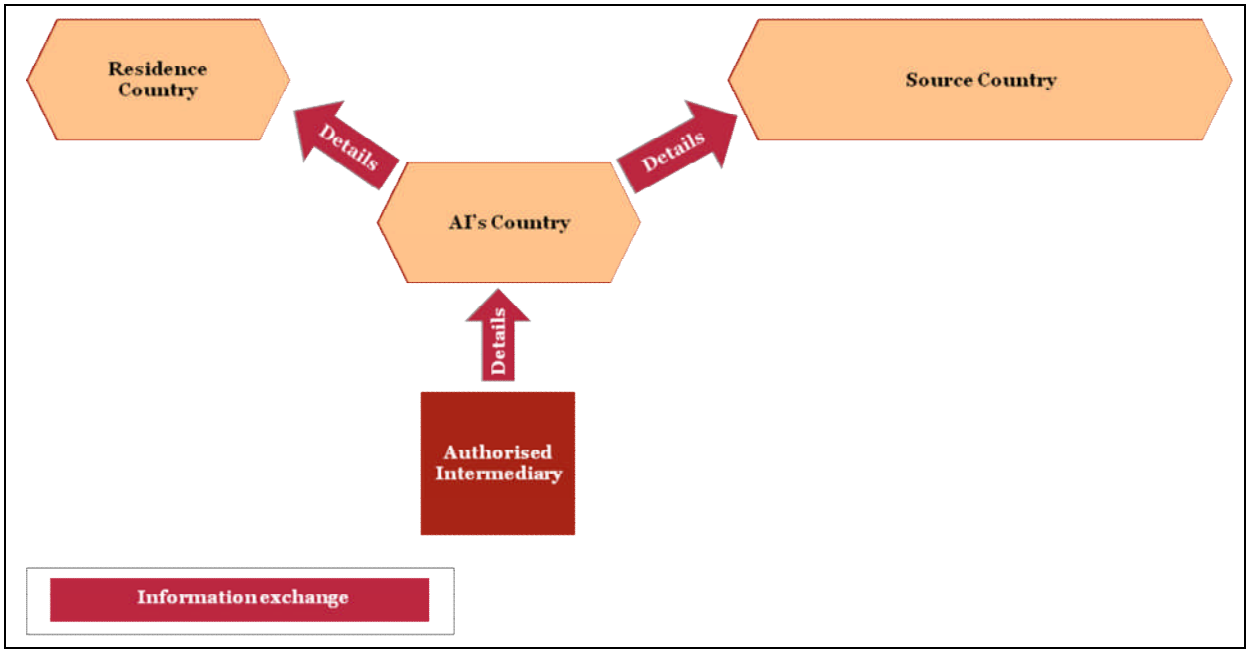


Figure 3: Routing AIC Model Exchange of Information Flows

SC Model v. AIC Model. Based on the above, both Models can be illustrated as follows (including the three types of flows, i.e. required information for DTT relief at source, cash flow and information exchange). We refer to the section 4.7 below for a high-level description of the operating models.

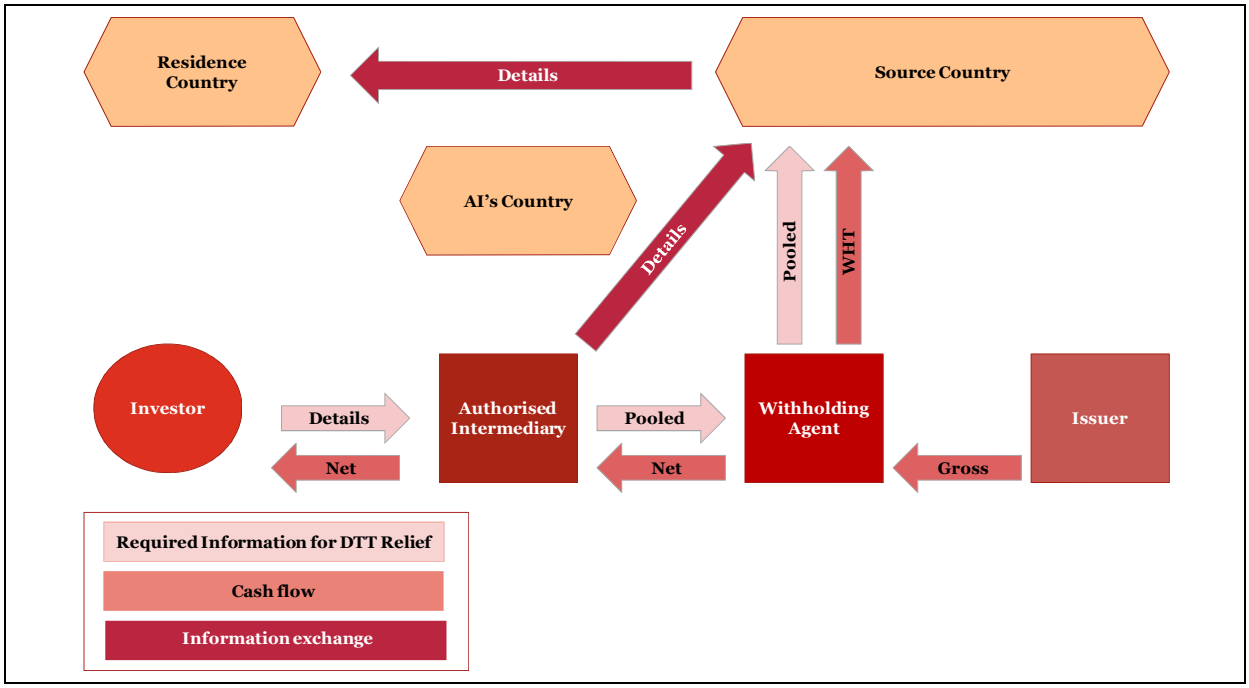


Figure 4: SC Model

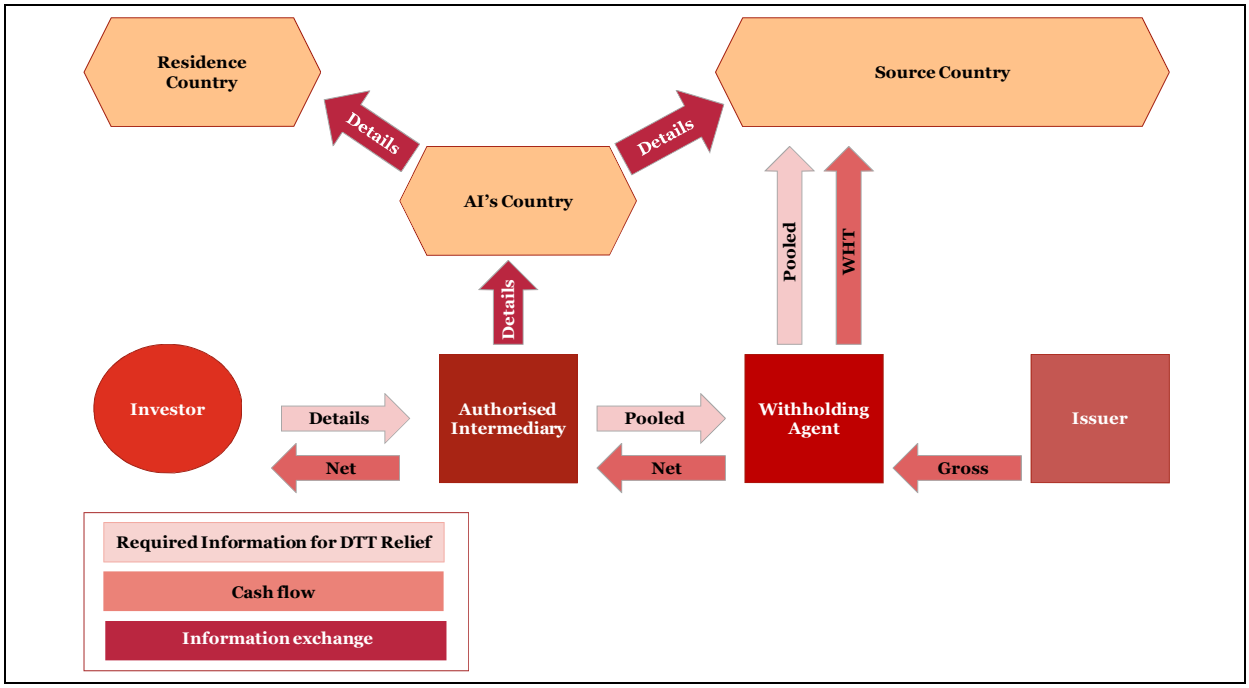


Figure 5: AIC Model

4.3.2 RETURN FLOWS: FEEDBACK LOOP

44. **Feedback Loop.** The outward flow of Investor-specific information provides a level of control but needs to be strengthened by a "feedback loop" to be effective. The feedback loop means the possibility for the RC or the SC having received the reporting to communicate, to the various AIs and the other MSs impacted, about the information that is considered as being wrong, incomplete or missing, and to obtain correction of such erroneous data.

The feedback loop relies on three different communication tools:

- The Request For Information (RFI) sent by MSs to request some data to be amended;
- The Change Notification integrating the changes pursuant to the RFI and sent to the other MSs impacted;
- The Request for Clarification; sent if a MS or the AI does not understand the request included in the RFI; and
- The reply message from the AI.

The feedback loop will differ in the SC and AIC Models as the routing is different.

45. **Request for Information (RFI).** The RFI is the electronic form that will support the communication between the MSs, and between MSs and the AIs, in the context of the feedback loop.

Since the feedback tool has not yet been developed, it is suggested that both Models should rely on the RFI. The RFI should be built on the same structure as the reporting itself and be mandatory in both Models. It contains all the data considered by the SC/RC as being ([28]):

- Wrong (e.g. the postcode in the address does not exist);
- Incoherent (e.g. the postcode is valid but is not the postcode of the city mentioned in the address);
- Incomplete (e.g. the postcode is valid but incomplete, a letter should be added to identify the city);
- Missing (e.g. the postcode is missing in the address).

For each data item included in the RFI, a free text box allows the tax administration of the SC/RC to explain why the information is not right from their perspective.

Moreover, the RFI will allow sorting the information by field or type of data. The main advantage of this functionality is that it should be easy to identify recurrent errors from a specific AI or errors having an important impact in terms of taxation (e.g. a SC will be able to immediately identify in a RFI the Investors that are not recognised as tax residents by a RC).

46. **Types of Feedback.** The two Models share the same vision on the information that should be included in the feedback loop.

- **Mandatory Feedback.** Mandatory feedback from the RC confirming whether the Investors included in the reporting are indeed tax residents of the RC;
- **Optional Feedback.** Optional feedback, including a list of information considered by the RC or the SC as unclear or wrong.

Hence, the RFI could be used in both Models as the communication tool for the feedback loop.

47. **SC Feedback Loop.** The SC Model organises the exchange of information from the AI to the SC and, subsequently, from the SC to the RC. The feedback loop will use the same logic. Being in direct contact with the AI, the SC is allowed to contact the AI directly, while the RC has to send its feedback to the SC (1) and the SC will then forward the request to the AI (2). The reply from the AI will follow the same flow, providing its reply to the SC (3), and the SC has to forward the reply message to the RC (4) if it is the RC that generated the original request.

The feedback loop (generated by the RC ([29])) under the SC Model is illustrated below.

28 It could also be envisaged that the RC use the RFI to positively confirm the residency status of the Investor.

29 Needless to say, if the feedback came from the SC, the flows of information between the RC and SC would not apply.

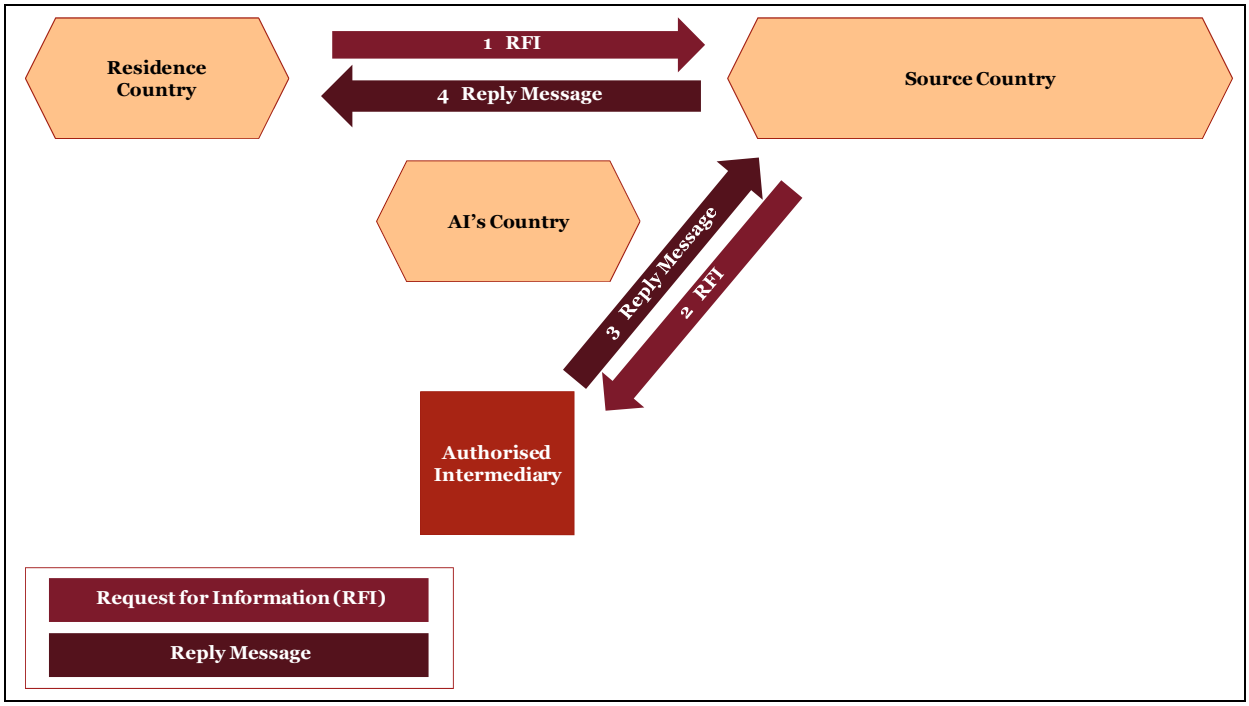


Figure 6: SC Model Feedback Loop

48. **AIC Feedback Loop.** As for the exchange of information flow, the key stakeholder in the AIC feedback loop is the AIC. If a RC wants to send feedback, it will be sent to the AIC (1), and the AIC will send the feedback to the AI (2) as well as to the other RC and/or SC impacted (3). Feedback from a SC should follow the same flow, from the SC to the AIC, and from the AIC to the AI and to the SC and/or RC impacted. The reply message from the AI will take the opposite way, from the AI to the AIC (4), and then the AIC will send the reply to the originator of the request (5) as well as to the other RC and/or SC impacted (6).

The feedback loop (generated by the RC) under the AIC Model is illustrated below.

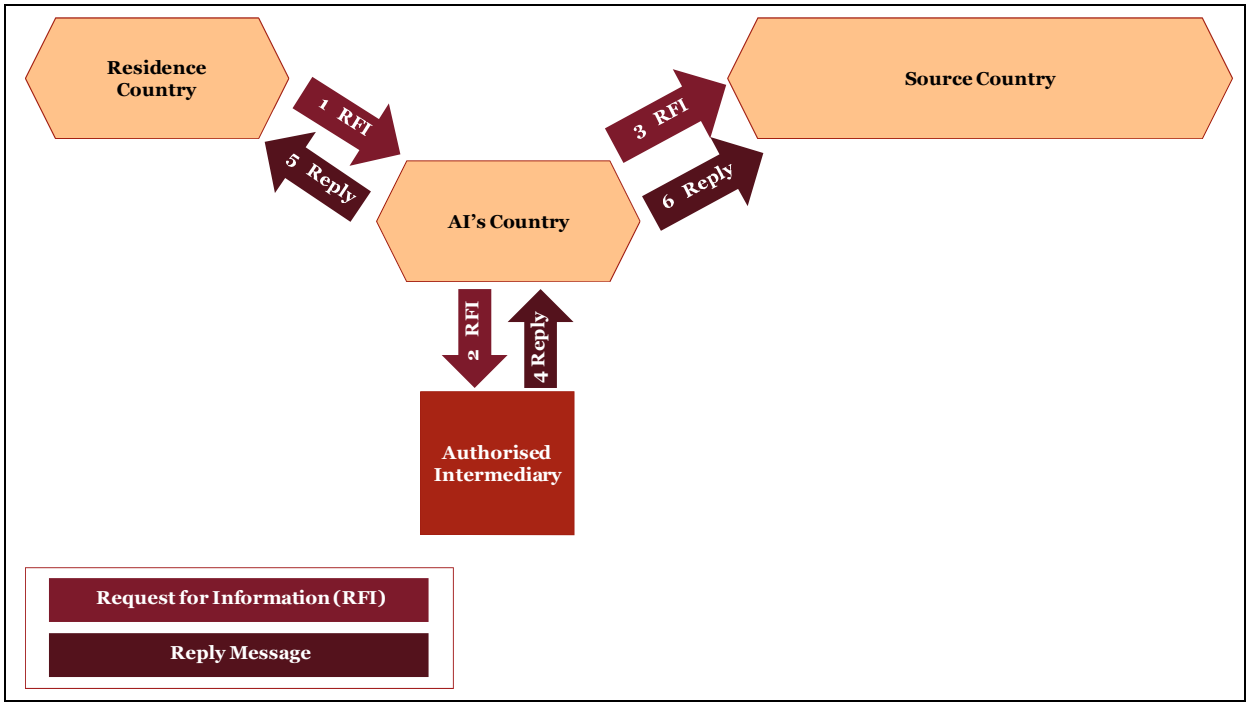


Figure 7: AIC Model Feedback Loop

4.3.3 COOPERATION BETWEEN COUNTRIES

49. **Cooperation.** The international cooperation between countries has to be organised. This can be done either bilaterally (between two countries) or multilaterally (between more than two countries).

- **SC Model.** To be effective, the cooperation has to be organised between the SC and the RC in a bilateral way (even if the SC could take the initiative to provide information to the RC unilaterally, without any prior request). In the SC Model, participating countries are expected to sign a memorandum of understanding to their double tax agreements, which determines what information the SC and the RC will have to exchange and when.
  - **Relief at Source in SC.** The objective of an efficient relief at source system is achieved by the SC without any cooperation between countries (where the SC signs an agreement with the AI without any involvement of the AIC, cf. below);
  - **Compliance in RC.** On the other hand, the compliance in the RC necessarily depends on information received from the SC;
- **AIC Model.** To be effective, the cooperation has to be organised between SC, RC and AIC in a multilateral way. Indeed;
  - **Relief at Source in SC.** The objective of an efficient relief at source system depends on information received from the AIC;

- **Compliance in RC.** On the other hand, the compliance in the RC also necessarily depends on information received from the AIC.

50. **Binding v. Non-binding Cooperation.**

- **AIC Model.** In the approach adopted in the AIC Model, the relief at source and the exchange of information would probably have to be achieved through a single multilateral instrument, such as European legislation that is binding on all MSs. As a consequence, in this Model, the AIC would be under an obligation to exchange information with both the SC and the RC (30);

- **SC Model.** In the approach adopted in the SC Model, the SC would exchange information with the relevant RCs through *"normal exchange of information programs* (31), *thereby allowing residence countries to apply effective matching programs to ensure taxation of that income"* (32).

51. **Automatic Exchange of Information.** Whatever the Model applied, the exchange of information flows (outward and return) must be organised in an automatic way so as to ensure compliance in both the SC and the RC (33) (34).

4.4 ADJUSTMENT OF UNDER- AND OVER-WITHHOLDING

52. **Under- and Over-Withholding.** The generalisation of the standardised relief at source system will not remove the risk of errors in tax rate applied. Two types of error can be distinguished:

- The under-withholding situation occurs when the tax amount withheld by the WA is lower than the amount that should have been applied, resulting in a loss for the SC;

30 *A priori*, one could consider that AIC has no direct interest in participating in the relief and exchange of information system under the AIC Model. It explains the reason for having an obligation imposed on AIC. On the other hand, AIC has a real interest in the system as it will also endorse the role of SC and RC in other cases.

31 Read *"automatic exchange of information programmes"* as mentioned in the Implementation Package.

32 At this stage, it is not yet clear how these "normal/automatic exchange of information programmes" will be put in place (via protocols to DTTs to be agreed bilaterally or otherwise) nor whether such programmes will be conditional upon the application of an effective relief at source system (under the SC Model or otherwise) in each of the Contracting States (i.e. effectively reciprocal).

33 In this respect, we concur with Itai Grinberg when he writes that achieving information exchange upon request is not adequate to combat offshore tax evasion. This is because, *"in order to receive information upon request, a tax administration is generally required to name the taxpayer, know which jurisdiction to ask for information, know at which financial institution a taxpayer may hold its account and have a credible suspicion of tax evasion. Otherwise, the request may be denied as a "fishing expedition". Thus, the requirement that a requesting tax administration have such specific and detailed information severely limits the effectiveness of information exchange upon request as a means to systematically combat offshore evasion"*. Beyond FATCA: An Evolutionary Moment for the International Tax System, Itai Grinberg, Draft of January 27, 2012, p. 8.

34 *"The OECD's approach to tax transparency requires information to be exchanged with other jurisdictions only on request. In other words, you must know what you are looking for before you request it. This is shockingly inadequate. We need the automatic exchange of tax information between jurisdictions and all developing countries must be included."* Ibid, pp. 8-9.

- The over-withholding situation occurs when the tax amount withheld by the WA is higher than the amount that should have been applied, resulting in a loss for the Investor.

Both Models include a possibility to adjust the under- and over-withholding that could be identified by AIs. This adjustment could be made at different times.

53. **Adjustment by AI before the Annual Reporting.** The SC and AIC Models offer the possibility to process certain adjustments before the annual reporting is sent out.

The Implementation Package distinguishes different procedures for under- and over-withholding.

- **Over-Withholding.** In the event of over-withholding, two possibilities are available: the reimbursement procedure and the set-off procedure;
  - **Reimbursement Procedure**. Once the error is identified, the AI may ask the WA or the next FI in the chain to repay the amount over-withheld;
  - **Set-off Procedure.** This procedure concerns an agreement between the AI and the WA or the previous FI in the chain to apply the amount over-withheld to any other Covered Payment that might have been subject to WHT;
- **Under-Withholding.** In the event of under-withholding, the Implementation Package specifies that the AI should notify the WA or the previous FI in the chain as soon as the error is identified. However, for transfer of the tax amount under-withheld, the SC Model is fairly flexible and leaves it up to the stakeholders impacted to choose the most appropriate corrective action (e.g. withhold the under-withheld amount from a future payment credited to the same account).

54. **Adjustment by AI with the Annual Reporting.** The SC and the AIC Models offer the same possibility to process to some adjustments via the annual reporting.

The annual reporting includes a year-end summary with a summary overview of the amount paid by income. If the AI identifies an error when compiling this overview, it can correct the error in the reporting. In the case of under-withholding, the AI must transfer the additional tax amount to the Competent Authority when filing the reporting. In the case of over-withholding, the SC will transfer the cash amount according to its own procedures and timing.

55. **Adjustments by AI after the Annual Reporting is Filed.** When an AI identifies an error after the filing of the annual reporting, both Models offer the possibility to correct the tax rate wrongly applied.

In the case of over-withholding, the AI that generated the TRI including the wrong information must send a claim for refund. This claim will follow the specific guidelines that could be included in the contractual agreement between the AI and the SC, for the SC Model, and the general refund procedures in the context of the AIC Model.

In the case of under-withholding, the AI must correct any error if it is detected within the period established in the agreement between the AI and the SC in the context of the SC Model, or within the period established in the EU relevant regulation in the context of the AIC Model.

If the AI has to correct the error according to the specified deadlines, the AI should send an amended reporting and pay the additional tax due to the Competent Authority as soon as possible and no later than 30 days after the error is detected.

56. **Adjustments Originating with the Competent Authority.** If a SC finds out that an AI has withheld a lower tax amount than it should have and if the SC identifies the AI as being liable for the under-withholding, the SC should notify the issue to the AI before contacting any other Financial Intermediary or WA. The AI has 30 days to either demonstrate to the SC that the tax amount was not under-withheld or pay the tax amount to the SC.

If the SC has not received the cash within 30 days and it still considers the tax amount as having been under-withheld, the SC will have the possibility to act against any party having liabilities.

4.5 REPORTING

4.5.1 CONTENT

57. **Two Reports.** To benefit from a standardised relief at source, an AI must send every year specific data on the Reportable Payments to the SC (SC Model) or to the AIC (AIC Model). Two reports make up this annual reporting:

- The year-end summary; and
- The annual information report.

For both reports, a template of the form is provided by the Implementation Package.

In both reports, the data exchanged concerns Reportable Payments. The Implementation Package provides a definition of the Reportable Payments and a list of the information to be included in each report.

58. **Reportable Payments.** According to the Implementation Package (35), a "Reportable Payment" means, *"any payment of dividends or interest* (36) *arising in the Source Country received by the AI with respect to an account that has been designated by the AI as one for which it is acting in its capacity as an Authorised Intermediary* [i.e. Covered Payments], *but only to the extent that it,*

35 Implementation Package - Appendix B: Procedures Regarding the Operation of a Financial Intermediary as Authorised Intermediary – Section III – Definitions.

36 This definition only mentions dividends or interest while, in the reporting, the type of income offers the possibility to mention a capital gain or "other income". This definition could potentially be too restrictive compared to what is included in the reporting.

- *is paid directly, or indirectly through one or more Contractual Intermediaries, to another Authorised Intermediary acting in its capacity as an Authorised Intermediary, or*
- *if not so paid, is either*
  - *paid, directly or indirectly, to a person who is a resident of the Source Country for tax purposes or*
  - *a payment that qualifies for a reduction or exemption from withholding tax in accordance with Paragraph 6 of the Agreement"*

59. **The Year-End Summary.** According to the Implementation Package (37), the year-end summary contains a summary of the data mentioned in the annual information report.

AI Identification. The first part includes generic information in order to identify the AI:

- Name of the intermediary,
- Address,
- AIIN:
  - For SC (context of the SC Model); or
  - For EU (context of the AIC Model).

Income Summary. The second part contains a summary of each income, mentioning the aggregated amount of Covered Payments in the currency of the SC and including:

1. Gross amount of Covered Payments received;
2. Gross amount of Reportable Payments paid, directly or indirectly through one or more CIs, to other AIs acting in their capacity as AIs;
3. Gross amount of Reportable Payments, not included in line 2 and paid, directly or indirectly through one or more CIs, to residents of the SC;
4. Gross amount of Reportable Payments not included in lines 2 and 3, on which a reduction of or exemption from withholding was applied;
5. Gross amount of Covered Payments paid to Account Holders that are not included in lines 2 to 4;
6. Aggregate tax withheld by AI on Reportable Payments;
7. Aggregate tax withheld on Reportable Payments by WA, if different from AI.

37 Implementation Package – Appendix B: Procedures Regarding the Operation of a Financial Intermediary as Authorised Intermediary – Annex 1: Year-End Summary of Covered Payments.

This year-end summary is relevant for the SC while the RC will not find relevant information to ensure tax compliance of its tax resident. In the SC Model, the SC receives the report directly from the various AIs across the EU. Hence, when the information is passed on to the RC, the year-end summary will be likely not to be included in the report split by RC.

The same approach could be adopted in the case of the AIC Model. The AIC will receive an exhaustive reporting from the AIs located in its territory, including the year-end summary. However, this year-end summary will only be forwarded to the SC as it is of no interest to the RC.

60. **The Annual Information Report.** The annual information report includes detailed information on all Reportable Payments and related beneficial owners. It comprises the following four parts.

AI Identification. A first part will provide details to allow a clear identification of the AI, as in the year-end summary.

- Name of the intermediary,
- Address,
- AIIN:
  - For SC (context of the SC Model); or
  - For EU (context of the AIC Model).

Investor Identification. A second part will include the information identifying the beneficial owner, which can be an individual or another entity:

- Information required for individuals:
  - Full name of the Investor;
  - Place of birth;
  - Date of birth;
  - Address;
  - Country of residence for tax purposes;
  - TIN;
- Information required for Investors other than individuals:
  - Name of the Investor;
  - Type of Investor (legal status in its country of residence);

- Place of incorporation;
- Date of incorporation;
- Address;
- Country of residence for tax purposes;
- TIN.

Reportable Payments Identification. The third part mentions the information on all the Reportable Payments that should be included in the reporting according to the "Reportable Payments" definition:

- Type of payment;
- Date of payment;
- Issuer of security;
- Security number;
- SC currency;
- Gross amount of payment (in SC currency);
- Tax rate applied to payment;
- Type of relief at source applied (domestic law v. DTT);
- Amount of tax withheld by AI;
- Amount of tax withheld by WA (if different);
- Proportion of payment qualifying for a reduced rate (if applicable for CIV, trust, partnerships etc.);
- Method applied to calculate this proportion (for widely held CIV).

This information has to be provided for each Reportable Payments that is credited to a client's account.

Intermediary Identification. The last part contains information to identify the CI to which the Investor provided an ISD and information to identify other CIs through which the AI received the Investor's ISD:

- Name of the intermediary;
- Address;
- Country of residence for tax purposes;

- TIN.

The same type of reporting will be required for Reportable Payments paid to an AI:

- Name of the intermediary;
- Address;
- AIIN:
  - For SC (context of the SC Model); or
  - For EU (context of the AIC Model).

61. **Correction of the Annual Reporting.** If an AI finds out that there is wrong, incomplete or missing information in the reporting sent to the tax administration, it must send a corrective reporting as soon as possible and no later than 30 days after it detected the error.

4.5.2 TIMING

62. **Timing of the Reporting.** The timing of the reporting could be similar but implementing the AIC Model via a Directive could lead to some minor differences.

- **Timing for the SC Model.** The Implementation Package specifies that the AI must send its reporting on or before 30 April for all the Reportable Payments received by the AI acting as an AI during the previous calendar year.

  Once the SC has received the reporting from the various AIs, it is expected that it will send the information to the relevant RC. However, no timing has yet been defined for this exchange (38). The Implementation Package specifies that this automated exchange should take place in a timely fashion and that the exact timing should be laid down in a memorandum (39). So, currently, it is difficult to know when the RC will receive the information or if this timing will be defined.

- **Timing of the AIC Model.** The timing of the AIC Model has not been defined and could be based on the timing of the SC Model. However, the timing for the exchange of information must be included in the common rules and not in a Memorandum of Understanding.

  With this in mind and in order to ensure consistency with the Savings Directive, the timing of the AIC Model could be modelled on the timing of the exchange of information organised by the Savings Directive (although other forms of timing could be explored).

38 The OECD is currently working on a draft memorandum according to which, *inter alia*, the content and the timing for the exchange of information will be agreed on a bilateral basis.

39 Implementation Package – Introduction to the Implementation Package – Outline of the Streamlined System for Claiming Reduced Withholding.

The AI would have to send the reporting to its AIC according to the timing prescribed by its internal legislation for all Reportable Payments received by the AI acting as an AI during the previous tax year (40);

In a second instance, the AIC would automatically send the information, within six months following the end of the AIC's tax year, for all Reportable Payments made during that year (41).

4.6 IDENTIFICATION (INVESTOR SELF DECLARATION V. CERTIFICATE OF RESIDENCE)

63. **Investor Self Declaration v. Certificate of Residence.**

Currently, it is common practice for a WA or a tax administration to request a Certificate of Residence. The authorities of the MSs generally consider this document as necessary but sufficient evidence to attest the tax residency of an Investor and grant a reduced tax rate. However, more and more stakeholders express their scepticism about the Certificates of Residence. Three reasons are commonly argued (non-exhaustive list):

- **The lack of Reliability.** Each MS has developed its own procedures and its own criteria for issuing a Certificate of Residence. In some cases, it is based on the current legal residence, in others, an Investor having submitted a tax return during the last fiscal year is considered a tax resident. So the criteria applied by the SC and the RC will often differ, creating a lack of reliability for the Certificate of Residence;

- **The Shift of the Cost.** The verification of the tax residency of an Investor is a check needed by the SC. It is in its own interest to make sure that the Investors are really entitled to a reduced tax rate under a DTT between the SC and the RC. However, with the issuance of a Certificate of Residence, the cost is shifted from the SC to the RC. Moreover, as the RC will often charge the Investor for the issuance of this administrative document, the cost is finally shifted from the SC (via the RC) to the Investor;

- **The Timing of the Process.** Certificates of Residence are usually paper documents. Between the initial request from an AI and the receipt of the document by the WA or the tax administrations, there is a delay that is hardly compatible with the short processing window of a relief at source procedure.

For these reasons, in the framework of the OECD TRACE Project, participating stakeholders have discussed the possibility that the new system would no longer rely on Certificates of Residence but would be based on the ISD.

The ISD includes all the data required to identify the Investor and the appropriate tax rate that should be applied to the relevant cross-border securities income. With this document, the Investor would certify that he is the beneficial owner of the income to be credited to his

40 The tax year applicable in a given AIC usually corresponds to the calendar year.
41 As provided in Article 9(2) of the Savings Directive.

account and would authorise his FI to disclose the information mentioned in the ISD to the tax administrations.

Under the SC Model, the ISD will be filled in by the Investor and will expire (42) on the last day of the fifth calendar year following the year in which the ISD is signed. It is up to the Investor to inform the AI of any change in the information included in the ISD. However, the AI will advise the Investor of his duty both at the time the account is being opened and periodically thereafter. The AIC Model would, in principle, follow the same rule in this respect.

The AI is allowed to rely on the information provided by the Investor unless it knows or, based on industry standards, has reasons to know that the ISD provided by an Investor is unreliable or incorrect, as described in the Implementation Package (43).

4.7 HIGH-LEVEL DESCRIPTION OF THE OPERATING MODELS

64. There are **four different flows** (three of them being information flows):

- The TRI flow
- The cash flow
- The exchange of information flow under the SC Model
- The exchange of information flow under the AIC Model.

Each of these flows will be documented using a flowchart and a narrative description (cf. Appendices 3 to 7). The flows are split into high-level phases as shown below and will be described in more detail in the narrative sections.

65. **TRI.** The TRI flow, corresponding to the communication of the applicable tax rate:

1. Notification of an income by the Issuer
2. Identification of the entitlement and generation of the TRI by an Authorised Intermediary (44)
3. Identification of the entitlement and generation of the report including beneficial owner details by a CI
4. Identification of the entitlement and generation of the TRI by an AI (45)

42 It will, however, remain valid indefinitely if provided by a government (including a central bank of issue, agency or instrumentality) or an international organisation.

43 Cf. Implementation Package – Procedures regarding the Operation of a Financial Intermediary as an Authorised Intermediary – Section V.

44 "Authorised Intermediary" designs an AI that is not in direct contact with the WA (Phase 2). So this Authorised Intermediary will have to go through another AI (Phase 4) in order to provide its TRI to the appropriate WA.

5. Processing of the TRI by the WA.

66. **Cash Flow.** The cash flow, which corresponds to the effective payment of the income:

1. Payment of the income by the Issuer
2. Processing of the income by the WA
3. Processing of the income by the AI
4. Processing of the income by the SC ([46])

67. **Exchange of Information Flow SC.** The exchange of information flow under the SC Model, including validation, correction and feedback:

1. Report generation by the AI
2. Treatment of the reporting by SC and sorting out of the information by RC;
3. Analysis of the information by the SC:
   - analysis of the data
   - elaboration of a RFI
4. Analysis of the reporting by the RC:
   - analysis of the data
   - elaboration of a RFI
5. Treatment of a RFI by the SC
6. Treatment of a RFI by the AI
7. Treatment by the SC of a reply message received from the AI
8. Receipt of a reply message by the RC.

68. **Exchange of Information Flow AIC.** The exchange of information flow under the AIC Model, including validation, correction and feedback:

1. Report generation by the AI
2. Treatment of the reporting by the AIC:

45 Ibid.

46 The SC receives the cash from the WA and reconciles that amount with the amount and the tax rates included in the TRI. Once reconciled, the cash amount can be recorded in the books of the SC.

- receipt of the reports from the AIC
- sorting out of data by SC and RC
- sending of reports to the SC and the RC

3. Analysis of the information by the AIC acting as SC or RC:
   - analysis of the data
   - elaboration of a RFI
4. Analysis of the information by the SC:
   - analysis of the data
   - elaboration of a RFI
5. Analysis of the information by the RC:
   - analysis of the data
   - elaboration of a RFI
6. Treatment by the AIC of a RFI generated by the SC or the RC
7. Treatment of a RFI by the AI
8. Treatment by the AIC of a reply message received from the AI
9. Receipt of a reply message by the SC or the RC.

69. **Two Different Exchange of Information Flows.** Both Models are based on the Implementation Package, which describes in detail a standardised relief at source system coupled with information reporting/exchange between Financial Intermediaries and tax administrations of both SCs and RCs. In that context, the two first flows (i.e. the TRI and cash flows) are common to both Models. The AIC Model differs from the SC Model when considering the channels used to provide Investor information to the SC and RC. This is why the exchange of information flows are distinguished according to the AIC Model and the SC Model.

70. **Operational Description**. The AIC and SC Models were not defined at an operational level at the start of the current study. Since such a definition is a prerequisite to carry out a feasibility study and a relevant comparative analysis, it was agreed that PwC would define these operating models for the sake of this study. The definition of these operating Models consists of a description of the various tasks to be performed by the various stakeholders in the context of the standardised relief at source system. This chapter is to be seen and therefore read from an operational perspective.

4.8 DETAILED DESCRIPTION OF THE OPERATING MODELS

71. A **detailed description** of the operating models is available in Appendix 3. It considers the various flows within the Models. Each of these flows is documented using also a flowchart (cf. Appendices 4 to 7).

* *

*

CHAPTER 5 INTERACTIONS WITH THE EU AND INTERNATIONAL ADMINISTRATIVE COOPERATION FRAMEWORK

Three Directives are examined in this chapter: the Directive on Administrative Cooperation, the Recovery Directive, and the Savings Directive. Each Directive is first briefly summarised. Interactions between each Directive and the contemplated Models are then detailed. Finally, other international cooperation instruments, bilateral and multilateral, are briefly covered.

The first section comprises an analysis of the Directive on Administrative Cooperation, essentially from the angle of the routing of information. From that angle, the Cross-border and Reversed Cross-border Scenarios are left out as they are considered mere simplifications of the more complex Triangular Scenario. The SC Model and the AIC Model are analysed separately at that stage as their routing is fundamentally different. Subsequently, other interactions between the Directive on Administrative Cooperation and the Models are examined.

An analysis of the Directive on Administrative Cooperation shows that the mandatory exchange of information system it provides for in its Art. 8.1 is not applicable, irrespective of the Model used (as it is clear that dividend and interest payments have been explicitly excluded from its scope). However, one should bear in mind that Art. 8.8 of the DAC in any case permits Competent Authorities of the MSs to agree to automatically and bilaterally/multilaterally exchange information on such categories of income.

In the framework of the SC Model, Investor-specific information received by the SC from the AI would in principle have to be transmitted from the SC to the RC pursuant to Art. 9.1 (b), of the Directive (spontaneous exchange of information). However, given the fact that such exchange of information would not be automatic and sufficiently automated, it will not be efficient. The SC Model would therefore require additional legal instruments between the SCs and the RCs to ensure an effective exchange of information.

The AIC Model would also require additional legal instruments between participating countries to ensure an effective exchange of information. Indeed, even if the exchange of information on request and the spontaneous exchange of information could be used, such exchanges of information would have to be automatic and sufficiently automated to be efficient, which is, here again, not the case.

The Recovery Directive is analysed in the second section of this chapter, essentially from the angle of the cross-border enforcement possibilities it creates for the RC. The cross-border enforcement is analysed at the level of the investor and at the level of the AI. Other interactions (some of which are similar to those described in the Directive on Administrative Cooperation) are then examined.

It results from the analysis that, irrespective of the Model, the SC could potentially have recourse to the Recovery Directive in order to enforce payment by the Investor in the case of an under-withholding.

The EUR 1500 threshold could however, constitute an important limitation. Special arrangements between Competent Authorities would probably resolve this issue.

On the other hand, in order to make sure the Recovery Directive could be used with respect to the AI, it would be necessary to ensure that its liability is defined so that it falls within the scope of the Directive.

The Savings Directive as it currently stands is detailed in the third section. Selected relevant lessons taken from the Savings Directive are then summarised, and the main interactions between the Directive and the contemplated Models briefly addressed.

Considering its goal, the Savings Directive as it currently stands is not directly suitable to enable the application of a relief at source Model, and the coexistence of the Savings Directive with the contemplated relief at source models (SC Model or AIC Model) would only lead to limited duplications in terms of information exchanged. It nevertheless includes elements that can be leveraged on to apply a relief at source Model, such as the minimum standards in terms of identification procedure. Besides, the Savings Directive has already created a practical environment that could be leveraged on, as shown in the second report from the European Commission on the operation of the Savings Directive.

The bilateral instruments described in the fourth section are the OECD Model Tax Convention (both its exchange of information and recovery provisions), the Model Agreement on Exchange of Information on Tax Matters and the Memorandum of Understanding between Competent Authorities on the Automatic Exchange of Information for Tax Purposes. The multilateral instrument briefly touched upon is the Convention on Mutual Administrative Assistance in Tax Matters.

Such cooperation instruments are subject to greater limitations than the Directive on Administrative Cooperation and the Recovery Directive and can therefore not be considered as effectively sustaining the application of the contemplated models. They nevertheless offer a substitutive legislative framework opening the way to the application of the contemplated Models between MSs and third countries.

* * *

5.1 DIRECTIVE ON ADMINISTRATIVE COOPERATION

72. **Introduction.** Given the scope of the Directive on Administrative Cooperation (a high-level summary of which is provided in subsection 5.1.1), its main interactions with the contemplated Models can be found at the level of the routing of information (where some differences can appear depending on the selected scenarios). For the sake of the explanation, the SC Model and the AIC Model are analysed separately on this point.

Other interactions of the Directive on Administrative Cooperation with both Models are briefly described in Appendix 8.

5.1.1 SUMMARY ([47])

73. **Scope.** This Directive repeals Directive 77/799/EEC and establishes new rules and procedures for the cooperation between MSs with a view to exchanging information that is relevant to the administration and enforcement of national laws in the field of taxation (Art. 1).

It applies to all taxes ([48]) except the following (Art. 2):

- Value added tax (VAT) and customs duties, or excise duties covered by other EU legislation on administrative cooperation between MSs;
- Compulsory social security contributions payable to the MS;
- Fees, such as for certificates and other documents issued by public authorities;
- Dues of a contractual nature, such as consideration for public utilities.

74. **Three Exchange of Information Types.** Three different types of exchange of information are foreseen by the Directive.

- **Exchange of Information on Request (Art. 5).** The requested authority must, at the request of the requesting authority, communicate any relevant information that it has in its possession or that it obtains from administrative enquiries. In order to obtain the requested information or to conduct the administrative enquiry requested, the requested authority must follow the same procedures as it would when acting on its own initiative or at the request of another authority in its own MS. MSs may not refuse to supply information solely because this information is held by a bank or other type of FI.

  The requested authority must confirm receipt of the request within seven working days and must then provide the information as quickly as possible, and no later than six months

47 This section reproduces the summary of the Directive as provided by the European Commission on its website, which can be retrieved at the following address: http://europa.eu/legislation_summaries/taxation/fi0006_en.htm.

48 Given Article 2.1 of the Directive provides that it shall apply to all taxes of any kind levied by, or on behalf of, a MS, WHTs fall within the scope of the Directive.

after receipt of the request. If, however, the requested authority already possesses the information, it must be provided within two months of that date;

- **Mandatory Automatic Exchange of Information (Art. 8).** Each competent national authority must send to the Competent Authority of any other MS, by automatic exchange, available information concerning taxable periods as from 1 January 2014 relating to residents in that other MSs on the following categories of income and capital:
  - Income from employment;
  - Director's fees;
  - Life insurance products not covered by other EU legal instruments on exchange of information and other such measures;
  - Pensions;
  - Ownership of and income from immovable property.
- **Spontaneous Exchange of Information (Art. 9).** Each competent national authority must communicate information to the Competent Authority of any other MS in the following situations:
  - The Competent Authority of one MS has reason to suppose that there may be a loss of tax in the other MS;
  - A person liable to tax obtains a reduction in, or an exemption from, tax in one MS which would give rise to an increase in tax or to liability to tax in the other MS;
  - Business dealings between two persons liable to tax in different MSs are conducted through one or more countries in such a way that a saving in tax may result in either or both of the MSs;
  - The Competent Authority of one MS has grounds for supposing that a saving of tax may result from artificial transfers of profits within groups of enterprises;
  - Information forwarded to one MS by another MS's Competent Authority has enabled information to be obtained which may be relevant in assessing liability to tax in the latter MS.

5.1.2 LINK WITH THE SELECTED SCENARIOS

75. **Cooperation.** As mentioned above (cf. subsection 4.3.3 above), the international cooperation between countries is organised in different ways depending on the Model:

- **SC Model.** To be effective, the cooperation has to be organised between the SC and the RC in a bilateral way (even if the SC could "from its own initiative" (49) provide information unilaterally to the RC without prior request), for the following reasons:
  - **Relief at Source in SC.** The objective of an efficient relief at source system is organised by the SC without any cooperation between countries (50) (where the SC signs an agreement with the AI without any involvement of the AIC);
  - **Compliance in RC.** On the other hand, compliance in the RC necessarily depends on information received from the SC;
- **AIC Model.** To be effective, the cooperation has to be organised between the SC, the RC and the AIC in a multilateral way, for the following reasons:
  - **Relief at Source in SC.** The objective of an efficient relief at source system depends on information received from the AIC (51);
  - **Compliance in RC.** On the other hand, compliance in the RC also necessarily depends on information received from the AIC.

76. **Link with the Selected Scenarios.** The above description actually explains the situation in the so-called "Triangular" Scenario (e.g. an Investor resident in Country A holds securities issued by an Issuer established in Country B in a securities account held with a FI established in Country C).

The Cross-Border Scenario and Reversed Cross-Border Scenario actually represent simplifications of that case. Their differences compared with the Triangular Scenario are highlighted below:

- **Cross-Border Scenario.** As mentioned above (cf. subsection 3.3.1), this situation concerns cases where the AI is established in the same country as the Investor (e.g. an Investor resident in Country A holds securities issued by an Issuer established in Country B in a securities account held with a FI established in Country A);
  - **SC Model.** In this case, compliance in RC does in principle not depend on information received from the SC (as the RC should, at least in theory, have sufficient

49 As we will see, such behaviour might be "favoured" by the current EU legislative framework, the Directive 2011/16/EU in particular.

50 In first instance at least, i.e. to check that the AI applied the right TRI based on the elements of information at its disposal. It is only in second instance, i.e. where the SC wants to double-check the residence status of the investors, that it will have to rely on information from the RC.

51 Information coming in first instance directly from the AIC, and in second instance indirectly from the RC.

investigative powers with respect to the Financial Intermediaries established in its territory to collect the relevant Investor specific information (52));

- **AIC Model.** Here again, compliance in the RC does in principle not depend on information received from another country.

RC Independent from any other Country. In this scenario, whichever the Model applied, the RC should be enabled to ensure tax compliance of its resident Investors.

- **Reversed Cross-Border Scenario.** This situation (cf. subsection 3.3.2) concerns cases where the AI is established in the SC (e.g. an Investor resident in Country A holds securities issued by an Issuer established in Country B in a securities account held with a FI established in Country B);

  - **SC Model.** This situation is similar to the Triangular Scenario (the SC collects information directly with the AI, and the RC needs information from the SC);

  - **AIC Model.** Considering the fact that the SC is also the AIC, the Reversed Cross-Border Scenario under the AIC Model shows the same interactions as under the SC Model (the SC/AIC collects information directly with the AI, and the RC needs information from the SC/AIC).

  RC Dependent on SC/AIC. In this scenario, both Models actually operate in the same way as far as the routing is concerned. In both Models, the RC is dependent on the SC/AIC to ensure tax compliance of its resident Investors.

77. **Only Triangular Scenarios.** Since the Cross-Border Scenario and the Reversed Cross-Border Scenario are simplifications of the Triangular Scenario, only the Triangular Scenario is covered in the remainder of this section.

5.1.3 ROUTING AND SC MODEL

78. **Information Flow between the AI and the SC: No Interactions.** Art. 1 of the DAC provides for cooperation between MSs (in practice between Competent Authorities of MSs).

- As the SC Model provides that the AI directly transmits the information to the (Competent Authority) of the SC, it does not interact with the Directive at this level;

- However, the SC Model interacts with the Directive at the level of the information flow between the SC and the RC once the SC has received such information from the AI.

52 In practice, however, this is not always the case. However, this is more a question of internal tax legislation of the RC, which is out of scope of the study. Example, Belgium considered as RC: until recently, the Belgian WHT retained by Belgian banks in case of foreign movable income paid to a Belgian individual investor was anonymous and considered as the final tax (with no obligation on the investor to report that type of income in his annual income tax return) so that the Belgian tax administrations did neither receive nor collect any information when a Belgian FI was involved in the payment.

To implement the latter aspect of the SC Model, advantage can be taken of several provisions that are available in the Directive and the underlying principles of which therefore have already been approved by the MSs.

79. **Information Flow from the SC to the RC: Automatic Exchange of Information.** First of all, it is interesting to have a look at Art. 8.1 of the DAC, which provides for a mandatory automatic exchange of information. Automatic exchange of information is indeed the most appropriate way to exchange information.

Art. 8.1 of the DAC provides that the Competent Authority of each MS shall, by automatic exchange, communicate to the Competent Authority of any other MS, information that is available concerning residents in that other MS, on very specific categories of income and capital as they are to be understood under the national legislation of the MS that communicates the information.

80. For the time being, interest and dividends are not included in these categories so that Art. 8.1 is not applicable (53).

- **Dividends.** As regards dividends, it could, however, potentially be applied in the future as Art. 8.5 provides that the list of categories could be extended to include dividends.

  Indeed, the Directive provides that, before 1 July 2017, the European Commission shall submit a report providing an overview and an assessment of the statistics and information received and, *"if appropriate"*, it shall make a proposal to the Council *inter alia* regarding the possible inclusion of dividends, capital gains and royalties in the scope of automatic exchange of information in view of *"further strengthening of the efficiency and functioning of the automatic exchange of information and raising the standard thereof"*.

  We can thus infer from the above that, until July 2017, dividends are not in scope of the automatic exchange of information, and that no political agreement has been reached so far in this respect, so that a consensus would still have to be found;

- **Interest.** As regards interest, the Directive remains silent. This is due to the already existing Savings Directive on taxation of savings income in the form of interest payments (the "Savings Directive"), whose principal purpose is the automatic exchange of information as regards interest payments.

  The Directive on Administrative Cooperation is indeed specifically drafted so as to avoid overlaps with the mandatory automatic exchange of information already provided in the Savings Directive (or that will be provided further to its recast) (54);

53 Of course, a revision of the Directive on Administrative Cooperation with a view to including these categories of income would offer a solid legal framework for the exchange of information that is required under the system.

54 In this respect, we refer to the category "life insurance products" with respect to which it is stated that the mandatory automatic exchange of information provided in Directive 2011/16/EU does not apply to these

- **Information Available**. Moreover, the mandatory automatic exchange of information is currently subject to information being available in the respective MSs (Art. 8.1). In this respect, the MSs must inform the European Commission before 1 January 2014 of the categories currently in scope (cf. above) in respect of which *"they have information available"* (55). In other words, even with respect to the categories currently in scope of the automatic exchange of information, there is not yet any certainty as regards whether or not there will be an effective exchange of information. In addition, there is currently a lack of consistency from MS to MS as the categories of information available are potentially different from one MS to the other and these categories can evolve over time. It is also interesting to note that the Directive on Administrative Cooperation provides for some rules so as to improve the cooperation between MSs whereby a MS not providing any information could in turn not receive any information either (56).

As a result, the mandatory automatic exchange of information provided by Art. 8.1 of the DAC does not appear to be suitable in the present case.

It should nevertheless be pointed out that, even if the "mandatory" automatic exchange of information provided by Art. 8.1 is not directly applicable, Art. 8.8 of the DAC will in any case enable (57) Competent Authorities of MSs to agree on automatic exchange of information with respect to dividend and interest payments. This could be of particular importance in practice as far as the implementation of the respective relief at source models is concerned: the Competent Authorities of two or several MSs could agree on exchanging information automatically and bilaterally/multilaterally for income not covered by Art. 8.1 without having recourse to the signature of new treaties (58).

Other provisions of the Directive on Administrative Cooperation might nevertheless be of interest.

81. **Information from the SC to the RC: Spontaneous Exchange of Information.** Art. 3.10 of the DAC defines "spontaneous exchange" as the non-systematic communication, at any time and without prior request, of information to another MS. The various cases where spontaneous exchange of information applies are defined in Art. 9.1.

---

products if they are covered by another Union legal instrument on exchange of information and other similar measures.

55 According to Article 3.9 of the Directive, available information refers to *"information in the tax files of the Member State communicating the information, which is retrievable in accordance with the procedures for gathering and processing information in that Member State"*.

56 More precisely, Article 8.3 of the DAC provides that *"a Member State may be considered as not wishing to receive information in accordance with paragraph 1, if it does not inform the Commission of any single category in respect of which it has information available"*.

57 Just as Article 3 of the Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the Competent Authorities of the MSs in the field of direct taxation and taxation of insurance premiums currently does.

58 It is useful to note in this respect that it is already foreseen that the formats under developments will comprise as many income as possible to allow MSs to exchange information in a uniform manner under Article 8.8 on those income not quoted in Article 8.1 (e.g. income from independent employment, interest, dividends, royalties, etc.).

Art. 9.1(b) of the DAC is potentially interesting with respect to the flow of information between the SC and the RC as set forth in the SC Model. It reads as follows:

> *1. The competent authority of each Member State **shall communicate** the information referred to in Article 1(1) to the competent authority of any other Member State concerned, in any of the following circumstances: [...] (b) a person liable to tax **obtains a reduction in, or an exemption from**, tax in one Member State which would give rise to an **increase in tax or to liability to tax** in the other Member State.*

According to this provision, a spontaneous exchange of information is required when the two following cumulative conditions are met:

- There should be **a reduction in/an exemption from tax in the SC**.

  By definition, any relief at source system (in the present study, the SC Model or the AIC Model) exists to permit Investors (i.e. persons liable to tax in the SC) to benefit from a reduction in or exemption from tax in the SC (in practice, a lower WHT rate than normally provided in the internal tax legislation of the SC);

- Such reduction in/exemption from tax in the SC should **increase the tax or liability to tax in the RC.**

  Furthermore the tax regime of the Investor in the RC will in principle depend on the tax treatment of the income in the SC (the taxation in the RC depends on the effective tax rate suffered in the SC). Most countries apply the tax credit method (the RC taxes the gross amount but credits the foreign taxes paid/suffered against the local tax). Other countries can apply other methods (e.g. the RC taxes only the net frontier income), but the taxes due in the RC will in principle generally be linked to the taxes due in the SC. The lower the taxation in the SC, the higher the taxation should be in the RC.

  Exchange of information about the application of a DTT is therefore *"foreseeably relevant"* to the administration and enforcement of the domestic laws of the RC in the meaning of Art. 1.1. of the DAC;

As a result, it can be argued that a reduction in or exemption from tax in the SC will give rise to an increase in tax or to liability to tax in the RC and thus Art. 9.1(b) of the DAC should be considered applicable.

In terms of timing, Art. 10 of the DAC provides that the information shall be forwarded as quickly as possible, and no later than one month after it becomes available.

In the framework of the SC Model (according to which information will be provided to the SC by the AI on a regular basis), the fact that the conditions for the application of Art. 9.1(b) are met combined with the time limit provided for in Art. 10 could thus, in theory, render the application of an exchange of information towards the RC mandatory.

This element of information would allow the RC to check whether the Investor that benefited from the relief at source declared his foreign income in his local income tax return. Art. 9 of the DAC would therefore ensure taxation in the RC. This aspect would of course be key to ensure tax compliance in the RC (cf. section 8.2 below).

However, it is already important to note at this stage that the theoretical analysis according to which an exchange of information must apply is in practice undermined considering the way the spontaneous exchange of information actually works. This is because the spontaneous exchange of information, not being "automated" (contrary to the automatic exchange of information), would require a sizeable level of human intervention (filling of specific forms each time, etc.) so that it would impair the efficiency of the whole system.

82. **Information from the RC to the SC: Spontaneous Exchange of Information and Exchange of Information on Request.** Information received by the RC (in the framework of the spontaneous exchange of information or otherwise) could enable the RC to check whether a given person is indeed tax resident (the Investor could be unknown by the RC, or although known, information in his respect might not be correct/up-to-date and therefore need correcting).

This is important as the SC could also require or have an interest in receiving information from the RC. Indeed, for the SC to make sure that it granted the treaty benefits on correct grounds, it would ultimately need confirmation from the RC as regards the residency status of the Investor to whom it granted the relief at source.

Such provision of information by the RC to the SC could, still in theory, be covered by two Articles of the Directive on Administrative Cooperation, namely Art. 9.1 (e) and/or Art. 5.

- **Spontaneous Exchange of Information.** Art. 9.1 (e) of the DAC provides for another specific case of "mandatory" spontaneous exchange of information when information forwarded to one MS by the other MS has enabled information to be obtained that may be relevant in assessing liability to tax in the latter MS (the information also has to be forwarded in the month after it becomes available according to Art. 10 of the DAC).

- **Exchange of Information on Request**. Besides, when providing information to the RC, the SC could also rely on Art. 5 of the DAC to make a request for information ([59]).

  Indeed, a request for information from the SC the purpose of which would be to check the residency status in the assumed RC for given taxpayers to whom treaty benefits have been granted could, in our view, be considered as a valid request for information: the request, although covering many taxpayers, would only concern specific cases; the requested information would be relevant to the tax affairs of the taxpayers in the SC and the information requested (basically, whether or not a given taxpayer is resident in the assumed RC) is "foreseeably relevant" (in the meaning of Art. 1.1 and recital number nine

59 Defined in Article 3.8 of the Directive as the exchange of information based on the request made by the requesting MS to the requested MS in a specific case.

of the DAC ([60])) to the administration and enforcement of the domestic laws of the MSs (the SCs). Considering the fact that the limitations provided in Art. 17 of the DAC do not apply (cf. Appendix 9), the information would then in principle have to be provided within six months from the date of receipt of the request (Art. 7.2 of the DAC).

Acquiring knowledge about the residency status of the Investor would permit the SC to make sure that it granted the treaty relief at source on correct grounds. This aspect would be key to ensure tax compliance in the SC (cf. section 8.2 below).

However, for the same reasons as those mentioned above, the theoretical analysis according to which an exchange of information (spontaneous or upon request) from the RC to the SC could possibly apply would in practice be inefficient if applied on a large scale.

83. **Need for Additional Legal Instruments.** It results from the above that the SC Model would currently require additional legal instruments between the SCs and the RCs to ensure an effective and automatic exchange of information.

Indeed, the analysis shows that a Source MS granting a relief at source must exchange information towards the various Residence MSs concerned (via the spontaneous exchange of information) and that a Residence MS could also, in return, be obliged to exchange information towards the Source MS (via the spontaneous exchange of information possibly combined with the exchange of information on request). An exchange of information should therefore occur, which is important from a tax compliance perspective.

However, in order to be efficient, such exchanges of information would have to be automatic and sufficiently automated, which is not the case. Should a Source MS want to apply the SC Model in an efficient way, it would have to enter into memorandums of understanding between Competent Authorities on the automatic exchange of information for tax purposes (based on Art. 8.8 of the DAC or other similar provisions) with potentially each and every MS (considering the fact that the Investors could be resident in any MS).

60 Article 5 provides that, at the request of the requesting authority, the requested authority shall communicate to the requesting authority any information referred to in Article 1.1 (information *"foreseeably relevant"* to the administration and enforcement of the domestic laws of the MS) that it has in its position or that it obtains as a result of administrative enquiries. In this respect, recital number nine of the Directive provides that *"The standard of 'foreseeable relevance' is intended to provide for exchange of information in tax matters **to the widest possible extent** and, at the same time, to clarify that Member States are **not** at liberty to engage in **'fishing expeditions'** or to request information that is **unlikely to be relevant to the tax affairs of a given taxpayer**."*

5.1.4 ROUTING AND AIC MODEL

84. **Information Flow between the AI and the AIC: No Interactions.** As in the SC Model, the AIC Model provides that the AI directly transmits the information to a Competent Authority of a MS (AIC this time). As a result, the AIC Model does not interact with the Directive on Administrative Cooperation at this level (no exchange of information between Competent Authorities but only between the AI and a Competent Authority).

However, the AIC Model interacts with the Directive on Administrative Cooperation at the level of the information flow between the AIC and the SC and the RC, respectively, once the AIC has received such information from the AI.

To implement this aspect of the AIC Model, it could also possibly be taken advantage of several provisions available in the Directive, the underlying principles of which having already been approved by the MSs.

85. **Information from the AIC to the SC and RC: Automatic Exchange of Information.** As for the SC Model, the mandatory automatic exchange of information provided by the Directive on Administrative Cooperation in its Art. 8.1 is not applicable for the time being. In this respect reference is made to the comments above.

Of course, as for the SC Model, Art. 8.8 of the DAC will in any case enable Competent Authorities of MSs to bilaterally/multilaterally agree on automatic exchange of information with respect to dividend and interest payments without having recourse to the signature of new treaties.

86. **Information from the AIC to the SC and RC: Exchange of Information upon Request.** As already mentioned above, Art. 3.8 of the DAC defines the exchange of information on request as the exchange of information based on the request made by the requesting MS to the requested MS "in a specific case" (it should be relevant to the tax affairs of a given taxpayer).

The need for a specific case excludes mere *"fishing expeditions"*. In other words, the requesting MS should already have some elements of information to be able to send a request to another MS.

However, in the AIC Model, neither the SC nor the RC has initially sufficient information to be able to identify specific cases with respect to the application of the DTTs. This is because, in a first instance, the SC has only the pooled information (received from the WAs), which could possibly be considered by a requested MS as not sufficient to have a specific case, and the RC is not yet aware of the treaty application.

Besides, if either the SC or the RC had to actually request information from the AIC, the Model would lose efficiency.

The other way round, the AIC has of course sufficient elements of information (received from the AIs) to issue requests for information to the respective SCs (e.g. to check whether the detailed information received matches the pooled information provided to the respective SCs) and RCs (e.g. to check the residency status of the respective investors).

87. **Information from the AIC to the SC and RC: Spontaneous Exchange of Information.** Considering the cooperative nature of the AIC Model (which could not be put in place by a single MS, unlike the SC Model), the question here is essentially to assess whether a spontaneous exchange of information from the AIC to the two other MSs could apply.

In this respect, Art. 9.2 of the DAC provides that a MS may communicate, by spontaneous exchange, to the Competent Authorities of the other MSs any information of which they are aware and which may be useful to the Competent Authorities of the other MSs (without any mandatory timeframe being included in the Directive, however).

The exchange of information from the AIC to the SC and the RC could thus be organised based on the framework of the spontaneous exchange of information provisions, although the nature of such type of information exchange would not be efficient (sizeable level of human intervention; administrative burden).

88. **Need for Specific Legislation.** It results from the above that the AIC Model would currently require additional legal instruments between participating countries to ensure an effective and automatic exchange of information.

This is because, even if the exchange of information on request and the spontaneous exchange of information could be used, such exchanges of information would have to be automatic and sufficiently automated to be efficient, which is not the case. Should MSs want to apply the AIC Model in an efficient way, they would have to enter into memorandums of understanding between Competent Authorities on the automatic exchange of information for tax purposes (based on Art. 8.8 of the DAC or other similar provisions) with potentially each and every MS (considering the fact that the Investors could be resident in any MS and any MS could potentially be an SC as well).

89. **Interactions with Third Countries: Wider Cooperation and Most-Favoured Nation Clause.** In this respect, it is also interesting to have a look at FATCA (61) and, in particular, at the Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA (62). These recent developments clearly push towards enhanced administrative cooperation in the form of automatic exchange of information via the AIC. They could open the door to closer international cooperation between MSs based on a similar routing mechanism.

61 http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-(FATCA)
62 http://www.treasury.gov/press-center/press-releases/Pages/tg1653.aspx

- **Context Change.** Following a Joint Statement issued by the US with France, Germany, Italy, Spain and the United Kingdom, on 8 February 2012 (63), regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA, these countries developed a Model Agreement (Model 1) to be used by countries that are interested in implementing FATCA through a government-to-government approach (cf. Appendix 1 for more information including on latest developments in this area).

  The United Kingdom has been the first country to sign an agreement with the US along the lines of Model 1 (64). Other EU MSs have done so after the UK (i.e. Denmark, Spain, Ireland) and others are expected to do so in the coming months. The key learning in this respect is that, in the near future, a large number of MSs (if not all) and also third countries will agree to actively participate in automatic exchanges of information with the US, based on information provided to them by their financial institutions. In other words, in those countries that will sign a Model 1 agreement with the US, FIs would be required to report investors' information to their own tax administrations instead of directly to a foreign tax administration (similarly to the routing provided in the Savings Directive and to the routing provided in the AIC Model).

- **Impacts within the EU.** Besides, the result of the above Intergovernmental Agreements will be that some MSs will enter into a "wider cooperation" as regards exchange of information with the US in the meaning of Art. 19 of the DAC (65).

  This could have important consequences within the EU as such wider cooperation could have to be extended to other MSs wishing to enter into such an agreement (so-called "most-favoured-nation" clause). Art. 19 of the DAC indeed states that: *"Where a Member State provides a wider cooperation to a third country than that provided for under this Directive, that Member State may not refuse to provide such wider cooperation to any other Member State wishing to enter into such mutual wider cooperation with that Member State."* (66)

63 http://www.treasury.gov/press-center/press-releases/Documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf

64 http://www.treasury.gov/press-center/press-releases/Pages/tg1711.aspx

65 The legal instrument providing for such wider cooperation is not relevant, the key element is the existence of a wider cooperation between a MS and a third country. In this respect, the Joint Statement refers to the existing DTTs, another option could be to rely on Article 6 of the Convention on Mutual Administrative Assistance in Tax Matters.
According to Revised Explanatory Report to the Convention on Mutual Administrative Assistance in Tax Matters, automatic exchange of information *"requires a preliminary agreement between the competent authorities on the procedure to be adopted and on the items covered. [...] Agreement on the items to be exchanged and the procedure to be adopted is a prerequisite"*. The OECD Model Memorandum of Understanding on Automatic Exchange of Information for Tax Purposes could serve as a basis for these types of agreements.

66 See also recital number 22 of the Directive: *"It should also be made clear that where a Member State provides a wider cooperation to a third country than is provided for under this Directive, it should not*

It thus opens the way to an increased level of cooperation between MSs (67) where the local FIs would also report to their own tax administrations.

It could even potentially lead to a pan-EU automatic exchange of information system (68) :

- For instance, considering the fact that the MSs having signed an agreement with the US, along the lines of the above-mentioned Model Agreement, will have to implement the legal provisions and to put in place the relevant procedures to collect from their local FIs information about US persons and to exchange it with the US, they would be in a position to do the same with respect to residents of other MSs.

- Besides, Art. 19 of the DAC could enable some of them (or any other MS) to even force similar exchange of information, subject to a condition of reciprocity (the MS requesting a wider cooperation as the one provided under the Model Agreement should endeavour to provide the same level of information).

5.1.5 CONCLUSION

90. **Mandatory Automatic Exchange of Information.** The Directive on Administrative Cooperation is not immediately applicable to interest and dividend payments (irrespective of the Model used). From a political perspective, it is clear that these dividend and interest payments have been explicitly excluded from the scope of the Directive on Administrative Cooperation as far as mandatory automatic exchange of information provided for in Art. 8.1 of the DAC is concerned.

- **Dividends.** Dividends are not in scope of the automatic exchange of information, and a political agreement would in addition still have to be reached should dividends be included therein;

- **Interest.** With respect to interest payments, already another Directive is applicable (the Savings Directive – cf. section 5.3 below), the objective of which is to ensure compliance in the RC irrespective of whether or not a DTT is applied (i.e. irrespective of the application of a WHT, and potentially thus of a WHT relief at source in the SC) (69). More importantly, the Directive on Administrative Cooperation is specifically drafted so as to

refuse to provide such wider cooperation to other Member States wishing to enter into such mutual wider cooperation."

67 Which is favoured in recital number 21 of the Directive according to which it "*contains minimum rules and should therefore not affect Member States' right to enter into wider cooperation with other Member States under their national legislation or in the framework of bilateral or multilateral agreements concluded with other Member States*".

68 Besides, this automatic exchange of information could take place even on income with respect of which a reduced WHT rate based on a DTT is not requested.

69 The fact that the Savings Directive does not consider the tax treatment in the SC (i.e. does not organise WHT relief at source/refund in the SC) might not constitute such a big issue in practice since there is in many MSs no WHT on interest income on widely held debt securities (internal tax laws often providing exemptions in this respect or a WHT rate equivalent to the maximum DTT rate), while it is much less often the case for dividend payments.

avoid overlaps with the automatic exchange of information already provided in the Savings Directive (or that will be provided further to its recast).

As a consequence, automatic exchange provided for in the Directive (as it currently stands) will never apply to interest payments.

However, one should bear in mind that Art. 8.8 of the DAC in any case permits Competent Authorities of the MSs to agree to automatically and bilaterally/multilaterally exchange information on such categories of income.

91. **Other Types of Exchange of Information.** The reasoning differs according to the Model chosen (SC Model or AIC Model):

- **SC Model.** In the framework of the SC Model (according to which information will be provided to the SC by the AI on a regular basis), the fact that the conditions for the application of the spontaneous exchange of information would be met combined with the time limit provided for in this respect obliges Source MSs wishing to apply the SC Model to proceed to an exchange of information towards the various RCs. In other words, the Investor-specific information received by the SC from the AI would have to be transmitted from the SC to the RC pursuant to Art. 9.1 (b) of the DAC. Besides, the Residence MSs would also be obliged to exchange information towards the Source MSs (either applying the spontaneous exchange of information provided in Art. 9.1 (e) or replying to a request for information). This aspect would of course be key to ensure tax compliance in the RC and in the SC.

  However, in order to be efficient, such exchanges of information would have to be automatic and sufficiently automated, which is not the case when not included in the framework of an automatic exchange of information. The SC Model would therefore currently require additional legal instruments between the SCs and the RCs to ensure an effective exchange of information.

- **AIC Model.** The AIC Model would also currently require additional legal instruments between participating countries to ensure an effective exchange of information.

  Indeed, even if the exchange of information on request and the spontaneous exchange of information could be used, such exchanges of information would have to be automatic and sufficiently automated to be efficient, which is, here again, not the case when not included in the framework of an automatic exchange of information.

92. **Other Elements.** Other provisions of the Directive on Administrative Cooperation might nevertheless be of interest, whichever the Model used (SC Model or AIC Model) and whatever the legal instrument that will be adopted, if any (cf. Chapter 6 below), to implement the selected Model.

5.2 RECOVERY DIRECTIVE (70)

5.2.1 SUMMARY

93. **Introduction.** Most tax claims (or debts) due to national treasuries are collected promptly through spontaneous payment by the debtor. When the claims are not settled promptly, national tax administrations can resort to a range of powers to recover the claim. In the worst-case scenario, the claim can be recovered through the seizure and sale of the debtor's property by the tax administration ("enforcement").

The original Community arrangements for mutual assistance between MSs were put in place because it was recognised that it was increasingly likely that the debtor, or recoverable assets belonging to the debtor, were within the jurisdiction of another MS. Arrangements at Community level were necessary to ensure that taxpayers did not successfully evade their obligations in this way. These arrangements (Council Directive 76/308/EEC), though originally developed to cover agricultural levies and customs duties as sources of Community revenue (traditional own resources), were later extended to VAT (Council Directive 79/1071/EEC), excise duties (Council Directive 92/108/EEC), taxes on income and capital and taxes on insurance premiums (Council Directive 2001/44/EC).

A codified version of this legislation was adopted on 26 May 2008 (Council Directive 2008/55/EC). Detailed implementation arrangements were to be found in Commission Regulation (EC) 1179/2008. This Regulation dealt with matters such as the details of the electronic communication system, deadlines for responses, administrative procedures and reimbursement arrangements for costs linked to recovery of debts.

94. **Recovery Directive and Commission Regulation (EU) 1189/2011.** On 16 March 2010, the Council adopted a new Directive on mutual assistance for the recovery of taxes: the new Recovery Directive. The aim is to extend the scope to all taxes and duties levied by MSs and by their territorial or administrative subdivisions. The creation of a European instrument permitting enforcement in another MS and the reinforcement of the possibility to take precautionary measures in another MS are two elements that should improve the capacity of MSs in cross-border collection of taxes. The EU MSs have to apply this new Directive as from 1 January 2012.

The European Commission adopted on 18 November 2011 Commission Regulation (EU) 1189/2011 laying down detailed provisions to implement the Recovery Directive. It contains tools allowing better cross-border recovery of tax debts by MS. These tools include, in particular, a uniform instrument to allow debt recovery decisions to be enforced. The aim is to avoid problems of translation and recognition of foreign legal and procedural instruments.

70 The below high-level summary of the Recovery Directive is based on the following elements of information/sources:
http://ec.europa.eu/taxation_customs/taxation/tax_cooperation/tax_recovery/index_en.htm

Another concrete tool is a uniform notification form that will enable taxpayers in other MSs to be notified of official documents and decisions. These measures are necessary to facilitate and accelerate cooperation between MSs' tax administrations, leading to more efficient revenue collection.

5.2.2 INTERACTIONS IN TERMS OF RECOVERY

95. **Cross-Border Enforcement.** As mentioned in the introduction, in many cases, taxing rights are shared between the SC and the RC pursuant to a DTT. In most of the DTTs, the SC is entitled to tax part of the movable income paid (dividends or interest). This taxation normally takes the form of a WHT. On the other hand, the RC keeps the right to tax the income collected by the Investor according to its local income tax rules. Both the SC and the RC can thus levy taxes on a given payment.

When the tax amount due has not been paid by the person or entity liable to pay such tax, in violation of the local rules applicable, then the taxing authority can enforce the payment (i.e. the tax administration can take the necessary actions for the amount due to be paid). The fact that the taxing authority is "in a position to" enforce payment is generally sufficient for the person liable to pay the tax.

When the person or entity liable to pay the tax is in another MS than the MS of the taxing authority, the latter can rely on the Recovery Directive (other interactions of this Directive with the contemplated Models are briefly described in Appendix 10).

96. **Cross-Border Enforcement Requested by the SC (SC as Applicant Authority).** In principle, depending on the circumstances, both the SC and the RC could have recourse to the Recovery Directive.

However, the majority of the assets potentially subject to enforcement measures being, by assumption, located in the RC, cases where the RC would have to initiate cross-border enforcement under the Recovery Directive should be very rare (i.e. cases where the Investor does not have enough assets in the RC to pay the taxes due in the RC).

As a result, only cross-border enforcements by the SC are further commented here (71).

97. **Cross-Border Enforcement Performed by RC or AIC (RC or AIC as Requested Authority).** By definition, the SC will seek cross-border recovery if the WHT due is not paid, i.e. in the case of under-withholding (e.g. an Investor has benefited from a treaty relief at source while he was actually not entitled to it).

In this respect, the ICG report (72) mentions that *"as a policy matter, the question (of the liabilities) seems to be very basic. That is, if an investor has made a claim for relief that is*

71 The AIC should not be entitled to request enforcement with the investor as AIC does in principle not levy WHT (unless in the Reversed Cross-border situation where AIC is also the SC). As a result, the SC Model and the AIC Model are similar on this point.

72 ICG Report, §§ 107 – 109, p. 29.

inappropriate, who should bear the cost of that mistake – the government, the intermediaries, or the investor? (...) The investor, of course, should not benefit from his inappropriate claim. The goal, therefore, should be to increase the ability of governments to collect the under-withheld tax from the investor (...) there may still be circumstances in which a government may be interested in pursuing an intermediary with respect to such under-withheld tax".

In the case of under-withholding, both the SC Model and the AIC Model provide two cumulative options (73):

- The SC can enforce recovery with the Investor, hence the need to involve the RC in the recovery process (whichever the selected scenario: Cross-Border, Reversed Cross-Border or Triangular) and/or;
- The SC can enforce the payment with the AI, hence the possible need to involve the AIC in the process (only in Cross-Border and Triangular Scenarios (74)).

98. **Recovery and Liability.** The question of the interactions between the relief at source Model to be put in place and the Recovery Directive is closely linked to the question of the liabilities of the various stakeholders.

- **Investor's Liability.** By definition, the Investor is liable to tax in the SC. When the SC seeks recovery with the Investor, SC therefore recovers "taxes" (more precisely, the WHT due by the Investor in the SC);
- **AI's Liability.** However, as mentioned above (cf. subsection 4.2.3 above), the type of liability the AI has to bear is not clearly defined in the ICG report and the draft Implementation Package, it is just mentioned that the AI is liable for any under-withholding. However, such responsibility of the AI could be of a contractual nature or of another nature. Such other nature would still have to be defined. For instance the AI could be liable to tax in the SC (75), but the AI could also be liable to a kind of administrative indemnity/penalty in the SC. This could be important should the SC want to be able to refer to the Recovery Directive to recover amounts from the AI.

99. **Scope of the Recovery Directive.** To understand this point, it is first necessary to have a look at the scope of the Recovery Directive.

---

73 As mentioned in the governing principles (liabilities), other intermediaries more remote from the investor in the chain of intermediaries should in most cases not be held liable for errors made by the intermediary closest to the investor (the AI) with respect to that investor's eligibility for treaty benefits. Since the function of those intermediaries is essentially limited to accurately passing on tax rate information provided by lower-tier intermediaries, their liability should be limited, as a practical matter, to errors that they themselves make with respect to such processing. The recovery questions relating to higher-tier intermediaries are basically the same as those relating to lower-tier intermediaries (i.e. intermediaries acting as AIs).

74 In the Reversed Cross-border situation, the recovery with the AI can indeed be carried out without relying on the Recovery Directive.

75 In this sense, the Implementation Package mentions that *"some countries may need to provide that the annual reporting forms constitute a "tax return" under the source country's domestic law"*.

According to recital number five of the Recovery Directive, this Directive is aimed at making it possible "to take account of all forms that claims of the public authorities relating to taxes, duties, levies, refunds and interventions may take, including all pecuniary claims against the taxpayer concerned or against a third party which substitute the original claim."

- Art. 2.1(a) of the Recovery Directive mentions that it shall apply to claims relating to *"all taxes and duties of any kind levied by or on behalf of a Member State or its territorial or administrative subdivisions, including the local authorities, or on behalf of the Union"*;

- In addition, Art. 2.2(a) of the Recovery Directive mentions that its scope shall also include *"administrative penalties, fines, fees and surcharges relating to the claims for which mutual assistance may be requested in accordance with paragraph 1, imposed by the administrative authorities that are competent to levy the taxes or duties concerned or carry out administrative enquiries with regard to them, or confirmed by administrative or judicial bodies at the request of those administrative authorities"*;

- On the other hand, Art. 2.3(c) and (d) of the Recovery Directive state that it shall not apply to *"dues of a contractual nature (and) criminal penalties imposed on the basis of a public prosecution or other criminal penalties not covered by paragraph 2(a)"*.

We can infer from the above that, in the case of under-withholding:

- **Recovery with the Investor.** The SC could have recourse to the Recovery Directive in order to enforce payment by the Investor;

- **Recovery with the AI.** On the other hand, in order to ensure the possibility to have recourse to the Recovery Directive with respect to the AI, it would be necessary to ensure that its liability is defined in such a way that it falls within the scope of the Directive. An option in this respect would be to provide that the AI is liable for an administrative penalty in the case of under-withholding or would be considered as being jointly liable with the Investor for any under-withholding (76).

As a result, it should be possible for the SC to appeal to the Recovery Directive to enforce payment by either the Investor or the AI.

76 If the liability of the AI was to be considered as "income tax", then the question would arise whether the DTT concluded between the AIC and the SC would not prevent the SC from collecting such a tax. Indeed, the AI is in principle only liable for tax in the SC if it has a permanent establishment in the SC through which it carries out its business (Article 7 of the OECD Model Tax Convention) or when it is the beneficiary of the movable income in question (cf. Articles 10 and 11 of the OECD Model Tax Convention for dividends and interest, respectively).

100. **Limits to the Requested Authority's Obligations.** Art. 18 of the Recovery Directive sets out some cases where the cross-border enforcement is not required in the requested MS (the requested MS having to inform the applicant MS of the grounds for refusing a request for assistance):

- **Serious Economic or Social Difficulties.** The requested MS shall not be obliged to apply recovery or precautionary measures if recovery of the claim would, because of the situation of the debtor, create serious economic or social difficulties in the requested MS, in so far as the laws, regulations and administrative practices in force in that MS allow such exception for national claims;
- **Five-Year Prescription Period**. The requested MS shall not be obliged to grant assistance under the Directive if the initial request for assistance is made in respect of claims which are more than 5 years old, dating from the due date of the claim in the applicant MS to the date of the initial request for assistance (77);
- **EUR 1.500 Threshold.** A MS shall not be obliged to grant assistance if the total amount of the claims covered by the Directive, for which assistance is requested, is less than EUR 1.500.

The main concern with respect to the above limitations is the EUR 1.500 threshold.

101. **Recovery with the Investor.** As mentioned above, there is a limit of EUR 1.500 under which a MS is not obliged to grant the assistance to another MS. This limit can have an important impact when assessing the possibility to use the Recovery Directive to enforce cross-border recovery with the Investor.

77 However, in cases where the claim or the initial instrument permitting enforcement in the applicant MS is contested, the 5-year period shall be deemed to begin from the moment when it is established in the applicant MS that the claim or the instrument permitting enforcement may no longer be contested. Moreover, in cases where a postponement of the payment or instalment plan is granted by the Competent Authorities of the applicant MS, the 5-year period shall be deemed to begin from the moment when the entire payment period has come to its end. However, in those cases the requested authority shall not be obliged to grant the assistance in respect of claims which are more than 10 years old, dating from the due date of the claim in the applicant MS.

For example, assuming a local WHT rate on dividends of 25% in the SC, a maximum WHT rate on dividends of 15% according to the DTT concluded between the SC and the RC and a return on equity of 4%, the RC could potentially refuse to provide assistance to the SC unless the Investor has an investment in shares of companies established in the SC of at least EUR 375.000 (78):

- Investment: EUR 375.000;
- Return on Equity: 4% = EUR 15.000;
- Local WHT Rate: 25% = EUR 3.750;
- Reduced DTT WHT Rate: 15% = EUR 2.250;
- WHT Reduction according to DTT: 25% - 15% = 10% = EUR 1.500.

It is therefore likely that the EUR 1.500 threshold will be effective for the majority of retail Investors (79).

Moreover, the risk of non-application of the Recovery Directive increases with the number of SCs (80). Indeed, in the above example, the minimum investment of EUR 375.000 is to be considered per SC.

It should be noticed that this issue exists regardless of the Model applied (SC Model or AIC Model) as the position of the SC is the same in both cases.

Moreover, Art. 18 of the Recovery Directive provides only for limitations to the requested authority's obligations. MSs could thus specifically agree either not to apply any threshold in the framework of DTT relief at source application or to apply lower thresholds.

102. **Recovery with the AI.** If the recovery can be enforced with the AI (irrespective of the number of Investors), then the EUR 1.500 threshold should not apply so that enforcement with the AI according to the Recovery Directive would be effective.

78 The Recovery Directive, although per definition a juridical instrument agreed upon multilaterally, essentially applies in a bilateral context, i.e. one country (SC) seeking recovery with another country (RC) of claims against a given taxpayer. It is important to note in this respect that the number of claims against a given taxpayer should be irrelevant (in so far as they are not statute-barred). This point of view is based on a strict reading of Article 18.3 of the Recovery Directive according to which the EUR 1.500 threshold applies to "claim**s**" covered by the Directive, and is based on the motives of the Directive, which are to make assistance more efficient and effective. Efficiency would not be achieved if the EUR 1.500 threshold had to be applied "per claim".

79 However, it has to be noted that this EUR 1.500 threshold can cover altogether various types of taxes (e.g.: VAT claims, income tax claims, etc) spread over a plurality of years. Theoretically speaking, it could therefore be possible to wait a few years so as to have a sufficient number of tax claims to reach the EUR 1.500 threshold and obtain assistance based on the Recovery Directive (but such threshold has still to be computed per investor).

80 It will most probably be an issue for retail investors since these are generally opting for a balanced and diversified portfolio, in terms of industry, geographic location and types of financial instruments.

103. **Procedures.** Provided that the claims against the AI fall within the scope of the Recovery Directive (which will depend on the way the relief at source Model is transposed into national legislation/arranged with Financial Intermediaries), then the procedural provisions of the Recovery Directive (briefly summarised in Appendix 10) provide for a suitable framework to enforce recovery, whenever needed, with the AI (or more generally, with a Financial Intermediary responsible for the errors).

5.2.3 CONCLUSION

104. **Conclusion.** In the case of under-withholding, the SC could potentially have recourse to the Recovery Directive in order to enforce payment by the Investor. The EUR 1.500 threshold could, however, constitute an important limitation. Special arrangements between Competent Authorities (81) could probably solve this issue.

On the other hand, in order to ensure the possibility to have recourse to the Recovery Directive with respect to the AI, it would be necessary to ensure that its liability is defined in such a way that it falls within the scope of the Directive.

Other provisions of the Directive might nevertheless be of interest (regardless of whether cross-border enforcement is actually applicable).

5.3 SAVINGS DIRECTIVE

105. **Introduction.** The present section starts with a summary of the lessons from the current Directive on taxation of savings income in the form of interest payments (hereafter "the Savings Directive", a summary of which can be found in Appendix 11) identified in the two review reports issued by the European Commission in accordance with Art. 18 of the Savings Directive. It then examines how the Savings Directive interacts with the contemplated relief at source Models (the SC Model or AIC Model).

5.3.1 LESSONS FROM THE SAVINGS DIRECTIVE

106. **Reports from the European Commission** (82)**.** In accordance with Art. 18 of the Savings Directive, every three years, the European Commission issues a report to the Council on the operation of this Directive. On the basis of these reports, the European Commission can, where appropriate, propose to the Council any amendments to the Directive that prove necessary in order to better ensure effective taxation of savings income and to remove undesirable distortions of competition. The reviews carried out are summarised as follows by the European Commission:

81 As provided for in Article 24 of the Recovery Directive.

82 Report from the Commission to the Council in accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments, 2 March 2012

- **First Review (2008 Report).** The report for the first review was prepared in 2008 and covered "*the transposition and implementation of the Directive, summing up the economic evaluation and the Commission's advice on the need for changes. The necessary changes identified in the 2008 Report were primarily meant to clarify certain interpretational issues and to close existing loopholes. To that end, the Commission adopted an amending proposal on 13 November 2008 to the Directive with a view to closing existing loopholes and better preventing tax evasion";*

- **Second Review (2012 Report).** The second report primarily covers *"the functioning and an economic evaluation of the Directive. The main findings of this document, i.e. the widespread use of offshore jurisdictions for intermediary entities and the growth in key markets that provide products comparable to debt claims reinforce the arguments for extending the scope of the Directive and the relevant agreements concluded in accordance with Article 17 of the Directive. These findings are also consistent with the political commitment expressed by the G20 to promote compliance with international tax and financial information exchange standards and to use all the countermeasures available to combat tax havens and non-cooperative jurisdictions that do not comply with these standards"*.

107. **Evaluation of the Effects of the Savings Directive** (83)**.** A questionnaire was sent in July 2011 by the European Commission to MSs experts in the Administrative Cooperation in Direct Taxation regarding the use of the data provided by the Directive by MSs. The questionnaire covered the fiscal years 2007 till 2009. Below are presented some extracts of the European Commission staff working document that could be relevant in the framework of this study:

- **Audits.** *"The majority of Member States use the information obtained from the Directive in order to perform specific audits on taxpayers. However, the extent of these audits varies between Member States";*

- **Organisation in Each MS. "***The structure set up by Member States to use the data exchanged under the Directive will naturally depend on the resources available and the amount of data they receive under the Directive. (...) From the replies, it would appear that a structured process of the dissemination of data from the receiving unit to the tax collections services in the Member State, and the latter's service feedback on the use of data, could improve the efficiency of the use of data to target specific taxpayers";*

- **Integration of the Data Received in Local Databases. "***Some Member States have confirmed that they import the received data directly into their national tax databases for verification purposes. The integration of a savings directive database with the national tax database can lead to a more efficient processing and monitoring system to ensure that*

83 Commission Staff Working Document presenting an evaluation for the second review of the effects of the Council Directive 2003/48/EC accompanying the document Report from the Commission to the Council in accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments.

the beneficial owners are correctly registered as taxpayers and to determine whether their savings income has been correctly declared";

- **Quality of Data. "***There is a wide variation reported by Member States of data that cannot be used due to its poor quality. Further investigation on this variation is needed but the possibility of a better registration of the Tax identification number (TIN) with which to identify the taxpayer has been highlighted by Member States as a major factor for improving the quality of the data received. (...) If these essential elements are not properly reported by paying agents, Member States face difficulties in identifying the beneficial owners".*

  "For the period under review, the Member States have highlighted a clear improvement in the quality of data received under the Directive that they attribute to the structured format and common rules of procedures under which the data are reported. By comparison with exchange of information under bilateral treaties, the quality of the data received under the Directive is significantly higher";

- **Feedback.** *Most Member States did not report any specific Member State from which they receive a high percentage of files which could not be processed due to the poor quality of data and stated that this varied from year to year and from Member State to Member State. Furthermore, most Member States have not contacted the corresponding Member State as a result of the poor quality of data received. These replies would tend to indicate the need for more regular bilateral follow-up between Member States which could be undertaken to improve the quality of data received;*

- **Checks by State of Establishment of the Paying Agent.** *Around half of the Member States conduct checks on the content of the information received from paying agents. Such checks should be made systematically, bearing in mind that many Member States indicated that they prefer to receive incomplete records rather than no records at all as this would in any case allow them to try to match these records with their own national database;*

- **Investigations on the Source of the Funds.** *"Most Member States have not used the information received under the Directive for the purpose of conducting investigations on the sources of the underlying funds* (even where the income tax on the interest payment concerned was not substantial or the income thereof was exempt) *or are not aware of the results given that it is part of the general audit process of taxpayers";*

- **Compliance Results.** *"Although most Member States have not yet undertaken a quantitative assessment* (of whether or not a better compliance by their taxpayers in the recording of interest payments resulted from the application of the Savings Directive), *those that have carried out an assessment have indicated positive compliance results. It appears nevertheless that the collection/control systems of Member States may not be able to provide them with information that is specific enough for income amounts falling under the Directive to gauge increased compliance".*

5.3.2 INTERACTIONS

108. **Different Objectives.** The link between the Savings Directive and the AIC Model as analysed in the present study relates to the routing used in order to exchange the detailed Investor information between the various stakeholders (in particular, the FIs are in touch only with their own tax administrations and the cross-border exchange of information is done between Competent Authorities of the participating countries – AIC, RC (=SC as the case may be)).

However, the objectives of the Savings Directive and of the AIC Model (or even the SC Model) are different:

- The Savings Directive aims to ensure compliance in the RC irrespective of the application of a DTT (i.e. irrespective of the application of a WHT, and potentially thus of a WHT relief at source in the SC);
- The AIC Model (and SC Model) aims to ensure application of an improved relief at source system in the SC coupled with an exchange of information system towards the RC to ensure better compliance in the latter country.

109. **Savings Directive Not Directly Suitable.** Obviously, considering its goal, the Savings Directive as it currently stands is not directly suitable to enable the application of a relief at source Model, especially for the following reasons:

- The WHT relief at source part of the Model is not legally provided for in the Directive (84);
- Dividends are not covered;
- Interest is defined more broadly than in the OECD Model Tax Convention (leading to the obligation to differentiate between the various categories of interest for the purpose of applying the WHT relief at source under the AIC Model or SC Model);
- The notion of beneficial owner in the Savings Directive only includes individuals. It differs from the notion of beneficial owner under the OECD Model Tax Convention as it will also include other beneficiaries (e.g. companies) (85).

It results from the above that the coexistence of the Savings Directive with the contemplated relief at source models (SC Model or AIC Model) would only lead to limited duplications in terms of information exchanged.

84 In particular, the rules for an AI to pass the TRI up the chain of intermediaries to the WA are not provided.

85 Besides, in case of doubt on the residency status of a given beneficial owner, the Savings Directive tends to favour tax residence in the EU compared to tax residence outside the EU (in a third country). This bias is the result of the objective and territorial scope of the Savings Directive, which is to ensure compliance in EU MSs as RCs (for which it is better to have redundant reporting than to have insufficient reporting), not to define the tax residence of a taxpayer with a view to applying a DTT.

It nevertheless also includes elements that can be leveraged on to apply a relief at source Model, such as the minimum standards in terms of identification procedure.

110. **Practical Environment.** Nevertheless, the Savings Directive has already created a practical environment. As shown in the second report from the European Commission on the operation of the Savings Directive,

- MSs are already used to participating in a multilateral automatic exchange of information programme, both as State of establishment of the paying agent and as RC of the beneficial owner;
  - As State of establishment of the paying agent, MSs are already used to receiving information from FI and to passing that information to other MSs (RCs);
  - As RC of the beneficial owner, MSs are already used to receiving information from other MSs;
- The multilateral character of the Savings Directive implies that all MSs are expected to cooperate in the system (yet with some exceptions). It therefore avoids the issues linked to the presence of non-participating MSs;
- Many other aspects such as the use of the CCN, the ongoing improvement process, the lessons already learned from the 7 years of experience with applying the Savings Directive, etc. are elements that facilitate setting up an efficient exchange of information Model.

5.4 OTHER INTERNATIONAL ADMINISTRATIVE COOPERATION FRAMEWORK

5.4.1 OECD MODEL TAX CONVENTION, MODEL AGREEMENT ON EXCHANGE OF INFORMATION ON TAX MATTERS AND MEMORANDUM OF UNDERSTANDING BETWEEN COMPETENT AUTHORITIES ON THE AUTOMATIC EXCHANGE OF INFORMATION FOR TAX PURPOSES

111. **Introduction.** As mentioned in the assumptions, when referring to DTTs, the study only considers the OECD Model Tax Convention. This pragmatic approach has been agreed upon since the assessment of a wide range of DTTs would probably not have influenced the choice between the AIC Model and the SC Model as a particularity in a given DTT would most probably have the same consequences (in terms of checks, exceptions, etc. to be put in place) regardless of the Model applied.

Before implementing any of the two Models, each DTT should in principle be submitted to an analysis that considers both treaty partners in turn as SC and RC (and even as AIC). Such analysis should cover the treaty rates (interest and dividends) and any conditional exemptions, but it could also cover the following issues, which might all be relevant when applying for, and checking the application of, a reduced WHT rate: definition of person (Arts. 1-3 of the OECD Model Tax Convention); definition of resident (Art. 4); definition of permanent

establishment; definition of beneficial owner; Triangular Scenario (payment of income by an establishment); definition of dividend/interest; possible application of anti-abuse provisions such as limitation on benefits clause, etc.

Assuming that all these issues are solved or, at least, lead to the same concerns in both Models, the remaining interactions between the DTT and the contemplated Models are to be found in two specific provisions:

- Art. 26: Exchange of information (complemented with the OECD Model Agreement on Exchange of Information on Tax Matters, which covers additional means of assistance between Contracting States (86));
- Art. 27: Assistance in the collection of taxes.

112. **Interactions between EU/International Cooperation Instruments.** It is worthwhile pointing out that, where international cooperation in tax matters is concerned, the possibilities of assistance provided by one legal instrument do in principle not limit, nor are they in principle limited by, those contained in other international agreements or other arrangements. This is for instance especially stated in the Directive on Administrative Cooperation, the Recovery Directive, the OECD Model Agreement on Exchange of Information on Tax Matters and the Convention on Mutual Administrative Assistance in Tax Matters.

5.4.1.1 ARTICLE 26

113. **Three Types of Exchange of Information.** Art. 26 of the OECD Model Tax Convention enables the same three types of exchange of information as the Directive on Administrative Cooperation:

- **On request**, i.e. with a special case in mind, it being understood that the regular sources of information available under the internal taxation procedure should be relied upon in the first place before a request for information is made to the other State;
- **Automatic**, when information about one or various categories of income having their source in one Contracting State and received in the other Contracting State is transmitted systematically to the other State. In such case, the DTT in question has to be complemented with a memorandum of understanding between Competent Authorities on the automatic exchange of information for tax purposes;

86 The main limitation of such agreement in the framework of the present study is the absence of any automatic exchange of information provisions, its relevance being basically limited to exchange of information upon request and the other forms of administrative assistance linked thereto. "*In the context of the development of the 2002 Model Agreement on Exchange of Information in Tax Matters, it was agreed that for purposes of implementing the commitments made by jurisdictions identified as tax havens in 2000, exchange of information on request would be sufficient*". The global forum on transparency and exchange of information for tax purposes, frequently asked questions, question n°27, www.oecd.org/dataoecd/35/16/46615395.pdf .

- **Spontaneous**, for example in the case of a State having acquired, through certain investigations, information which it supposes to be of interest to the other State.

114. **Main Principles.** The main principles governing the exchange of information, the limits and obligations are also similar as in the Directive, yet with slightly wider limitations:

- **Information Foreseeably Relevant.** As in the Directive, the exchange only concerns information that is *"foreseeably relevant"* (for carrying out the provisions of the DTT or) to the administration or enforcement of the domestic laws concerning taxes of every kind imposed on behalf of the Contracting States. The exchange of information is not limited to residents of the Contracting States but may include particulars about non-residents as well. The exchange of information is, however, only permitted insofar as the taxation that would follow the exchange of information is not contrary to the DTT;

- **Other Forms of Administrative Cooperation.** Although not precluding them, other forms of administrative cooperation such as presence in administrative offices, participation in administrative enquiries and simultaneous controls are not explicitly governed in the OECD Model Tax Convention. These forms of administrative cooperation are, however, provided in the OECD Model Agreement on Exchange of Information on Tax Matters;

- **Disclosure of Information.** As in the Directive, information received is covered by the obligation of official secrecy. It can, however, only be disclosed to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes mentioned in the DTT, or the oversight of the above. Besides, such persons or authorities can use the information only for such purposes (unless otherwise mentioned in the DTT (87)). They may also disclose the information in public court proceedings or in judicial decisions;

- **Transmission of Information to a Third Country** (88)**.** Moreover, the information received by a Contracting State may not be disclosed to a third country unless there is an express provision in the DTT allowing such disclosure (89);

- **Contradiction to Legislation or Administrative Practice.** While the Directive does not impose any obligation upon a requested MS to carry out administrative measures or to supply information if it would be contrary to its legislation to do so for its own purposes, the OECD Model Tax Convention is more limitative as administrative practices can also be invoked to refuse to provide assistance;

- **Reciprocity.** Besides, where, according to the Directive, the Competent Authority of a requested MS may refuse to provide information where the requesting MS is unable, for

87 This has not been provided for in the OECD Model Tax Convention as such.
88 Read here, not a Contracting State.
89 This has not been provided for in the OECD Model Tax Convention as such.

legal reasons, to provide similar information, the OECD Model Tax Convention is also more limitative as the administrative practices of the requesting State can also be invoked by the requested State to refuse to provide assistance (90);

- **Public Policy.** As in the Directive, the provision of information may be refused where it would lead to the disclosure of a commercial, industrial or professional secret or of a commercial process, or of information whose disclosure would be contrary to public policy;

- **Bank Secrecy.** As in the Directive, Art. 26 of the OECD Model Tax Convention prohibits refusal to supply information only because this information is held by a bank, other FI, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person;

- **Own Tax Purposes.** Finally, as in the Directive, the requested State has the obligation to provide the information even if the requested information is useless for its own tax purposes;

- **Usual Source of Information Exhausted.** Where the Directive provides that a requested authority in one MS shall provide a requesting authority in another MS with the requested information provided that the requesting authority has *"exhausted the usual sources of information which it could have used in the circumstances for obtaining the information requested, without running the risk of jeopardising the achievement of its objectives"*, Art. 26 subjects (91) the exchange of information to the requesting State having *"pursued all domestic means to access the requested information except those that would give rise to disproportionate difficulties"*.

115. **Need for Memorandum.** Given the slightly more limited scope of Art. 26 of the OECD Model Tax Convention (and of the OECD Model Agreement on Exchange of Information on Tax Matters), an effective enforcement of an automatic exchange of information would at first sight be less effective than with the Directive on Administrative Cooperation.

However, considering the fact that the relevant double tax convention could be complemented with a memorandum of understanding between Competent Authorities on the automatic exchange of information for tax purposes, this issue could be solved.

90 According to the Commentaries to the OECD Model Tax Convention, *"a State may refuse to provide information where the requesting State would be precluded by law from obtaining or providing the information or where the requesting State's administrative practices (e.g. failure to provide sufficient administrative resources) result in a lack of reciprocity"* although *"reciprocity should be interpreted in a broad and pragmatic manner."*

91 Although not specifically mentioned in the official commentaries to Article 26 of the OECD Model Tax Convention, such statement appears on the OECD's official website, just as in Article 5.5 (g) of the Model Agreement on Exchange of Information on Tax Matters.

5.4.1.2 ARTICLE 27

116. **Generalities.** Art. 27 of the OECD Model Tax Convention provides for assistance in the collection of revenue claims, i.e. amounts owed in respect of taxes of very kind. In a nutshell, Art. 27 contains general provisions with respect to enforcement, conservancy measures, prescription periods, and suspension or withdrawal of requests for recovery. The mode of application of this Article is then to be mutually agreed upon between Competent Authorities of the Contracting States.

117. **Limitations.** This Article provides some specific limitations according to which a Contracting State is not obliged to:

- Carry out administrative measures at variance with the laws and administrative practice of that or the other Contracting State;
- Carry out measures that would be contrary to public policy ("l'ordre public");
- Provide assistance if the other Contracting State has not pursued all reasonable measures of collection or conservancy, as the case may be, available under its laws or administrative practice;
- Provide assistance in those cases where the administrative burden for that State is clearly disproportionate to the benefit to be derived by the other Contracting State.

These limitations are slightly different to those in the Recovery Directive of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures, but they should normally have similar effects.

In particular, the fourth limitation mentioned above could lead to the application of a threshold as in the Directive.

5.4.2 CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS

118. **Introduction.** The Convention provides for all possible forms of administrative cooperation between states in the assessment and collection of taxes, in particular with a view to combating tax avoidance and evasion. This cooperation ranges from exchange of information, including automatic exchanges, to the recovery of foreign tax claims. It also provides a framework for other administrative assistance such as the participation in administrative enquiries and simultaneous controls.

119. **Multilateral Automatic Exchange of Information.** Just as Art. 26 of the OECD Model Tax Convention, Art. 6 of the Convention enables Competent Authorities to agree on an automatic exchange of information. In this respect, the added value of the Convention is its multilateral character: more than two Competent Authorities can agree to automatically exchange the information (92).

* *

*

92 As it is in principle already the case within the EU based on the Directive on Administrative Cooperation.

CHAPTER 6 EUROPEAN LEGAL TOOLS AVAILABLE

Where the previous chapter analyses the interactions between the contemplated Models and the existing administrative cooperation framework, this chapter is aimed at analysing which type of legal tool would be the most suitable in order to put in place the contemplated Models within the EU and, as the case may be, with third countries.

The first section comprises a description of the most relevant legal tools, multilateral and bilateral, available within the EU. It covers EU secondary legislation (including enhanced cooperation as a specific legislative procedure), EU international agreements, and international agreements amongst MSs and between MSs and third countries. The second section analyses which type of tool would be the most suitable in order to put in place the contemplated Models.

It concludes that a Directive would be the most appropriate binding form of legislation to implement the contemplated Models across the EU. If a Directive were gone for, it would have to be sufficiently detailed in order to ensure, within the EU, the uniformity required for a relief at source and exchange of information system to be efficient.

However, a Directive could only be adopted with unanimity amongst the MSs, and experience shows that the negotiations could take some time and lead to compromises between MSs, thus limiting the efficiency of the overall system.

Nevertheless, various factors (the side effects, within the EU, of the Intergovernmental Agreements MSs are going to sign with the US to improve tax compliance and to implement FATCA; the possibility for MSs to set up enhanced cooperation between themselves; and considerations about non-participating MSs) are likely to push towards faster agreement between MSs.

When dealing with a third country, an agreement will have to be signed with that specific country and the more third countries enter into the system, the more agreements will have to be signed. In terms of agreements with a MS, for most cases (Cross-Border and Reversed Cross-Border Scenarios), this is feasible as the AIC would either be the RC or the SC. In the Triangular Scenario, the three actors (SC, RC and AIC) would have to contract on a bilateral basis, but a specific clause could automatically provide for a financial institution established in one of the countries to act as AI when the other two countries act as SC and RC. This clause should be provided for at the very beginning and ideally in the common rules governing the interactions between EU MSs and third countries.

* * *

6.1 LEGAL TOOLS AVAILABLE

120. **Introduction.** In the below subsections, we go through the various legal tools available to MSs to put in place the contemplated Models within the EU and, as the case may be, with third countries. In this framework, we analyse the following options:

- EU Secondary Legislation (in particular, Directives which are binding for the 27 MSs);
- International agreements of the EU (binding for the 27 MSs and for the third country(ies) involved);
- Agreements amongst MSs and between MSs and third countries (binding for the contracting parties).

In the context of the analysis on EU Secondary Legislation, we also examine the possibility for MSs to have recourse to "Enhanced Cooperation", insofar as this specific legislative procedure provided by the TEU enables the adoption of a Directive without the participation of the 27 MSs.

121. **EU Framework.** The EU institutions can act in several different ways (93). Laws adopted by EU institutions through exercising the powers conferred on them by the EU Treaties is referred to as "secondary legislation", the second important source of EU law after the EU founding Treaties.

As binding legal acts, the measures that can be adopted include both general and abstract legal provisions on the one hand and specific, individual measures on the other in the form of Directives or Regulations. The EU institutions also have the power to issue non-binding statements such as Communications and Recommendations. Many other acts do not fit into specific categories. These include resolutions, declarations, action programmes or white and green papers.

- **Unanimity.** As far as direct taxes are concerned, which is of particular interest here, Art. 115 of the TFEU provides for the Council, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, to issue Directives for the approximation of laws, regulations or administrative provisions of the MSs which directly affect the establishment or functioning of the internal market. Art. 115 of the TFEU is effectively the only means of legislating in the direct tax area. Therefore, the only possibility for the European institutions to legislate in this respect is to adopt a Directive in accordance with the special legislative procedure, i.e. by reaching unanimity through consensus.

93 The most important of these are listed and defined in Article 288 of the TFEU.

- **Directives and Recommendations.** At first glance, two EU instruments could be used so as to implement (part of) the contemplated Models (the first one having already been used):

  - **Recommendation.** Recommendations have no binding force. The party to whom they are addressed is called on, but not placed under any legal obligation, to behave in a particular way;

  - **Directive.** A Directive is binding, as to the result to be achieved, upon each MS to which it is addressed (it cannot be applied incompletely, selectively or partially) but leaves to the national authorities the choice of form and methods. Once adopted at European level, the Directive has to be transposed by MSs into their internal law by a given deadline (and is in principle not applicable in a given MS before its transposition).

- **Enhanced Cooperation.** Art. 20 of the TEU provides for special procedures allowing those countries of the Union that wish to work more closely together to do so, while respecting the legal framework of the Union. The MSs concerned can thus move forward at a different speed to the other MS and/or towards different goals (94).

  Enhanced cooperation nevertheless requires the fulfilment of a number of conditions and is subject to a number of limits which are briefly explained below (95):

  - **No Exclusive Competence of the EU.** Enhanced cooperation may not be applied to areas that fall within the exclusive competence of the Union (96);

  - **Pertain to an Area Covered by the Treaties**. Enhanced cooperation does not allow extension of the powers as laid down by the Treaties, nor can it be used in order to create reserves and exceptions to Union acts or to amend existing instruments. It has to cover a field which is sufficiently broad to constitute an "area";

  - **Aim to Further the Objectives of the Union, Protect its Interest and Reinforce its Integration Process - Comply with the Treaties and Union Law.** Enhanced cooperation must be aimed at ensuring one or more of the Union objectives and must respect EU primary and secondary law;

94 Enhanced cooperation is governed by Article 20 of the TFEU, Articles 326-334 of the TFEU and Article 3 of Protocol (No 36) on transitional provisions and Declaration (No 40) on Article 329 of the TFEU.

95 An important precedent in tax matters is currently being developed in the framework of the EU Financial Transactions Tax where the Commissioner Šemeta announced on 9 October 2012 that sufficient MSs are willing to participate in the enhanced cooperation process. Cf. *Statement by Commissioner Šemeta on an EU Financial Transactions Tax – ECOFIN Council*, 9 October 2012, MEMO/12/762.

96 In this respect, one could query whether it would be legally possible to have recourse to enhance cooperation at least for the part of the proposed system that concerns information exchange. In fact, given that information exchange is already covered by EU legislation (notably the Directive on Administrative Cooperation and the Savings Directive), it may be argued that this pertains to an area where there is, now, an exclusive competence of the EU.

- **Last Resort.** Enhanced cooperation may be undertaken only as a "last resort", when it has been found within the Council that the objectives in question cannot be attained within a reasonable period by the Union as a whole. To this end, after such a finding within the Council, the MSs wishing to initiate enhanced cooperation must address a request to the European Commission, specifying the scope and objectives of the enhanced cooperation proposed. It is only after such a request that the European Commission may submit a proposal to the Council to authorise proceeding with the envisaged enhanced cooperation, after obtaining the consent of the European Parliament (97); the authorisation to proceed is then granted by the Council, on a proposal from the European Commission and after obtaining the consent of the European Parliament);

- **At Least 9 MSs but Open to the Others.** In principle, at least nine MSs must be involved in enhanced cooperation. However, it has to be open to any other MS that wish to participate from the beginning or that wish to join at a later stage (any time);

- **Binding for Participating MSs.** Any acts that are adopted within the framework of such cooperation are binding only on the participating MSs and do not constitute a part of the EU acquis;

- **Not undermine the internal market or economic, social and territorial cohesion, nor constitute a barrier to or discrimination in trade between MS, nor distort competition between them;**

- **Respectful of Non-Participating MSs.** It must respect the competences, rights and obligations of those MSs which do not participate in it;

- **Reinforce Integration.** It must further the objectives, protect the interests and reinforce the integration process of the Union.

Although, based on a quick examination of the above-mentioned list, it would appear that nothing would prevent the MSs from using the "Enhanced Cooperation" to implement a standardised relief at source system, we are not in a position to make a complete and in-depth assessment in this respect.

122. **International Agreements of the EU.** Another source of EU law is connected with the EU's role at the international level. As one of the focal points of the world, Europe concerns itself with economic, social and political relations with the world outside. The EU therefore concludes agreements in international law with non-member countries ("third countries") and with other international organisations

97 It should be noted that the European Commission is not obliged to make a proposal for enhanced cooperation. However, it seems to us that the European Commission could not simply ignore such a request and should give proper consideration to it.

An important precedent in direct tax matters are the Agreements between the EU and certain third countries (respectively Switzerland, Andorra, Liechtenstein, Monaco and San Marino) in the framework of the Savings Directive (98).

123. **Agreement Amongst MSs.** Finally, MSs could implement the proposed system by signing bilateral agreements between themselves and even with third countries.. MSs are free to conclude agreements on whatever subject they wish but such agreements must not include any aspects which overlap with areas in which common action by the EU has been taken or is envisaged Given that, under the current state of EU law, direct taxation still falls essentially within the competence of MSs, they are, in principle, free to sign agreements with each other to share their taxation rights. The only limitation to their fiscal sovereignty lies in the fact that, in the exercise of their respective competencies, MSs must respect their EU Treaty obligations. Thus, they are not allowed to discriminate on the basis of nationality or to apply unjustified restrictions to the exercise of the freedoms guaranteed by the TFEU.

In the context of this study, besides Conventions and Treaties, the Directive on Administrative Cooperation, DTTs and/or the Convention on Mutual Administrative Assistance in tax matters enable Competent Authorities to enter into memorandums of understanding (MoUs) on the automatic exchange of information for tax purposes. This could have an important impact on the implementation of the contemplated Models as, as we have seen in the previous chapter, it will be necessary to organise between MSs such automatic exchange of information (regardless of the Model ultimately applied).

124. **Agreements between MSs and Third Countries.** Moreover, and it is important in a global context, such types of agreements between Competent Authorities are not limited to MSs as they can also be concluded with third countries in the framework of DTTs and/or the Convention on Mutual Administrative Assistance in tax matters.

However, it should be noted that the negotiation/conclusion of information exchange agreements between MSs and third countries may raise issues of competence between MSs and the EU. Given that the EU has enacted secondary legislation in that area (which also includes agreements between the EU and certain third countries), the agreements should not cover areas that are already covered by EU law and should not adversely affect or modifies the scope of existing EU legislation on tax cooperation (99). The situation seems to be different in cases where the EU has not even initiated negotiations for the conclusion of a tax cooperation and information exchange agreement with a particular third country. In this case MSs are still competent, provided that the agreements they sign are not incompatible with the principles and rules already laid down in the EU legislation.

98 Agreements concluded based on Article 218 of the TFEU (former Article 300 of the TEC). We refer to Appendix 1 for a summary of the key features of the Savings Directive.

99 An example of issues of competence between MSs and the EU can be found in the so-called Rubik agreements (cf. Appendix 1 for a short summary in this respect).

6.2 LEGAL TOOL TO BE USED TO IMPLEMENT THE CONTEMPLATED MODELS

125. **Legislative Instrument(s) Required for Both Models.** As already mentioned, the complete and efficient working of both the SC Model and the AIC Model relies on an increased international cooperation between countries.

As we have seen in Chapter 5 dealing with the interactions between some existing EU legislative instruments and the contemplated Models, this increased international cooperation between countries is definitely required in terms of exchange of information and recovery of claims as there are some missing links in the current EU framework (and obviously, when considering interactions with third countries) that could fundamentally impair the working of the Models.

However, the need for international cooperation is not limited to these elements. This is because the more the system will be coordinated between MSs (and third countries, as the case may be) the more the system applied will be efficient. Moreover, a uniform legislation or, at least, a coordinated approach could be necessary, within the EU, in order to ensure a level playing field and avoid discrimination of financial institutions and investors based on the place where they are established/their place of residence. Ideally, provided a political agreement can be achieved in a reasonable timeframe, such coordination should be applied to the various governing principles listed in Chapter 4 (recognition process and effects; uniform rules and conditions that FIs have to comply with in order to become AIs; uniform rules on audit; etc.).

Both Models therefore require legislative instrument(s) that can ensure cooperation between countries.

126. **Coexistence of Various Models.** For obvious reasons linked to efficiency and standardisation, a single Model should ideally be applied for treaty relief and for exchange of information, and this worldwide or at least within the EU.

The implementation of the Model that would ultimately be selected would require the agreement of participating countries on a common definition of the Model (i.e. the governing principles and the practical details) and the legal instruments that would enact it.

Should some MSs nevertheless want both Models to coexist, which we certainly do not recommend at EU level, they would have to duplicate the work so as to enforce local legislations permitting to do so.

Besides, if we consider third countries, it will be most probably difficult to avoid having to manage interactions between different systems and different routing of information. This is especially true considering that not only the SC Model and the AIC Model are at stake, but also other systems such as QI and FATCA. It is therefore highly advisable to design a system that, to the extent possible, takes into account any developments in these areas.

The interactions between the two contemplated Models analysed in the present study will be further addressed in the IT and cost-benefit analyses.

127. **Recommendations.** Non-binding instruments such as the European recommendation of 19 October 2009 on WHT relief at source procedures (COM(2009)7924 final), although useful (100), could hardly lead to the level of harmonisation of the MSs' legislation required to effectively implement an efficient relief at source and exchange of information Model (irrespective of whether the Model should be more like the SC Model or the AIC Model). Ideally, a binding legal instrument should therefore be adopted.

128. **Directive.** A Directive seems therefore the most appropriate binding legislative way to implement the contemplated Models across the EU. It would leave the MSs some transposition margin but would still force them to produce a specific result, regardless of their respective different approaches. Of course such Directive would have to be sufficiently detailed in order to ensure the uniformity required for such a system to be efficient.

It should be noted, however, that unanimity should be reached in order to adopt such a Directive, as direct tax policies require the special legislative procedure, which will most certainly need a lot of debate and negotiations. The experience shows that such kind of negotiations could take a very long time and lead to compromises between MSs limiting the efficiency of the overall system (101).

129. **International Context.** Nevertheless, various factors push towards a faster agreement between MSs. Such faster agreement could potentially go far beyond what would in principle be necessary to effectively apply the SC Model or the AIC Model. These factors are the following:

- The side effects in the EU of the agreements that MSs are going to sign with the US to enhance tax compliance and to implement FATCA, along the lines of the Model Intergovernmental Agreement developed by the US ("wider cooperation" according to Art. 19 of the DAC);
- The possibility to set up enhanced cooperation between some MSs;
- The spontaneous exchange of information required towards non-participating MSs.

These points are further described below.

130. **Agreements between MSs and the US on FATCA and Wider Cooperation.** As already mentioned, the fact that several MSs are going to sign bilateral agreements with the US on FATCA means that these countries will enter into a "wider cooperation" as regards

100 MSs indeed report having already implemented some of the elements mentioned in the FISCO Recommendation of 19 October 2009.

101 The experience from the Savings Directive shows that, in order to have a Directive efficiently ensuring compliance in the RC, compromises on critical elements should be avoided as far as possible. For instance, the Savings Directive allows the MSs to restrict the minimum amount of information to be provided by the paying agents to the total amount of interest or income and to the total amount of the proceeds from sale, redemption or refund. Most MSs have used this option to restrict the exchange of information between them. Logically, if MSs have the possibility to opt for less constraining options, most MSs will do.

exchange of information with the US, as provided under Art. 19 of the DAC (102). As a result, such wider cooperation could have to be extended to other EU countries wishing to enter into such mutual wider cooperation (so-called "most-favoured nation" - MFN clause).

This provision of the Directive on Administrative Cooperation is subject to interpretation. The main question is how far this wider cooperation should extend. This question could basically be assessed at two levels: at the level of the objective pursued by such wider cooperation or at the level of the content of information exchanged.

- **Objectives.** One of the main objectives of FATCA is to ensure that all FIs (including European ones), wherever based, collect and report certain information to the IRS so as to enable the US to impose its tax laws on US persons who could otherwise use foreign investments and foreign accounts to hide their income and assets abroad, and thus potentially evade their US tax filing and payment obligations.

  Where such information was initially expected to be provided directly by European FFIs to the IRS, the Model 1 Agreement basically provides that the participating MSs of establishment of the FFIs would collect such information from their local FIs and provide it to the IRS on an automatic basis.

  The objective of FATCA described above is therefore endorsed by the participating MSs: they basically committed to collect (via their financial institutions) and report to the IRS information aimed at enabling the US to impose its tax laws on US persons.

  From this point of view, any MS "X" could require a MSs participating in a FATCA agreement with the US i.e. MS "P", to provide the same level of cooperation to MS "X" so as to enable MS "X" to impose its tax laws on persons resident in MS "X" (or even on its nationals) who could otherwise use foreign investments and foreign accounts to hide their income and assets abroad, and thus potentially evade their MS "X" tax filing and payment obligations.

  Moreover, from this angle, Art. 19 of the DAC provides that the extension of such wider cooperation to EU MSs has to be "mutual", meaning that MS "P" could also require MS "X" to collect and report information aimed at enabling MS "P" to impose its tax laws on persons resident in MS "P" (or even on its nationals) who could otherwise use foreign investments and foreign accounts to hide their income and assets abroad, and thus potentially evade their MS "P" tax filing and payment obligations.

- **Content.** Another point of view could be to assess the wider cooperation from the content of the information exchanged.

  Without entering into the details, FATCA basically requires the reporting of the following elements of information to the IRS, all defined under the US legislative framework:

102 Wider cooperation which, by the way, already exists between some MSs and third countries (the US in particular). The impact of such wider cooperation was therefore already a topical question before the Joint Statement. The reasoning we describe in the following paragraphs could therefore apply, *mutatis mutandis*, to these cases as well.

- For accounts held by specified US persons: the name, address and TIN; the account number; the account balance or value of the account; the payments made with respect to the account during the calendar year (dividends, interest etc.); other information as is otherwise required to be reported under the regulations;

- For accounts held by US owned foreign entities: the name, address and TIN of the US owner foreign entity; the name, address and TIN of each substantial US owner of such entity; the account number; the account balance or value; the payments made with respect to the account during the calendar year (dividends, interest etc.).

Where such specific elements of information were initially expected to be provided directly by European FIs, the Model 1 Agreement basically provides that the participating MSs of establishment of the FIs would try to collect such elements of information from their local FIs and providing it to the US.

From this angle, the extension of such wider cooperation would be limited to a mutual exchange of the elements of information provided in the FATCA legislation (103) irrespective of whether or not these particular elements are suitable for the respective MSs to impose their tax laws on their own residents.

In our view, this second interpretation, where the content of the reporting would not be tailored to the tax environment of the MSs concerned, can hardly be sustained as it would not enable Art. 19 of the DAC to be effective.

As mentioned above, the wider cooperation provision of the Directive on Administrative Cooperation is far-reaching as it could potentially lead to a pan-EU automatic exchange of information system (104).

However, the wider cooperation provision of the Directive on Administrative Cooperation being by nature "bilaterally-minded" (in the sense that it each time applies to the relationship between only two MSs) could lead to an uncoordinated development of automatic information exchange with the EU (different types of exchange of information agreements could arise throughout the EU, each time on a reciprocal basis but nevertheless with the risk of comprising fundamental differences between each other). It therefore pushes towards an EU coordinated solution.

131. **Enhanced Cooperation.** It is important to note that five important MSs already took a position further to the Joint Statement of 8 February 2012: France, Germany, Italy, Spain and

103 Pushed to its limits, the interpretation based on the content could even lead to exchange of information on US persons between MSs – which is of course not the purpose of the Directive on Administrative Cooperation.

104 Note that we could even wonder whether the Joint Statement of 8 February 2012 could not lead to generalisation, amongst the participating MSs (as SCs) of relief at source under the DTTs concluded with the US (this could indeed be considered as part of a mutual cooperation between Contracting States). Provided it can also be considered as part of a "wider cooperation" in the meaning of the Directive on Administrative Cooperation, it could also be required by other MSs.

the United Kingdom, while several other MSs have announced that they will follow the same route.

As a result, regardless of the "actual use" of Art. 19 of the DAC, wider cooperation with the US could also open the door to its preventive recast, leading to a more effective and far-reaching automatic exchange of information (Art. 8). The MSs participating in the exchange of information with the US under FATCA have indeed already agreed in this sense with a third country. Hence there would normally be no objective reason why these MSs would refuse to participate in a similar cooperation throughout the EU (besides the fact that they could even be obliged to do so, should a MS want to apply the most-favoured nation clause of the Directive on Administrative Cooperation).

Moreover, even if unanimity could not be achieved within a "reasonable period by the Union as a whole" (to be defined, in our view, according to the current moving international context), the possibility to have recourse to "Enhanced Cooperation" could be explored. A necessary condition in such case would be to have at least nine participating MSs.

Besides, it should be pointed out that the AIC Model could also possibly be achieved based on bilateral agreements only, provided that the relevant clauses are provided for in those agreements. This point is further described in section 6.3 below where we touch upon the integration of third countries to the AIC Model as it would be developed in the EU.

132. **Spontaneous Exchange of Information and Non-Participating MSs.** As mentioned above the fact that the conditions for applying the spontaneous exchange of information would be met combined with the time limit provided for in this respect would oblige Source MSs wishing to apply the SC Model to proceed to an exchange of information towards the various RCs.

The application of a relief at source system on a large scale as provided in the SC Model (105) by only some MSs would lead to important consequences:

- Participating MSs (as SCs):
  - The participating MSs would grant relief at source under the DTTs concluded with non-participating MSs (as RCs); and
  - The participating MSs would in addition have to exchange information with such non-participating MSs (as RCs), helping them ensure compliance of their own tax resident Investors; while,

105 The same reasoning could apply to the "relief branch" of the AIC Model (SC granting relief at source). Indeed, even if the AIC was not exchanging information with the RC, then the SC would nevertheless have to exchange such information with the RC spontaneously. The Models could potentially be amended to avoid this issue.

- Participating MSs (as RCs):
  - The non-participating MSs (as SCs) would, by assumption, not grant relief at source on such a large scale to Investors from participating MSs (as RCs); and
  - The non-participating MSs (as SCs) would, by assumption, not be required (pursuant to Art. 9.1 of the DAC (106)) to exchange information with the participating MSs (as RCs).

6.3 INTEGRATION OF THIRD COUNTRIES

133. **Extension of the AIC Model to Third Countries.** Obviously, as already mentioned above, the agreements providing for extension to third countries of a standardised relief at source system applied within the EU should cover the various governing principles listed in Chapter 4 (authorisation of the AI rather than bilateral contracts; uniform rules and conditions that FIs have to comply with in order to become AIs; uniform rules on audit; etc.).

Assuming the AIC Model were applied within the EU based on a Directive (for simplicity's sake, the hypothetical Directive is called the "AIC Model Directive") (107) it is interesting to analyse the consequences that bilateral or multilateral agreements concluded by MSs with third countries (108) could have in light of the selected scenarios detailed in Chapter 3 (109) in order to assess whether the AIC Model can be extended to third countries, and under what conditions.

In the remainder of this paragraph, we focus only on the exchange of information. The analysis should apply *mutatis mutandis* to the other aspects of the AIC Model as well.

- **Cross-Border Scenario** (only cases involving third countries)

ISSUER	WA	AI	INVESTOR	SCENARIO
EU X	EU X	Non-EU Y	Non-EU Y	SC = WA's Country & AIC = RC
Non-EU X	Non-EU X	EU Y	EU Y	

Table 5: Interaction with Third Countries – Cross-Border Scenario

106 Not taking into account the potential application of an agreement/memorandum of understanding between Competent Authorities on the automatic exchange of information on tax matters.

107 In such a case, the most-favoured nation clause provided in the Directive on Administrative Cooperation would not *de facto* be relevant (the 27 MSs already participate in the system). If the AIC Model were based on enhanced cooperation, other MSs could decide to enter the system in any case. It is only if the AIC Model were based on different agreements between MSs on the one hand and third countries on the other hand, that the most-favoured nation clause could apply.

108 Another option would be for the EU to sign an agreement with third countries. Of course, this option would be less flexible and therefore much more complex to implement.

109 We refer to Appendix 2 for more details with respect to the process for selecting these scenarios.

In such cases, a bilateral agreement between a MS and a third country should be sufficient to give that third country access to the AIC Model. The key factor here is that AIC is also the RC, so that cooperation between the tax administrations of the contracting parties (SC and AIC/RC) is sufficient to effectively apply the AIC Model.

- **Reversed Cross-Border Scenario** (only cases involving third countries)

ISSUER	WA	AI	INVESTOR	SCENARIO
EU X	EU X	EU X	Non EU Y	SC = WA's Country = AIC
Non-EU X	Non-EU X	Non-EU X	EU Y	

Table 6: Interaction with Third Countries – Reversed Cross-Border Scenario

The same analysis applies in the Reversed Cross-Border Scenario: in such cases, a bilateral agreement between a MS and a third country should also be sufficient to give that third country access to the AIC Model. The key factor here is that AIC is also the SC, so that cooperation between the tax administrations of the contracting parties (SC/AIC and RC) is sufficient to effectively apply the AIC Model.

- **Triangular Scenario** (only cases involving third countries)

CASE NO.	ISSUER	WA	AI	INVESTOR	SCENARIO
1	EU X	EU X	EU Y	Non-EU Z	SC = WA's Country
2	EU X	EU X	Non-EU Y	EU Z	
3	EU X	EU X	Non-EU Y	Non-EU Z	
4	Non-EU X	Non-EU X	EU Y	EU Z	
5	Non-EU X	Non-EU X	Non-EU Y	EUZ	
6 (110)	*Non-EU X*	*Non-EU X*	*EU Y*	*Non-EU Z*	

Table 7: Interaction with Third Countries – Triangular Scenario

The Triangular Scenario is obviously more complex given that, to work properly, the AIC Model requires agreements on its application *at least* between the AIC and both the SC and the RC.

We use Case 4 (which is closely linked to Case 1) above to illustrate the problems created by the Triangular Scenario, but also the possible remedies. The reasoning can be extended to the other cases as well.

110 Although the situation where the SC and RC are outside the EU was initially excluded from the selected scenarios (as there is no budgetary impact within the EU in such cases), it is nevertheless interesting for this part of the analysis.

Example (Case 4): Assuming AIC (EU Y) has a bilateral agreement with a third country SC (Non-EU X). Such agreement could be sufficient for the AIC Model to be applied to residents of RC (EU Z). The reason for this is that AIC would be in a position to exchange information with SC based on the bilateral agreement (between AIC and SC) and AIC would be in a position to exchange information with RC based on the AIC Model Directive.

In order to achieve this, certain prerequisites are required:

- The third country SC (Non-EU X) should agree in the bilateral agreement to apply the relief at source not only to residents of AIC (EU Y) (111) but also to the residents of RC (EU Z and, by extension, residents *of any Residence MS*) with which it has a double tax treaty.
- The AIC Model Directive should provide that RC (EU Z and, by extension, *any RC MS*) has to apply the AIC Model if AIC (EU Y) has entered into an agreement with a third country SC (Non-EU X).

However, it might well be that such prerequisites are beyond reach (for instance, if the third country wants full reciprocity when acting as RC instead of SC (Case 1), it might fear that the other MSs than the one with which it entered into a bilateral agreement would refuse to apply the relief at source in such cases; after all, the other MSs are not party to the bilateral agreement with the third country).

In other words, it might be very difficult to achieve clauses (in the AIC Model Directive or in bilateral agreements) entailing automatic extension of the AIC Model to other countries as soon as a single participating country agrees to extend the Model, even if those other countries already have agreements in place to apply, and do already actually apply, the AIC Model in other situations.

The application of the AIC Model to Case 4 could nevertheless be achieved if RC (EU Z) also signed a bilateral agreement with the third country SC (Non-EU X). In that case, the three countries involved would have bilaterally agreed to apply the AIC Model in their *bilateral* relationships.

One clause would then nevertheless be mandatory (in both the AIC Model Directive and in the bilateral agreements) in order to apply the AIC Model in *triangular* relationships:

- If a country (C1) applies the AIC Model with another country (C2);
- If that other country (C2) applies the AIC Model with yet another country (C3);
- If that other country (C3) applies the AIC Model with the first country (C1);
- Then a clause should automatically allow a financial intermediary established in one of the countries to act as AI when the two other countries act as SC and RC.

111 Otherwise, only the Cross-Border Scenario would be applicable.

This clause would in our view constitute the keystone for a wide-ranging extension of the AIC Model.

* *

*

CHAPTER 7 DATA PROTECTION ANALYSIS

This chapter gives an overview of the possible data protection concerns that could arise from the SC and AIC Models as both entail the collection and cross-border exchange of personal (tax) information regarding individuals by financial intermediaries and tax administrations.

This chapter highlights the main data flows under the contemplated Models and presents the main actors involved in these exchanges of information flows. It also explains the scope of application of the EU Data Protection Directive and the criteria for lawful personal data processing.

The last section addresses the critical question of the transfer of information to third countries under both envisaged Models.

The data protection issues are mainly related to (i) the identification of the entity or country ultimately liable for the compliance with the data protection requirements under the Data Protection Directive and (ii) the legitimatising ground based upon which the different data processing operations required under both models can take place.

Not surprisingly, the interactions with third countries add a layer of complexity in the resolution of these issues.

From a data protection perspective, the AIC Model seems to offer more safeguards than the SC Model as all processing operations from the Investor to the various MSs acting as AIC, SC and RC would be based on a single legitimising ground being the need to comply with a legal obligation (although other legitimising grounds would be applicable to the SC Model). The legal tool used to implement the system and creating such legal obligations for all the actors involved (which should ideally be a Directive) could also be used to establish a precise and complete data protection framework. Moreover, the information transferred to third countries would be better protected because all transfer of information under the AIC Model would take place via tax administrations (while, under the SC Model, the first transfer of information is carried out between an AI and the SC). In particular, the direct transfer of information from a Financial Intermediary to third countries, outside the scope of DTTs, raises some concerns if an adequate level of protection in the meaning of Art. 25 (2) of the Data Protection Directive is not guaranteed in such third countries.

At this stage, the most appropriate way forward would be to create an appropriate legal basis (Directive or other binding legal instrument) setting a clear legal framework on how personal data could legally and validly be exchanged between AIs and countries participating in the WHT relief at source system in a way that is able to reconcile the needs of this system with the basic human rights of the data subjects involved (i.e. the Investors) in terms of personal data protection.

* * *

7.1 INTRODUCTION

134. **Introduction.** The two WHT relief models are compared in this study from different perspectives, one of which is their interaction with the EU legal framework on the protection of personal data. Both models indeed implicitly entail the collection and cross-border exchange of personal (tax) information regarding private individuals by financial intermediaries and tax administrations.

The main question is whether the cross-border exchange of such information can be legitimately done under both models, and if so, under which conditions. Our first findings in this respect are further described in this chapter.

As agreed with the European Commission, the objective of this chapter is to give an overview of the possible data protection concerns arising from the models under examination, taking into account the EU Data Protection Directive (94/46) (as defined below) but not to conduct a full analysis in this respect at this stage.

135. **Main Information Collection and Information Flows under Both Models – Recall.** As a recall, the main exchange of information flows of the SC Model and the AIC Model can be summarised as follows (we refer to subsection 3.3.1 above for more details in this respect):

- **SC Model:** the Financial Intermediary authorised to apply for treaty relief with a particular SC (the AI) closest to the beneficial owner of the income (Investor) reports the personal information directly to the relevant SC, which then provides this information automatically to the relevant RC.
- **AIC Model**: The AI closest to the Investor reports the personal information to the MS in which it is established (AI country or "AIC"), which then passes the information automatically to both the relevant SC and RC.

Under both models, personal data will need to be exchanged between the Investor, the AI, the WA and MSs (112) acting in their capacity of either SC, RC or – under the AIC Model – AIC.

The personal data flows (113) under both Models are further described below.

136. **SC Model – Scenario 1 (SC ≠ RC).** Under the SC Model, the personal data to be exchanged will originally be collected directly from the Investor by the AI, via an Investor Self-Declaration (ISD) signed by the Investor and returned to the AI. The purpose of such

112 To keep this first legal analysis from a personal data perspective as simple as possible, we have assumed – at this stage – that the information exchanges taking place under both models are limited to countries which are MSs. A high-level analysis on the legitimacy of the possible transfer of personal data to third countries is made under subsection 7.3.

113 We have also limited this first legal analysis to the processing and transfer of personal data between AI / MSs. Other data processing done by the relevant actors internally (e.g. processing of personal data for HR, accounting or other purposes or mere storage or use of personal data) will of course also need to be compliant with the applicable legal framework on personal data protection.

collection is to enable the AI to apply, on behalf of the Investors (its clients) (114) for treaty relief at source in the relevant SC. The Financial Intermediary will be able to apply for such relief in all SC for which it has been appointed as AI. This obligation to collect a pre-set amount of personal information from the Investors and to forward such information (115) to the relevant SC, is one of the obligations a Financial Intermediary will need to comply with in order to become an AI for such SC under the provisions of the Implementation Package. The underlying purpose for the personal data exchange between AI and SC is to enable the tax administration of SC to check whether the treaty relief at source it has provided on the basis of the Pooled Information received anonymously (see below) by the respective WA was appropriate.

The rights and obligations of a Financial Intermediary acting as an AI for a particular SC will be set out in a bilateral agreement concluded between the relevant AI and SC. An AI will conclude a new agreement on a bilateral basis with each MS (as SC) for which it wants to act as an AI ("**one-by-one approach**").

SC will in its turn forward the information received to the RC of the relevant Investor to enable the tax administration of such RC: (1) to check whether or not the investor is effectively a tax resident in that country; (2) to double-check the amount of movable income reported in the Investor's tax return. This information exchange, as well as the terms and conditions and scope thereof, will be set out in a Memorandum of Understanding concluded between the relevant MSs acting as either SC or RC.

This scenario is further referred to as "*SC Model – Scenario 1*" for the present data protection analysis and can be visualised as follows:

114 The Financial Intermediary will usually carry out services for its clients under a service agreement. This agreement can but will not always explicitly refer to the application of WHT relief at source (where the FI acts as AI).

115 The information to be exchanged by the AI will include the information contained in the ISD but can also include information which the AI had previously already obtained from its Investor-customer for the performance of other services or for WHT relief purposes and has therefore not been collected a second time via the ISD.

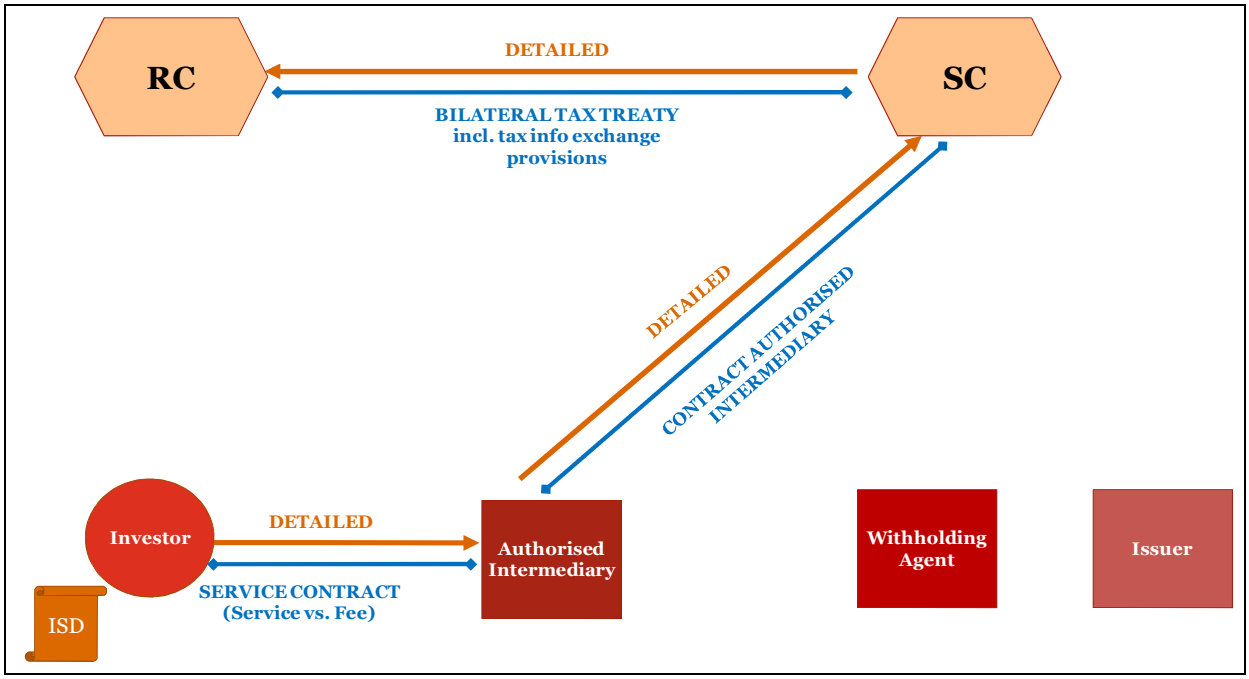


Figure 8: SC Model – Scenario 1

137. **SC Model – Scenario 2 (SC = RC).** However, as an AI, the Financial Intermediary would also have to use reasonable efforts to obtain completed consent forms, in the form of ISDs, from its customers who are residents of the SC (i.e. where SC and RC are the same MS), and who, therefore, are not entitled to claim any DTT relief from SC.

This scenario is further referred to as "*SC Model – Scenario 2*" for the present data protection analysis and can be visualised as follows:

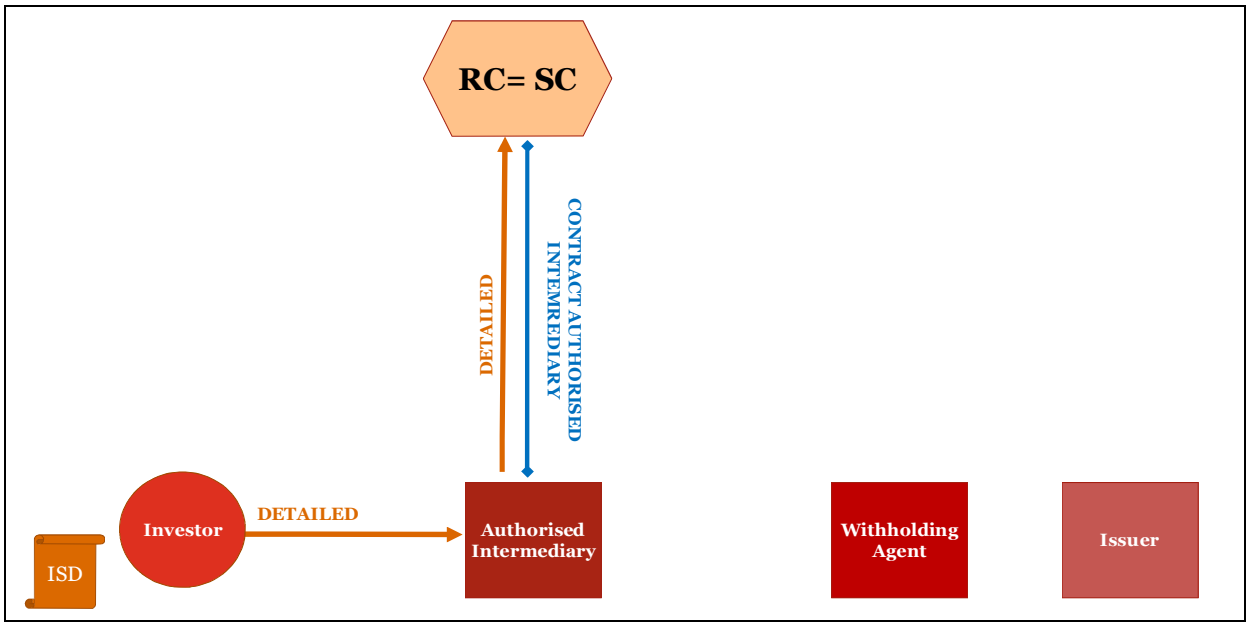


Figure 9: SC Model – Scenario 2

138. **AIC Model.** Under the AIC Model, the personal information of the Investor is originally also collected by the Financial Intermediary directly from the Investor via an ISD. This obligation of the Financial Intermediary will be laid down by law, which the Financial Intermediary will need to comply with in order to become AI. The rights and obligations of such AI will be set out in the national legislation of AIC, which will implement the multilateral legal framework negotiated between all participating MSs (e.g. a Directive or multilateral convention or, at least, bilateral agreements (116)).

The difference with the SC Model is that, if a Financial Intermediary decides to participate in the relief at source model on the basis of an (almost) EU-wide legal framework, multilaterally or bilaterally agreed by all participating MSs (including its own MS), it will benefit from the AI status and bear the AI requirements for all the MSs ("**all-or-nothing approach**").

In return, the Financial Intermediary will also be obliged as AI to forward the collected personal information, though – unlike under the SC Model – it will only need to communicate such information to its own tax administration in AIC and not cross-border to SC (difference in communication channels referred to above).

AIC will then, based on the multilateral EU legal framework (to be) negotiated between all participating MSs, be obliged to forward the information received automatically to both:

- the relevant SC, to enable the tax administration of such SC to check whether the treaty relief at source it has provided was appropriate;

116 Referring to the approaches developed in view of the application of FATCA and its compatibility with the Data Protection Directive, inspiration for the underlying analysis could be sought in the so-called "Intergovernmental Approach" for FATCA. In the letter of the Article 29 Data Protection Working Party (Ref. Ares (2012)746461 – 21 June 2012) providing a first analysis of the compatibility of FATCA with the Data Protection Directive, such Intergovernmental Approach, which was announced by the US in its draft implementing regulations on FATCA on 8 February 2012 (cf. http://www.irs.gov/newsroom/Article/0,,id =254068,00.html) as an alternative to FATCA's originally intended approach, provides under p.4 no. 5.3 that *"signatories to the alternative approach would be committed [via binding bilateral agreements] to creating new legislation or amending existing legislation that would introduce a legal obligation for [foreign financial institutions or] FFIs to enhance their existing due diligence procedures and share the relevant information with their own tax authority. Provisions within existing tax treaties which already facilitate the transfer of personal data in relation to tax obligations have been suggested as possible legal basis that these authorities share the personal data from FFIs under FATCA with the IRS, although in the case of some countries this obligation may need to be clarified by way of a protocol or other additional arrangements with the US"*. The Working Party furthermore concludes on p.11 no. 16.3 as follows: *"The Intergovernmental Approach currently being discussed by some Member States and the US that would allow for a binding bilateral agreement to be implemented through national legislation could provide a way of ensuring that both sets of obligations are taken into account with full consideration being given to Article 8 of the European Convention on Human Rights in order to demonstrate the necessity and proportionality of such a measure. WP29 stresses that only a binding agreement can be considered as providing the appropriate legal framework for allowing data controllers to collect and transfer the data referred to in the FATCA"*. It could therefore be considered to implement the AIC Model through a series of binding bilateral agreements between (each of the) MSs. If, for whatever reason, the adoption of a multilateral agreement within the EU, such as a Directive, would not work (or would not work in a reasonable period of time), such a solution would be regarded as providing more flexibility than the implementation of a Directive.

- the relevant RC, to enable the tax administration of such RC to (1) check whether or not the investor is effectively a tax resident in that country; (2) double check the amount of movable income reported in the Investor's tax return.

The rights and obligations of all participating MSs acting respectively as AIC, RC or SC will be set out in a Directive or multilateral convention or series of bilateral agreements.

The AIC Model can be visualised as follows:

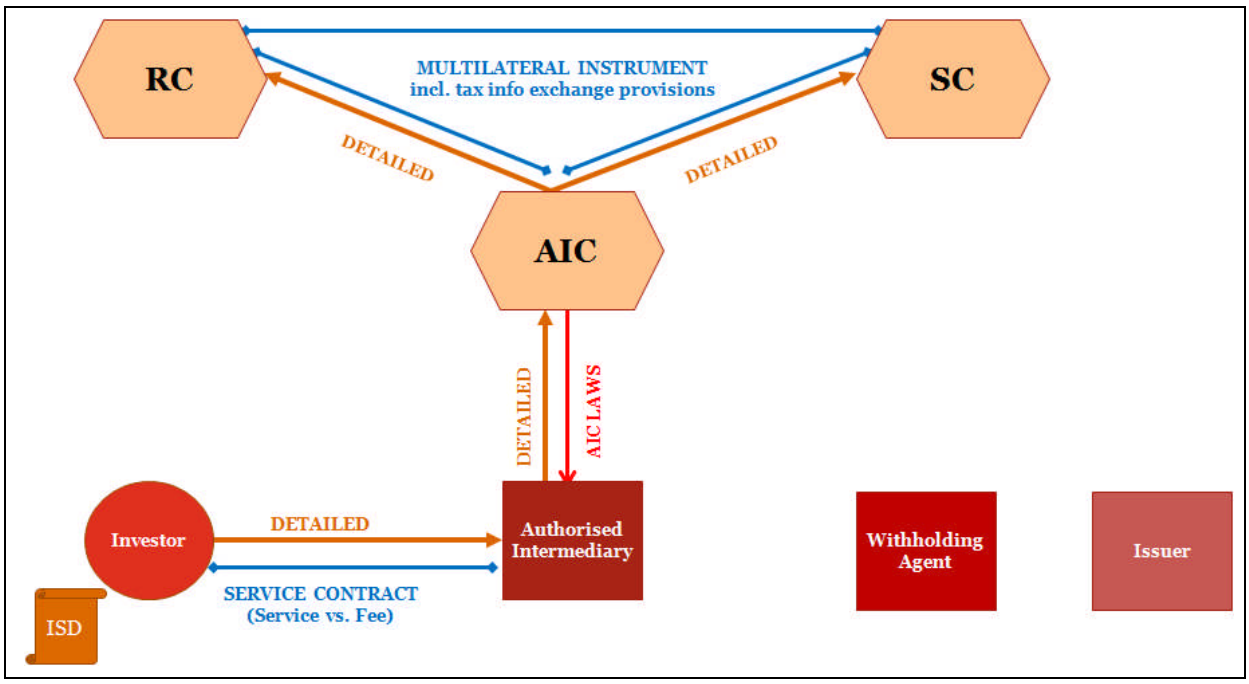


Figure 10: AIC Model – Personal data flows

7.2 Analysis of the Main Relevant Concepts Under the Data Protection Directive in a EU Context

7.2.1 Scope of Application

139. **Processing of Personal Data.** The Directive (117) 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data (118) (below the "***Data Protection Directive***") applies to "*the processing of personal data wholly or partly by automatic means, and to the processing otherwise than by automatic means of personal data which form part of a filing system or are intended to form part of a filing system*" (Art. 3(1) Data Protection Directive).

117 The principles of personal data protection at EU level are currently provided in a Directive, imposing a *de minimis* range of obligations to MSs, but based upon which private individuals or other persons cannot directly invoke rights in terms of personal protection. The principles provided by the Directive first need to be implemented in national legislation. Currently a new EU legal framework is however being developed

The Data Protection Directive defines:

- **Personal Data** as *"any information relating to an identified or identifiable natural person ('data subject'); an identifiable person is one who can be identified, directly or indirectly, in particular by reference to an identification number or to one or more factors specific to his physical, physiological, mental, economic, cultural or social identity"* (Art. 2 (a) Data Protection Directive);

  Under both the SC and the AIC Models, the type of data exchanged will include:

  – **Data relating to the AI.** Assuming the AIs are legal entities and not natural persons, they do not qualify as 'data subjects' under the Data Protection Directive and all data exchanges relating to AI's are therefore not covered by such Directive (119).

  – **Data relating to the Investor.** Data relating to the Investor can either be under a pooled or detailed form:

    ◦ **Pooled Form,** i.e. without identifying specific Investors by name but characterising a group as having attributes that entitle them to a particular treaty rate in the framework of their application of treaty relief at source in the SC (below "*Pooled Information*").

      The principles of private data protection under the Data Protection Directive are not to be applied to data rendered anonymous in such a way that the data subject is no longer identifiable (cf. Recital 26 Data Protection Directive). Assuming all Pooled Information can indeed be qualified as data made anonymous in the meaning of this Recital, the processing of such personal data should not fall within the scope of the Data Protection Directive.

    ◦ **Detailed Form**, i.e. identifying each Investor by clearly detailing the full name, address, place of birth, date of birth, tax identification number and income data (120) (below "*Detailed Information"*).

      This Detailed Information clearly qualifies as personal data under the Data Protection Directive.

---

which will substantially change these current data protection principles and will therefore have an impact on our analysis as reflected in the present document (cf. Commission proposals of January 2012 for a Regulation setting out a general EU framework for data protection and a Directive on protecting personal data processed for the purposes of prevention, detection, investigation or prosecution of criminal offences and related judicial activities).

118 OJ L 281, 23.11.1995, p. 31-50.

119 Note however that under some national laws, the requirements relating to processing of personal data are not limited to personal data of natural persons/private individuals, but also cover personal data of "legal entities". Moreover, a number of Data Protection Authorities are of the view that information relating to legal entities can also constitute "personal data".

120 We assume no so-called "sensitive" personal data will be processed, such as personal data revealing racial or ethnic origin, political opinions, religious or philosophical beliefs, trade-union membership, and the processing of data concerning health or sex life (cf. Article 8 of the Data Protection Directive).

- **Processing** as *"any operation or set of operations which is performed upon personal data, whether or not by automatic means, such as collection, recording, organisation, storage, adaptation or alteration, retrieval, consultation, use, disclosure by transmission, dissemination or otherwise making available, alignment or combination, blocking, erasure or destruction"* (Art. 2(b) of the Data Protection Directive);

  Under both the SC and the AIC Models, personal data will be collected by an AI via an ISD completed by the Investor, and then further transmitted:

  - **in detailed form** ("Detailed Information"), via automated means:

    > to the SC under the SC Model, which in turn will provide this data to the RC;

    > to the AI's Country under the AIC Model, which in turn will provide these data to the SC and/or the RC.

    These information collection and exchange actions classify as "processing" under the Data Protection Directive.

  - **in pooled form** ("Pooled Information"), under both models, via automated means to the WA, which in turn will provide these data to the SC.

    As mentioned above, assuming this Pooled Information is made anonymous, this will not qualify as an exchange of personal data under the Data Protection Directive, and will therefore not be further considered in the scope of this analysis.

As a result, the data flows between AI and WA, and WA and SC do not fall within the scope of the Data Protection Directive.

140. **Collection and Transfer.** It should be noted that the analysis carried out in this chapter focuses on two specific processing activities which are the collection and the transfer of investors' personal data, while other processing operations that will/may take place (e.g. recording, storage, use by the various actor involved in the system) are not examined. However, we anticipate that the use of the information by the data controller is very important as it is closely linked with the "purpose limitation" principle which is examined in section 7.2.3.1 below.

7.2.2 IDENTIFICATION OF THE DATA PROCESSING ACTORS INVOLVED

141. **Four Types of Actors.** The Data Protection Directive identifies 4 different types of actors in data processing operations in addition to the data subject itself i.e. controllers, processors, third parties and recipients as defined under Art. 2 of the Data Protection Directive.

7.2.2.1 CONTROLLER

142. **Definition.** A controller is the natural or legal person, public authority, agency or any other body which alone or jointly with others determines the purposes and means (121) of the processing of personal data; where the purposes and means of processing are determined by national or Community laws or regulations, the controller or the specific criteria for his appointment may be designated by national or Community law.

It is important to identify the controller(s) in a data processing model to "*determine who shall be responsible for compliance with data protection rules, and how data subjects can exercise their rights in practice. In other words: to allocate responsibility.*" (122)

The control and hence liability of the data processing can lie with one or more parties, depending on whether or not the purposes and/or the (essential elements of the) means of such processing are determined by one or more actors. The participation in the exercise of control may take different forms and does not need to be equally divided.

The mere fact that different actors cooperate in the processing of personal data (as is the case here) does however not automatically mean that all these actors are joint controllers. A factual analysis needs to be made to determine whether the sequential processing operations are to be considered as disconnected operations with each a different independently defined purpose, or whether the processing operations are to be considered as a set of operations pursuing a shared purpose and/or via jointly defined means (123).

To identify the controller(s) in the present case, it is important to breakdown and identify the personal data flows with their respective purpose in each model:

121 According to the Article 29 Working Party, determining the purpose of the processing (including the decision to process personal data for an additional purpose) would in any case trigger the qualification as controller, while determining the means would only imply control when the determination concerns the essential elements of the means, i.e. the determination of the answer to questions such as "which data shall be processed?", "for how long shall they be processed?" and "who shall have access to them?", Cf. Opinion 1/2010 on the concepts of "controller" and "processor", as adopted by the Article 29 Data Protection Working Party on 16 February 2010, p. 14.

122 Cf. Opinion 1/2010 on the concepts of "controller" and "processor", as adopted by the Article 29 Data Protection Working Party on 16 February 2010, p. 8-9.

123 Cf. Opinion 1/2010 on the concepts of "controller" and "processor", as adopted by the Article 29 Data Protection Working Party on 16 February 2010, p. 19-20.

143. **SC Model – Scenario 1 (SC ≠ RC).**

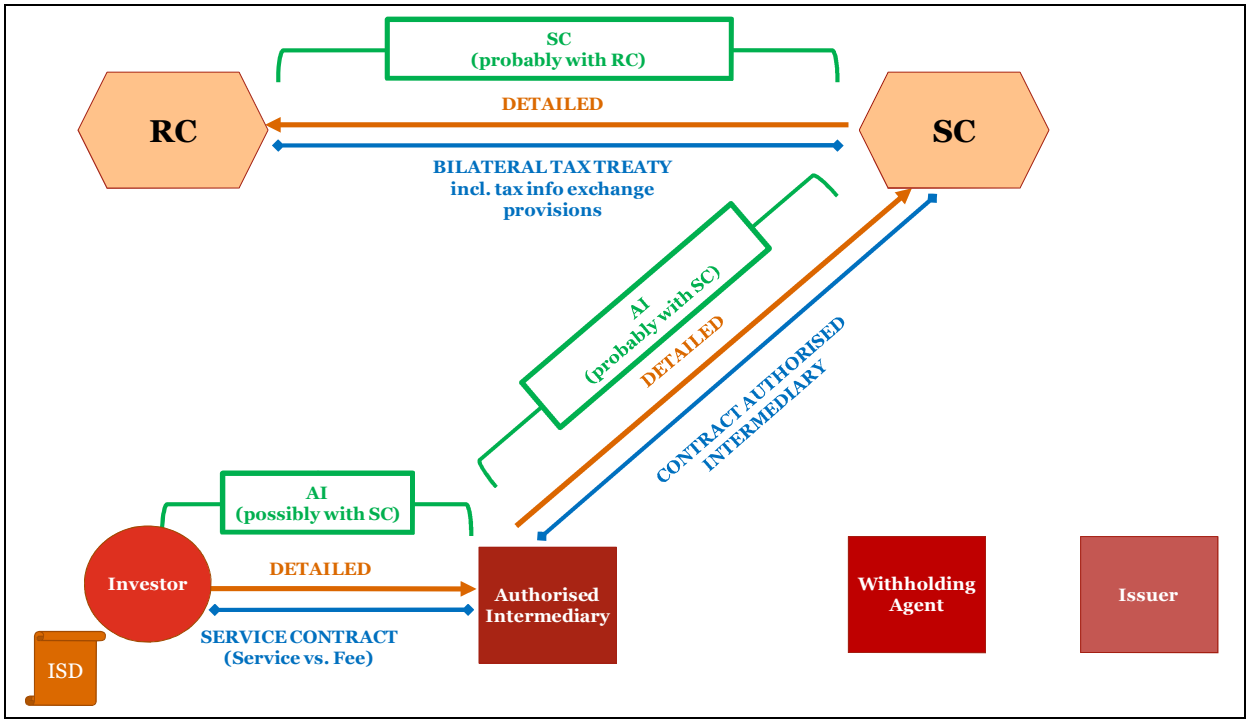


Figure 11: SC Model – Scenario 1

PROCESSING OPERATIONS OF PERSONAL DATA	PURPOSE	IDENTIFIED CONTROLLER(S)
Investor → AI ***(Detailed Information)***	Enable AI to apply for treaty relief at source on behalf of the Investor in relevant SC.	**AI (possibly jointly with SC)** AI collects information to perform a service towards its Investors (124). It could however be argued that the collection of the personal data by AI and the further transfer by AI to SC are interrelated and are done for the same purpose and means, jointly determined between AI and SC, and that this data collection is also done under joint control of AI and SC. In other words, that the data processing operations from the collection of the Investor personal data until the transfer of such data to SC should be considered as 1 chain of linked operations done

124 In this respect, it seems that an explicit reference, among the services provided by the financial institution, to the application of WHT relief at source, is necessary in order for the service agreement to be regarded as a possible legitimising ground for the processing of information by the financial institutions.

		under joint control of AI and SC.
AI → SC ***(Detailed Information)***	Enable the tax administration of SC to check whether the treaty relief at source it has provided on the basis of the Pooled Information received anonymously by the respective WA was appropriate.	**AI (probably jointly with SC)** AI decides to commit itself to (automatically) exchange personal data with SC ("opt-in") in return for its appointment as AI for such SC. However, since the purpose, the type of information to be exchanged and other (essential elements of the) means of data exchange will be imposed by SC (according to the AI contract), it could reasonably be argued that AI and SC are to be considered as joint controllers for this processing operation.
SC → RC ***(Detailed Information)***	Enable the tax administration of RC to: (1) check whether the investor was effectively resident therein and provide feedback to the SC; (2) double check the amount of movable income reported in the Investor's tax return.	**SC (probably jointly with RC)** SC decides to commit itself to (automatically) exchange personal data with RC. However, since the purpose, the type of information to be exchanged and other (essential elements of the) means of data exchange will be determined by negotiation with RC (according to a Memorandum of Understanding), it could reasonably be argued that SC and RC are to be considered as joint controllers for this processing operation.

Table 8: SC Model – Scenario 1

144. **SC Model – Scenario 2 (SC = RC).**

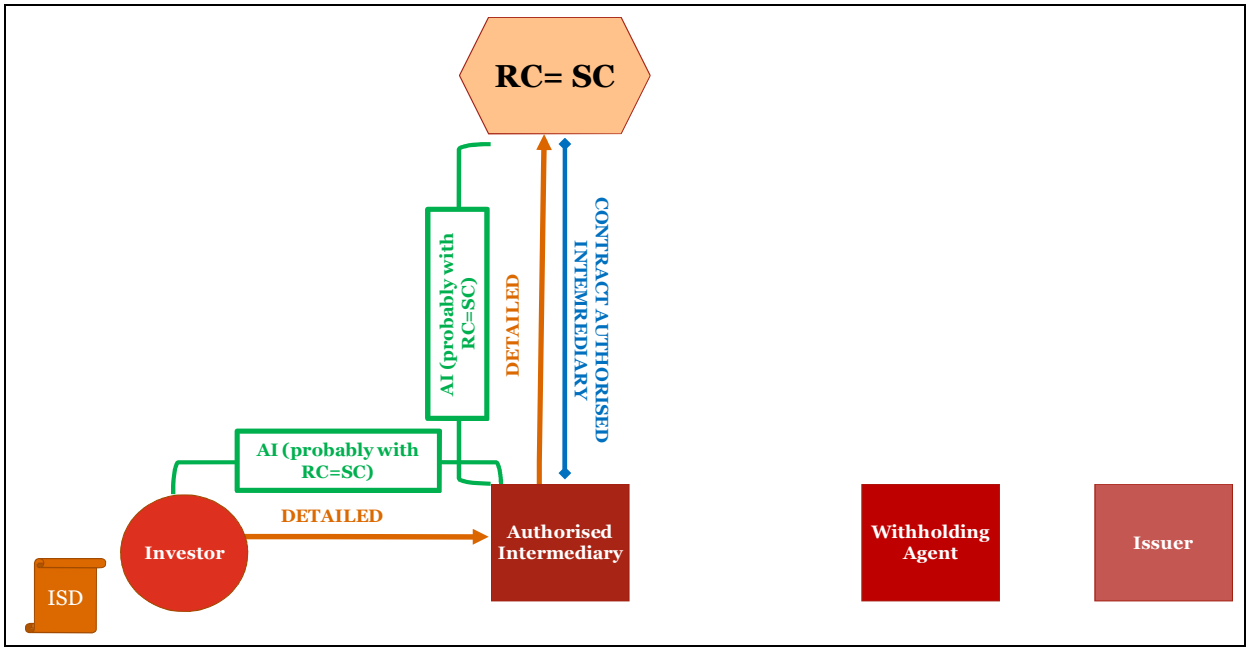


Figure 12: SC Model – Scenario 2

PROCESSING OPERATIONS OF PERSONAL DATA	PURPOSE	IDENTIFIED CONTROLLER(S)
Investor → AI ***(Detailed Information)***	Enable AI to be appointed as an AI by SC and apply for treaty relief with such SC (on behalf of *other* Investors, having a SC different from their RC).	**AI (probably jointly with SC=RC)** AI must, as part of the contract that it concludes with SC, commit itself to collect and (automatically) exchange personal data with SC on Investors for whom SC=RC, and who thus are not entitled to claim any DTT relief in such SC ("opt-in"), in return for its appointment as AI for such SC. However, since the purpose, the type of information to be exchanged and other (essential elements of the) means of data exchange will be imposed by SC as a condition to be appointed as AI for such SC (according to the AI contract), it could reasonably be argued that AI and SC are to be considered as joint controllers for both the collection and transfer of data.
AI → SC=RC ***(Detailed Information)***	Enable the tax administration of RC (=SC) to double check the amount of movable income reported in the Investor's tax return.	

Table 9: SC Model – Scenario 2

145. **AIC Model.**

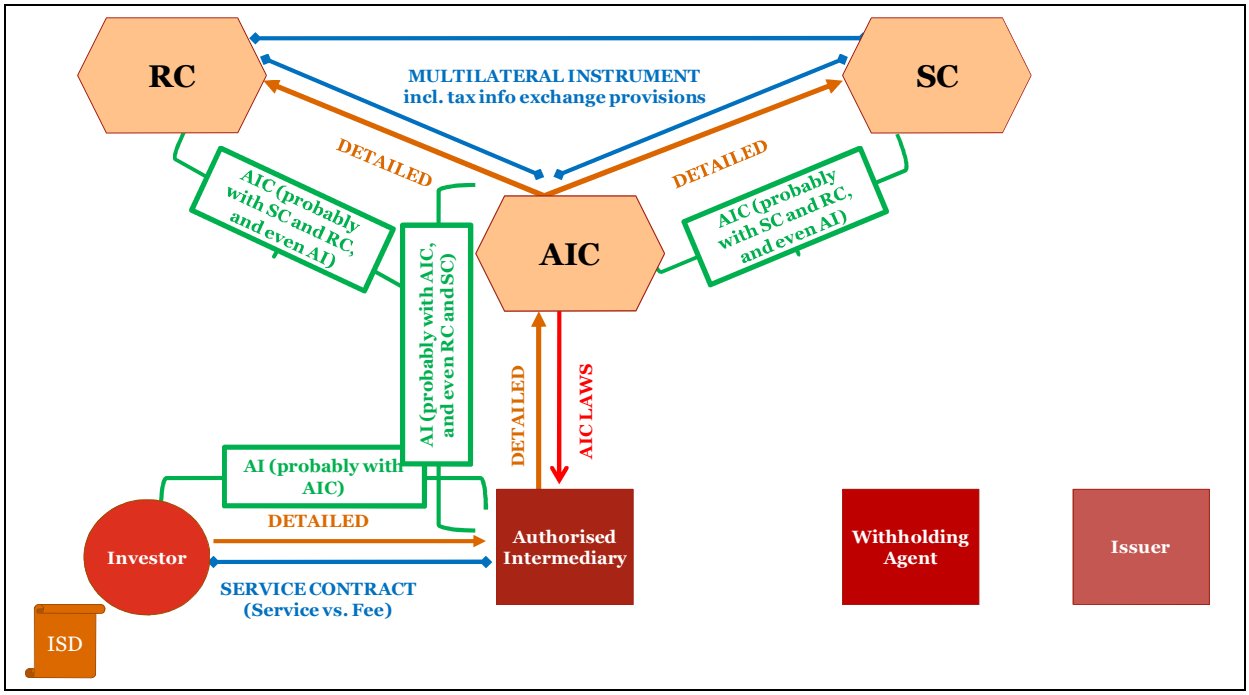


Table 10: AIC Model

PROCESSING OPERATIONS OF PERSONAL DATA	PURPOSE	IDENTIFIED CONTROLLER(S)
Investor → AI ***(Detailed Information)***	Enable AI to apply for treaty relief at source on behalf of the Investor in all participating MSs in their capacity of SC.	**AI (possibly jointly with AIC)** AI decides to collect information to carry out a service towards its Investors. It could however be argued that the collection of personal data by AI and the further transfer by AI to AIC are interrelated and are done for the same purpose and means, jointly determined between AI and AIC, and that this data collection is also done under the joint control of AI and AIC. In other words, that the data processing operations from the collection of personal data from the Investor until the transfer of such data to AIC should be considered as one chain of linked operations carried out under the joint control of AI and AIC.
AI → AIC ***(Detailed Information)***	Enable AI to be appointed as AI for all MSs in their capacity of SC.	**AI (probably jointly with AIC, and even SC and RC)** AI decides to commit itself to comply with the necessary (information exchange) requirements ("opt-in"), in return for its appointment as AI for

		all participating MSs. However, since the purpose, the type of information to be exchanged and other (essential elements of the) means of data exchange will be imposed by AIC as a condition to be appointed as AI for all participating MSs (according to the AIC laws implemented as a result of the multilateral instrument concluded between all MSs), it could reasonably be argued that AI and AIC (and even SC and RC) are to be considered as joint controllers for this transfer of data.
AIC → SC ***(Detailed Information)***	Enable the tax administration of SC to check whether the treaty relief at source it has provided on the basis of the Pooled Information received anonymously by the respective WA was appropriate.	**AIC (probably jointly with SC and RC, and even AI)** AIC decides to commit itself to (automatically) exchange personal data with SC and RC. However, since the purpose, the type of information to be exchanged and other (essential elements of the) means of data exchange will or have already been determined in negotiation with SC and RC (according to a multilateral instrument on the exchange of information) and even in collaboration with the relevant AI's, it could reasonably be argued that AI, AIC, SC and RC are to be considered as joint controllers for these processing operations.
AIC → RC ***(Detailed Information)***	Enable the tax administration of RC to: (1) check whether the investor was effectively resident therein and provide feedback to the SC; (2) double check the amount of movable income reported in the Investor's tax return.	

Table 11: AIC Model

7.2.2.2 PROCESSOR

146. **Definition.** A processor is a natural or legal person, public authority, agency or any other body which processes personal data on behalf of the controller (Art. 2(e) of Data Protection Directive).

The data controllers identified above have the possibility to call upon a service provider or an authority/body under their control or which acts on their behalf to process the personal data. It could for instance be envisaged that a given country would appoint a FI as data processor to process (collect and transfer) personal data on its behalf and under its responsibility. This would mean that FI would *de facto* collect and further process personal data from an Investor, for purposes/means determined by such country.

7.2.2.3 THIRD PARTY

147. **Definition.** A third party is defined as any natural or legal person, public authority, agency or any other body than the data subject, the controller, the processor and the persons who, under the direct authority of the controller or the processor, are authorised to process the data (Art. 2 (f) of Data Protection Directive).

7.2.2.4 RECIPIENT

148. **Definition.** A recipient is a natural or legal person, public authority, agency or any other body to whom data are disclosed, whether a third party or not (Art. 2(g) of Data Protection Directive). AIC, SC and RC all qualify as recipients under the Data Protection Directive.

7.2.3 CRITERIA FOR LAWFUL PERSONAL DATA PROCESSING

149. **Minimum Criteria.** Though the conditions for lawful personal data processing are defined under national legislation, the Data Protection Directive includes a number of minimum criteria.

7.2.3.1 DATA QUALITY

150. **Five Requirements.** Based on Art. 6 of the Data Protection Directive, personal data must – on the data controller's responsibility – be:

a. Processed **fairly and lawfully**

b. Collected for **specific, explicit and legitimate purposes** and **not further processed in a way incompatible with those purposes**

c. **Adequate, relevant and not excessive** in relation to the purposes for which they are collected and/or further processed

d. **Accurate** and, where necessary, kept **up to date**

e. **Kept** in a form which permits identification of data subjects **for no longer than is necessary** for the purposes for which the data were collected or for which they are further processed.

The second and third requirements deserve some comments.

151. **Personal Data Collected for Specific, Explicit and Legitimate Purposes and Not Further Processed in a Way Incompatible with those Purposes** ("purpose limitation" principle). (125)

In the models at stake, the Detailed Information is collected and further processed by the AI to enable the latter to apply for treaty relief on behalf of its Investors. At first sight, it seems that the personal data collected under both models for the relief at source systems could be considered as meeting the requirement that they have to be collected for specific, explicit and legitimate purposes, i.e. the application of WHT relief at source under an AI system.

The AI is however requested to transfer such Detailed Information:

- to SC (under the SC Model – Scenario 1), which in its turn (automatically) further transfers such personal data to the RC of the relevant Investor;
- to AIC (under the AIC Model), which in its turn (automatically) further transfers such personal data to SC and the RC of the relevant Investor.

To fulfil its original purpose, AI only needs to:

- pool the Detailed Information received from the Investors and exchange such Pooled Information with the respective WA on an anonymous basis, which exchange is not prohibited/regulated under the Data Protection Directive and not taken into account in this analysis, as mentioned above;
- transfer the Detailed Information to the SC (under the SC Model – Scenario 1) or to AIC which in its turn will transfer the Detailed Information to SC (under the AIC Model) in a view to applying the treaty relief at source.

The further transfers to other MSs acting as RC would in our view not be strictly necessary for the SC to be able to apply the relief at source (126). From a data quality perspective, one could thus wonder whether such further transfers to RC meet the purpose limitation requirement.

This point of view should however be qualified to some extent as one could indeed consider that the exchange of information to the RC with respect to Investors who have benefitted from

125 The "purpose limitation" principle is closely linked to another principle which is that of "data minimisation". According to this principle, the processing operations should be limited to those data that are necessary to fulfil the specific purpose for which they are processed.

126 However, in certain circumstances, such as the case of cooperation between tax authorities, the further processing for a different purpose may be necessary. In this case exceptions to the principle of purpose limitation could be justified under Article 13 of the Data Protection Directive, in specific circumstances and provided that they are necessary and based on legislative measures either at national or Community level (cf. Recital 19, Opinion 2007/C 91/03 of the European Data Protection Supervisor on the Proposal for a Regulation of the European Parliament and of the Council laying down the procedure for implementing Regulation (EC) No 883/2004 on the coordination of social security systems (COM(2006)16 final). This means that if it would be provided by law that the full chain of data processing operations under the SC or AIC Models needs to be completed together by one sole entity under its sole control, the full chain would be legitimate and the aforementioned split would no longer be necessary.

a reduced WHT rate is essential for the functioning of the standardised relief at source system as one of the objectives of this exchange of information is enabling the RC to provide feedback to the SC on whether or not the Investors are effectively resident therein (and thus "treaty entitled") (127). Nevertheless, considering the audit procedures and the liability of the AI foreseen in both models (see section 4.2), it could be argued that such transfer of information to the RC is not really an essential element to grant the relief at source (128).

Moreover, it remains that the main objective of this further transfer to RC is to enable the RC to check whether the Investors have correctly included the income received in their tax returns, which is not essential for the functioning of the WHT relief system.

Furthermore, in the SC Model – Scenario 2 (where SC = RC) an exchange of information to the SC (RC) is not at all necessary in the absence of DTT relief in such case.

If performed under the sole initiative, control and responsibility of the AI (or even jointly with SC), there is thus a risk that this chain of processing operations would be considered as a "*further processing in a way incompatible with the original purpose*" for which such information was collected (129).

One could however argue that there is no breach of the purpose limitation principle if the model (SC Model or AIC Model) can be considered as forming a whole, i.e. where the WHT relief in the SC (including checking the residency status with the concerned RCs) would be irremediably linked to ensuring taxation in the RC.

In this respect, the "link" between granting the relief at source in the SC on the one hand and ensuring taxation is the RC on the other hand should, in our view, be properly documented before the launch of any of both models.

Under the SC Model – Scenario 1 for instance, relevant legislations in the SC having chosen to grant the relief at source, between SC and the respective RCs (e.g. Memorandums of Understanding) should provide for automatic exchanges of information between the SC and the respective RCs further to the granting of the WHT relief. In other words, WHT relief at source in a given SC (in the framework of the AI system or even otherwise) should be made strictly correlative to exchange of information towards the RC (130). The same reasoning of applies, *mutatis mutandis*, with respect to the AIC Model.

127 Knowing also that the envisaged new WHT relief model would simplify the process to the benefit of the Investors, by amongst others abolishing the use of certificates of residence.

128 The QI regime is in this respect a good example since the US does not even want to receive detailed information from the QIs, hence obviously does not require a double check by the RCs.

129 It may be useful to point out that this full chain of data processing operations, including the further exchange up to RC, would *de facto* not put the data subject (Investor) in a worse situation than the one in which he/she currently is. Currently, in order to obtain reduction of WHT rate in the SC (under the refund procedure), the Investor usually needs to submit information directly to its RC in order to obtain the certificate of residence required by the SC.

130 In the absence of strict correlation in all cases, the two purposes, i.e. granting the relief at source in the SC and ensuring taxation is the RC, could, in our view, be uncoupled.

152. **Personal Data Adequate, Relevant and Not Excessive in Relation to the Purposes for which they are Collected and/or Further Processed.**

Only the data necessary to achieve specific, explicit and legitimate purposes may be collected / exchanged (cf. proportionality principle (131)).

Although it is difficult for us to assess the type or amount of data needed by respectively the AI or the tax administrations, it looks at first sight that the amount of data required could be considered proportionate in relation to the purpose for which the data are collected.

This is certainly true if we consider, as mentioned above, that the purpose of the data collection and processing is actually not limited to enabling the AIs to claim WHT relief at source on behalf of their Investors, but also comprises ensuring taxation in the RC. Indeed, if the two purposes were considered essential for the proper functioning of the AI system, then the full chain of information processing and transfers would be considered as a "whole" because each part is essential to the functioning of the entire system.

7.2.3.2 LEGITIMACY OF THE PERSONAL DATA PROCESSING

153. **Six Legitimate Grounds.** Based on Art. 7 of the Data Protection Directive, personal data may only be processed if:

a. the data subject has unambiguously given his **consent**; or

b. the processing is necessary for the **performance of a contract** to which the **data subject is party** or in order to take steps at the request of the data subject prior to entering into a contract; or

c. the processing is necessary for **compliance with a legal obligation** to which the **controller is subject** (132); or

d. the processing is necessary in order to **protect the vital interests of the data subject**; or

131 The proportionality principle also applies with regard to the number of competent bodies having access to data as well as the period of storage of personal data. Only relevant authorities and institutions (cf. relevant AI, SC, RC and AI's Country) should have access to the Detailed Information and these data should only be stored (in a form that permits identification of the Investor) for no longer than necessary for the purpose for which they are processed. (Cf. Recital 23, Opinion 2007/C 91/03 of the European Data Protection Supervisor on the Proposal for a Regulation of the European Parliament and of the Council laying down the procedure for implementing Regulation (EC) No 883/2004 on the coordination of social security systems (COM(2006)16 final).

132 It should be noted that, under the new proposed Regulation on the protection of individuals with regard to the processing of personal data and on the free movement of such data (COM(2012) 11 final of 25.01.2012), where processing is carried out in compliance with a legal obligation to which the controller is subject or where processing is necessary for the performance of a task carried out in the public interest or in the exercise of an official authority, the processing should have a legal basis in Union law, or in a MS law which meets the requirements of the Charter of Fundamental Rights of the European Union for any limitation of the rights and freedoms. The proposal acknowledges the case-law and relevant opinion of the Article 29 Working Party in this area.

e. the processing is necessary for the performance of a task carried out in the **public interest** or in the exercise of an **official authority** vested in the **controller or in a third party to whom the data are disclosed**;

f. the processing is necessary for the purposes of the **legitimate interests** pursued by the controller or by the third party to whom the data are disclosed.

Each of the identified personal data processing operations needs to fall within the scope of (at least) one of the above grounds in order to be legitimate under the Data Protection Directive.

154. **Consent of the data subject (Art.7.a).** Consent could be a viable legitimising ground for data processing, to the extent it is specific (133) and it has been given freely (134) by an informed data subject (135) before the data processing takes place (e.g. via the signature of the ISD).

However, data protection experts consider that, if the data processing could take place based on a different legitimising ground (e.g. performance of a contract) presenting the data subject with a situation where he/she is asked to consent could be considered as misleading or inherently unfair. This means that if there is another ground justifying the data processing, consent should as far as possible be avoided.

Though the provision of consent often seems the preferred legitimising ground, it is not always the most appropriate ground to legitimise the processing of personal data. Also the provision of consent does not give a data controller a "free pass" to process data at will, as it appears to be often misunderstood in data processing practice. Even if the processing operation is based on consent, the data controller will nevertheless need to comply with its obligations with regard to fairness, necessity, proportionality and data quality (136).

133 The requirement of specific consent excludes the validity of so-called blanket consents or catch-all consent provisions intended to cover e.g. all the legitimate purposes followed by the data controller or all the legitimate further transfers (Cf. Opinion 15/2011 on the definition of consent, as adopted by the Article 29 Data Protection Working Party on 13 July 2011, p.17).

134 Data experts consider that consent is given freely when there is no risk of deception, intimidation, coercion or significant negative consequences if the data subject does not consent. A consent given under threat of not obtaining a service or a lower quality service cannot be considered as free. (Cf. Opinion 15/2011 on the definition of consent (among others referring to opinion WP131 – Working document on the processing of personal data relating to health in electronic health records), as adopted by the Article 29 Data Protection Working Party on 13 July 2011, p.12-13). In addition, consent can only be deemed free if there are viable alternatives for the person concerned (Cf. Recital 31, Opinion 2007/C 91/03) of the European Data Protection Supervisor on the Proposal for a Regulation of the European Parliament and of the Council laying down the procedure for implementing Regulation (EC) No 883/2004 on the coordination of social security systems (COM(2006)16 final).

135 In practice, this means that the data subject needs to be aware of the nature of the data to be processed, the purposes of processing, the recipients of the possible transfers and his/her rights. (Cf. Opinion 15/2011 on the definition of consent (among others referring to opinion WP131 – Working document on the processing of personal data relating to health in electronic health records), as adopted by the Article 29 Data Protection Working Party on 13 July 2011, p.19).

136 Cf. Opinion 15/2011 on the definition of consent, as adopted by the Article 29 Data Protection Working Party on 13 July 2011, p.7 and 13.

We also stress the importance of other arguments considering consent as a weak legitimising ground, in particular the fact that "*consent is unlikely to provide an adequate long-term framework for data controllers in cases of repeated or even structural transfers [...] particularly if the transfer forms an intrinsic part of the main processing"* (137) which will be the case under both models envisaged (138).

155. **Necessary Processing (Art.7. b - f).** Though however already shortly touched upon herein above under the subsection about "data quality" (subsection 7.2.3.1), the importance of the so-called "necessity" test also needs to be stressed in the analysis of the legitimacy of personal data processing: i.e. in order to call upon the legitimacy grounds under Art.7 b to f, the "necessity" for the data processing first needs to be verified.

In the present case, it requires assessing whether the type and amount of information contained in the ISD (name, address, taxpayer identification number) and the other information linked to the reportable payments concerned (amount, type of income, etc.) are strictly necessary and truly proportionate in view of the purpose for which the data are collected, processed and further transferred, i.e. obtaining a tax relief and/or ensuring taxation is the RC. In other words, even if the data processing would be based on the performance of a contract, this would not legitimise the collection of excessive personal information in relation to that purpose.

156. **Application to the Different Cases.** The legitimising grounds are further addressed below with respect to the SC Model (Scenario 1 and 2) and the AIC Model.

137 Cf. Working document on a common interpretation of Article 26(1) of Directive 96/46/EC of 24 October 1995, adopted on 25 November 2005, as referred to in Opinion 15/2011 on the definition of consent, as adopted by the Article 29 Data Protection Working Party on 13 July 2011, p. 27.

138 Cf. Opinion 15/2011 on the definition of consent, as adopted by the Article 29 Data Protection Working Party on 13 July 2011, p.27.

157. **SC Model – Scenario 1 (SC ≠ RC).**

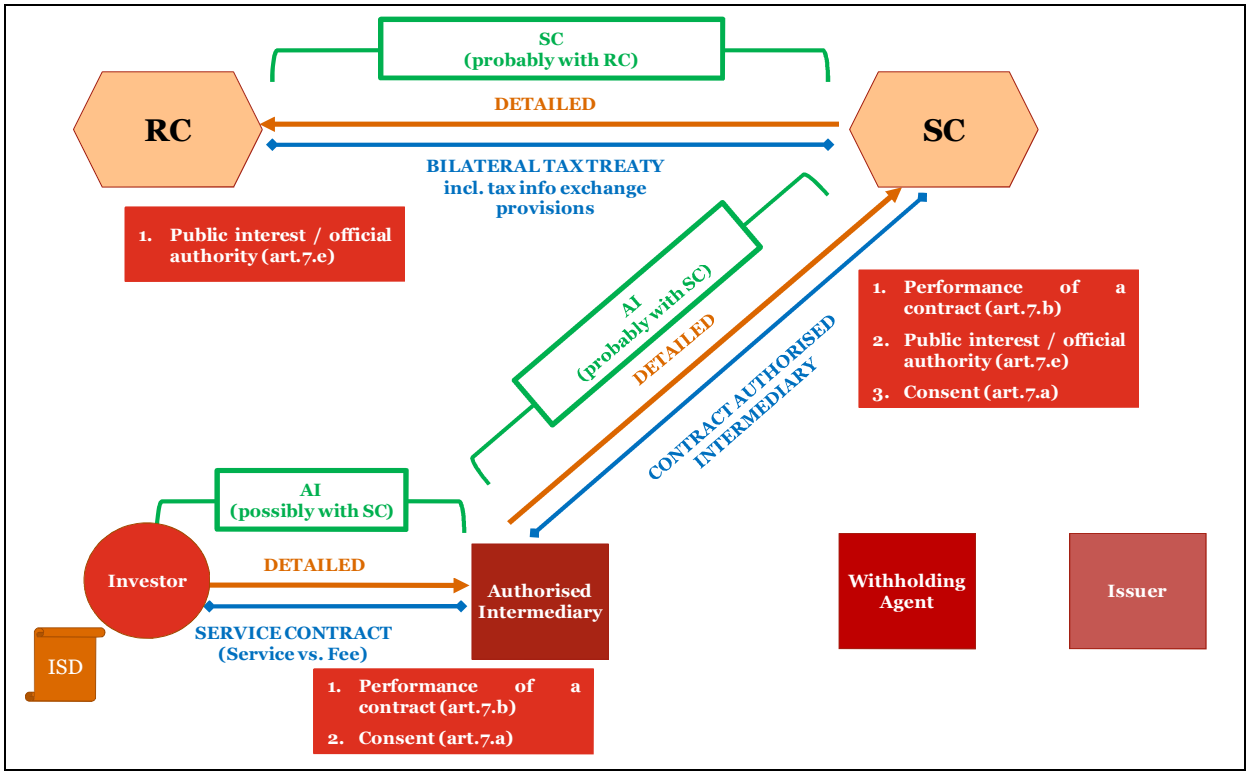


Figure 13: SC Model – Scenario 1

PROCESSING OPERATIONS OF PERSONAL DATA	POSSIBLE LEGITIMISING GROUND(S)
Investor → AI	**Performance of a contract to which the data subject is a party (Art.7.b)** AI needs the Detailed Information to be able to perform the service contract concluded with the Investors whereby it will apply for treaty relief on their behalf. **Consent of the data subject (Art.7.a)** Consent could also be a viable legitimising ground for this data processing, to the extent it is specific and it has been given freely by an informed data subject before the data processing takes place (e.g. via the signature of the ISD). These criteria seem to be fulfilled for this data processing i.e. collection by AI from the Investor directly. However, as already mentioned above, consent is considered as a weak legitimising ground.

PROCESSING OPERATIONS OF PERSONAL DATA	POSSIBLE LEGITIMISING GROUND(S)
AI → SC	**Performance of a contract to which the data subject is a party (Art.7.b)** The further transfer of the Detailed Information by AI to SC could in our view also be considered as a processing needed for the performance of the service contract concluded between AI and the data subject. **Public interest / Official authority in controller or in recipient (Art.7.e)** In addition, such further transfer could also be legitimised based on the public interest of SC as recipient (tax matters are considered to be a matter of public interest) (139). SC needs the Detailed Information for its tax administration to be able to conduct the necessary checks to ensure the WHT reduction or exemption has been correctly granted. **Consent of the data subject (Art.7.a)** Cf. above Investor → AI
SC → RC	**Public interest/Official authority in controller or in recipient (Art.7.e) (140)** Though the further transfer of the Detailed Information by SC to RC is in our view not necessary to perform the service contract between the Investor and AI, such further transfer could be legitimised based on the public interest of RC as recipient (tax matters are considered to be a matter of public interest). RC needs the Detailed Information for its tax administration to be able to (1) check whether the investor is effectively resident therein and provide feedback to the SC and (2) check whether the movable income reported on the Investor's tax return is correct.

Table 12: SC Model - Scenario 1

139 Art. 7.e. provides for the possibility to call upon the public interest of the controller *or the recipient.* As such, data transfer appears necessary in the public interest of SC (as recipient), AI should be able to call upon this legitimising ground.

140 A discussed in Subsection 5.1.5, considering that the conditions for the application of the spontaneous exchange of information would be met under the Directive on Administrative Cooperation, one could wonder whether a MS acting as SC would not already be under the obligation to proceed to an exchange of information towards the various RCs. Therefore, the further processing could also be necessary for the compliance of SC with its legal obligations (Art.7.c).

158. **SC Model – Scenario 2 (SC = RC).**

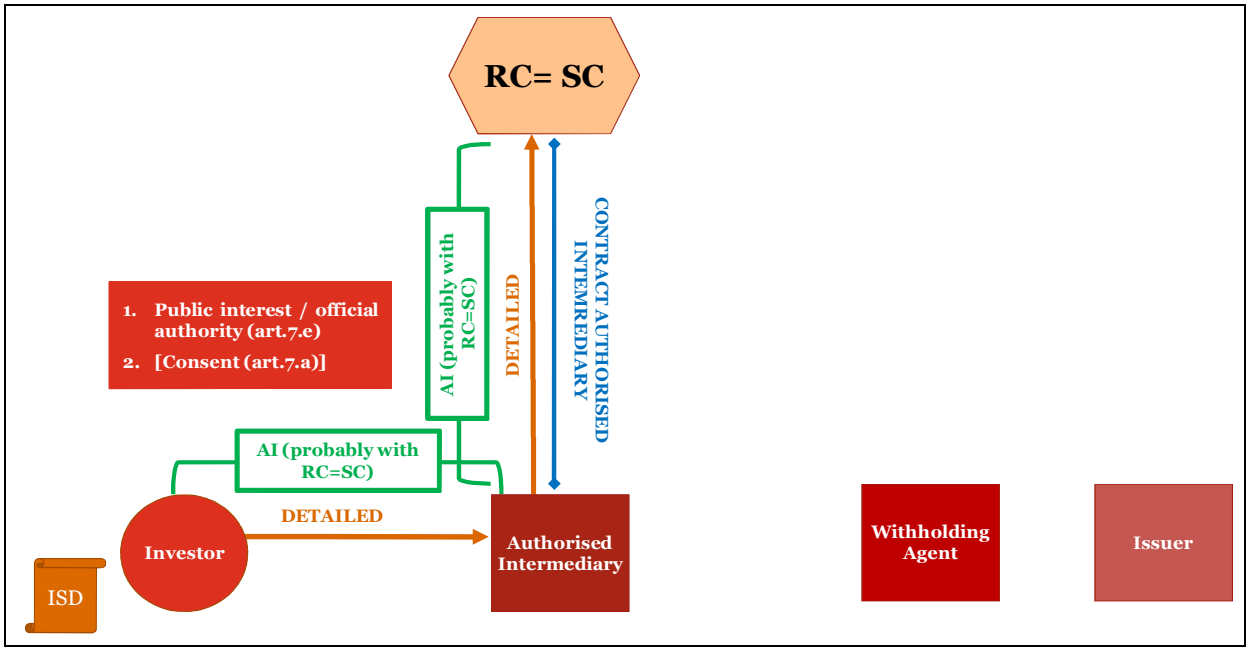


Figure 14: SC Model – Scenario 2

In this situation, identifying the legitimising ground is more complex. As the Investor will not be entitled to WHT relief at source with respect to income arising in SC=RC, there is no reason for AI to collect the Detailed Information from the Investor.

PROCESSING OPERATIONS OF PERSONAL DATA	POSSIBLE LEGITIMISING GROUND(S)
Investor → AI	**Performance of a Contract to which the Data Subject is a Party (Art.7.b)** Given the Investor does not contract with the AI with respect to income originating in SC=RC, it cannot be upheld that the processing would be necessary for the performance of a contract *to which the data subject is party* (141)). **Consent of the data subject (Art.7.a)** Assuming such data processing would be done under the control of AI (probably jointly with SC=RC) consent of the data subject could be a viable legitimising ground for the collection and transfer of the personal data information to SC=RC to the extent the consent is valid (i.e. free,

141 This is especially true for Investor not interested at all in claiming relief at source as such Investors will not even enter into any such kind of contractual arrangements with their FI.

PROCESSING OPERATIONS OF PERSONAL DATA	POSSIBLE LEGITIMISING GROUND(S)
	specific and informed) in line with Art. 7. a of the Data Protection Directive. There is however a risk that such consent would be weakened as a legitimising ground for such data processing operations as data protection experts consider that: • as already mentioned above, "*consent is unlikely to provide an adequate long-term framework for data controllers in cases of repeated or even structural transfers [...] particularly if the transfer forms an intrinsic part of the main processing"* (142) which will be the case under both envisaged models (143); • in the absence of WHT relief, an Investor does not have an interest in accepting a processing and subsequent transfer of his personal data to his own RC, where he could e.g. be subject to a tax audit; • the power of the data controller can have an impact on the adequacy of consent as legitimising ground for a data processing, especially when consent is used to legitimise data processing by public authorities vested with authoritative powers. In such case, if possible, the grounds of a legal obligation (Art. 7.c) or the performance of a task of public interest (Art. 7.e) should be used rather than consent (144); • when consent is used as legitimising ground, it is recommended to review after a certain time an individual's choice by informing them of their current choice and offering the possibility to either confirm or withdraw (145).

142 Cf. Working document on a common interpretation of Article 26(1) of Directive 96/46/EC of 24 October 1995, adopted on 25 November 2005, as referred to in Opinion 15/2011 on the definition of consent, as adopted by the Article 29 Data Protection Working Party on 13 July 2011, p. 27. Although this working document deals with one of the possible derogations for authorising transfers to third countries (cf. Art. 26 of the Data Protection Directive), whereas this section of the report addresses the broader notion of consent in the sense of Art. 7 of the Data Protection Directive, the comments and analysis provided under such working document are in our opinion still interesting to consider for the underlying analysis.

143 Cf. Opinion 15/2011 on the definition of consent, as adopted by the Article 29 Data Protection Working Party on 13 July 2011, p.27

144 Cf. Opinion 15/2011 on the definition of consent, as adopted by the Article 29 Data Protection Working Party on 13 July 2011, p.15-16

145 Cf. Opinion 15/2011 on the definition of consent, as adopted by the Article 29 Data Protection Working Party on 13 July 2011, p.17 and 20 also referring to a preliminary ruling of the ECJ dated 5 May 2011 (Deutsche Telekom AG (Case C-543/09) concerning the need for renewed consent of data subjects when personal data will be used for other purposes than those for which the data were collected originally. In the models at hand, it could be reasonably argued that a renewed consent would be necessary in the event new countries (MSs or third countries) would subscribe to one of the models and personal data would be

PROCESSING OPERATIONS OF PERSONAL DATA	POSSIBLE LEGITIMISING GROUND(S)
	Note also that if it would be envisaged to have the ISD – signed as (blanket) consent by the relevant Investor – covering the further transfer of personal Detailed Information collected to all MSs, irrespective of whether the Investor benefits from the right to treaty relief at source, this could jeopardise the free character of the consent to the extent that the consent for such transfer to one MS (in the absence of treaty relief) would become a condition precedent to the application for treaty relief with another MS. **Public interest of SC as recipient (Art.7.e)** The only possible legitimising ground for the transfer to SC is in our view Art. 7.e of the Data Protection Directive, i.e. the **public interest of SC** as recipient (tax matters are considered to be a matter of public interest) (146). SC (=RC) needs the Detailed Information for its tax administration to be able to perform the necessary checks to ensure that the movable income reported on the Investor's tax return is correct.
AI → SC=RC	Idem.

Table 13: SC Model - Scenario 2

exchanged to countries which could not have been envisaged when the data subject granted consent. As mentioned above, blanket or catch-all consents are not valid.

146 This would require that the public interest in question (or the legal obligation if applicable) be clearly recognised and specified in an EU or national legal instrument (rather than in a contract which would not provide for sufficient safeguards and legal certainty.

159. **AIC Model.**

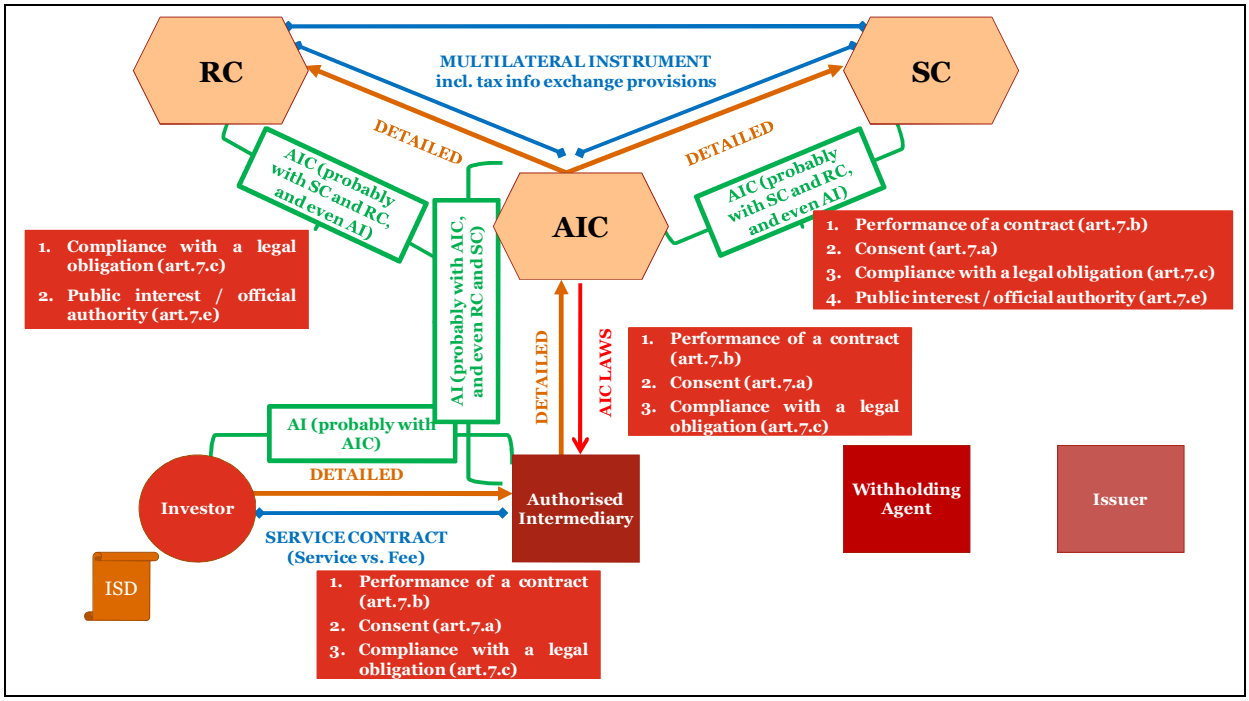


Figure 15: AIC Model

PROCESSING OPERATIONS OF PERSONAL DATA	POSSIBLE LEGITIMISING GROUND(S)
Investor → AI	**Cf. Analysis under SC Model – Scenario 1 (Contract / Consent)** **Compliance with a legal obligation to which the controller is subject (Art. 7.c.)** This could also possibly constitute an appropriate legitimising ground from a data protection perspective (see below).
AI → AIC	**Cf. Analysis under SC Model – Scenario 1 (Contract / Consent)** **Compliance with a legal obligation to which the controller is subject (Art.7.c)** Assuming the purpose and the means for the transfer of the Detailed Information from AI to AIC will be set out in AIC laws (further to the implementation of a new EU-wide or almost EU-wide Directive or multilateral convention or other arrangement governing the model to be implemented) to which AI will be subject, the legitimising ground for such data processing will lie in Art. 7.c authorising data processing necessary to comply with a legal obligation to which the controller is

PROCESSING OPERATIONS OF PERSONAL DATA	POSSIBLE LEGITIMISING GROUND(S)
	subject.
AIC → SC	**Cf. Analysis under SC Model – Scenario 1 (Contract / Consent)** **Compliance with a legal obligation to which the controller is subject (Art.7.c)** Since the (new) Directive or instrument to be implemented would in principle regulate not only the information transfers between AI and AIC but also those between AIC and SC/RC, art.7.c would also seem to be applicable to these further transfers. **Public interest / Official authority in controller or in recipient (Art.7.e)** This further transfer could also be legitimised based on the public interest of SC as recipient (tax matters are considered to be a matter of public interest). SC needs the Detailed Information for its tax administration to be able to make the necessary checks to ensure the WHT reduction or exemption has been correctly granted.
AIC → RC	**Compliance with a legal obligation to which the controller is subject (Art.7.c)** Since the (new) Directive or instrument to be implemented would in principle regulate not only the information transfers between AI and AIC but also those between AIC and SC/RC, art.7.c would also seem to be applicable to these further transfers. **Public interest/Official authority in controller or in recipient (Art.7.e)** This further transfer could also be legitimised based on the public interest of RC as recipient (tax matters are considered to be a matter of public interest). RC needs the Detailed Information for its tax administration to be able to check whether the movable income reported on the Investor's tax return is correct.

Table 14: AIC Model

7.2.3.3 INFORMATION TO BE GIVEN TO THE DATA SUBJECT

160. **Minimum Amount of Information.** When a data subject provides information about himself, Arts. 10 and 11 of the Data Protection Directive include the obligation of the respective data controllers (or their representatives) to provide the data subject with a minimum amount of information.

161. **Information Collected from the Data Subject or Otherwise.** The type of information and date by which such information has to be provided differs depending on whether the personal data collected have been obtained directly from the data subject (Art. 10 of the Data Protection Directive) or not (Art. 11 Data Protection Directive).

Taking into account the data exchange flows identified in the present cases,

- it appears that for the data exchange between the Investor and the AI, personal data was obtained directly from the data subject via the ISD; while
- for all other data exchange flows (e.g. reportable amounts) personal data was not obtained directly from the data subject.

162. **Difficulties.** Although it is essential for data subjects to be able to track who is processing their personal data, especially when many authorities in different countries are involved, it is very difficult to have each identified data controller under both the SC and the AIC Models providing this minimum amount of information to the relevant Investors (data subjects) in line with the provisions of the Data Protection Directive, taking into account the complexity of both models.

163. **Scope Restrictions.** Art. 13 of the Data Protection Directive provides for a number of cases based on which MSs may adopt legislative measures to restrict the scope of among others the obligations under Arts. 10 and 11 of the Data Protection Directive. One of these cases is the situation where such restriction would be necessary to safeguard "*an important economic or financial interest of a Member State or of the European Union, including monetary, budgetary and taxation matters"*.

On this basis it could be reasonably argued that the information obligation of data controllers is not absolute and can be mitigated under national law or under another Directive derogating from the Data Protection Directive (provided there are sound (tax) reasons, and the principles of proportionality, etc. are complied with) (147). However, we understand that the position of data protection authorities would be that these restrictions can only be applied on a case-by-

147 Reference needs to be made in this respect to the Directive on Administrative Cooperation providing for the exchange of personal (tax) information and the cooperation between tax administrations in this respect. Recital 27 of such Directive recognises the applicability of the Data Protection Directive while at the same time providing that "*it is appropriate to consider limitations of certain rights and obligations laid down by* [the Data Protection Directive]. *Such limitations are necessary and proportionate in view of the potential loss of revenue for Member States and the crucial importance of information covered by this Directive for the effectiveness of the fight against fraud."* The possibility to derogate from certain rights and obligations laid down by the Data Protection Directive is explicitly provided for under Article 25 of the DAC.

case basis and not as a general rule. We have not further investigated this statement nor the possibility to call upon possible restrictions to the data subject rights as it is likely that the same issue will arise whatever the Model used.

7.2.3.4 RIGHTS LINKED TO THE DATA SUBJECT

164. **Right of Access and of Correction.** In addition to its right to be duly informed by the data controller, the data subject benefits from other rights, in particular the right of access including the right of correction of such data (Art. 12 of the Data Protection Directive).

165. **Difficulties.** In complex and cross-border projects involving several authorities and institutions, such as in the present case, it is however very difficult to implement and ensure these rights from a practical point of view.

166. **Restrictions.** Like for the right of being duly informed, the Data Protection Directive provides under Art. 13 the possibility for MSs to adopt legislative measures which restrict the scope of Art. 12 of the Data Protection Directive, in the event such restriction would be necessary to safeguard among others "*an important economic or financial interest of a Member State or of the European Union, including monetary, budgetary and taxation matters"*.

As a result, the right of access of the data subject is not absolute either and can possibly be mitigated under national law (provided there are sound (tax) reasons, and the principles of proportionality, etc. are complied with). However, we understand that the position of data protection authorities would be that these restrictions can only be applied on a case-by-case basis and not as a general rule. We have not further investigated this statement nor the possibility to call upon possible restrictions to the data subject rights as it is likely that the same issue will arise whatever the Model used.

167. **Other Rights of the Data Subject.** Data subjects benefit from other rights such as the right to object (Section VII of the Data Protection Directive, i.e. art. 14 and following) and the right to judicial remedy (art. 22 of the Data Protection Directive) or the right to hold the controller liable for compensation of damages (art. 23 of the Data Protection Directive).

The Directive does not provide explicitly (like for Art. 12) the possibility to restrict the application of these rights.

One could however wonder whether it would be possible, subject to conflict of law rules at EU level, to provide for an exemption or restriction to such provisions in another Directive or legislative instrument, provided the basic human rights of data protection are sufficiently guaranteed. We have not further investigated this question as it is likely that the same issue will arise whatever the Model used.

A potential practical solution would be to create the possibility (by law) for data subjects (i.e. the Investors) to enforce their rights through one single authority or institution. In the present case, the authority or institution which is in direct contact with the Investor, i.e. the AI, would be called upon to act as a one-stop-shop with regard to any personal data processed in

connection with the application of treaty relief (148). This practical solution however does not discharge the controller from his liability to compensate any damages incurred by the relevant Investors as a result of unlawful data processing.

7.3 TRANSFER OF INFORMATION TO THIRD COUNTRIES

7.3.1 ADEQUATE LEVEL OF PROTECTION REQUIRED

168. **Adequate Level of Protection Required.** Based on Art. 25 of the Data Protection Directive, the exchange of personal data to a third country is prohibited in so far such country does not provide an adequate level of protection in the meaning of Art. 25 (2) of the Data Protection Directive.

In many third countries an adequate level of protection will not be reached so that it is necessary to assess whether derogations to this general rule can apply.

7.3.2 DEROGATIONS

169. **Principles.** By way of derogation to Art. 25 (2) of the Data Protection Directive, Art. 26 (1) of the Directive allows MSs to provide for derogations to such prohibition, with respect to a transfer or a set of transfers to a third country which does not ensure an adequate level of protection in the meaning of Art. 25 (2) of the Data Protection Directive, when (149):

a. the data subject has **given his consent unambiguously** to the proposed transfer; or

b. the transfer is necessary for the **performance of a contract** between the **data subject and the controller** or the implementation of pre-contractual measures taken in response to the request of the data subject; or

c. the transfer is necessary for the **conclusion or performance of a contract** concluded in **the interest of the data subject** between the controller and a third party; or

d. the transfer is **necessary or legally required on important public interest grounds** or for the establishment, exercise or defence of **legal claims**; or

e. the transfer is necessary in order to **protect the vital interests of the data subject**; or

f. the transfer is made from a **register** which, according to laws or regulations, is intended to provide information to the public and which is open to consultation either by the public in general or by any person who can demonstrate legitimate interest, to the extent that the conditions laid down in law for consultation are fulfilled in a particular case.

148 The legislator could provide for such possibility based on examples already provided in other Commission proposals cf. Recital 38, Opinion 2007/C 91/03 of the European Data Protection Supervisor on the Proposal for a Regulation of the European Parliament and of the Council laying down the procedure for implementing Regulation (EC) No 883/2004 on the coordination of social security systems (COM(2006)16 final).

149 Contrary to the grounds justifying the data processing with the EU, the "legal obligation" is not foreseen with respect to third countries.

The most relevant possible legitimising grounds in the present case are those under Art. 26 (1) a (consent), b (performance of a contract between the data subject and the controller), c (conclusion or performance of a contract concluded in the interest of the data subject) and d (public interest).

170. **Consent.** As mentioned above, the use of consent as legitimising ground will most likely be a weak legal basis for data transfers to third countries considering the fact that "*consent is unlikely to provide an adequate long-term framework for data controllers in cases of repeated or even structural transfers [...] particularly if the transfer forms an intrinsic part of the main processing"* (150) which will be the case under both envisaged models (151).

In addition, the Art. 29 Data Protection Working Party has recently also underlined, in its letter regarding the compatibility of FATCA with the Data Protection Directive (152) that: "*the reporting of any information required under FATCA via consent is not a valid criteria for processing given the imbalance between the position of the data subject and the data controller, and the improbability that consent could be withdrawn*". Based on this analysis, it could be reasonably expected that consent would not be an appropriate legal basis for any data transfers to third countries under either of the models envisaged.

171. **Performance of a Contract Between the Data Subject and the Controller.** Art. 26 (1) b could be used as a possible legitimising ground for the transfers of the Detailed Information to third countries (acting as SCs), to the extent that such transfers pass the "necessity test" and fit within the scope of the performance of the contract concluded between the Investor and the relevant AI. In this respect, we refer to our analysis above which can be applied accordingly (cf. 7.2.3.2).

172. **Performance of a Contract Concluded in the Interest of the Data Subject (SC Model only).** The exception under Art. 26 (1) c (contract concluded between AI and a third country acting as SC) could possibly provide for a legitimising ground for part of the envisaged data exchanges to third countries. However, this possibility should be qualified to some extent as the contract concluded between the AI and a third country acting as SC is not specific to one Investor and is not only concluded in the interest of the Investors but also the interest of the AI itself as part of its business.

173. **Public interest.** Recital 58 of the Data Protection Directive explicitly provides that "*cases of international transfer of data between tax or customs administrations*" are to be considered as an example of the exception mentioned herein above under d.

150 Cf. Working document on a common interpretation of Article 26(1) of Directive 96/46/EC of 24 October 1995, adopted on 25 November 2005, as referred to in Opinion 15/2011 on the definition of consent, as adopted by the Article 29 Data Protection Working Party on 13 July 2011, p. 27 .

151 Cf. Opinion 15/2011 on the definition of consent, as adopted by the Article 29 Data Protection Working Party on 13 July 2011, p.27

152 Letter of the Article 29 Data Protection Working Party (Ref. Ares (2012)746461 – 21 June 2012) providing a first analysis of the compatibility of FATCA with the Data Protection Directive, p.7 no. 10.4.

As a result, Art. 26 (1) d of the Data Protection Directive could at first sight appear be the appropriate legitimising ground for transfers to third countries which would be necessary under either the SC Model or the AIC Model.

Data protection experts however consider that this public interest rule is an exception that, as such, should be strictly construed so as not to circumvent the system and guarantees established by the Data Protection Directive. Therefore, this exception would not appear to constitute the most appropriate legal basis for authorising bulk and repeated transfers of data and would not apply to any transfers between tax administrations as such. Only transfers relating to investigations of particular cases will be legitimate on this ground of public interest, which can only be used if the transfer is (also) of interest to the authorities of a MS and not only to a public authority in a third country (153).

Such restrictions are not reflected in the Data Protection Directive and even seem to be in contradiction with Recital 58 of the Data Protection Directive, which explicitly provides for the possibility of personal data transfers to tax administrations in third countries based on Art. 26 (1)d, without limiting the scope of such exception to "particular cases" (154).

In addition, it needs to be considered that, while the (outbound) transfer of personal data to a tax administration in a third country may in itself not be in the public interest of the exchanging MS, the (inbound) return of personal information from such third country to a tax administration of a MS required in exchange for the outbound exchange may fully be in the interest of the MS. The reciprocal character of the data exchanges with third countries may in fact entail that both inbound and outbound exchanges are in the public interest of one or more MSs.

174. **Other Considerations.** It has to be pointed out that Art. 26(1) exceptions may not provide a satisfactory level of legal certainty to both the data subjects concerned and the national tax administrations as that Article of the Data Protection Directive is in itself subject to possible derogations provided under the domestic laws of the MSs and may therefore lead to divergent interpretations and applications.

153 Cf. Working document on a common interpretation of Article 26(1) of Directive 95/46/EC of 24 October 1995, as adopted by the Article 29 Working Party on 25 November 2005, p. 15.

154 It may be useful to refer to the letter of the Article 29 Data Protection Working Party (Ref. Ares (2012)746461 – 21 June 2012) providing a first analysis of the compatibility of FATCA with the Data Protection Directive, p.10 nos. 13.10 and 13.11, first refers to WP114 stating that "[...] the use of derogations under Article 26.1 (if used) should be "strictly interpreted" and that when there are "cases where mass or repeated transfers can legitimately be carried out on the basis of Article 26(1)", and when certain conditions are met, "transfers of personal data which might be qualified as repeated (…) or structural should, where possible, and precisely because of these characteristics of importance, [must] be carried out within a specific legal framework(…).", and goes on stating that "Therefore, and provided that an EU/national law is adopted, given the nature of FATCA as systematic bulk transfer, use of Article 26.1 (d), because it derogates from the general regime, can only used if an important public interest is clearly defined and it is shown that it overrides the data subject's right to privacy. Even if using it, safeguards aimed at ensuring that those rights and freedoms of the data subjects are upheld are strongly advisable."

7.3.3 ADEQUATE SAFEGUARDS

175. **Another Exception.** Besides, Art. 26 (2) provides for another exception to the prohibition of data transfers to third countries not ensuring an adequate level of protection, i.e. where the controller adduces adequate safeguards with respect to the protection of privacy and fundamental rights and freedoms of individuals and as regards the exercise of the corresponding rights; such safeguards may in particular result from appropriate contractual clauses.

In the present Models, the use of adequate safeguards could constitute a way to justify the transfer of personal data to third countries. These safeguards would have to be included in the various legal instruments envisaged in the respective Models (SC Model: agreement between the SC and the AI, DTTs and/or MoUs; AIC Model: DTT and/or MoUs).

176. **Data Protection under DTTs.** In this respect, safeguards for third country personal data transfers are included under Art. 26 of the OECD Model Tax Convention (155) relating to "Exchange of Information". We refer to subsection 5.4.1.1 above for a summary of the provisions of such Article.

In particular, Art. 26 (1) and (2) of the OECD Model Tax Convention provides for the possibility to exchange certain personal tax information to (third) countries under specific conditions, which provide some safeguards with respect to the amount of information to be transferred as well as the use of the information (i.e. purpose limitation).

- **Information Foreseeably Relevant.** First, the information which can be exchanged has to be "foreseeably relevant" for carrying out the provisions of the Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind (knowing that a Contracting State may not decline to supply information solely because it has no domestic interest in such information).

- **Disclosure of Information.** Secondly, there is a confidentiality clause according to which information exchanged must be treated as secret (in the same manner as information obtained under the domestic laws of the recipient State) and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of taxes (or the oversight of the above). Such persons or authorities shall use the information only for such purposes (156). In addition, the OECD commentary underlines the principle that "*the information received by a Contracting State may not be disclosed to a third country unless there is an express provision in the bilateral treaty between the Contracting States allowing such disclosure*".

155 Update to Article 26 of the OECD Model Tax Convention and its Commentary, as approved by the OECD Council on 17 July 2012.

156 According to the last paragraph of Article 26 (2) of the OECD Model Tax Convention, information may be used for other purposes when such information may be used for such other purposes under the laws of both States and the competent authority of the supplying State authorises such use.

The DTTs following the OECD Model Tax Convention on these points offer therefore a certain level of protection to the investors (157).

As a result, the AIC Model may appear better than the SC Model since in the first case the cross-border exchange of information is done between tax administrations (between the AIC and the RC/SC) where in the second case the initial exchange of information is done directly further to a contractual agreement by a financial institution (the AI) to a foreign tax authority (the SC), outside any DTT.

7.4 CONCLUSION

177. **Conclusion.** We have performed a high level analysis of the proposed SC and AIC Models from a data protection perspective with a view to identifying possible issues or concerns that these Models could raise.

Following such analysis, it appears that both Models may give rise to data protection concerns which need to be tackled. These issues mainly relate to (i) the identification of the relevant controllers in each system and hence, the identification of the entity or country ultimately liable for the compliance with the data protection requirements under the Data Protection Directive and (ii) the legitimatising ground based upon which the different data processing operations required under both models can take place.

While a more in-depth analysis, in principle, could in our view provide solutions to these main issues (as well as other minor concerns identified) in a European context, these issues are more complex to solve in a non-European context.

From a data protection perspective, the AIC Model offers more safeguards than the SC Model as all processing operations from the Investor to the various MSs acting as AIC, SC and RC would be based on a single legitimising ground being the need to comply with a legal obligation (although other legitimising grounds would be applicable to the SC Model). The legal tool used to implement the system and creating such legal obligation for all the actors involved (which should ideally be a Directive) could also be used to establish a precise and complete data protection framework.

Moreover, the information transferred to third countries would be better protected because all transfer of information under the AIC Model would take place via tax administrations (while, under the SC Model, the first transfer of information is carried out between an AI and the SC). In particular, the direct transfer of information from a Financial Intermediary to third countries, outside the scope of DTTs, is of concern if an adequate level of protection in the meaning of Art. 25 (2) of the Data Protection Directive is not guaranteed in such third countries.

157 One could however wonder whether the level of protection offered by the OECD Model Tax Convention can be considered as sufficient. This point would deserve a detailed analysis regardless the Model ultimately applied.

The main conclusion to be drawn is that the most appropriate way forward would be to create a legal basis (Directive or other binding legal instrument) setting a clear legal framework on how personal data could legally and validly be collected and exchanged between AIs and countries participating in the system so as to reconcile the needs of the simplified WHT relief at source system with the basic human rights of the data subjects involved (i.e. the Investors) in terms of personal data protection.

We therefore recommend to involve all the parties concerned upon development of such legal basis (including both tax and data protection experts) in order to produce both a workable and balanced instrument fulfilling all the initial goals set out for the WHT relief system to be put in place.

* *

*

CHAPTER 8 EFFECTIVENESS AND TAX COMPLIANCE

This chapter includes two main sections. The first section focuses on the effectiveness of the two Models. It analyses how the proposed system, deployed in the two different Models under examination, would work in practice.

The second section analyses the ability of the Models to ensure tax compliance of the Investors, from both a RC and a SC perspective, considering that they are effectively working according to the required standards. In other words, it covers the possibility for tax administrations of RCs and SCs to make sure that the tax paid by their tax residents and the foreign investors is in line with the income/WHT tax legislation.

The findings are summarised in section 3, which also includes an identification of barriers that will have to be removed and obstacles that could have an impact on the concrete functioning of the Models.

In terms of effectiveness and tax compliance, both Models offer advantages, but globally, based on the criteria applied, the AIC Model seems comparatively more convincing.

The AIC Model offers more guarantees to the RC that it will receive investor information as does the SC, while the SC Model refers to a memorandum of understanding that will need to be signed on a bilateral basis and whose terms still needs to be set down.

The AIC Model offers other advantages, such as consistency with current existing exchange of information standards, the standardisation of the procedures under which data is reported, the limited filtering of information potentially enabling further development of the automatic exchange of information between MSs, and the fact that it could avoid conflict-of-laws issues linked to the cross-border transfer of information.

A major benefit of the AIC Model, as currently described, results from the fact that it goes in the same direction as other recent initiatives in the area of information exchange. . Indeed, the AIC Model seems most appropriate to capitalise not only on existing exchange of information programmes, as the current EU Savings Directive, but also on future programmes that will be implemented in the coming years, as FATCA (in the light of the Model 1 Agreement).

Obviously, it appears from this section that extending automatic information exchange with respect to other income and with respect to other types of investors than those covered in the Savings Directive should inevitably lead to an improvement of overall compliance in RCs. However, in the SC Model, the improvement for the RCs is conditional upon the adoption and the effective application of the memorandum of understanding that should determine the timing and the content of the information sent by the SC to the RC.

It appears from this section that the main advantage of the SC Model is the direct financial interest of the various stakeholders involved, while the AIC has no direct interest in the AIC Model. However, some MSs have highlighted the added value that the AIC could bring to the system (e.g. in terms of fraud detection or to facilitate communication with the AIs).

In addition, the SC Model, being based on contractual agreements, benefits from a greater flexibility due to the fact that it can be adapted to the local legal frameworks. However, from a global perspective, that flexibility towards the local regulations could generate a lack of consistency.

It should be noted that the advantages of the contemplated models could be limited due to the specific context or tax regimes applied by some MSs (e.g. local WHT rate in the SC lower than or equal to DTT rate).

There are other aspects that are of course relevant to both Models. The following examples can be highlighted: the need for a structured format, effective requests and exchange of feedback, crosschecking systems and dissemination of data within MSs.

An important note to conclude is, however, that none of the two contemplated Models provides for exchange of information to the RC in the absence of DTT application. Moreover, none of the two contemplated Models provides for an exchange of information to the RC about the principal and its origin. The SC Model foresees the report of information about investors who are resident of the SC (SC=RC); however, this does not seem to be an effective tool to combat tax fraud/evasion being based on the consent of the investor in having his/her information reported.

* * *

8.1 EFFECTIVENESS

178. **Contextual.** When analysing the effectiveness of both Models, it appears that the AIC Model has several advantages that will be highlighted in this section. However, the effectiveness and the ability of the Models to ensure tax compliance will vary taking into account many factors, such as the local tax regime, the IT architecture or the local legal/regulatory framework. As a result, while this analysis will identify the strengths and weaknesses of both Models, the impact of these factors will greatly differ from one country to another.

It is therefore likely that one Model could be more efficient for one country while another country will consider the second Model as more efficient, both countries being right from their local perspective.

The effectiveness of the Models can also depend on the perspective adopted, one of the Models could for instance be more efficient in terms of feedback while it would be less efficient to ensure data quality.

8.1.1 INTEREST OF THE VARIOUS STAKEHOLDERS

179. **SC Model.**

- **Each Stakeholder Has an Interest.** The effectiveness of the SC Model is strengthened by a major factor: each actor in the Model (AI, SC and RC) has in principle a direct financial interest (in terms of revenue) in providing the information to the other;

  - **AI.** The AI has to comply with its obligation to ensure that its clients can benefit from a relief at source and this both from a commercial and operational perspective (note that the interest of the AIs is the same in both Models);

  - **SC.** The key factor is the interest of the SC. The SC receives the reporting from the various AIs, first processes the information received and, in a second stage, sends the information to the various RCs impacted. This process could potentially represent a heavy workload, but the SC receives this information essentially for its own benefit (i.e. to verify whether the reduced WHT at source has been correctly applied by the AI). Moreover, this workload is also compensated by the fact that the SC has a direct interest in providing the information to the RCs. This is because, once the RC receives the information from the SC, it has to provide feedback mentioning which Investors included in the reporting are not having their tax residence in the RC (158). Therefore, it is by providing the reporting to the RC that the SC is able to check if the Investors having benefited from a reduced tax rate were actually entitled to benefit

158 It is interesting to note that the communication made by the SC to the RC (as well as the feedback from the RC to the SC as regards the DTT entitlement of the investors) has not been provided for in the US QI regime since the US as SC is apparently not interested in receiving detailed information on investors (except for US investors). The compliance of the system is indeed rather ensured by external audits, and not by exchange of information. In this sense, the QI regime differs from the SC Model.

from this rate. Moreover, the faster the SC sends the reporting to the RC, the faster it will receive the RC's feedback;

- **RC.** The RC has obviously first an interest in the system as it will receive information on investments made abroad by its tax residents, ensuring tax compliance. It has also an interest in providing feedback to the SC, since the latter will probably be less inclined to cooperate in the future in the absence of such feedback;

- **Investors.** The interest of the Investors is the same in both Models, being that they will effectively benefit from a reduced tax rate under the applicable DTT via a simplified and more efficient procedure.

The fact that all the stakeholders have a direct financial interest in exchanging the information is an advantage of the SC Model;

- **Important Source Countries.** Some countries have queried this advantage of the SC Model. Indeed, some countries, especially countries representing an important capital market, consider the SC approach too heavy as they, as SCs, would have to handle very high volumes of information for the benefit of the RCs. These countries find that the main objective of this element of the system is to prevent tax evasion and they do not want to act as a clearing house for information exchange towards RCs. They would prefer to handle only the information sent by their own AIs;

- **Unconditional Relief at Source.** Initially, the SC Model was essentially aimed at improving the DTT application mechanisms (relief at source and refund) in the SC without having much regard to the situation in the RC. Even if the situation has evolved over time (e.g. the draft Implementation Package is still under development), the SC Model as it currently stands does not submit the application of an AI agreement between a SC and a FI to the effective exchange of information by the SC towards the various RCs concerned by the movable income payments flowing through the AI and with respect to which a DTT relief at source has been applied.

  As a result, in the absence of any bilateral agreement between countries providing for an automatic exchange of information, the risk exists that there will not be a systematic exchange of information from the SC to the RC. This is essentially due to the following elements:

  - The SC Model considered as a whole, i.e. its relief at source and its exchange of information parts, cannot be established solely based on contractual arrangements between the SC and FIs. Indeed, each SC should in addition put in place automatic exchange of information programmes with theoretically as many countries as there are RCs concerned (where, in the AIC Model, this would be replaced by a single piece of legislation, at least within the EU);

- In this respect, it should be recalled that the recent explosion of TIEAs and DTT (protocols) only endorses the international standard for exchange of information on request but not the automatic exchange of information (159);

- As a result, the SC Model cannot be considered as being directly efficient, at least as far as the RC is concerned, in the absence of a broad network of automatic exchange of information programmes (160);

- Considering the quality of the information in principle provided by the AI (and the measures in place to ensure its compliance such as the audit requirements, the risk of being excluded from the system, and its liability towards the SC), the SC does not need in "first instance" (i.e. to check that the AI applied the right TRI based on the elements of information at its disposal) to receive information from the RC (unless in order to check the residence of the Investor claiming the DTT benefits) and therefore will not necessarily be encouraged to provide information to the RC (161). As an example, and as mentioned in the ICG Report, *"the US QI regime* [which, in our view, is like the SC Model as far as the DTT relief at source is concerned] *does not require the QI to provide investor-specific information to the countries of residence of any investors other than US investors, nor to provide such information to the IRS for potential forwarding to the residence countries."* In the QI system, the IRS did not even want to receive any information on Investors, which shows that the application of an efficient relief at source system can be totally independent from any exchange of information with the RCs.

180. **AIC Model.**

- **Lack of Incentive.** As many MSs highlighted the fact that the direct financial interest of all the actors would strengthen the effectiveness of the SC Model, the same actors also insisted on the fact that the AIC is the key actor of the AIC Model but has no direct financial interest in the Model. Indeed, all the information flows, the reporting, the feedback and the corrections, will go through AIC services. Many MSs fear that the lack of incentive for the AIC will have an impact on the system effectiveness. A breach in the processing of the information received and sent by the AIC would have a negative impact on the whole system. Two types of impact are put forward by MSs: the timing and the data quality;

  - **Timing.** The lack of incentive could generate a delay in the processing of the reports by the AIC, which could have an impact on the ability of the system to ensure tax compliance aspects. It could also impact the follow-up of the feedback or correction

159 Even if, as pointed out by some authors, there is nothing in the OECD standards that is conceptually limited to spontaneous exchange of information or to exchange of information upon request.

160 According to Stafford Smiley *"Perhaps the most limiting aspect of the TRACE initiative is its reliance on tax exchange agreements to move information reported by financial institutions to source countries on to residence countries."* Qualified Intermediaries, The EU Savings Directives, *Trace—What Does FATCA Really Add?*, CORP. TAX'N, Sept–Oct. 2011, at 20.

161 As the US QI model currently works as far as the DTT relief is concerned.

requests generated by other MSs. Several MSs are worried that, in the context of the AIC Model, it would take longer for them (acting as SCs) to recover the tax amount under-withheld by the AI, as the AIC has no interest in this procedure;

- **Data Quality.** Other MSs believe that the lack of incentive for the AIC would result in a lack of quality of the data exchanged. In their view, there is a risk that the AIC will not use sufficient resources to verify that the information included in the report meets the required standards. It could be convenient for them to act as mere mailboxes, limiting their action to the transmission of information. In such cases, they would have limited added value and would only increase the time needed for processing and decrease data quality by adding another intermediary in the chain, meaning an additional possibility of errors in processing.

181. **Important AICs.** This problem will be even higher for countries having a great number of AIs but which are not important SCs, or for SCs applying a WHT rate (on dividends or interest paid to non-residents) equal to or lower than the DTT tax rate (as these SCs prefer the SC Model as, in practice, they would not have to handle any information). Indeed, as some countries expressed their concern about the SC approach as they do not want to act as a clearing house for information exchange towards RCs, other countries will have the same criticism with respect to the AIC Model. Both criticisms are valid as it will depend on the specificities of the local framework.

182. **AIC Potential Added Value.** On the other hand, some MSs have expressed their real interest in the role performed by the AIC. They even defend the interest they see, as an AIC, to endorse these responsibilities.

- **Guarantee for the RC**. In the AIC Model, the AIC sends the information to the SC and the RC at the same time and according to the principle described in a Directive or other common regulation. This means that the RC has the guarantee that it receives all the information provided by the AIs. In the SC Model, the content of the reporting sent by the SC to the RC will be determined in a memorandum of understanding. This means that the RC still has to find an agreement to receive this information and that the content of this reporting could be different from one SC to another.

- **Close Relationship.** The AIC generally has a closer relationship with the AI than the SC as the AI often is already acting as a tax intermediary for other purposes (e.g. internal WHT, reporting of local client's income to the tax administration, reporting in the framework of the Savings Directive, stamp duties, etc.) and is already subject to auditing by the AIC. This should enhance effectiveness as the AIC already has to audit the AI for other purposes in any case. Besides, questions raised in the framework of several audits can often overlap;

- **AIC in Turn also SC or RC.** Some MSs believe that the AIC will grasp the system as a whole and are confident that the AIC will be fully aware that the information which it will provide will be a first step to ensure the overall quality of the system. The AICs will see

their responsibility in the context of the mutual responsibilities of each AIC and remember that it is also SC and RC for other AICs in other cases;

- **AIC Simultaneously also SC or RC.** In addition, even in a given case (i.e. with respect to a particular transaction), the AIC will generally also be either the SC (Reversed Cross-Border Scenarios) or the RC (Cross-Border Scenarios). In most cases, AIC will thus in fact have a direct interest in the system, as part of its work as "AIC" is used for its own purposes. This is confirmed by the FIs themselves. It is difficult for them to estimate the percentage that each scenario represents out of all cross-border investments. However, they globally confirm that the triangular situation, being the only scenario where the AIC has no direct interest, is less important than the two others (often less than 10%). So the lack of interest of the AIC is quite relative;

- **Information for Other Purposes.** Information collected from the AIs could be used for purposes other than only exchanging information:

  - Some MSs believe that the AIC can also have an interest in the information transmitted by the AIs. It could be used at a different level. Some MSs already have a long experience in using information transmitted via the current exchange of information system under the Savings Directive in the fight against fraud in their own country. While this information should not impact them at first sight (Investors being tax residents in another MS), it could allow them to identify their own tax residents who are "hidden" by a foreign tax structure;

  - Other MSs believe that the information gathered as an AIC could be very useful from a statistical perspective. This is because, with such data, an AIC should have exhaustive statistics on the foreign investment and could be able to use it as a tool to develop and/or adjust fiscal policy, to carry out macroeconomic analysis, etc. However, for such use, one needs to have sufficient (human and IT) resources available, which is not possible for some tax administrations facing budgetary constraints.

183. **AI's Counterparts.** In addition, from a business perspective, the AIs will have to deal with only one tax administration, being its own tax administration (AIC), which should facilitate the overall effectiveness of the system in many respects (e.g. same language, existing relationships, procedures already known, compatibility of IT systems possibly already in place, etc. (162)). As mentioned by Itai Grinberg (163), who considers the AIC Model routing system as superior, *"financial institutions in cooperative jurisdictions need only send information to one government, under whose law they already operate, thereby avoiding the*

162 In this sense, the ICG Report recognises that the AIC Model "*would probably involve the smallest transition costs for the financial institutions. In particular, this system likely would require the least in terms of changing computer systems, since in many cases intermediaries will already have some reporting obligations with their local tax authorities, which likely take place in electronic form"*.

163 Beyond FATCA: An Evolutionary Moment for the International Tax System, Itai Grinberg, Draft of January 27, 2012, p. 59

specter of thousands of financial institutions attempting to comply with different reporting obligations to dozens of governments".

8.1.2 NUMBER OF INFORMATION FLOWS

184. **Standalone Perspective: Two Flows v. Three Flows.** One of the advantages mentioned by the MSs for the SC Model is the reduced number of information flows. In the SC Model, the AI sends the information to the SC, which then forwards the report to the RC. So there are two flows. In the AIC Model, however, the AI sends the information to the AIC, which then forwards the report to the SC and the RC, giving a total number of three information flows. The SC Model is therefore defined as the more efficient approach.

185. **Global Perspective: Different Multiplication Factors.** However, this aspect should be put in a more global perspective, considering the total number of information flows for the whole exchange of information.

The first factor influencing the total amount of flows for the SC Model is the number of AIs within the MSs (*#AIs*). This number should be multiplied by the number of SCs (second factor). Adding third countries will increase the number of information flows but will not have an impact as such, as the number of participating countries remains the same in both Models, the variable being the number of AIs. Therefore, for this calculation, the amount will be limited to the 27 MSs (*27MSs*) of the EU.

- SC Model
  - In first instance, the number of information flows generated by the SC Model is: *#AIs*27MSs;*
  - In second instance, each SC (*27MSs*) will send the report to each RC (*27MSs*);

    Note that the exact figure is "27" MSs and not "27-1" as the SC will also be the RC for the income paid to its tax residents (and assuming both roles, a flow of information "internal" to the tax administration of the SC will have to take place) (164) considering that all the MSs are exchanging information;
  - The total number of information flows is therefore: #AIs*27MSs + 27MSs*27MSs
- AIC Model
  - In the context of the AIC Model, there is one report per AI (*#AIs*) that is sent to the tax administration of the AIC. Each AIC will then transmit the information to each SC (*27MSs*) and to each RC (*27MSs*);
  - The total number of information flows is therefore: *#AIs+27MSs*(2*27MSs);*

164 Although cases where the SC is also the RC are not, strictly speaking, cross-border payments from a tax perspective and the relief at source according to DTTs does not apply, it is important to address this point. The reason for this is that a SC may nevertheless require the AI to report information not just on payments made for which DTT relief is claimed, but also on payments to residents of the SC that arise in the AIC.

- Comparing both Models from this angle leads to the following mathematical equation:
  - SC Model = AIC Model
  - x*27 + 27*27 = x+27 *(2*27)
  - 27x-x = 1458-729
  - 26x = 729
  - x = 28,03

    Where "x" is the number of AIs participating in the system (#AIs) and assuming that the 27 MSs are participating in the system.

Accordingly, it appears that summing up all the information flows leads to the conclusion that, as soon as 29 AIs participate in the system, the total number of flows in the SC Model becomes larger than in the AIC Model. Assuming (and it seems quite likely) that there will be more than 29 AIs that will participate in the Model, it is reasonable to say that the SC Model entails more information flows for the same result than the AIC Model (165).

186. **Standalone v. Global Perspectives.** This point is important as it was an advantage mentioned by some MSs. So it is interesting to see that reality is different when the system is not analysed on a standalone basis but from a global perspective (i.e. taking into account all the information flows included in the respective Models).

8.1.3 LOCAL WHT RATE IN THE SC LOWER THAN OR EQUAL TO DTT RATE

187. MSs applying a tax rate on dividends or interest paid to non-residents that is equal to or lower than the tax rate included in the DTT have less interest in the contemplated Models as they currently stand (SC Model or AIC Model). The reason for this is that, as foreign Investors already benefit from a tax rate equal to or lower than the treaty rate, there is less risk of fraud and hence less interest, from a SC perspective, in implementing a monitoring tool to fight fraud.

As an example, many MSs as SCs have mentioned the existence of local WHT exemption for interest payments made to non-residents (where this is less often the case for dividends). Accordingly, DTTs are much less often applied to interest payments. Another country even also reported not applying any WHT to movable income payments made to non-residents (regardless of their nature: interest or dividends).

In these cases, the SC Model would at first sight offer the tax administrations of these SCs an advantage in terms of workload. Indeed, as the Investors will not request to benefit from the DTT on certain types of income, this income will not be included in the reporting made by the

165 One could object that not all AIs will effectively receive income from the 27 MSs or will have investors resident in the 27 MSs. Nevertheless, the key element to be taken into account in comparing the two Models from a number of flows perspective, is the "multiplication factor", which is always "1" in the AIC Model (cf. "x") but much higher than 1 in the SC Model (cf. in our example "27x").

AIs and sent to the SC. Hence, the workload for the tax administration of the SC to handle and send this information to the RC would be more limited. These SCs usually see the SC Model as more effective from their perspective as it entails a lower administrative burden.

However, this argument loses part of its relevance considering the effectiveness of the Model as a whole. This is because the overall workload for the tax administrations should remain roughly the same regardless of the Model applied (SC or AIC), as the level of work is more or less simply passed on to one tax administration (SC) or another (AIC). Indeed, unless in the very specific case of absence of WHT on cross-border payments, each tax administration will in any case have to have the relevant resources in place (IT systems, staff, procedures, etc.).

Besides, even if not directly the subject of this study, this argument is mitigated should one consider that, in order to reach the compliance objective in the RC, the exchange of information should cover any movable income payments, regardless of whether or not a DTT is applied (in such case, even SCs without any WHT levied at source should report elements of information to the RCs in the framework of the SC Model (166)).

8.1.4 FEEDBACK LOOP

188. **Direct Relationship between SC and AI.** Under the SC Model, the SC has direct contact with the various AIs. Some tax administrations have confirmed that they believe that a direct relationship between the SC and the AI could be more efficient than an indirect communication going through the AIC. Some tax administrations (as SCs) are concerned about the lack of responsiveness of the AI in the AIC Model or the fact that they will not be able to contact or chase directly the AI if the latter does not reply in time. They find it important that the SC, having the possibility to remove the AI status of the Financial Intermediary, and the AI be in a direct relationship.

Other countries suggest that the handling of feedback loops (RFI, Request for Clarifications, etc. from the SC and/or the RC and passed on to the AIs) by the AIC as provided in the AIC Model could increase the effectiveness of the system. They argue for example that these requests are centralised by Investor within the AIC and not multiplied by the number of SCs. The consequences are that the AIC will have to handle many queries in which it often (but not always) has no direct interest, but the total number of queries for the system decreases. This is especially important from a business perspective.

Moreover, the AIC has a good knowledge of the national legal framework and the specificities of its financial sector. This (technical, legal and cultural) understanding could facilitate communication. In addition, if a specific problem results from the local legal framework, the AIC's tax administration is in a better position to take the appropriate measures or raise the problem at a more political level (167).

166 The SC should first have (to request) access to such information (either directly with the Issuers provided that the latter have access to such information, or with the AIs).

167 However, one should also consider the possibility to extend the system to relief at source under the internal tax legislation of the SC (i.e. relief not applied pursuant to a DTT). In such case, one could argue that the

From a business perspective, it would be more efficient for an AI to build a relationship with only its own tax administration than with the tax administrations of all the MSs. For example an AIC could easily implement a query identification system, including a query number for each request, that would allow the AIC and the AI to ensure a proper follow-up of the various queries. However, such system would be difficult to use if AIs are contacted by all the SCs and have to work with 27 different systems.

189. **Administrative Burden.** However, another aspect should be taken into consideration: the increase of the administrative burden that would result from the SC approach. This may involve following up several hundreds of requests. For example if an Investor indicated a wrong RC, it is one AIC but potentially 27 MSs (if the Investor benefited from a reduced tax rate in the 27 MSs). So it could be one request handled by one AIC instead of 27 requests handled by 27 countries. Considering the total number of requests handled by the MSs, there is a clear lack of effectiveness, due to the fact that it is not possible to consolidate the various requests at Investor level. This aspect will be particularly important for the AIs who will be confronted with a multiplication of the requests for one and the same issue.

190. **Relationship between Tax Administrations.** Some countries expressed concerns about the effectiveness and efficiency of the cooperation between tax administrations of various MSs in the AIC Model. These concerns could constitute a potential barrier to finding a broad consensus for adopting the AIC Model and it could (in a first stage) impact the effectiveness of the system.

However, as some MSs explicitly indicated, it appears to be more a matter of sensitivity than a judgement based on facts and figures. Indeed, for instance, when a question is raised on the functioning of the exchange of information under the current Savings Directive, MSs do not express any major complaint as to the work performed by the other tax administrations. Besides, it also results from the second report of the European Commission on the operation of the Savings Directive where the European Commission mentions that "*Member States have expressed satisfaction with the overall system of automatic exchange of information provided for by the Directive to enable them to ensure that interest payments are effectively taxed. For the period under review, Member States have indicated a clear increase in the quality of data received that they attribute to the structured format and common rules of procedure under which the data is reported.*"

Moreover, the cooperation between tax administrations is also a concern in the framework of the SC Model considered as a whole (i.e. considering its relief at source and its exchange of information parts). As already mentioned, each SC should put in place automatic exchange of information programmes with theoretically as many countries as there are RCs concerned, but the legal cooperation framework so created should then also be effectively and efficiently applied in practice.

SC is in a better situation than the AIC to assess the correct application of such reliefs, and more generally, of its internal tax legislation. This issue could nevertheless be solved in the EU considering the possibilities offered by the Directive on Administrative Cooperation providing foreign agents the possibility to participate in administrative enquiries carried out in other countries.

191. **Statistics.** Other factors increase the effectiveness of the AIC Model. As an example, some countries intend to keep statistics of the feedback to identify recurring errors that could indicate a shortcoming in the procedures of some AIs. This practice is currently applied by some MSs in the current exchange of information system under the current Savings Directive and it allows the State of Establishment of the paying agent to help the paying agent in identifying their weaknesses and to apply sanctions when appropriate. This function, when accurately carried out, is key to ensure the effectiveness of the AIC Model. When considering statistical records as a tool to ensure compliance of the AI, the AIC Model is more appropriate because a single tax administration (i.e. that of the AIC) has a full view on all the AI's operations and not only with respect to one country as in the SC Model.

8.1.5 NON-PARTICIPATING COUNTRIES

192. **Flexibility of the SC Model.** The SC Model is built on contractual agreements between a SC and an AI. This means that on one side, each AI has the option to decide for which country it would like to benefit from the AI status and for which it does not. On the other side, the SC also has the possibility to decide whether it would like to be part of the system or not and, if so, it can decide to authorise some FIs to act as AIs and others not, and this according to the criteria it will have defined. This flexibility of the system is welcomed by the business as well as by some MSs.

193. **Side Effect.** However, there is also a side effect on the effectiveness. If some MSs decide not to participate in the system, it will have a strong impact on the whole Model.

If a MS does not join the system as a "SC" (i.e. it does not enter into agreements with FIs to enable them to act as AIs as provided in the SC Model), which is a unilateral decision, it will not be in a position to automatically exchange information towards the RCs while they could still benefit (168) from the work performed by such countries acting as "SCs" (i.e. data collection) which have decided to join the system.

This could create an imbalance between countries leading to frustrations and less effectiveness.

Example (Triangular Scenario in the EU involving Country X, Country Y and Country Z).

- Country X does not participate in the system (it does not enter into agreements with FIs to enable them to act as AIs);
- Country Y and Z participate in the system (they do enter into AI agreements);

168 Either based on an automatic exchange of information programme entered into between the Competent Authorities of both countries or, within the EU, possibly based Article 9 of the DAC, which specifies that each competent national authority shall communicate information to the Competent Authority of any other EU country in the case a person liable to tax obtains a reduction in, or an exemption from, tax in one EU country which would give rise to an increase in tax or to liability to tax in the other EU country (cf. Subsection 5.1).

- Assuming a dividend from Country X as SC to Country Z as RC (and Country Y as AIC): Country X does not grant relief at source according to the DTT between Country X and Country Z (169) and is therefore not in a position to automatically exchange information on Investors resident in the latter;

- Assuming now a dividend from Country Z as SC to Country X as RC (and Country Y as AIC): Country Z grants relief at source according to the DTT between Country X and Country Z and is therefore in a position to automatically exchange information on Investors resident in the latter;

- This may mean that the tax administration of Country X could receive information about its own resident Investors so as to ensure their tax compliance while not being obliged (or, at least, with the risk of not being in a position) to exchange similar elements of information towards Country Z.

The same kind of issue would arise at the level of the feedback loops. Indeed, in the above example, in the case Country X has not put in place the systems and procedure necessary to send the relevant feedback to Country Z, then Country Z will not be in a position to double-check the residence status of the Investors deemed to be resident in Country X either.

194. **Potential Solutions.** Different options could be proposed to solve this issue (i.e. to avoid that non-participating SCs benefit from the work performed by participating SCs):

- The agreement between the SC and the AI could provide that the system can only be accessed by Investors resident in participating countries. But this option is not included in the SC Model as it currently stands, and would reduce the effectiveness of the Model (e.g. a list of participating SCs would have to be maintained, the AI agreements would have to be updated taking into account additional participating countries);

- Within the EU, a specific piece of legislation could force all MSs to enter into the SC Model (170).

195. **AIC Model.** On the contrary, the AIC Model is less flexible by definition as it requires in principle the agreement of 27 MSs, unless enhanced cooperation can be put in place. This lack of flexibility is compensated by the robustness that results from the common legal basis of the system.

8.1.6 DATA QUALITY

196. **Data Quality.** The SC Model and the AIC Model will only be efficient provided that sufficient data quality is delivered.

More precisely, it is important that all the required elements of information are reported (171), but also that the elements of information reported are accurate (e.g. when a TIN has to be

169 At least, it does not grant relief at source on a large scale as it would be the case when applying the SC Model. Such cases are put aside for the sake of the example.

170 Even in such case the issue however remains in case of non-cooperating (third) countries.

reported, it is important that a correctly formatted TIN is reported, but also that such TIN is the correct one).

The governing principles of both Models listed below should *a priori* ensure reaching sufficient data quality for both Models:

- the mandatory feedback from the various stakeholders;
- the audit and liabilities of the AI (and the potential sanctions, especially in the case of under-withholding); and
- the IT architecture.

197. **Lessons from the Savings Directive.** With respect to the quality of the data, and whichever the Model used, it is useful to consider the lessons learned from existing regulations organising an automatic exchange of information on a large scale (i.e. the Savings Directive).

As already mentioned above, MSs have generally expressed their satisfaction with the data received under the Savings Directive to ensure their taxpayers' compliance for the reporting of interest income. The MSs have also highlighted a clear improvement in the quality of data received under the Savings Directive that they attribute to the structured format and common rules of procedures under which the data is reported. By comparison with exchange of information under bilateral treaties, the quality of the data received under the Savings Directive is considered as being significantly higher.

198. **Effective Feedback to Improve Data Quality.** Regarding the current exchange of information under the Savings Directive, it is interesting to note that some countries complained about the quality of the data. However,

- **State of Establishment of the Paying Agent.** They also mentioned that they usually do not provide feedback to the paying agents as they are often able to identify the Investors with the other elements of information included in the reporting (the main problem being due to the absence of TIN or its wrong format) (172);
- **Residence Country.** Most of the MSs confirmed that they usually do not send feedback to the state of residence of the paying agents unless they suspect fraud. They prefer to avoid sending feedback as they do not want to create extra administrative workload.

This behaviour does not contribute to the overall improvement of the data quality (besides being contradictory).

Indeed, in the current situation, FIs know that a missing or wrong TIN is not a blocking factor (upon upload of the report in the systems of its state of establishment) or is not

171 In the scope of this study, the content of the information reported is assumed to be the same in both models.

172 According to the Commission Staff Working Document mentioned above, "*not all the MSs carry out checks on the content of the information received from paying agents where such checks should be made systematically*".

corrected/sanctioned (after the checks have been carried out by its state of establishment or by the RC of the Investor). Therefore, some FIs may consider the report's quality sufficient without the TIN in practice. In such case, the FIs are not motivated to update their files (e.g. by contacting clients to obtain the required information). If the feedback becomes mandatory, then FIs will know that they should better contact the client to obtain its TIN (if there is a TIN in its RC) as they will have to obtain the TIN at a later stage in any case.

This situation can find explanations in the drafting of the Savings Directive, which does not provide for automatic feedback.

The SC Model and the AIC Model solve partially this issue as both Models provide for automatic feedback. On this point, the effectiveness of both Models should be strengthened compared to the Savings Directive.

- **Current Version of the Models.** Even if feedback is mandatory only for tax residence of the Investor, it should still increase the amount of feedback provided and therefore the overall quality of the data;

- **Recommendation to Increase Data Quality.** The feedback should be mandatory for all the information mentioned in the report, for which the RC and SC is able to check the information. This mandatory feedback should offer two advantages:

  - First, once the information is corrected in the database of the AI, it should be right in the following reporting. The overall quality of the data should therefore increase;

  - Second, knowing that they will have to obtain the right information in any case, the AIs will be encouraged to anticipate feedback requests from the various tax administrations by collecting and providing more accurate information.

199. **Liability of the Financial Institutions.** The Savings Directive does not directly provide for sanctions in the case that paying agents do not comply with their obligations (173). Art. 1.2 of the Directive indeed only mentions that *"Member States shall take the necessary measures to ensure that the tasks necessary for the implementation of this Directive are carried out by paying agents established within their territory, irrespective of the place of establishment of the debtor of the debt claim producing the interest."* In other words, the responsibility for defining the sanctions applicable to the paying agents in the case of non-compliance lies with the various MSs, which can lead to discrepancies.

From the report of the European Commission, it appears that all MSs have introduced significant safeguards to ensure the correct implementation of the Savings Directive.

The approaches range from inducing compliance by way of cooperation with paying agents to imposing relevant penalties and sanctions in the case of non-compliance.

173 In particular, there was no need to provide specific sanctions in the case of "under-withholding" in the framework of the Savings Directive in the absence of any WHT levied (except during the transitional period).

The SC Model and the AIC Model, on the other hand, do provide for specific sanctions in the case of non-compliance, which should improve the effectiveness of the Models.

- The AI is liable for any under-withholding and the liability of the AI remains, even if the AI complied with all the procedures and guidelines defined in both Models;
- Poor quality or recurring errors could trigger additional external audits and, in the worst case, termination of the agreement between the AI and the SC (under the SC Model), or withdrawal of its authorisation (under the AIC Model). So the AI would no longer be allowed to offer its client the benefit of the relief at source system, which could constitute a competitive disadvantage (on top of reputational impact). This strong incentive should have an impact on the quality of the reporting.

200. **IT Supporting Solutions.** In the framework of the Savings Directive, it has been mentioned that the development of risk management and a more automated process of crosschecking the data should be encouraged to limit the need for costly investigations of individual taxpayers. Besides, it would appear that a structured process of the dissemination of data from the receiving unit to the tax collection services in the MSs could improve the effectiveness of the use of data to target specific taxpayers.

The IT architecture to be put in place in both Models should leverage on this experience so as to ensure the data quality. The IT architecture that will support the SC Model and the AIC Model has not been defined yet but it will have to contain sufficient filters and coherence checks to ensure that the information inserted in the system, if not correct, is at least consistent in terms of format and coherence. For instance, in the future architecture, it should not be possible for an AI to insert a TIN that does not fit with the TIN format of the RC (174); the AIC/SC should reject any reporting made by AIs with missing data; and reconciliation tools should ensure that the data received from the various AIs matches the data included in the various reports sent by the AIC/SC (175).

201. **Importance of the TIN**. Many MSs have highlighted the fact that the TIN is really important as it would allow routing of the information to be automated. However, it is often missing in the reports provided under the current Savings Directive.

Potential solutions to this issue have already been mentioned in the mandatory feedback, which should motivate FIs to look for this information that is not always in their databases. It has also been addressed in the paragraph on the IT solutions, where the solutions put forward

174 In this respect, it has been mentioned in the framework of the Savings Directive that "*the possibility of a better registration of the Tax identification number (TIN) with which to identify the taxpayer has been highlighted by Member States as a major factor for improving the quality of the data received. If such a number is properly reported by the paying agent, the tax administrations of Member States can then easily identify the beneficial owner. By default or for countries where no TIN exists, the date and place of birth must be correctly reported. If these essential elements are not properly reported by paying agents, Member States face difficulties in identifying the beneficial owners*".

175 These IT functionalities and procedures have been defined for the purpose of this feasibility study and are recommended for the implementation of both Models. However, they will have to be discussed and agreed with the EU MSs.

should prevent the AIs from including a wrong TIN format in the reporting. Two additional tools should increase the quality of the TIN:

- **The "TIN on Europa" Application**. This is a portal whereby information about TINs that Member States choose to publish is available in one single Internet page and include among others the following: descriptions of the structure and specificities of the national TIN, examples of official documents showing the TINs, national websites and contact points;
- **TIN Mandatory on ISD**. The TIN should be requested in the ISD, if there is a TIN available in the RC. As the TIN is sometimes not mentioned on an ID card, a passport or another identity document, it would ease the identification of this information. Moreover, it would mean that, if an Investor has benefited from relief at source, the AI should have the TIN in its database if it complies with the requirements.

From a more general perspective, the TIN has demonstrated its added value in the countries where it is used, especially for the automation of the routing of the information and for the reconciliation of the data located in different databases. Therefore, the adoption of a TIN in all the participating countries is strongly recommended to improve the overall effectiveness of the system. A standardised TIN at EU level (176) would offer additional possibilities. However, many countries have expressed a clear opposition to the idea, as it would require them to adapt their IT applications and in many cases official documents (ID cards, passports etc.).

8.1.7 ADJUSTMENT OF UNDER- AND OVER-WITHHOLDING

202. **Flexibility of the Models.** If an AI discovers that it applied to cross-border securities income a lower tax amount than it should have, it can pay the tax amount under-withheld at the time of or after the annual reporting.

If this error is discovered before the annual reporting, then the Models leave to the stakeholders impacted the opportunity to choose the most appropriate corrective actions (e.g. withhold the under-withheld amount on a future payment credited to the same account).

This flexibility is an advantage for the business but it could also have an impact on the effectiveness of the Model. Indeed, if an AI corrects many errors via the set-off procedure, it will be very difficult to keep track of the tax applied to the various transactions.

203. **Effective Error Tracking.** If an error has to be corrected before the report generation, the AI will always have to transfer the cash via a specific transaction, referring to the transaction for which a wrong tax amount was withheld.

176 Brussels, 27 June 2012, COM(2012) 351, "*Communication from the Commission to the European Parliament and the Council on concrete ways to reinforce the fight against tax fraud and tax evasion including in relation to third countries";* Press Release IP/12/697, Brussels, 27 June 2012, *"Tackling tax fraud and evasion: Commission sets out concrete measures"*.

This procedure is less flexible but it has the advantage that it will be easier to identify the errors and how they have been corrected, even some years later. It would therefore be more efficient in the long run.

8.1.8 CONTRACTUAL AGREEMENTS V. COMMON REGULATION

204. **SC Model.**

- **Flexibility.** As the SC Model is built on contractual agreements between SC and AIs, it offers the possibility to the SC to amend some parts of the templates provided by the Implementation Package, even though the objective of the Implementation Package is to standardise to a maximum extent the legal documentation which should be used. These amendments could incorporate some specificities of the SC's local framework. So, a SC will always be free to amend the agreement it wants to use, knowing that some countries have more power than others in negotiating the terms, content and wording of contractual documentation (177);

- **Lack of Consistency.** There is, however, a risk that this flexibility, aimed at strengthening the system, results in a lack of consistency of the processes and procedures applied by the various SCs. This would decrease the effectiveness of the SC Model, especially for the AIs that would have to generate one report for each SC and according to different requirements.

205. **AIC Model.**

- **Consistency.** Contrary to the SC Model, the AIC approach is based on a common regulation (such as an EU Directive). The main advantage is the consistency of the procedures and processes between all the countries participating in the system. There is thus no negotiation between countries about the content and the wording of an agreement. This homogeneity should strengthen the effectiveness of the AIC Model.

8.1.9 INDEPENDENT REVIEWER'S REPORT / AUDIT BY TAX ADMINISTRATIONS

206. **SC Model.**

- **Designation of the Independent Reviewer.** The Implementation Package specifies that the AI selects the independent reviewer to be approved by the SC. It is likely that the agreement on the independent reviewer should not be an issue. However, potentially, this requirement could lead to a situation where one AI would be audited by different independent reviewers for different SCs, which would be inefficient (increase costs for the AI, loss of time in the review process, duplicated issues, etc.);

- **Standardisation.** From the same perspective, the Implementation Package also encourages the SCs to agree on a common external review. Again, an SC should in

177 Whereas in the AIC Model, where a common regulation would apply, the allocation of power between MSs is more balanced (considering the unanimity requirement in direct tax matters) leading to relatively more safeguards to less powerful MSs.

principle not be reluctant to rely on an audit carried out for another SC, but it still includes the possibility for an AI to be audited several times for different SCs (by an independent reviewer or by representatives of the SC or the tax administration of the country where the AI is located, as provided in the Implementation Package).

207. **AIC Model.**

- **Designation of the Independent Reviewer.** The AIC Model specifies that the AI selects the independent reviewer according to criteria that should be determined at EU level. The audit report produced by this independent reviewer will therefore be valid for all the SCs, thereby avoiding the risk of decreasing the effectiveness of the audit process due to a difficulty to reach an agreement between SCs;

- **Joint Audit.** In addition, in order to avoid duplicative audits for the same AI, the AIC Model favours simultaneous controls, presence in administrative offices and participation in administrative enquiries by foreign agents as provided in the Directive on Administrative Cooperation (a specific procedure in this respect being proposed in the governing principles).

8.1.10 EXISTING EXCHANGE OF INFORMATION BALANCE

208. **Consistency with Existing Exchange of Information Standards.** According to the existing standards on exchange of information provided for in the OECD Model Tax Convention, the Competent Authorities should already be able to collect information held by local banks, without restrictions, so as to be able to comply with requests for information made by treaty partners even if the first country has no interest in the information requested. Given the territorial character of the tax legislation and the data protection legislations, such access is limited to the tax administration of the country of establishment of the financial institutions (i.e. the AIC to the exclusion of tax administrations of other countries, such as SCs).

The AIC Model follows the same approach, and in this sense, is more in line with current practice and recent developments (178). In this respect, the ICG reports recognises that the approach taken under the AIC Model *"is more consistent with existing structures for exchange of information, in that a financial institution would be required to deal only with one tax authority, and that tax authority would then deal with other tax authorities"*.

On the other hand, the approach followed in the SC Model would have the following consequences:

- Different routings would apply to different types of income (e.g. dividends and interest would be passed directly and automatically by the AI to SC (and then in principle to the RC) while information on other types of income such as capital gains, principal, information on derivative products, etc. would most probably have to flow to the RC (with

178 Cf. the recent Joint Statement mentioned in the introduction to this study.

a view to ensuring tax compliance of the Investor) from the AIC if such information is held by a FI (on request or spontaneously or possibly even automatically (179));

- More importantly, different routings would apply to the same type of income depending on whether or not DTT relief at source was requested. Indeed, where DTT relief at source is applied, information would flow from the AI to the SC and then from the SC to the RC while, in the absence of DTT application, information would most probably have to flow to the RC (with a view to ensuring tax compliance of the Investor) from the AIC if such information is held by a FI or from the SC (provided that the latter has access to this information).

209. **Power Relationships.** The SC Model empowers the SC and, in extreme cases (e.g. for big SCs), enables the SC to obtain a tremendous amount of valuable confidential information on non-resident Investors all over the world without necessarily having the need for such information (180) and without safeguards on the utilisation of such information (and it is obvious that, banking/financial information is sensitive by nature, and not only for tax reasons). One should agree with Itai Grinberg when he mentions that the Savings Directive routing system *"avoids concerns about power shifts associated with adopting a multilateral information exchange regime that alters the distribution of information with respect to non-resident accounts"* (181) (182).

8.1.11 FILTERING OF INFORMATION

210. **Filtering of Information.** The SC system's routing Model, on the other hand, *"is inapt for a multilateral regime focused on residence taxation"* (183) as *"it disaggregates the information relevant to residence countries – a complete picture of their residents' offshore accounts – and excludes part of that picture, namely information related to payments not eligible for reduced withholding"*. For example,

- Assuming an AI has potentially 100% of information available regarding movable income payments made to its clients;
- Such information is filtered when exchanged to the respective SCs as only information on movable income payments for which DTT relief at source has been applied is provided (the objective of the SC being to check that the DTT has been correctly applied);

179 If an automatic exchange of information programme is in place between AIC and RC.

180 In the framework of the QI system, the US agreed not to.

181 Beyond FATCA: An Evolutionary Moment for the International Tax System, Itai Grinberg, Draft of January 27, 2012, p. 59

182 The author goes even further when he mentions that *"a globalized version of the EU routing system would send information about non-residents through the country where asset management occurs. The government of the asset-management country presumptively already could access that information today. For that reason alone, this system seems both the most fair and least disruptive."*

183 Beyond FATCA: An Evolutionary Moment for the International Tax System, Itai Grinberg, Draft of January 27, 2012, p. 59

- Besides, the information is also filtered per SC, as a given SC will only receive information regarding payments originating in the latter (an SC has no interest in payments originating in other countries);
- In such case, should the RC want to ensure compliance of its resident Investors as regards movable income payments for which a DTT has been applied, it will have to reconcile all the information received from the various SCs;
- Moreover, should the RC want to also ensure compliance for other movable income payments (i.e. without DTT application), its only recourse will be the AIC (through exchange of information upon request);
- In the framework of the AIC Model, on the other hand, the information automatically received will of course still only concern movable income payments where a DTT has been applied, but such information will be received only from one tax administration, being that of the AIC. Moreover, as the AIC has access to information about the whole portfolio of the Investor, the AIC will in any case be the right interlocutor with respect to any further request for information that would for instance concern payments for which no DTT was applied.

8.1.12 LINK WITH OTHER AUTOMATIC EXCHANGE OF INFORMATION PROGRAMMES

211. **The EU Savings Directive and FATCA.** During the past years, several automatic exchange of information programmes have been developed and some are expected to be implemented in the coming years. While these tools represent progress for the tax administrations and the fight against fraud, they also represent an increase of the administrative burden for the financial sector. If these tools adopt different communication channels, they could even become operationally too heavy for tax administrations. This concern was highlighted by the business representatives but also by some MSs.

This subsection considers two automatic exchange of information programmes that are expected to have an impact on all the EU MSs: the current EU Saving Directive and the FATCA.

212. **Interactions with the EU Savings Directive**. The business has clearly expressed its wish to have the exchange of information required under the Savings Directive integrated within the new AIC Model, if this approach is adopted by the MSs.

However, as it has been demonstrated in section 5.3 analysing the interaction with the Savings Directive, the scope of this Directive (payment of interest, irrespective of the fact that a DTT was applied (184)) and the content of the reporting (gross amount added according to defined categories) are different than in the SC and AIC Model. Therefore, this integration would

184 The fact that the Savings Directive does not consider the tax treatment in the SC (i.e. does not organise WHT relief at source/refund in the SC) might not constitute such a big issue in practice since there is in many MSs no WHT on interest income on widely held debt securities (internal tax laws often providing exemptions in this respect or a WHT rate equivalent to the maximum DTT rate), while it is much less often the case for dividend payments.

require some amendments in terms of scope, functioning and objectives of this Directive, which are currently not planned.

213. **Capitalising on the EU Savings Directive**. If the integration of the Savings Directive and the future AIC Model seems hypothetical at this stage, capitalising on this approach is a real advantage. Indeed, FIs have already developed IT systems to provide such information to their tax administration, and tax administrations are used to sort and send the reporting by RC. From an IT architecture perspective but also from a training perspective, the AIC Model can capitalise on the Savings Directive and decrease the administrative burden resulting from the reporting.

214. **Interaction with FATCA**. The FATCA regulation should apply as of 1 January 2013 and is still evolving (cf. Appendix1). There is no need to come back on the objectives and the logic of the FATCA, which are totally different than in the SC or AIC Model. The business knows that the FATCA will be implemented and, in recent years, they have been negotiating with the IRS with a view to making the application of FATCA less burdensome and costly. The financial sector has expressed the major concern that such projects would be multiplied and developed without any consistency. Taking into consideration the EUSD, which is already applied, and FATCA, which will be applied, the SC or AIC Model would necessitate a third exchange of information.

215. **Consistency with the Model 1 Agreement**. The Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA (Model 1) provides for the implementation of FATCA in a different way than originally designed. MSs that will enter into an agreement with the US along the lines of this Model Agreement (185) will automatically exchange with the US information that will be provided to them by their financial sector. So the channel of communication is also AI-AIC. As for the Savings Directive, the integration of the FATCA and the SC or AIC Model would require amendments that would change the philosophy and the objectives of the Models. However, the AIC Model would allow the financial sector and the MSs' tax administrations to use the same IT infrastructure and similar procedures to generate, process and send the reporting. This would decrease the administrative burden for the various stakeholders and reduce the implementation costs of the AIC Model.

This consistency may be reduced in the light of the Joint Statements signed by the US, respectively, with Switzerland and Japan and of the Model 2 Agreement developed by the US to facilitate the implementation of FATCA. The Model 2 Agreement provides two elements:

- On the one hand, a direct reporting of information by FIs to the US with respect to Investors consenting on such information exchange; and
- On the other hand, an exchange of information by the country where the FIs are established on the basis of group requests for information made by the US, with respect to non-consenting Investors.

185 The United Kingdom and the US entered into such kind of agreement on 12 September 2012.

Therefore, the Model 2 introduces a different system, meaning that FIs located in different countries may need to comply with three different procedures (i.e. original FATCA, Model 1 and Model 2).

216. **Future Integration of the AIC Model.** Whereas integration of the current Savings Directive into the AIC Model is not envisaged at this stage, the AIC Model can still capitalise on existing and future automatic exchange of information programmes within the EU, and this will also ease a potential future integration of the AIC Model and the Savings Directive and/or the FATCA.

8.1.13 CONFLICT-OF-LAW

217. **Potential Conflict-of-Laws.** Finally, the AIC Model, being supported by a solid legal basis, could offer a solution to the potential conflict-of-law issues associated with FIs reporting directly to foreign sovereigns (cf. Chapter 5 on the data protection analysis). This is a very important aspect and should not be underestimated by MSs wishing to implement a simplified a relief at source system like the one examined in this feasibility study.

8.2 TAX COMPLIANCE

218. **Tax Compliance Matrix.** The question of the tax compliance can be illustrated according to two basic dimensions in Cross-Border Scenarios (i.e. when the SC is different than the RC):

- Which country is at stake (SC or RC)?
- Is a DTT applied or not?

This framework leads to basically four situations:

	SOURCE COUNTRY	RESIDENCE COUNTRY
NO DTT APPLICATION	Compliance OK (out of scope / no issue)	Compliance OK? (out of scope / big issue)
DTT APPLICATION	Compliance OK? (in scope = relief at source part of the Models)	Compliance OK? Income / Principal (amount and origin) (in scope = exchange of information part of the Models)

Table 15: Tax Compliance Matrix

- **No DTT Application.** Situations where no DTT application is requested by the taxpayer are, *per se*, out of scope of the present study;
  - **Tax Compliance in SC.** It is nevertheless interesting to note that, in such case, there is by definition no issue of tax compliance in the SC since the latter should in such case apply the WHT rate fixed in its internal tax legislation (thus no specific

"benefits" for the taxpayer; more specifically no relief at source or refund according to a DTT);

- **Tax Compliance in RC.** However, the situation in terms of tax compliance in the RC is totally different as none of the two contemplated Models as they currently stand provides for exchange of information towards the RC (186). As a consequence, non-compliance in the RC is not tackled. Although this is not within the scope of this study, one could recommend an extension of the automatic exchange of information Model applied (SC Model or AIC Model) to all movable income payments, regardless of whether or not DTT application is requested. This can basically cover the three following situations:
  - **No Need.** The Investor can benefit from a lower WHT rate (or even exemption) based on the local legislation of the SC, so that there is no need for applying a DTT;
  - **No Possibility.** The Investor is resident in the SC, so that there is no possibility to obtain a reduced WHT rate under a DTT;
  - **No Willingness.** The Investor, whatever the reason, does not request the application of the reduced WHT rate under the DTT. This choice can be based on various reasons, including, but not limited to, tax fraud/evasion.

  It is important to note that, the Implementation Package requires AI to report to the SC income received by Investors having their tax residence therein (SC=RC), even if no DTT was applied as it is a domestic situation. This information is particularly relevant for the RC to ensure that its tax residents have correctly mentioned this income in their tax returns. However, this does not seem to be an effective tool to combat tax fraud/evasion as it suffers from the same limitations as the cross-border income. This is because this exchange of information will be limited to Investors who have signed an ISD, hence to Investors who have actually agreed to have their information disclosed to their RC. Consequently, the system clearly offers an opportunity to Investors to stay outside the scope of the AI's reporting obligations.

- **DTT Application.** Situations where DTT application is requested by the taxpayer have an impact both on the SC and the RC, the consequences being closely related with each other. In this situation, both Models provide for an automatic exchange of information between SC and RC so that both countries should normally have enough information to ensure tax compliance;
  - **Tax Compliance in SC.** In the SC, information (indirectly) collected from the RC will enable checking the residence status of the Investor;
  - **Tax Compliance in RC.** In the RC, information (indirectly) collected from the AI will enable checking that the Investor complied with its income tax obligations.

186 Especially for dividend income with respect to which the Savings Directive is not applicable.

However, such conclusion must be put into perspective taking into account the fact that compliance in the RC is highly dependent on the RC's income tax system:

- Information required to correctly assess the WHT rate in the SC under the relevant DTT is not necessarily sufficient (e.g. the income definition under the DTT does not match with the internal tax legislation qualification in the RC) or necessary (e.g. the movable income is not as such subject to tax in the RC) to ensure compliance in the RC;

- None of the two contemplated Models as they currently stand provides for an exchange of information about the principal and its origin to the RC. In other words, only information about the movable income payments (as defined in the OECD Model Tax Convention) is exchanged.

219. **Contextual.** To know whether the SC Model or the AIC Model would allow the tax administrations of the MSs to apply correctly, as a RC and as a SC, their own tax legislation, the system has to be considered in its *"to be"* situation. This means that the various constraints or errors that could occur in processing will not be taken into consideration here. The reason for this is that these aspects will mainly depend on the quality of the implementation and on compliance with the required procedures.

220. **Effectiveness Leads to Compliance.** This section is obviously closely linked to effectiveness (effectiveness can indeed be understood as "leading to" compliance, even if two systems with different effectiveness degrees can lead to the same level of compliance in the end). Most of the comments made in the previous section in this respect should still be considered.

221. **Content.** As already mentioned, the main focus of the study is the analysis of the channels of information used to exchange information towards the RCs and SCs, whereas the content and level of information required are in principle out of scope (187). These elements have indeed already been considered in the Implementation Package and both the AIC Model and the SC Model are similar on that point (cf. subsection 4.5.1 above). Since the content of information is, in this part of the report, the same in both Models, there is no difference between the Models in terms of compliance.

Some MSs have highlighted the fact that the information provided is not sufficient (188) to allow them to calculate the tax amount to be included in the tax return. All the countries using the principal amount for taxation purposes (189) instead of the income (dividend and/or interest) are especially concerned about this inadequacy between the information received and their need to determine the tax amount due. In other words, the elements of information reported would not be sufficiently detailed to fit in each RC's tax system, whichever the

187 The study nevertheless addresses in the Fraud Analysis chapter whether other elements of information could be relevant in the fight against tax fraud.

188 As it is already the case in the framework of the Savings Directive.

189 Income taxes, but not only (e.g. succession duties, net wealth tax, etc.).

Model used. Such countries nevertheless consider the information received as an incentive to ensure compliance in the RC (combined with the possibility to send requests for information).

From a general perspective, it seems very unlikely to identify a reasonable panel of information that would allow all the tax administrations to compute the tax amount to be included by the tax residents in their tax returns. There is indeed no harmonisation at EU level with respect to taxable income, income definition, deductible items, computation of the taxable basis, consequences of FX differences, etc. (and, on top of that, different rules generally apply to different types of Investors in the same country).

Another difficulty for tax administrations in both Models is the identification of the beneficial owners and the use of various legal figures for treaty-shopping and/or tax fraud/evasion.

222. **Compliance Issue Essentially in RC.** Exchange of information and compliance is more an issue for the RCs because SCs, as already mentioned, can rely on the audit, liabilities, sanctions, etc. provided in the Models to already ensure a sufficient level of compliance.

223. **Increased Compliance in RC.** Both Models should increase compliance in the various RCs compared to the existing situation. This conclusion is drawn from the fact that, so far, the only automatic exchange of information system on a large scale across the EU in place is the Savings Directive, the scope of application of which is rather limited. Extending automatic information exchange with respect to other income and with respect to other types of Investors should inevitably lead to an improvement of overall compliance in RCs (190). However, this exchange of information is automatic in the AIC Model, implemented via a Directive, while the content and the timing of the exchange of information towards the RCs are determined via a memorandum of understanding in the SC Model. The AIC Model therefore offers more guarantees in this respect.

224. **Lessons from the Savings Directive.** The Savings Directive has already delivered several lessons demonstrating an increase in tax compliance in the RC (even if there is still much room for improvement), and the quality of data received by comparison with exchange of information under bilateral treaties is apparently significantly higher. This is probably due to the manner in which the cooperation between MSs is organised in the Directive (essentially multilateral and binding on all MSs) as well as the very nature of this regime, which is "residence-based".

The AIC Model as it is presently conceived, attaches the same importance to source and residence taxation, while the SC Model, as a source-based system, focuses mainly on source taxation. As a result, the AIC Model offers better perspectives with respect to tax compliance in the RC.

190 However, better compliance does not mean that it will automatically lead to increased tax revenue for EU countries considered together, nor for each separate MS, since setting up the SC Model or of the AIC Model at EU level will in principle entail increased application of DTT reliefs. There will thus be a trade-off between loss of tax revenue in SCs (in terms of WHT retained, but also in terms of pre-financing advantage compared to refund systems) and increased tax revenue in RCs (taking into account that most SCs will also be RCs).

When saying that the SC Model is a "source-based" system, it means that;

- **In the Case of Application of a DTT.** Considering the quality of the information in principle provided by the AI (and the measures taken to ensure the AI's compliance such as the audit requirements and its liability towards the SC), the SC does not need to receive information from the RC (unless in order to check the residence of the Investor claiming the DTT benefits) and therefore will most probably not be encouraged to provide information to the RC (191);

- **In the Absence of Application of a DTT.** The SC, by definition, does not need any information from anybody, and will not seek such information (the only exception to this fact is when the SC is also a RC). As a result, in the absence of information received, there will not be any effective exchange of information towards the RC.

In the SC Model, this lack of interest of the SC in the absence of DTT application also tends to limit the development of the SC Model. Indeed, as mentioned above, it is not in the interest of the SC to receive from the AI more information than required to ensure the correct application of the DTTs. On the other hand, the AIC Model is already suitable should more information have to be automatically exchanged towards RCs (192).

225. **Timing.**

- **SC Model;**

  - **SC Perspective.** The timing of the SC Model is mainly impacted by the fact that the system is built on contractual agreement. Therefore, the timing for the various AIs to send the report to the SC could potentially differ depending on the agreement. The main advantage in terms of tax compliance from a SC perspective is that the SC will be able to request the reporting from the AIs according to its tax procedures. So the information should be available at the time it would need it (193);

  - **RC Perspective.** From a RC perspective, the SC Model provides less guarantees. Indeed, as this is not part of the contractual agreement, the RC can only rely on the interest of the SC to verify that the Investors included in the reporting are indeed tax residents of the RC. If the SC wants to receive this information in time, it has to send the report to the RC as soon as possible. However, this timing is more based on the needs of the SC and not of the RC (194);

191 As the US QI model currently works as far as the DTT relief is concerned.

192 For instance, in the framework of the Memorandum of understanding on automatic exchange of information for tax purposes.

193 Provided that the SC needs and seeks such information at all (cf. above).

194 However, Article 10 of Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation specifies that "*the competent authority to which information referred to in Article 9(1) becomes available, shall forward that information to the competent authority of any other Member State concerned as quickly as possible, and no later than one month after it becomes available*". If this Article is applicable, it would mean that the SC would have no more than one month to send to the various RCs concerned the information in its possession.

The RC could rightly fear that it will not receive the information when it needs to, according to its specific tax procedures. To cope with that issue, the SC Model suggests that governments adopting the system are encouraged to agree on the timing and procedure of such exchange of information by entering into a memorandum.

- **AIC Model;**

  - **Timing is not Defined.** Currently, the timing of the exchange of information under the AIC Model is not defined. The existing Savings Directive specifies that the communication is automatic and takes place at least once a year, within six months following the end of the tax year of the MS of the paying agent, for all interest payments made during that year (195).

    Some MSs have advised that this timing is not aligned with their tax calendar. They highlighted the fact that they need the information earlier in the year. As for the SC Model, it is likely that the countries participating in the system will have to define a timing that would allow them to ensure tax compliance. This agreement will have to take into consideration the point of view of the business. The financial sector is indeed concerned by the fact that they would have to provide a reporting more important than the current one in a shorter period;

  - **Timing for Ensuring Compliance.** It should be pointed out that, although the timing as determined in the Savings Directive could appear to be insufficient in some countries to confront the Investor with the information from the AIC in the framework of the filing of the income tax return in the RC or to compare the information reported by the Investor in his tax return with the information from the AIC before sending out the initial assessment notice (i.e. the assessment notice in principle sent out based on the information originally reported by the taxpayer), it should nevertheless be sufficient to ensure compliance in the framework of the normal course of audits of the taxpayer's situation.

226. **Ability to Use the Information.** Receiving the information is definitely a first step but it is not sufficient to ensure the tax compliance of the tax residents. If the information is not received by the relevant services in charge of tax collection, then the information is useless. During the second review of the effects of the Savings Directive (196), the European Commission confirmed that some MSs are still not able to dispatch the information to the team that needs this information to check that the cross-border securities income has indeed been included in the tax return, while other MSs import the received data directly into their national tax databases for verification purposes.

195 Ibid

196 Commission Staff Working Document presenting an evaluation for the second review of the effects of the Council Directive 2003/48/EC accompanying the document Report from the Commission to the Council in accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments.

Both Models are therefore strong tools to ensure tax compliance, but still, if they are not integrated into the other IT architectures and databases at national level, they will only allow of carrying out sample-based checks or crosschecking information on a case by case basis, which is not sufficient from a tax administration perspective.

8.3 SUMMARY TABLES

227. **Summary Tables.** The two tables below summarise the findings in terms of effectiveness and compliance.

Where applicable, the tables make a distinction between the SC Model and the AIC Model. In such case, the symbols "+", "-" and "=" are used to show whether a specific element tends to be rather positive, negative or neutral for a given Model.

EFFECTIVENESS	SC MODEL		AIC MODEL	
INTEREST OF THE VARIOUS STAKEHOLDERS				
Financial interest	+	Each actor has a direct financial interest in providing the information to the other.	-	• In a Triangular Scenario, AIC has no direct financial interest, hence lack of incentives leading to potential impact in terms of timing and data quality. • The AIC is, however, also often SC (Cross-Border Scenario) or RC (Reversed Cross-Border Scenario).
Country characteristics	-	Important SCs would have to act as clearing houses for the RCs, while the SC does actually not need in "first instance" to receive information from the RC and therefore will not be encouraged to provide information to the RC (a good example in this respect is the QI regime).	-	Important AICs would have to act as clearing houses for the SCs and RCs.

EFFECTIVENESS	SC MODEL		AIC MODEL	
AIC's potential added value		N/A	+	• Close relationship with local AIs (audits already carried out/possible overlaps); • AIC in turn also SC or RC; • AIC simultaneously also SC or RC; • Information collected from AIs could be used for other purposes (understanding tax schemes; statistics); • AIs only have to deal with their own tax administration (same language, procedures already known, etc.).
Conditions for granting the relief at source	-	The application of an AI agreement between a SC and a FI is not subject to an effective exchange of information by the SC towards the various RCs; A broad network of automatic exchange of information programmes is required to ensure exchange of information with the various RCs.	+	The exchange of information is an integral part of the Model.
NUMBER OF INFORMATION FLOWS				
Standalone perspective	+	Two flows	-	Three flows
Global perspective	-	More flows	+	Fewer flows
LOCAL WHT RATE IN THE SC LOWER OF EQUAL TO DTT RATE				
Administrative burden	+	Limited administrative burden for such SCs		

EFFECTIVENESS	SC MODEL		AIC MODEL	
FEEDBACK LOOP				
Relationship with the AI	+	SC able to directly chase the AI if need be	+	• The centralisation of feedback loops with the AIC should decrease the total number of queries of the system and the administrative burden; • The AIC has a good knowledge of the national legal framework and the specificities of its financial sector; • The AI would only have to manage its relationship with its own tax administration.
Relationship between tax administrations	=	Each SC should put in place automatic exchange of information programmes with theoretically as many countries as there are RCs concerned, but the legal cooperation framework so created should then also be effectively and efficiently applied in practice.	=	Some countries expressed concerns about the cooperation between tax administrations between the MSs; however, experience with the Savings Directive shows that MSs do not express major complaints on the work performed by the other tax administrations.
Statistics to ensure compliance	-	No single country with a full view on the AI's operations	+	A single tax administration (AIC) has a full view on all the AI's operations.

EFFECTIVENESS	SC MODEL		AIC MODEL	
NON-PARTICIPATING COUNTRIES				
Flexibility	+	• Each AI has the option to decide for which country it would like to benefit from the AI status; the SC has also the possibility to decide whether it would like to be part of the system and it can decide which Financial Intermediaries it wants to authorise; • Side effect: non-participating countries will not be in a position to automatically exchange information to the RCs while they could still benefit from the work performed by such countries acting as SCs; • Potential solutions should be found (e.g. modification of the SC Model; specific piece of legislation at EU level). • It should be noted that this flexibility can result in a lack of coherence of the system.	-	• This Model is less flexible by definition as it requires in principle the agreement of 27 MSs, unless enhanced cooperation can be put in place. • Assuming enhanced cooperation, the same concerns as in the SC Model would arise (non-participating MSs could still benefit from the work performed by participating SCs). • This lack of flexibility is compensated by the robustness that results from the common legal basis of the system.
DATA QUALITY				
Lessons from the Savings Directive	A structured format and common procedure rules for reporting the data are important factors of effectiveness.			
Effective feedback to improve data quality	Effective requests for and exchange of feedback are crucial elements for both Models to function efficiently.			
Liability of the financial institutions	The liability of the AI in the case of non-compliance should contribute to the effectiveness of the Models.			
IT architecture	As for the Savings Directive, crosschecking systems and dissemination of data within MSs will be key to ensure compliance in RCs (relevant information should be readily available to tax collection services).			
ADJUSTMENT OF UNDER- AND OVER-WITHHOLDING				
Set-off procedure	Possible, although it could lead to reconciliation difficulties.			

EFFECTIVENESS	SC MODEL		AIC MODEL	
CONTRACTUAL AGREEMENTS V. COMMON REGULATION				
Flexibility	+	Possibilities to deviate from the defined Model	-	
Consistency	-	Risk of lack of consistency of the processes and procedures applied by the various SCs	+	A common regulation should ensure consistency.
INDEPENDENT REVIEWER'S REPORT / AUDIT BY TAX ADMINISTRATIONS				
Recognition of the independent reviewer	-	Risk of having various independent reviewers for a given AI	+	The AI selects the independent reviewer according to criteria to be determined at EU level.
Redundant audits	-	Risk of various audits of the same AI for the same period (either by the independent reviewer(s) or by tax administrations)	+	The audit report produced by the independent reviewer is valid for all the SCs, and joint audits by MSs are favoured.
EXISTING EXCHANGE OF INFORMATION BALANCE				
Consistency with existing exchange of information standards	-	• Different routings would apply to different types of income. • Different routings would apply to the same type of income depending on whether or not DTT relief at source was applied.	+	The Competent Authorities should already be able to collect information held by local banks, without restrictions, so as to be able to comply with request for information made by treaty partners.
Power relationships	-	SC gets direct access to information and is thus empowered.	+	The AIC keeps the power to exchange the information it should already have access to.
FILTERING OF INFORMATION				
Filtering of information	-	Source-based system not suitable for RCs' needs	+	Better suitable for RCs' needs (although information initially exchanged still concerns only DTT application)
CONFLICT-OF-LAWS				
Conflict-of-laws	-	Potential issues	+	Potential issues associated with FIs reporting directly to foreign sovereigns is avoided.

Table 16: Summary Table – Effectiveness

COMPLIANCE	SC MODEL		AIC MODEL	
DTT application only	None of the two contemplated Models provides for exchange of information towards the RC in the absence of DTT application: recommendation.			
Principal and origin	None of the two contemplated Models provides for an exchange of information towards the RC about the principal and its origin: recommendation.			
Content	• Information provided is not always sufficient to compute the taxable basis (depending on the RCs' tax systems). • Lack of harmonisation does not enable the production of a sufficiently broad panel of information to meet each RC's tax system specificities. • But in any case the information exchanged constitutes an incentive to ensure compliance.			
Increased compliance in RC	Extending automatic information exchange with respect to other income and with respect to other types of Investors than in the Savings Directive should inevitably lead to an improvement of the overall compliance in RCs.			
Increased information exchange scope	-	Source-based system (SC only requires information when DTT is applied, and only information it needs in order to be able to check DTT application): limits the development of the SC Model.	+	The AIC could easily collect with its local AIs more information than just the information required to ensure DTT application.
Timing	=	• The SC will be able to request the reporting from the AIs according to its tax procedures. • Timing for exchange of information towards the RCs has not yet been defined (and will probably differ from memorandum to memorandum).	=	• The timing provided for in the Savings Directive could be used (although not yet defined). • In any case, such timing should ensure compliance in RCs.
Ability to use the information	The information has to be systematically received by the relevant services in charge of tax collection.			

Table 17: Summary Table – Compliance

* *

*

CHAPTER 9 FRAUD ANALYSIS

This chapter considers the risk of tax fraud/evasion related to a standardised relief at source system. It looks at the risks related to "pooled information", coupled with the information reporting/exchange.

The first section sets the scene by listing the assumptions supporting the fraud analysis. It also explains the methodology used to identify and assess the impact and likelihood of the various risks identified in relation to the various information channels and considering the various business and tax relations: between financial intermediaries and tax administrations and between tax administrations themselves.

The second and third sections analyse the risks relating to the refund and relief at source procedures in the current situation and under a standardised relief at source system following respectively, the SC Model and the AIC Model. Each of these sections includes a matrix summarising the likelihood and impact of the different risks identified as well as a detailed assessment explaining the rationale behind the scoring that can be consulted in the appendices.

The fourth section goes a step further. Assuming the common good practices identified have been duly applied, it makes various recommendations aimed at increasing the effectiveness of the Models against fraud risks, yet requiring amendments to the Models as they currently stand. Finally, the two last sections of this chapter address interactions with third countries and set out a comparative analysis of both Models, respectively.

In both models, the data transferred by the AI is considered as key. If this data is manipulated or altered for fraudulent purposes, this has a severe impact on both Models. Although the probability that an AI actively and intentionally abuses the system is considered as rather limited, it cannot be ruled out theoretically - certainly not where an AI is under pressure from financial markets or key clients.

When comparing the AIC Model and the SC Model, it can be fairly stated that both, as they currently stand, enable tax administrations in the SCs and in the RCs to fight some of the fraud risks. Given the identical scope of the two Models, the fraud risks tackled by them are not very different, but the AIC Model offers more guarantees than the SC Model:

First, under the AIC Model, the RC has more guarantees to that it will receive the information and therefore that it will be able to identify certain fraudulent transactions; while, under the SC Model, the effectiveness of the information reporting to the RC depends on the memorandum of understandings (MoUs) to be signed between SC and RC.

Second, the flexibility associated with the SC Model for amending bilateral agreements v. amending a common regulation could create a lack of homogeneity that would have a negative impact on the relief at source system. This is because the SC approach, based on contractual agreements, cannot move towards a more constraining or automatic exchange of information, while such move is required to improve the effectiveness of the Models against fraud risks.

Finally, the AIC Model, based on a common regulation such as an EU Directive, offers more latitude for extending its scope and, in that respect, the AIC model seems more robust to face the requirements of a constantly evolving reality as there is one legal basis common to all actors, though it requires time to put in place. By amending this legal basis, it is possible to create constraining obligations for all involved actors.

However, it does not mean that the Models are able to address all fraud risks associated with cross-border securities payments. Indeed, as mentioned above, the contemplated Models do not provide for any exchange of information to the RCs on cross-border securities income payments when no DTT is applied. Due to this loophole combined with the option left to the Investor not to request DTT application, the main fraud risk, being tax evasion, remains unchanged. From that point of view, it is crucial to consider some adjustments to the contemplated Models: make the reporting mandatory, at least partially, for the beneficial owner details and the account number (given the recent developments concerning FATCA, this amendment seems more feasible than it was some months ago), the communication of the value of the Investor's portfolio, etc.

The IT integration of the system supporting the exchange of information with the systems used by the local tax administrations will also be a decisive aspect. Nevertheless, even "adjusted", the Models would not be "fraud-proof". The reason for this is that Investors could still locate their securities with financial institutions located in non-participating countries. However, if the system expanded, opting for these jurisdictions would be an increasingly costly solution (hence performed by rather sophisticated Investors with larger portfolios). The adjusted Models would not therefore fully remove the tax fraud risk but would increase the threshold as from which tax fraud becomes interesting for the Investor.

* * *

9.1 ASSUMPTIONS TO THE FRAUD RISK ASSESSMENT

228. **Information Channel at Stake**. The purpose of the study is to compare the SC Model and the AIC Model. In doing so, the main focus has been set on the part of the relief at source system concerning information channels up to the chain of Financial Intermediaries; between Financial Intermediaries and tax administrations; and between tax administrations themselves.

229. **Definition and Level of Information Required**. The level of information described in the Implementation Package will be used as a basis for the study. However, as part of the fraud analysis, it will be considered, as far as possible, whether other information could have an impact on the fight against fraud and tax evasion.

230. **Assumptions**. The assumptions described in section 3.2 of this report are also the basis of the fraud risk analysis in this section. In addition, the fraud risk assessment also relies on some additional assumptions listed under the following points.

231. **Models Efficiency**. Information flows (pooled information, information reporting and information exchange) between all actors (MS tax administration and Financial Intermediaries) involved in each Model are operating effectively and to utmost efficiency. Every MS is cooperating and adopts the Models as described in this report.

232. **MSs Cooperation**. All MSs' tax administrations participate in a proactive manner and, regardless of their roles (SC, RC or AIC), they respond to requests from other MSs' tax administrations within an agreed time frame.

233. **IT Architecture**. All MSs' tax administrations have an adequate IT architecture in place, which enables them to perform efficient and effective matching of data information transferred, exchanged and reported between all actors (MSs' tax administrations and Financial Intermediaries) throughout each Model.

234. **Good Practices**. The assessment of likelihood and impact of the identified fraud risks takes into account some good practices that work effectively and efficiently. A detailed description of these practices is included in Appendix 12.

235. **Recommendations**. However, the recommendations are not considered for the rating of the fraud risks. The impact of the recommendations on the rating is described in Appendix 13 providing a recapitulative overview of the various risks in the current and future situations.

236. **Tax Fraud and Evasion**. Tax fraud and/or evasion may have a different meaning and legal consequences from country to country. In this chapter, references to "fraud" should be read with the following in mind:

- Tax evasion, if considered illegal in your country – if considered legal in your country, it is no fraud and consequently falls outside the scope of this chapter;
- Any type of intentional errors in processing;
- Any behaviour aimed at not reporting revenue or at illegally avoiding taxes;

- Any behaviour aimed at benefiting from a reduced tax rate treatment while the Investor is not entitled to it.

237. **Fraud Committed by Tax Administrations.** Fraud risks that may occur within countries' tax administrations are left out of consideration. The reason for this is that such risks will mainly relate to bribery and/or misappropriation of funds, i.e. behaviours that are deemed to be addressed by internal control measures that should be implemented within the tax administrations (e.g. a SC paying more than it should have, due to an unintentional error or due to an act of bribery).

238. **Risks not included in the Assessment.** In both Models (SC and AIC), the non-tax-authority information flow between the business relations, as illustrated below, also contains fraud risks that can indirectly lead to tax evasion or tax fraud.

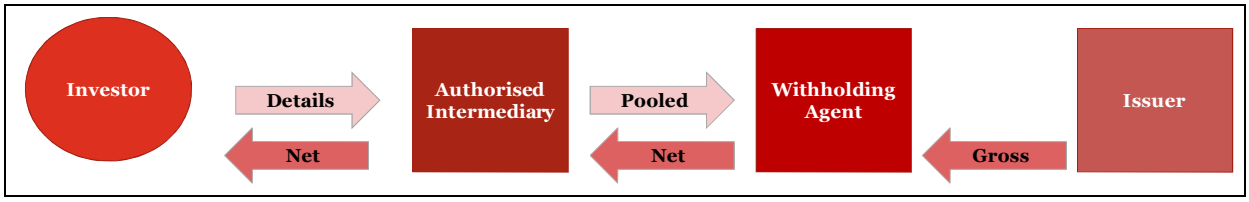


Figure 16: Fraud Risks in Business Relations

A number of fraud risks directly linked to this information flow have been identified (cf. Table 15), but they have not been included in the detailed risk assessment of the study as these fraud risks will need to be tackled by the actors concerned themselves. The reason for this is that it is the responsibility of the Investor to ensure that he receives the right amount of cash from the AI and it is also up to the latter to ensure that it receives the right payment from the WA (via reconciliation and internal control measures).

RELATION	RISKS
Investor / FI	AI avoids paying the relief at source to the Investor or pays only part of the refund.
	AI avoids paying the refund to the Investor or pays only part of the securities income.
WA / FI	WA avoids paying the securities income to the Financial Intermediary or pays only part of the securities income.

Table 18: Risks not included in the Assessment

239. **Approach and Methodology.** The approach and methodology adopted to carry out the Fraud risk identification and assessment is detailed in Appendix 14. For the reader's convenience, it has been decided to keep the criteria used to assess the likelihood and impact in the following paragraphs.

240. **Likelihood Criteria**. The likelihood or the chance that a particular risk will occur is measured using the following criteria:

CRITERIA	DESCRIPTION
0 – Unlikely	Probability of occurrence is generally accepted as almost zero, and no change in process/parties involved/territories/environment that could increase the probability of occurrence is expected.
1 – Remote	Even if no occurrence is expected, and there is no indication that it will occur frequently, the theoretical risk exists but with a low or seldom level of occurrence.
2 – Possible	Limited occurrence is expected, but frequency remains minor. Also, in the case of purely theoretical risks for which no occurrence is expected, a set of realistic conditions is or could be present that may cause the risk to materialise.
3 – Likely	Regular or repeated occurrence is expected. Also, so many conditions co-exist that the risk, even if not materialising, has a high probability of occurring.

Table 19: Likelihood criteria

241. **Impact Consideration**. The level of impact of a risk (being the outcome of a risk if it occurs) is determined by the following items:

1. Potential direct financial impact;
2. Image and reputational risk;
3. Regulatory and compliance risk;
4. Safeguarding of information;
5. Impact on stakeholders.

DESCRIPTION		SCORING			
		3	2	1	0
IMPACT	1. Potential direct financial impact	High	Medium	Low	Minimal
	2. Image and reputational risk	Severe adverse impact on media	Negative impact on media	Limited impact on media	Minimal
	3. Regulatory and compliance risk	Major infringements of regulations and policies Major legal exposure	Exceptions reported on compliance with laws and regulations Possible legal exposure	Minor infringements of regulations and policies Moderate legal exposure	Minimal
	4. Safeguarding of information	High risk of disclosure of confidential information Severe adverse impact on data integrity through ability to modify critical/sensitive data Major continuity risk for critical activities (no BCP)	Medium risk of disclosure of confidential information Negative impact on data integrity through ability to modify data Continuity risk for activities (Untested BCP)	Low risk of disclosure of confidential information Limited impact on data integrity through ability to modify internal data Continuity risk for business activities of second importance	Minimal
	5. Impact on stakeholders	High	Medium	Low	Minimal

Table 20: Impact Considerations

9.2 CURRENT SITUATION OF REFUND AND RELIEF AT SOURCE PROCEDURES

9.2.1 FRAUD RISK IDENTIFICATION

242. **Fraud Risk Identification**. Table 18 is an overview of fraud risks linked to the current relief at source and refund Model of cross-border WHTs. A detailed description of these risks is included in Appendix 15.

RELATION	MODEL	RISKS
A. Investor / RC	1. Refund / Relief at source	Investor avoids declaring cross-border securities income in tax return.
B. FI / SC	1. Refund / Relief at source	Relief at source/refund request sent to SC includes incorrect information in respect of beneficial owners, residence information or payment details.
	2. Refund / Relief at source	FI requests relief at source for income that does not qualify for relief at source.
	3. Refund	FI requests refund for type of income that does not qualify for any refund.
	4. Refund	FI requests refund on behalf of Investor for income that has been subject to relief at source.
	5. Refund	FI requests multiple times same refund on behalf of Investor.
C. WA / SC	1. Relief at source	WA avoids paying tax to SC or pays only part of tax to SC.
E. Investor / FI	1. Refund / Relief at source	Investor provides incorrect/false information and/or documents (e.g. forged or counterfeit Certificate of Residence) to attest own identity and residence to FI, or Investor avoids updating own residence status.

Table 21: Fraud Risks in the Current Situation

9.2.2 FRAUD RISK ASSESSMENT

9.2.2.1 INTRODUCTION

The different fraud risks in the current situation (as identified above) have been assessed by giving a score based on:

- The likelihood and impact criteria, as described above;
- The assumptions made, as described above.

9.2.2.2 MATRIX

The matrix illustrated in the below figure provides a visual overview of the risk assessment (197):

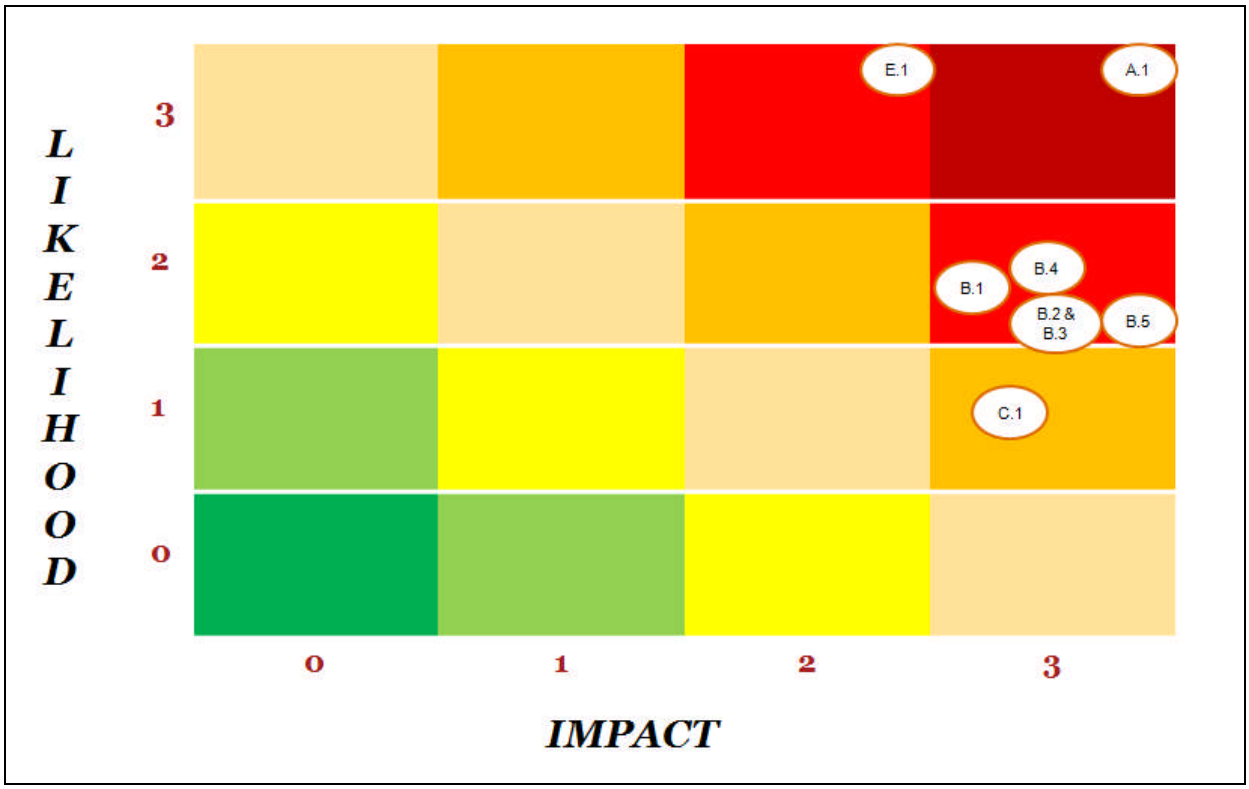


Figure 17: Fraud Risks Matrix for the Current Situation

243. **Tax Evasion**. In the current situation of cross-border investments, fraud risks have a relatively high chance of occurring and, when they do occur, their impact is often considerable. The fraud risk where Investors avoid declaring cross-border securities income (risk A1) is considered as a risk that is the most likely to occur and has the highest impact.

244. **Relation between FI and SC**. The likelihood that fraud risks linked to the FI – SC relation (risks B) occur is possible. The probability that an FI actively and intentionally abuses the system is low but cannot be ruled out because, in theory, this risk exists. In situations where an FI is under pressure from financial markets or key clients, the possibility exists that the FI provides fraudulent information or intentionally avoids cooperating. In cases where the FI and the SC are not located in the same country, the ability of the SC to have oversight control and authority vis-à-vis the FI is limited. Moreover, the lack of common legislation and communication platforms, the language barriers and potential cultural differences may hamper the functioning of the simplified system of cross-border WHT and increase the likelihood of fraud occurring. If the fraud is detected, the reputational damage for

197 The detailed assessment of likelihood and impact in the current situation is available in appendix.

the FI is severe. The impact on the Model is even higher, however, because all transactions conducted by the fraudulent FI will be questioned and require further investigation.

245. **Fraud Committed by the WA**. The likelihood that a WA avoids paying tax to the SC or only pays a part of the tax to the SC (risk C1) is considered as remote with a high impact.

246. **Identity Fraud**. Identity fraud is widely spread and thus expected to occur often, although tax evasion is not always the major goal where identity fraud is committed. Nevertheless, the use of a forged or counterfeit Certificate of Residence has a medium impact.

9.3 SITUATION UNDER AIC AND SC MODELS

9.3.1 FRAUD RISK IDENTIFICATION

247. **Fraud Risks Related to the Refund Procedure**. The "refund" procedure will remain in place when the AIC Model or the SC Model becomes operational in the EU. The actual use of the refund procedure will decrease significantly, however, because it is expected to be used only on an exceptional basis. The fraud risk assessments of the AIC and SC Models do not include the fraud risks related to the refund procedure ([198]). The fraud risks related to the refund procedures, as described above, will continue to exist when the AIC Model or the SC Model becomes operational. However, it should be noted that the major decrease in the number of refund requests expected if a relief at source system is implemented, should also have an impact on the risks of fraud in the refund procedure. This is because some MSs have confirmed that, due to the increasing volume, the quality of the checks operated to ensure the validity of the refund requests decreases. In some cases, refund requests below a given threshold are even no longer submitted to such checks. So it is possible that an important volume decrease would allow a quality increase of the checks performed on refund requests. Nevertheless, in the context of this study, it is not possible to take into consideration this side effect on the risk rating of the refund procedure. These risks are therefore referred to as not applicable in the future situation.

248. **No Risk Assessment on the First Year.** The fraud risks are assessed assuming that the Models have been fully implemented and that the various practices have been integrated by the different stakeholders, i.e. at least one year after system implementation. This is because the first year of the system will not be representative of its regular functioning. In addition to the many errors that will be made by all stakeholders, some frauds may be attempted because Investors are not familiar with the system and its performance, or other Investors could try to assess the robustness of the system and to identify some weaknesses. So the first year is very specific and should not be considered for the risk assessment.

198 The FISCO Recommendations include some guidelines to improve and standardise the refund procedure. However, these modifications are optional and there is some flexibility in the development of these measures. Therefore, they are not part of the model as such.

249. **Fraud Risks Identified**. The table below is the overview of fraud risks identified for the AIC and SC Models. A detailed description of these risks is included in Appendix 15.

RELATION	MODEL	RISKS
A. Investor / RC	1. AIC / SC	Investor avoids declaring cross-border securities income in tax return.
B. AI / SC	1. SC	Reports sent to SC include incorrect information in respect of beneficial owners, residence information or payment details.
	2. SC	AI requests relief at source for Investor not entitled to it.
	6. SC	AI avoids replying to requests for information sent by SC.
	7. SC	AI avoids reporting to SC.
C. WA / SC	1. AIC / SC	WA avoids paying tax to SC or pays only part of tax to SC.
	2. AIC / SC	WA communicates wrong allocation in TRI to SC.
D. AI / AIC	1. AIC	Reports sent to AIC include incorrect information in respect of beneficial owners, residence information or payment details.
	2. AIC	AI avoids reporting to AIC.
	3. AIC	AI avoids replying to requests for information sent by AIC.
	4. AIC	AI requests relief at source for Investor not entitled to it.
E. Investor / AI	1. AIC / SC	Investor provides incorrect/false information and/or documents (e.g.: forged or counterfeit Certificate of Residence) to attest own identity and residence to AI, or Investor avoids updating own residence status.
F. WA / AI	1. AIC / SC	AI communicates wrong allocation in TRI to WA.

Table 22: Fraud Risks Identified under the SC and AIC Models

9.3.2 FRAUD RISK ASSESSMENT UNDER THE AIC MODEL

9.3.2.1 INTRODUCTION

The different fraud risks of the AIC Model (as identified above) have been assessed via scores based on:

- The likelihood and impact criteria as described above;
- The assumptions made as described above.

9.3.2.2 MATRIX

The matrix illustrated in the figure below provides a visual overview of the risk assessment (199):

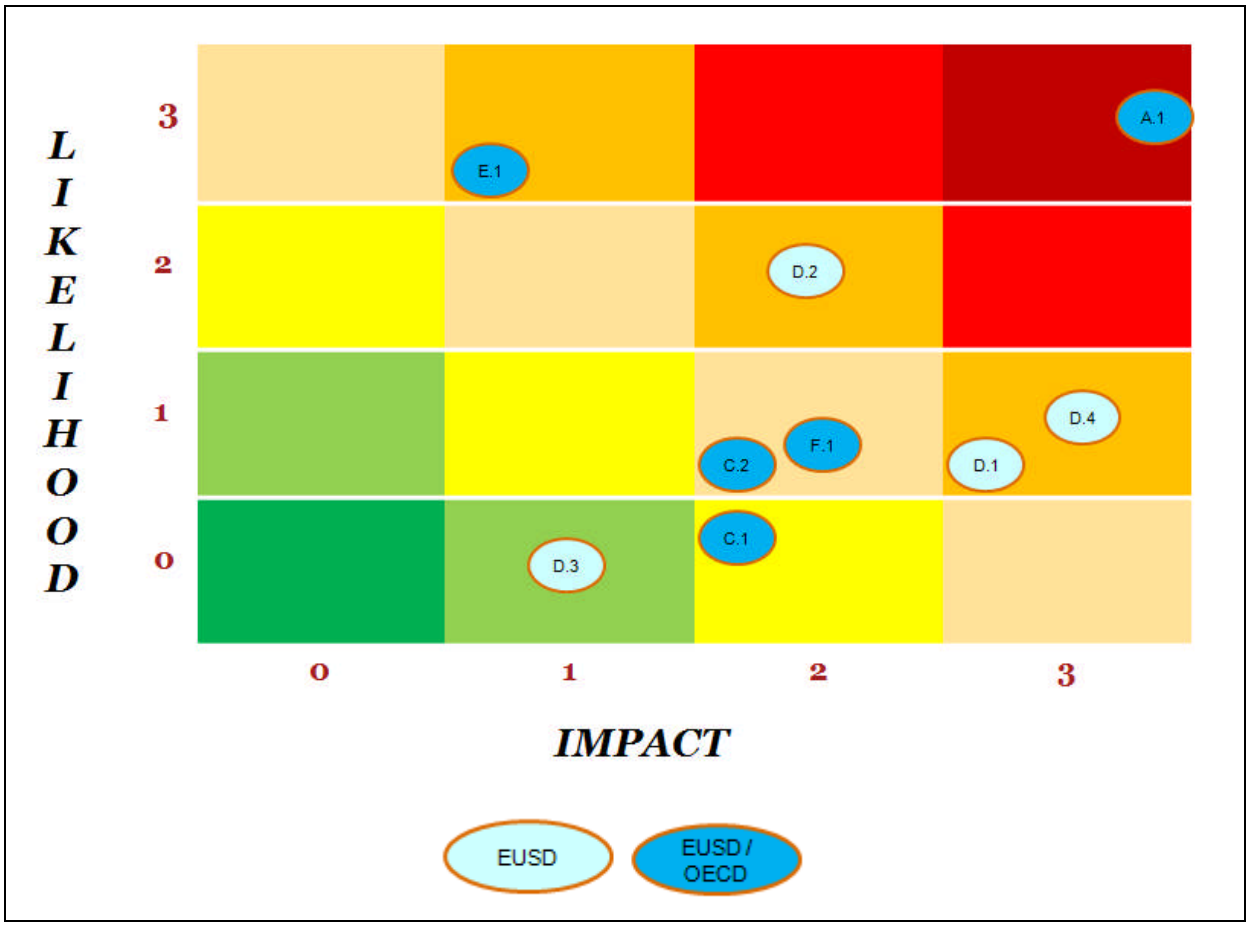


Figure 18: Fraud Risks Matrix under the AIC Model

250. **Failure to Fight Tax Evasion**. The main fraud risk (risk A1) in the current situation, being an Investor avoiding declaring to the relevant tax administration cross-border securities income or domestic income received via an AI located in another MS, will not disappear if the AIC Model is applied. The likelihood and the impact of this fraud risk will only slightly decrease. An Investor can opt to apply for the relief at source system. Therefore, the possibility to avoid declaring income continues to exist. Not opting for the relief at source system implies that an AI is under no obligation to include that Investor in the exchange of information to its AIC and consequently to the RC. Current fraudsters may never opt for the relief at source system and continue acting as in the current situation.

251. **Transformation of Identity Fraud**. Identity fraud via false information and documents provided by the Investor to the AI (risk E1) will be a new risk of fraud. Identity fraud is not

199 The detailed assessment of likelihood and impact under the AIC Model is available in appendix.

used solely for tax evasion purposes. Nevertheless, it will impact the relief at source system. Tax evasion by Investors is expected to occur on a regular basis, but the AIC Model will enhance the means to detect and prevent it, resulting in a lower likelihood and impact.

252. **Fraud Committed by the WA**. The fraud risks at the level of the WA (risk C) are expected to occur rarely under the AIC Model. The direct financial impact, however, can still be important because the WA handles the largest amount of money compared to the other Financial Intermediaries. The AIC Model provides the means to detect this type of fraud relatively quickly. Therefore, it is less likely that WAs will avoid paying taxes to the SC or communicate an incorrect TRI allocation in information reporting.

253. **Relation between AI and AIC**. The likelihood of the fraud risks linked to the relation between the AI and the AIC (risks D) will decrease compared to the current situation. Although the probability that an AI actively and intentionally abuses the system is low, it cannot be ruled out theoretically – certainly not where an AI is under pressure from financial markets or key clients. However, under the AIC Model, the AIC and AI are located in the same country, which increases the ability of the AIC to have oversight, control and authority vis-à-vis the AI. Furthermore, the AI and the AIC use a common communication platform with limited language barriers and cultural differences. The risk that the AI provides incorrect information to the AIC (risk D1) is considered as remote. However, if this risk materialises, its impact cannot be underestimated because, in the AIC Model, this relation is key. The risks where the AI would avoid reporting to the AIC (risk D2) or would avoid replying to requests from the AIC (risk D3) only slow down the process and would thus have a limited impact only. Where an AI requests relief at source for income that does not qualify for relief at source (risk D4), however, this will not be detected immediately by the AIC or even the WA.

9.3.3 FRAUD RISK ASSESSMENT UNDER THE SC MODEL

9.3.3.1 INTRODUCTION

The different fraud risks of the SC Model (as identified above) have been assessed via scores based on:

- The likelihood and impact criteria as described above,
- The assumptions made as described above.

9.3.3.2 MATRIX

The matrix illustrated in the figure below provides a visual overview of the risk assessment (200):

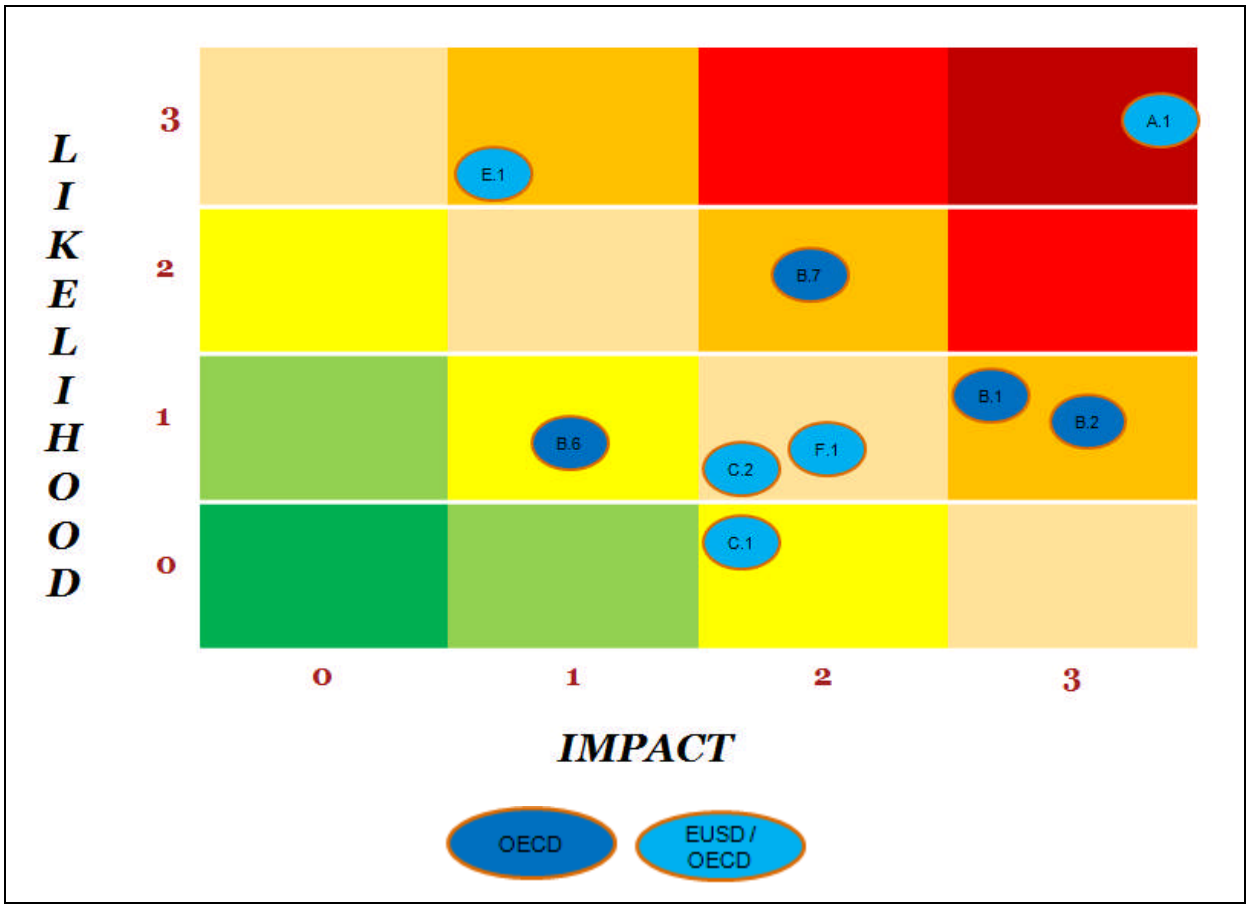


Figure 19: Fraud Risks Matrix under the SC Model

254. **Failure to Fight Tax Evasion.** Similarly as for the AIC Model, the main fraud risk (risk A1) in the current situation, being an Investor avoiding declaring to the relevant tax administration cross-border securities income or domestic income received via an AI located in another MS, will not disappear if the SC Model is applied. The likelihood and the impact of this fraud risk will only slightly decrease. An Investor can opt to apply for the relief at source system. Therefore, it is very unlikely that current fraudsters would apply for relief at source as they would rather continue acting as in the current situation.

255. **Transformation of Identity Fraud**. Identity fraud via false information and documents provided by the Investor to the AI (risk E1) will also be a new risk of fraud in the SC Model. Identity fraud is not used solely for tax evasion purposes. Nevertheless, it will impact the relief at source system. Tax evasion by Investors is expected to occur on a regular basis, but

200 The detailed assessment of likelihood and impact under the SC Model is available in appendix.

the SC Model will enhance the means to detect and prevent it, resulting in a lower likelihood and impact.

256. **Fraud Committed by the WA**. The fraud risks at the level of the WA (risk C) are expected to occur rarely under the SC Model, which is again similar to the AIC Model. The direct financial impact, however, can still be important because the WA handles the largest amount of money compared to the other Financial Intermediaries. The SC Model provides the means to detect this type of fraud relatively quickly. Therefore, it is less likely that WAs will avoid paying taxes to the SC or provide an incorrect TRI allocation in information reporting.

257. **Relation between AI and SC**. The main difference between the SC Model and the AIC Model in respect of fraud risks is the fact that the AI reports directly to the SC, which is similar to the current situation. However, under the SC Model, the likelihood of the fraud risks linked to the relation between the AI and the SC (risks B) will decrease compared to the current situation. Although the probability that an AI actively and intentionally abuses the system is low, it cannot be ruled out theoretically – certainly not where an AI is under pressure from financial markets or key clients. The fact that, in many cases, the AI and the SC are not located in the same country will increase the likelihood of the fraud risks linked to this relation occurring, compared to the AIC Model. Cross-border oversight, control and authority vis-à-vis the AI by the SC will be more difficult in the SC Model compared to the AIC – AI relation in the AIC Model. Moreover, the fact that the exchange of information from the SC to the RC is not mandatory (it will be agreed via a memorandum on a bilateral basis), while the RC has the information to confirm the validity of Investors' details, increases the risk of the AI providing wrong information (risk B1). The fact that the AI can lose its AI status in a MS is, however, a strong mitigation measure that will decrease the likelihood of occurrence for these types of fraud. The risk that the AI provides incorrect information to the SC (risk B1) is considered as remote. However, if this risk materialises, its impact cannot be underestimated because, in the SC Model, this relation is key. The risk where the AI would avoid reporting to the SC (risk B7) is considered as possible because it does not mean that the AI will not send a reporting, but the AI could avoid reporting certain transactions, which is more difficult to detect. The risk that AI would avoid replying to requests from the SC (risk B6) only slows down the process and would thus have a limited impact only. Where an AI requests relief at source for income that does not qualify for relief at source (risk B2), however, this will not directly be detected by the SC or even the WA. From a global perspective, the AI – SC relation in the SC Model seems less readily identifiable and less efficient to mitigate fraud risks than the AI – AIC relation in the AIC Model.

9.4 RECOMMENDATIONS

258. **Common Good Practices.** The Common Good Practices will guarantee a higher effectiveness of the Models in the fight against fraud. The main advantage of these good practices is that they could be easily implemented without any modification of the Models' principles. However, as highlighted while explaining the rating of the risks, these measures are not sufficient to reduce all the risks to an acceptable level, for one or the other Model.

259. **Key role of the European Commission**. Under current European legislation, due to a lack of harmonised approach to respond to and limit fraud risks, not enough focus is being given to the mitigation controls and fraud prevention measures currently in place within each MS. To the contrary, for each of the Models (SC and AIC), the detailed risk assessment includes the main means that should be installed by the MSs' tax administrations to mitigate the identified fraud risks. For each Model, the detailed assessment includes a description of high-level mitigating controls and fraud prevention measures.

We consider that the European Commission has a key role to play in ensuring that every MS implements, as a minimum, this set of mitigating controls and fraud prevention measures so as to reduce significantly the occurrence of the identified fraud risks.

260. **Recommendations**. Besides these good practices and fraud prevention measures mentioned above and described in Appendix 12, some recommendations have been identified. These recommendations are not part of the Model and may therefore lead to a change in the currently defined principles of the Models to make them more efficient towards the fight against fraud.

261. **Recommendations and Way Forward**. It is difficult to imagine that MSs will agree to invest in a Model, knowing that it is not effective against some of the greatest risks in terms of fraud. Moreover, as both Models are still under development, it is still possible and recommended to amend the structuring principles so as to improve their performance against the major fraud risks that have been identified. As already mentioned in the previous paragraph, these recommendations may require the structuring principles to be amended. However, before amending the Models, further analysis should be carried out to have more insight in their impact on the various dimensions of the Models and understand their implications for the different actors of the relief at source system.

262. **Main Obstacles and Consequences of the Recommendations.** The following paragraphs highlight the main obstacles and consequences associated with the recommendations identified. These recommendations relate to the following five aspects:

- Reporting obligation;
- Content of the reporting;
- Pooled information;
- Adjustment by the AI;
- Identification of the income type;
- Identification of entities;
- Exchange of information when SC = RC.

9.4.1 REPORTING OBLIGATION

263. **Tax Evasion**. The biggest challenge for tax administrations is tax evasion, i.e. Investors who avoid declaring their cross-border securities income in their tax returns. However, none of the Models is effective against tax evasion as such. The likelihood that the tax evasion risk happens in the future situation remains at 3 ("likely"), as in the current situation, even if it slightly decreases. This decrease is not a concrete result of the system itself. It rather results from the threat of the consequences that would be triggered by Investors' fraudulent behaviour, or from the taxation advantages offered by the system.

264. **Lack of Interest to Request Relief at Source**. One of the challenges for both Models results from the lack of interest for Investors to benefit from relief at source. Indeed, in many cases, the application of the DTT coupled with the tax rate applied by the RC is less interesting than a standard tax rate applied by the SC without including this amount in the tax return. In addition, even when the total tax amount paid is more interesting, it is not obvious that Investors would opt for relief at source as it would first require them to adjust these amounts vis-à-vis their tax administrations ("regularisation"). Finally, there are many local tax laws that will give Investors some reason(s) to refrain from declaring their income. For example, Investors could prefer not to benefit from a lower tax amount on their securities income so as to obtain a lower rate on their succession duties. In other words, there is a real incentive for regular Investors, but it is probably not sufficient to bring fraudsters to regularise their amounts hidden in foreign accounts.

265. **Inability of Both Models against Tax Evasion**. The main reason of the inability of the Models to address this risk is that, under both Models, the provision of Investors' information to the tax authorities of the countries concerned is dependent on the request for relief at source by the Investor. If the Investor does not ask to benefit from a reduced WHT rate, his/her income will not be reported by the AI and, therefore, will not be included in the exchange of information. Thus, an Investor still has the possibility to remain hidden from the tax administration if the Investor specifies to his AI that he never wants to benefit from a DTT. The main problem is that, in the current situation, Investors who avoid declaring their cross-border securities income in their tax return do usually not request the application of a DTT. The reason for this is that they fear that, if the SC is advised that Investors have received such income, the SC could provide the RC with this information. So, these Investors can avoid the exchange of information without changing their behaviour.

The easiest solution to decrease this risk is to make the exchange of information mandatory, or partially mandatory, even for Investors who did not request the application of a DTT (201).

266. **Partial v. Full Exchange of Information**. The exchange of information on Investors who do not request the application of a DTT could be either exhaustive, meaning including

201 It should be pointed out that from a data protection perspective, such mandatory reporting could not be based on the consent of the Investor/service contract between the Investor and the AI. The mandatory report should be based on a law requiring AI to collect and report such information, like under the Savings Directive.

the details on all the cross-border securities income paid by Investors, or partial, meaning including only some details on the beneficial owner and/or the income received.

The full exchange of information seems not the most suitable option for two reasons:

- First, the contemplated systems are considered as a 'win-win' situation. On the one hand, the Investor benefits from relief at source and, on the other hand, they are subject to an exchange of information. This ensures that the Models will be accepted by all the stakeholders (tax administrations, business and Investors) and it increases its overall efficiency. Moving towards a full exchange of information would considerably increase the repressive dimension of the Models and it would radically change its philosophy.

- Second, it would heavily increase the volume of the reporting. This is because the reporting would include the data from all the cross-border income, even when no DTT was applied. Therefore, it would also include information on transactions for which the standard WHT rate is equal to or below the DTT rate. This represents a major increase in the volume of information to be exchanged. From a tax administration's perspective, this volume increase would be compensated by the interest of such information. However, from a business perspective, there is no compensation for this additional workload. The benefits of such approach are clear for tax administrations but it would be a major constraint for the business.

267. **Partial Exchange of Information**. A partial exchange of information could be limited to the **beneficial owner details** and the **account number**. This type of information should limit the impact on the volume of information to be exchanged and the workload resulting from the reconciliation process. The repressive dimension is lighter than in the full exchange of information, with a smaller change in the Models' philosophy. Finally, the account number seems sufficient to ensure the efficiency of the system against tax evasion. In effect, Investors would be more inclined to include information about their accounts in their tax return and, if they do not do so, the tax administrations will have, in any case, sufficient information to request the AI to provide the details on the income paid in this account.

268. **Mandatory Exchange**. There are different ways to make the exchange of information mandatory. A solution could be to leave the option to Investors whether or not to benefit from relief at source in the participating MSs. In this case, the personal details and the account number would be included in the reporting. However, this possibility is not fraud-proof because it would be easy for Investors to sign a self-declaration and request the application of the DTT but to make sure that no income is paid in the account (e.g. by investing in capitalisation CIVs). The most effective option is therefore to include all the beneficial owners' details and account numbers for non-resident Investors, regardless of whether or not they agreed to benefit from the system.

9.4.1.1 MAIN OBSTACLES

269. **Political Consensus.** An automatic exchange of information including as a minimum the beneficial owner details and the account number is a change in the approach of the system.

From a standardised relief at source system, to the benefit of the financial sector and Investors, the Models move to a more constraining approach aimed at fighting tax evasion. It is not guaranteed that MSs currently supporting the relief at source system would still support a model including a mandatory exchange of information. The political consensus will require a relatively long time for negotiations, and a consensus will be difficult to reach.

270. **Opposition from the Financial Sector**. While initially requesting this standardised relief at source system, the financial sector will most likely object to this evolution. The reason for this potential opposition is that such automatic exchange of information would be more constraining for them and some institutions could be concerned that some Investors transfer their accounts to non-participating countries. This potential opposition from the financial sector could be coped with if the system is implemented via a Directive (such as the AIC). Moreover, recent developments concerning FATCA may play a role in persuading the business sector that including additional reporting obligations would not be that burdensome to the extent that it is done by using the same IT infrastructures and communication channels. Differently, this element will certainly render impossible an implementation of the system via contractual agreements, as under the SC Model. Therefore, as it is the case for the data protection framework, it seems unrealistic to implement such amendment in the context of the SC Model.

9.4.1.2 MAIN CONSEQUENCES

271. **Efficiency against Fraud**. A mandatory reporting would clearly increase the efficiency of the system against fraud. If the system is applied by a large number of countries, fraud would become more complex, especially for small and medium Investors. However, for Investors having a large portfolio, it could still be worthwhile transferring their positions to non-participating countries. It should also be noted that this transfer could have an economic impact on MSs whose economy is relying on financial services. However, this impact is difficult to estimate at this stage.

272. **Request for Special Regime**. The request for a special regime is a direct consequence of the difficulty to reach a political consensus. Past experience provides many examples of political consensus reached by granting a special regime to some MSs to remove their opposition. Such exception could be required but each exception will weaken the system. Moreover, exceptions will decrease the efficiency of the system against fraud and could create a competitive advantage of the financial industry of some MSs compared to the other participating countries. So, if the political consensus is a mandatory step to implement such automatic exchange of information, the cost of this consensus should be balanced with its impact on the standardisation, the robustness and the efficiency of the Model against tax fraud.

273. **Cost Increase**. With the volume of data increasing, the cost of the system will also increase in terms of implementation and maintenance. However, the cost increase should not be too high if we consider that an IT system to report information has to be put in place in any case and that only the amount of information to be reported would change. Moreover, to be in a position to make effective use of the data, it is important that the tax administrations

implement an IT solution to match the content of the reporting with the information included in their databases.

9.4.2 CONTENT OF THE REPORTING

274. **Calculation of the Tax Due**. As described in the tax compliance analysis, in both Models, the content of the reporting will not enable all tax administrations to calculate or even estimate the tax amount that an Investor should pay. Even for Investors who participate in the system and request to benefit from DTT application, the transaction details are not always sufficient to allow tax administrations to calculate a tax amount. This is due to the specificities of each local tax regime, some MSs calculating the tax on the principal rather than on the income, but also to the common trend to develop financial products in order to bypass tax regulations.

275. **Value of the Portfolio**. Adding information will always benefit the tax administration of some MSs. However, it is unrealistic to imagine that, by adding information, it is possible to exchange sufficient information in order to enable all tax administrations to calculate the tax amount due by their tax residents. Moreover, the perspective of additional information should be balanced with the additional workload it would entail. It appears that there is "one item of information" that could be added to effectively complete the report without burdening the process: the value of Investor portfolio on 31 December. In addition to the signal it gives, being that the Investor has an account in another MS, this also shows the importance of the portfolio and the income it should generate. Even if tax administrations calculating taxes on the principal and not on income are not able to calculate the exact tax amount, they should at least be able to estimate this amount and perform checks if the amount declared in the tax return differs substantially from their estimate. Moreover, this would make it less interesting for Investors to invest in financial products not subject to exchange of information for the sole purpose of avoiding reporting.

9.4.2.1 MAIN OBSTACLES

276. **Consensus on Information to be added.** As mentioned above, it is not realistic to include in the reporting sufficient information to allow all the participating countries to calculate the appropriate amount of tax due by their tax residents. Therefore, the MSs have to agree on the relevant elements that should be added. The decision for adding information needs to be balanced taking into account the following points:

- First, between the volume of information increase and the interest that this information would represent for MSs' tax administrations;
- Second, between the interest of the SC and the RC: the value of Investor portfolio on 31 December would allow the RC to estimate the amount of tax based on a principal or capital gain, while the mention of the AIIN would allow the SC to operate an automated matching of the WHT applied at AI level.

277. **Opposition from the Financial Sector**. Naturally, the financial sector will object to any information to be added in the reporting. This increase in the volume of information

exchanged has no added value for them, but would on the contrary entail additional costs. Therefore, it is likely that it will be opposed by the business. For that reason, it is important to limit the amount of new information so as to ensure the ability of the business sector to deal with that information and maintain the overall efficiency of the system. From this perspective, the value of the portfolio on 31 December should not be a major obstacle. This is particularly important in the context of the SC Model as AIs will not enter into a contractual agreement if they perceive the system as too constraining.

9.4.2.2 MAIN CONSEQUENCES

278. **Estimation of Tax Based on Principal**. Some MSs calculate the tax not on the income received but on the principal. For these MSs, the value of the portfolio on 31 December will enable them to estimate the amount of tax that should be included in the tax returns. In this specific context, this information is more interesting than all the details on income received during the year. Moreover, it could persuade some MSs, which do not see a real interest in receiving detailed information on transactions, to participate in the system.

279. **Cost Increase**. As mentioned for the automatic exchange of information, any increase in the volume of information exchanged will have an impact on the cost incurred to exchange the information and to make effective use of this information. Moreover, the information may not be available as such in the current systems and it may require several amendments or improvements to the current IT systems.

9.4.3 AMENDMENT TO THE POOLED INFORMATION

280. **Difficulties linked to the Pooled Information**. The MSs who participated to this feasibility study do not believe that the pooling of information leads to increased fraudulent behaviours, given that the MSs will receive beneficial owner details in the reporting and that this information will be validated by the RCs. However, the pooled information will add some complexity to the controls applied by the tax administrations. Moreover, if the IT solution does not allow an automated matching, it is likely that the verifications will be performed on a sample basis, which, theoretically, decreases the detection rate for fraudulent transactions. Therefore, some amendments to the pooled information should be considered to ease the task of the tax administrations.

281. **AI Identification Number**. If standardised and not different for each SC (202), the AIIN could also increase the effectiveness of the system in the fight against fraud. Indeed, if the AIIN is included in the TRI, meaning that the AI would still provide pooled information to the WA but split it by AIIN number, the SC's tax administration would be able to easily develop an automated matching between the information provided by the WA and the information from the various AIs. In the current version of the pooled information, reconciliation between the information provided by the WA and the information sent by the various AIs is still possible, but it implies that all the AIs in the chain of intermediaries need

202 The current version of the Implementation Package provides that each SC will determine an identification number for each AI.

to be looked at to identify the error. Adding the AIIN in the TRI will increase the workload required for the TRI but it will also increase the ability of the SC's tax administration to quickly identify any discrepancy between WA and AIs and between AIs located at different levels in the chain of intermediaries, which would speed up detection of fraudulent transactions.

282. **Anonymisation of the TRI**. An alternative to pooling the information would be to anonymise the data. An identification number could be assigned to each Investor (as its account number), but no personal detail would be provided with the TRI. With the anonymisation of the TRI, the investor identification number could be passed up through the whole chain and the WAs would provide to the SC's tax administration the tax rate applied at Investor level. With the reporting provided by each AI at the end of the year, the SC would then be able to perform an automated matching based on Investors' identifiers. The system would then automatically identify Investors for whom discrepancies arose and which consequently require further investigation.

9.4.3.1 MAIN OBSTACLES

283. **Consensus on Information to be Added.** As for the amendment of the content of the reporting, a modification of the information exchanged in the FI chain should be balanced between the benefit that this extra information could generate and the impact it could have on the various stakeholders.

284. **Opposition from the Financial Sector**. The financial sector will object to any additional information to be exchanged. The reason for this is that, again, there is no real benefit for the business but they would see it as extra work and investment from their side. The anonymisation of the information could potentially have an important impact for the business as this identification is operated at beneficial owner level. Therefore, one may expect rather strong opposition from the financial sector to the anonymisation of Investors. From this perspective, the AIIN appears to be an interesting compromise, taking into account the interests of both the financial sector and the tax administrations.

9.4.3.2 MAIN CONSEQUENCES

285. **Automated Matching between AI and WA Reports**. As already mentioned, the AIIN number should not increase the volume of the reporting considerably, but it will ease the check performed by the SCs. Indeed, with this AIIN in the TRI, the SC will exactly know the tax rates requested by each AI. When the SC receives the reporting, it will then be able to automatically identify all the AIs mentioning a tax rate different from the tax rate communicated by the WAs.

With such automated matching, it would even be possible to automate the generation of RFIs for AIs where discrepancies are identified or to carry out investigations above a given threshold. This information would efficiently compensate the risks resulting from the pooling of information without jeopardising the interest for the system.

The anonymisation of the data follows the same logic as for the AIIN number, but the identification and the automated matching, based on Investors' identifiers, is operated at beneficial owner level. Consequently, it provides more detailed results, which will enable to quickly identify Investors for whom discrepancies arose and which thus require further investigation.

286. **Cost Increase**. Both amendments will generate additional costs to be incurred in the implementation and the maintenance of the system. However, from a cost perspective, the anonymisation of the data will clearly have a bigger impact than the AIIN.

9.4.4 ADJUSTMENT BY THE AI

287. **Under-Withholding.** In the case of under-withholding, both Models offer the possibility to adjust the tax amount applied. However, for the transfer of the tax amount under-withheld, the SC Model is quite flexible and leaves to the stakeholders impacted the opportunity to choose the most appropriate corrective action (e.g. withhold the under-withheld amount on a future payment credited to the same account). This flexibility could also encourage fraud. A concrete example can illustrate this weakness: if an AI under-withholds two times the exact same amount for the same Investor and then requests a correction of this amount only once. If one of the amounts is spotted, either by the tax administration or during the audit, the AI can justify this error by the correction applied. So both errors need to be detected to identify the fraud. This flexibility can be used by the AIs as a "joker" for the first fraud identified. To prevent such fraud, both Models should specify that the AI and the WA must make one correction for each error and should clearly include the reference of the transaction corrected.

288. **Correction before Reporting**. It is likely that, in some cases, when realising that they will be subject to an exchange of information, Investors will put pressure on their FI to remove them from the report. An easy way to do so would be to amend all the transactions, applying the regular tax rate in order not to benefit from DTT application. The transactions would no longer be classified as Covered Payments and would not require to be included in the report. This attempt to avoid reporting could particularly occur when the reporting is being elaborated. It could be interesting to complete the Model with some regulation to avoid such abuses, for example, an obligation to mention in the reporting any correction processed more than a month after the payment date.

9.4.4.1 MAIN OBSTACLES

289. **No Major Obstacles.** These two recommendations should not raise major opposition from the financial sector because the most important advantage is the possibility for the AIs to correct errors without having to face an administrative burden. It should therefore not be too complex to reach an agreement with the financial sector.

9.4.4.2 MAIN CONSEQUENCES

290. **Efficiency in Investigation and Audit**. These recommendations will ease the work of external auditors or tax administrations because they will be able to carry out investigations

per transaction based on the reference used. Moreover, it will not be possible to justify errors/fraud in one transaction by a correction operated for another transaction.

291. **Less Flexibility in Correction**. This recommendation reduces the flexibility of the system for AIs. However, the impact should be limited and it could even facilitate internal investigations when reconciling income credited to a client account. This is particularly true when an investigation is carried out some weeks or months after the payment of the income.

9.4.5 IDENTIFICATION OF THE INCOME TYPE

292. **Income Identification**. The identification of the income is the responsibility of the AI. Considering the diversity in terms of tax rates applied under the various DTTs and in terms of Investor categories, this is a third variable that will have an impact on the tax rate to be applied. This income type identification could be a real challenge for AIs and it could also be an opportunity to justify the application of a lower tax rate if they believe they have sufficient reasons to justify this choice. This is a fraud and an efficiency problem, as it a barrier that could encourage fraud attempts. Indeed, if AIs do not want to take any risk, they could decide not to request relief at source each time there is doubt as to the income nature. This decision would be reasonable in the context of the AIs' liability.

293. **Identification by the Issuer**. In order to avoid any abusive interpretation of the income nature, the responsibility of the income nature should be that of the Issuer itself. Being by definition located in the SC, the Issuer should have a good view on the local tax regulation and the nature of the income distributed. An EU regulation could create a standardised code allowing Issuers to communicate, along with the income details, the nature of the income according to the national legal framework. With such information, the AIs would not be able to interpret the nature of the income for their own benefit. Moreover, it would strengthen the efficiency of the systems, enabling the AIs to request relief at source for all income types, even when they do not have sufficient information to identify the income nature.

9.4.5.1 MAIN OBSTACLES

294. **Participation of the Private Sector.** The main obstacle results from the participation of the Issuers because, with this system, the liability of the income type is transferred from the AIs to the Issuers. This means that the whole private sector is required to cooperate while they would not benefit from the system, at least not directly. However, as the income type is defined according to the SC's local regulation, the Issuer should be familiar with these definitions and this should not be a complex task in their position.

9.4.5.2 MAIN CONSEQUENCES

295. **Reliability of the WHT Rate Applied**. The WHT rate varies with the income type. So if the income type is given by the Issuer, first it will avoid errors on the part of AIs, unfamiliar with the local tax legislation, and second, it will reduce the fraud risks, as it is not possible to justify the application of a lower tax rate by a fallacious argumentation.

296. **Reduce the Liability of the AIs**. The liability of the AIs is one of the major stumbling blocks for the financial sector. By shifting the identification of the income type from the AIs to the Issuers, it reduces the liability of the AIs and they would be keener to participate in the system, which is really important in the context of optional participation.

9.4.6 IDENTIFICATION OF ENTITIES

297. **Identification of Beneficial Owners of Entities**. The identification of entities' beneficial owners is an issue for some MSs. They fear that a tax resident of their country or another investor not entitled to treaty benefit could create an entity in another country to hide his cross-border income or to benefit from a reduced tax rate. Some MSs would even consider the possibility of not allowing entities to participate in the standardised relief at source system.

This issue is very complex as it raises the question of conflict between MSs' local regulations. It will not be resolved in the context of this feasibility study. However, it is possible to improve the identification of beneficial owners.

298. **Identification of the Beneficial Owner in the ISD**. The ISD could be modified so as to include more information on entities' shareholders. It would be easy to add a section for the beneficial owner details of any shareholder holding more than a certain percentage of the entity. The names and addresses of these shareholders could then be included in the annual reporting. This would not prevent fraud, but it would clearly limit it. Moreover, if an entity does not provide accurate information in its ISD, this would make it guilty of fraud and it could be prosecuted in each MS and would forego the benefit of a more flexible local context.

9.4.6.1 MAIN OBSTACLES

299. **Liability of the Financial Sector.** This additional field in the ISD will probably give rise to opposition from FIs, especially as they already complained about this in the context of FATCA. Moreover, as already mentioned throughout this feasibility study, the liability of AIs is a major concern for the Financial Sector. Therefore, if an AI can be considered as liable if entities provide wrong information regarding their shareholders or if the information is not properly updated, this will increase the liability of AIs such that they could reject the system. A solution would be to consider this information as falling under the liability of the entities themselves.

9.4.6.2 MAIN CONSEQUENCES

300. **Identification of the Entities' Beneficial Owners**. If they want to benefit from the system, it will be more complex for Investors to create an entity to invest in another MS without mentioning this in their tax return. If they provide wrong information, they will be committing fraud in most if not in all local legal contexts.

9.4.7 EXCHANGE OF INFORMATION WHEN SC = RC

301. **Uncertainty about the Utility of this Measure**. Annual reporting includes transactions under which payment is made to Investors who are tax resident in the SCs if they have signed an ISD. These transactions may create an issue from a data protection perspective, even if the Investor provides an ISD (cf. Chapter 7). Moreover, the effectiveness of this measure is not clear: if an Investor does not want information to be exchanged with his RC, he will not provide an ISD to his AI. By contrast, if he wants to benefit from the Model, he will provide an ISD and RC will receive information on the cross-border income received by the Investor. It is very unlikely that an Investor will omit income paid from the RC while agreeing to have his personal data sent to his tax administration. In such a case, RC would in any case have sufficient information to obtain all the details of the Investor's cross-border investments.

302. **Not Fraud-proof**. Moreover, if, for any reason, an Investor wants information on his cross-border investments exchanged with the exception of income paid by Issuers located in his own country (SC = RC), it will be easy for him to open one account with ISD for his cross-border investments and another (perhaps in a separate AI) with the investments in RC.

9.4.7.1 MAIN OBSTACLES

303. **Perception of some MSs.** Some MSs consider this information as a tool against fraud. Even though it would probably be limited to non-fraudulent transactions, they perceive this as a guarantee and it will be difficult to get them to agree to remove it from the Models. If the full exchange of information is made mandatory, even for Investors who did not request the application of a DTT, this recommendation would no longer be relevant.

9.4.7.2 MAIN CONSEQUENCES

304. **Simplification of the Models**. It will be easier to identify transactions as only one criterion will count: application of a DTT. Moreover, it will reduce the volume of information exchanged and therefore the workload for handling the reporting.

305. **Solution of certain Data Protection Issues**. This exchange of information may cause problems in terms of data protection. Withdrawing this measure would resolve these issues.

9.5 COMPARATIVE ANALYSIS

306. **Introduction.** As already indicated in this chapter, one of the objectives of the study is to compare the fraud risks identified and their assessment of likelihood and impact under the AIC Model and the SC Model. To that end, the focus has been mainly set on the part of the relief at source system that concerns information channels up to the chain of Financial Intermediaries; between Financial Intermediaries and tax administrations; and between tax administrations themselves.

307. **Communication Channel**. The assessment was based on the assumption that all MSs' tax administrations participate in a proactive manner and respond to requests from other MSs' tax administrations within an agreed time frame, regardless of their roles (SC, RC or AIC).

Taking into account this assumption and our focus on the information channels, the main difference between the two Models is the relation between the AI and the tax administration to which the AI reports and communicates or transfers data. In that respect, under the AIC Model, the AI interacts with its AIC while, under the SC Model, the AI interacts with the SC.

The data transferred by the AI is considered as key for both Models because, if this data is manipulated or altered for fraudulent purposes, this has a severe impact on both Models. Although the probability that an AI actively and intentionally abuses the system is considered as remote, these fraud risks cannot be ruled out theoretically, certainly not where an AI is under pressure from financial markets or key clients.

Under both Models, as currently defined, the fraud risks do not greatly differ. However, the AIC Model offers more guarantees than the SC Model because the RC is assured that it will receive the information under the AIC model and consequently be able to identify certain fraudulent transactions. It is interesting to note, however, that MSs have different analyses of the communication channel, as highlighted in the following two paragraphs.

308. **Preference of the AIC Model**. A first group highlights the fact that, in the AIC Model, the AIC is in a better position to communicate with its AIs. The AIC has a good knowledge of the language, the local financial practice and the national legal framework. Moreover, it has a coercive power that could be interesting to force an AI to actively and effectively fulfil its duties. The SC has indeed the possibility to terminate the agreement of the AI, but it is the only sanction, there is no "progressivity" to force the AI.

309. **Preference of the SC Model**. A second group defends the greater effectiveness of the SC Model. The direct relation between the SC and the AI is a guarantee that there is no loss of information and that there is a good follow-up of the requests. Indeed, under the AIC Model, if there is a delay in the treatment of a request, the SC could place the responsibility for the delay on the AIC, creating tension between MSs' tax administrations, while the SC will be in charge of the request and therefore responsible for the follow-up in the SC Model. Reacting to the argument of the cultural barrier, these MSs point out that direct contact would allow the SC to better understand the difficulties faced by a foreign AI in replying to a request, when it is due to the local context.

310. **Local Context will be a Determining Factor**. Both positions are valid and the prevalence of one over the other will vary from case to case as it is probably not possible to identify the most appropriate option at MS level.

Given the importance of the AI in both Models, these FIs should be submitted to regular and "to the point" audit procedures by the AIC (in case of AIC) and by the SC (in case of SC). The fact that, under the SC Model, the AI and tax administration performing these audit procedures are not essentially located in the same country could pose additional difficulties that:

- Increase the occurrence of the fraud risks identified; and
- Reduce the effectiveness and efficiency of prevention and detection measures.

Nevertheless, this difference is too light and will be appreciated too differently from one MS to another and it is therefore difficult to attest that one of the contemplated Models is more effective than the other in the fight against fraud. Moreover, the efficiency of one Model will differ depending on the local context.

311. **Recommendations** Both Models provide tax administrations the opportunity to combat the fraud risks existing in the current situation. However, under both Models, Investors can still opt not to apply for relief at source, which means in essence that the main fraud risk remains present. The reporting of income received by Investors having their tax residence in the SC is also a key step to fight fraud risks, but it is totally neutralised as it is limited to Investors who agree to sign an ISD. The implementation of the AIC Model or the SC Model will only have an impact if the Investor has opted for relief at source. In that respect, it is crucial to consider some adjustments to the contemplated Models.

The stronger amendment would be to make the reporting mandatory, at least partially, for the beneficial owner details and the account number. This would considerably increase the effectiveness of the Models against tax evasion, decreasing the likelihood rate from a 3 ('likely') to 1 ('remote'). This amendment could seem too repressive, affecting the philosophy of the project. However, in the light of the recent developments concerning FATCA, this amendment seems more realistic than it was some months ago. There is a clear trend at international level to implement a more constraining exchange of information. This amendment would conciliate the two approaches, the contemplated Models and the request for more regulation at international level.

It is unrealistic to believe that increasing the amount of information exchanged will allow all the participating countries to calculate the tax amount due by their residents. The diversity of the various local tax regimes is too large to be captured by one Model. However, if some recommendations are implemented, the tax administrations could be provided with sufficient elements to identify Investors having a high probability of not declaring all their cross-border securities income. The communication of the value of the Investor portfolio would definitely strengthen both Models in this respect.

312. **Adaptability of the Models.** The effectiveness of the Models in the fight against fraud will rely on these amendments, which could be developed before Model implementation or in a second step (e.g. after a first assessment of the system effectiveness). So, the ability of both Models to integrate these amendments is an important part of this comparative analysis.

313. **Adaptability to SC Model v. AIC Model.** At first sight, the SC Model seems more flexible than the AIC Model. Admittedly, it is relatively easier to amend bilateral agreements than a common regulation that would require an agreement between all the participating countries. However, this flexibility could be at the cost of homogeneity, which would have a negative impact on the system. As demonstrated in the obstacles to the various recommendations, the SC approach, based on contractual agreements, cannot move to a more constraining or automatic exchange of information, while this amendment is required to improve the efficiency of the Models against fraud risks.

Moreover, if the system is amended with a more constraining exchange of information, including a mandatory (even if partial) feedback, the SC Model should be less flexible to integrate this dimension. The problem results from the bilateral agreements between MSs and between SC and AI building the SC Model. First, this Model requires that the AI and the SC have an interest in contracting this agreement. If, by signing the agreement, the AI will have to include in the reporting all the cross-border income securities paid to non-resident Investors, then the interest of the AI decreases and it is likely that many FIs will prefer not to participate in such Model. On the other hand, the SC itself will have a smaller interest in the system as it will have to handle all the transactions for which the DTT was not applied, while the SC has no interest in this information. Second, if the Model has to be amended after its implementation, it seems more complex to amend all the bilateral agreements, between all the stakeholders (MSs and AIs). Last but not least, from a data protection perspective, it would be difficult to regards the consent of the Investor or the service contract signed between the Investor and the AI as an adequate legal basis for supporting a mandatory reporting by the AI.

The AIC Model, based on a common regulation such as an EU Directive, offers more latitude to extend its scope because it does not require acceptance by all the FIs but only considers an agreement at political level, which is already a significant challenge. In addition, it is possible to adjust the AIC Model in a second step by amending the common regulation. So, the AIC Model seems more robust to face the requirements of a constantly evolving reality as there is one legal basis common to all actors, though it requires time to put in place. By amending this legal basis, it is possible to create constraining obligations for all involved actors. Finally, as far as data protection is concerned, a common regulation would be a better legal basis to support the mandatory collection and transfer of Investors' information by an AI.

To conclude, the ability of both Models, as currently defined, to fight fraud will depend on two key factors:

- First, as described in the assumption of the fraud analysis, the effective participation of MSs' tax administrations, their investment to meet the requirements in terms of controls, reconciliation, responsiveness and follow-up of the various requests as well as their determination to apply the mitigation measures identified in this fraud analysis;

- Second, the IT integration of the system supporting the exchange of information with the systems used by the local tax administration. Some countries may decide to reduce or postpone the investments for the integration part of the IT implementation. However, as demonstrated by the second survey on the performance of the current exchange of information under the EUSD, it appears clearly that, without this investment to connect the output of the system with the local IT architecture, the local tax administration will not be able to make effective use of the information exchanged, reducing sharply the ability of the Models to support the fight against fraud.

314. **Tax Evasion**. Nevertheless, even when these principles are applied, the two Models, as currently defined, are not best equipped against fraud. The recommendations can clearly compensate the Models' weaknesses but not solve all fraud issues. Indeed, it should be noted that, even if a Model providing access to all the information on cross-border securities

investments is implemented, it will not solve the risk of tax evasion. Investors will always have the possibility to open an account with a FI located in a less constraining country. However, the choice for these non-participating countries increasingly represents a costly solution and it will be made by rather sophisticated Investors with larger portfolios. In other words, the exchange of information is not eliminating tax evasion but it is increasing the threshold as from which tax evasion is interesting for an Investor.

The adoption of a consequent WHT rate to be applied to Investors who do not want to be identified or FIs which do not cooperate (203) is a perspective that could efficiently improve the fight against tax evasion, but it would require a fundamental change in the Models.

9.6 INTERACTION WITH THIRD COUNTRIES

315. **Preliminary Remarks**. The purpose of this part is to consider the impact that the participation of a third country could have on the fight against fraud. In that respect, the reader should pay attention to two preliminary remarks:

- First, if a third country joins the system, it is assumed that it will accept all the rules, requirements and procedures that govern this system. The possibility that the MSs amend the Model is therefore not analysed as it could potentially have an impact on all the levels of this analysis.
- Second, the risks were analysed and rated in the context of the Models under scrutiny. For the risks that would not be removed following the implementation of one or the other Model, we have suggested some measures in order to better equip the tax administrations to fight these risks. These measures are also applicable for third countries that would like to participate in the new system. Focussing the fraud analysis on the Models and leaving out of consideration all the specificities resulting from the various local contexts, the current fraud analysis is also valid for third countries.

316. **Local Regulation of Third Countries**. However, the participation of third countries in the relief at source system naturally has an impact on the fight against fraud, resulting directly from the local regulation of the third country itself. The national legal framework will not be considered for third countries, as it would require analysing the regulation in all the potential third countries that may have an interest in the system.

317. **EU Legal Framework**. This impact will also result from the non-application of the EU legal framework to these third countries. As mentioned in the analysis of the interactions between the EU laws and the Models, it appears clearly that the new system, both under the SC Model and under the AIC Model, will be integrated in a complex legal structure that already offers a strong basis in the fight against fraud. The rationale here is that, as already highlighted, the EU Directives strengthen the Models in terms of automation of the exchange of information, its timing or the possibility to ask for more information on specific cases (Directive on Administrative Cooperation), or the possibilities to recover tax amounts under-

203 This approach is adopted in other projects such as FATCA or RUBIK.

withheld by an Investor located in another MS (Recovery Directive). This means that the new system will be enhanced by the EU legal framework, but the system will also provide valuable input for this framework. Let us take the Recovery Directive as an example: this is a very strong tool against fraud, provided that the tax administration has already identified the fraud and the amount to be recovered. So the system will provide the tax administration with sufficient elements to require the application of this Directive and effectively use the tools developed at EU level. Both, the Model to be implemented and the EU legal framework, are elements of a global system and each of them is strengthening the other.

Another question one may have is whether the Models are still efficient in the fight against fraud if they are not supported by all the EU legal tools that are not part of the system (e.g. the Recovery Directive). The answer is clearly affirmative. Both Models offer a powerful input in the fight against fraud. Moreover, as for all the participating countries, the efficiency of the system will rely more on the existence of IT solutions that will enable the tax administrations to match the information included in the reporting with the information included in the various local databases, than on these EU legal tools.

318. **Legal Support of the Model.** In the context of the SC approach, the EU legal framework strengthens the system as it will provide a legal support to the exchange of information in terms of automation and timing. If this support disappears, it could create some delays in the exchange and reduce the ability of the Model to quickly identify fraud, timing being often an important parameter in terms of fraud. These aspects will have to be included in a memorandum, as provided for in the Implementation Package, in order to guarantee that the third countries will provide and benefit from input of equal quality.

If the AIC Model is implemented via a Directive in the EU, it is crucial that the third countries share the same requirements and benefits as the EU MSs. A legal tool will have to be used to reach this result. For example, a memorandum of understanding, such as the one described in the SC Model, could be added to the various DTTs, defining the content, the timing, the various standards and the other controls applied by the different actors. This memorandum could be contracted on a bilateral or multilateral basis. Of course, other legal tools can be developed to create a legal basis that would ensure that all the actors, EU MSs and third countries, meet the same standards, face the same obligations and are offered the same benefits.

319. **External Tools.** As regards external tools, it is clear that Directives such as the EU Directive on Recovery will increase the efficiency of the Model in the fight against fraud. Third countries will not be able to benefit from these advantages. To compensate the absence of this EU legal framework, third countries could develop similar tools, for example to ease recovery of claims between themselves and the EU MSs. These tools could be implemented via bilateral agreements or on a separate multilateral basis.

* *

*

CHAPTER 10 IT ANALYSIS

This chapter presents the IT part of the feasibility study. It compares the AIC and SC Model from an IT architecture perspective and identifies the AIC Model, based on the criteria applied, as the preferred Model. The comparison of both Models is based on findings from desk research and interviews conducted with IT experts of participating MSs.

After an analysis of the AIC's and SC's operating models, including their required information objects, IT functionalities and IT components, this study derives a standardised relief at source architecture. This developed architecture supports the information exchange under both standardised relief at source Models.

The study identifies and examines two strategic implementation aspects which will shape the different hypothetical ways forward to implement the IT solution for a standardised relief at source system:

- Leverage vs. not leverage the IT systems used to exchange tax information under the current Savings Directive;
- Develop IT components collaboratively vs. locally.

Based on the evaluation of the strategic implementation aspects, the study identifies "*leveraging the IT systems used to exchange tax information under the current Savings Directive while collaboratively developing the IT solution*" as the ideal way forward.

The operating model of the current Savings Directive is similar to the one of the standardised relief at source system. Hence leveraging the current IT systems reduces the gap by about 50% and leads to a lower implementation effort. Furthermore, the collaborative development of IT components leads, compared to local development, to a significant reduction of the required implementation effort as the effort is spread among MSs.

Taking the standardised relief at source architecture and identified way forward into account, the study compares the AIC Model with the SC Model from a gap and challenges (barriers, dependencies and risks) point of view. It identifies the AIC Model, as it stands currently, as the preferred Model. The AIC Model requires a lesser implementation and operation effort, as the required IT solution bears greater similarity to the IT systems used under the current Savings Directive. Tax Administrations do not need to communicate with non-resident AIs (required under the SC Model). Hence the implementation and operation efforts related to these cross-border transfers would be avoided. In addition, the SC Model would force AIs and Tax Administrations to cope with the different national data transfer and encryption standards of other MSs as there is a lack of pan-European standards for the exchange of data between AIs and Tax Administrations.

Furthermore, these cross-border data exchanges lead to a significant increase in the total number of needed connections as each Tax Administration needs to be able to exchange data with all AIs of all participating MSs. With the participation of 1000 AIs, the AIC Model would lead to the annual exchange of 3.800 messages. The SC Model with it cross-border communication with non-resident AIs would lead to 43.000 annual messages.

The study uses a cost function to come up with initial cost estimations. These estimations show that the effort to implement, operate and maintain the data exchanges between Tax Administrations and non-resident AIs should not be underestimated.

An initial estimation of the implementation cost for MSs and AIs shows a difference between the AIC Model and the SC Model. Under the assumption that MSs would develop their IT solutions locally, the initial IT implementation cost for 27 MSs in total is estimated at 22,6 million EUR for the AIC Model (29,6 million EUR for the SC Model). If MSs would opt for a collaborative development approach, potential cost savings of up to 50%, depending on the degree of collaboration, could be realised.

The implementation cost for an AI is estimated at an average cost of 0,5 million EUR for the AIC Model (0,8 million EUR for the SC Model) if the AI is leveraging his current IT systems. If an AI decides to develop the needed IT solution from scratch the initial estimation of the implementation cost is 0,9 million EUR for the AIC Model (1,1 million EUR for the SC Model). Assuming that 1000 AIs participate in a standardised relief at source system, this would lead to a total AI IT implementation costs of 0,5 to 0,9 billion EUR, depending on the collaboration, under the AIC Model (0, 8 to 1,1 billion under the SC Model).

The preference for the AIC Model is also supported by the majority of the MSs which participated in the IT interviews we conducted. No objections against the AIC Model have been raised by the MSs' interviewed IT experts. A majority of them see a challenge in the SC Model due to its requirement for a Tax Administration to communicate with non-resident AIs. Main identified issues due to these cross-border data exchanges are (a) the much larger number of interfaces to be maintained, (b) the much larger annual amount of exchanged extra messages, (c) the different national encryption and e-signature standards to be supported, and (d) the cultural and linguistic aspects to be dealt with.

In addition, the study identifies the low quality of data under the current Savings Directive as a still prominent concern for all participating MSs. The introduction of structured formats and common rules of procedures helped to increase the data quality compared to the data exchanged under DTT. However, the quality of the data sent by financial institutions to MSs still needs particular attention. This study therefore suggests incorporating data quality improvement activities within the implementation programme for the standardised relief at source system.

* * *

10.1 PRESENTATION OF THE IT ANALYSIS

320. **Structure of the IT Analysis**. The current chapter presents the IT part of the feasibility study on a standardised relief at source system. It identifies a preferred Model from an IT architecture point of view.

- **First Section.** The first section briefly describes the AIC and SC Models, elaborate on the objectives and scope for the IT part of the feasibility study and present the approach used;
- **Second section.** The second section presents the standardised relief at source architecture. It also identifies the way forward to implement the IT solution needed to support the information exchange under the AIC or SC Model. The architecture developed and the way forward serve as input for comparing both Models;
- **Third section.** The third section compares the AIC and SC Models and identifies, from an IT architecture point of view, the preferred Model for a standardised relief at source system. The comparison focuses on gaps and challenges Tax Administrations and AIs face when implementing the architecture;
- **Fourth section.** Finally, section four concludes the IT part of the feasibility study by presenting the main findings.

10.1.1 INTRODUCTION TO THE OPERATING MODEL OF BOTH MODELS

321. **Description of the Operation Models**. Section 4.7 describes the two operating models with the help of a process flow and detailed process description.

322. **Similarity of the Operating Models**. An analysis of the process flow and description shows that the two operating models for a standardised relief at source system under the AIC or SC Model have a lot in common:

- TAs receive relief at source reports generated by AIs and validate them;
- TAs generate a relief at source report for each impacted peer TA;
- TAs receive relief at source reports from peer TAs and validate them;
- Both AIs and TAs need to process RFIs and requests for confirmation to handle data quality issues.

323. **Difference between Both Models**. The main difference between both Models lies in the assignment of the responsibilities to collect data from and dispatch data to TAs and AIs:

- **The SC Model requires the direct exchange of information between TAs and non-resident AIs.**

  Under the SC Model, a SC has to collect data from all resident and non-resident AIs and provide each affected RC with the required relief at source information.

- **Under the AIC Model, the AIC acts as a middleman between TAs and non-resident AIs.**

  Under the AIC Model, an AIC acts as a single point of contact for the information exchange with its resident AIs. Hence AIs only have to communicate with their AIC. The AIC then acts as a middleman and provides each affected SC and RC with the required relief at source information.

324. **Multiple Roles of the TAs**. Therefore, under the SC Model, a TA acts as either SC or RC. Under the AIC Model, a TA can have the role of an AIC, SC or RC. A few examples:

- A participating country will act as SC for dividends/interest payments paid by entities registered in that country;
- A participating country will act as RC for persons or entities registered in the country and benefiting from cross-border dividend/interest payments;
- A participating country will act as AIC for the AIs redistributing the dividends/interest paid to their effective clients.

10.1.2 OBJECTIVE

325. **Objectives of the IT Part**. The objective of the IT part of the feasibility study is threefold:

- **Developing a Standardised Relief at Source Architecture.** Developing a logical IT architecture to support the information exchange required in a standardised relief at source system.

  The standardised relief at source architecture helps compare the AIC and SC Models by providing an overview of how the required IT solution for a standardised relief at source system could look like. This overview of the different IT components needed (incl. their functionalities and interfaces) is leveraged during the comparison of both Models. It is used to assess the current IT systems of the MSs. In addition, the architecture developed guides and facilitates the development of the IT solution later on during the standardised relief at source system implementation.

- **Identifying a Way Forward to Implement the IT Solution.** Identifying, from an IT architecture point of view, a way forward to implement the IT solution needed to support the information exchange in a standardised relief at source system.

  The way forward provides a first high-level answer, independent from both Models, on how the implementation approach of the IT solution should look like. Like the standardised relief at source architecture, it serves as input for comparing both Models. The cost function leverages the way forward to determine an initial estimate of the IT solution implementation costs.

- **Identifying a Preferred Model from an IT Architecture Point of View.** Identifying whether the AIC or SC Model is, from an IT architecture point of view, the preferred Model for a standardised relief at source system while taking the developed standardised relief at source architecture, the identified way forward and the current IT systems of the MS into account.

10.1.3 SCOPE

326. **Scope of the IT Part**. The scope of the IT part of the feasibility study slightly differs from the other parts. The following functional, geographical and architectural aspects determine the scope of the IT part.

- **Functional Aspects.** The IT part of the feasibility study focuses only on the IT support of the operating model under the AIC or SC Model. The study uses the two flow charts and process step documentations describing the two operating models as a set of high and mid-level functional business requirements for developing the IT architecture. Hence other procedures under the standardised relief at source system which are not part of the operating model documentation, like the exchange of tax rate information, the execution of tax controls or statistical analysis activities, are out of scope.

  Geographical Aspects. The comparison of both Models is based on the data gathered through interviews with IT representatives of eight MSs of the FISCALIS Project Group on IT Collaboration (FPG083): Belgium, The Czech Republic, Germany, Ireland, Italy, the Netherlands, the United Kingdom and Spain.

- **Architectural Aspects.** The scope of the architecture is, in terms of TOGAF ([204]), limited to the conceptual (**"***what?": IT functionality*) and logical level (*"how?": clustering of the IT functionality*). The translation of the logical architecture to a physical architecture (*"with what?": technologies/products to be used*) like the mapping of logical IT components to existing or future IT systems (incl. technologies or products to be used) is thus out of scope. However, the study will highlight the implications of the developed logical architecture on the physical architecture.

  The IT architecture developed by this study includes a high-level logical IT infrastructure architecture.

10.1.4 APPROACH

327. **Approach Used.** This study uses the following approach to achieve the objective described. Appendix 16 contains a detailed version of the approach used.

- **Developing a Standardised Relief at Source Architecture.** The high similarity of tasks an AI or TA needs to perform under both Models results in a common architecture on the logical level which can support both Models. Two architectures – one for each Model – are derived from the two operating models. The study derives from the two architectures

204 A proven widely-accepted industry standard to develop IT architectures: http://www.opengroup.org/togaf/

one standardised relief at source architecture which supports the information exchange under the AIC Model and SC Model. An evaluation of the architecture takes place.

- **Identifying a way forward to Implement the Standardised Relief at Source Architecture.** This study identifies a set of strategic implementation aspects to derive multiple hypothetical ways forward to implement the architecture. It then examines these aspects from an IT architecture point of view to identify a Model-independent way forward.

- **Identifying a Preferred Model from an IT Architecture Point of View.** Taking the developed standardised relief at source architecture and the identified Model-independent way forward into account, the study compares the AIC and SC Models and determines, from an IT architecture point of view, a preferred Model. The study uses a feasibility maturity model and a cost function to compare both Models. The comparison focuses on gaps and challenges TAs and AIs face when implementing the architecture.

10.2 AN ARCHITECTURE AND WAY FORWARD AS INPUT FOR COMPARING BOTH MODELS

328. **IT Architecture and Way Forward.** This study leverages the concept of IT architecture and a way forward to compare the AIC and SC Models. It therefore develops a standardised relief at source architecture and identifies a way forward. Both are described in this chapter.

10.2.1 THE STANDARDISED RELIEF AT SOURCE ARCHITECTURE

329. **IT Components, IT Functionality and Interfaces**. The study uses the concept of IT architecture to provide an overview of the IT components needed, including their functionality and interfaces, to support the information exchange under a standardised relief at source system. Based on the two operating models, it develops a standardised relief at source architecture. Appendix 28 elaborates on the standardised relief at source architecture in detail. It describes the structure behind it, provides an overview, and contains an architecture evaluation.

330. **Insight to better manage the complexity.** The architecture-based insight into the required IT components, IT functionality and interfaces helps to better manage the complexity of the IT solution. Therefore the architecture developed provides good guidance when designing and developing the IT solution. In addition, the insight is leveraged during the comparison of the AIC and SC Models. The study uses the IT components and their IT functionality provided to assess the gap between the current IT systems of the MS and the IT solution needed for a standardised relief at source system.

331. **Common Architecture**. As mentioned in subsection 10.1.1, a TA has to perform multiple roles (SC, RC and AIC) in order to participate in a standardised relief at source system. A comparison of the tasks a TA needs to perform under the AIC and SC Models shows a big overlap. This suggests also a big overlap of the IT architecture on the conceptual (IT functionality) and logical architecture level (IT components), as the IT architecture is

directly derived from the two operating models. In addition, no decision has been made yet on which standardised relief at source system will be implemented. Hence this study develops a standardised relief at source architecture by first developing two architectures – one for each Model – and then deriving a common architecture from the two model-specific architectures. This common architecture supports both Models and offers therefore the required flexibility with regard to the decision on a standardised relief at source system.

332. **Alignment between the IT Architecture and the Description of the Models**. By using the documentation of both operating models (Appendices 3, 6 and 7) as two sets of high and mid-level functional business requirements, the study ensures a proper alignment between the architecture and the two Models to be supported.

333. **High-Level Architecture Overview.** The following architecture drawings help provide more insight into the required IT components and their interfaces. The following figure depicts the high-level communication paths between TAs and AIs of MSs participating in a standardised relief at source system. TAs receive relief at source reports from AIs via the internet or dedicated (leased) lines. TAs then use the Common Custom Network (CCN) to exchange relief at source reports with their peer TAs.

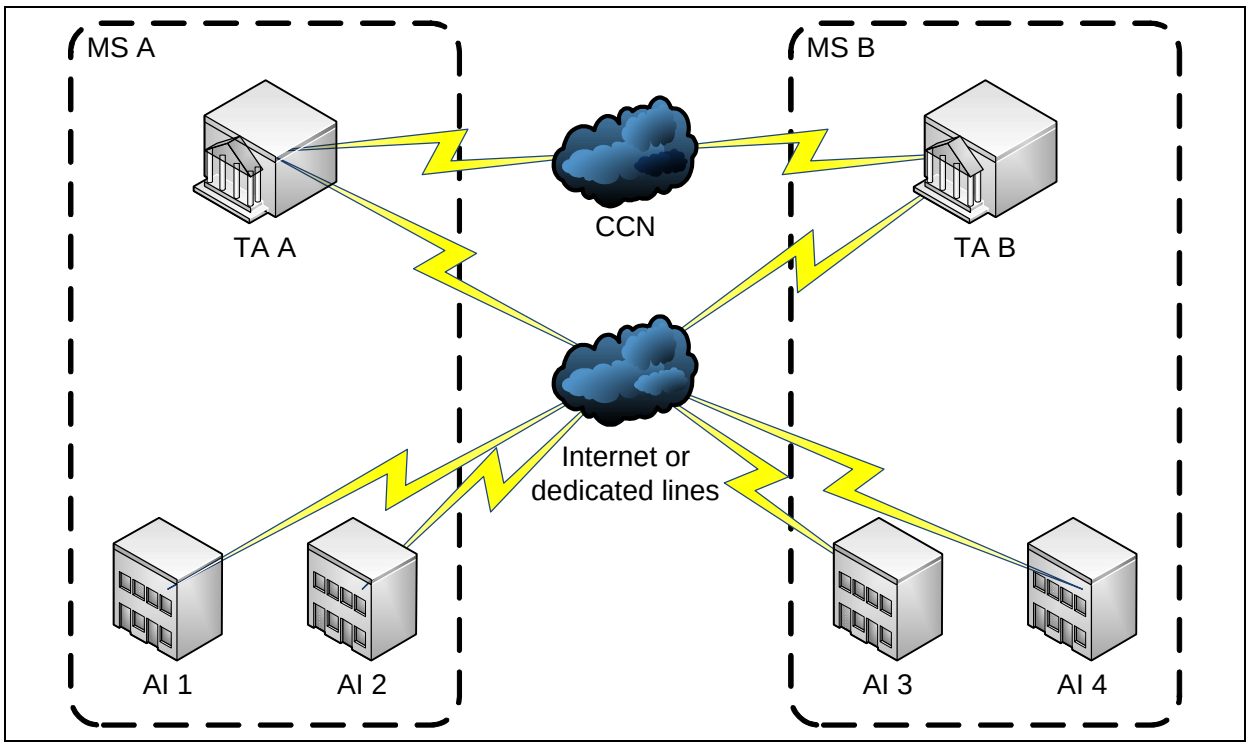


Figure 20: High-level overview of the connections between actors in a standardised relief at source system

334. **TA architecture.** The following Figure illustrates the different identified logical application components used by a TA to facilitate its participation in a standardised relief at source system.

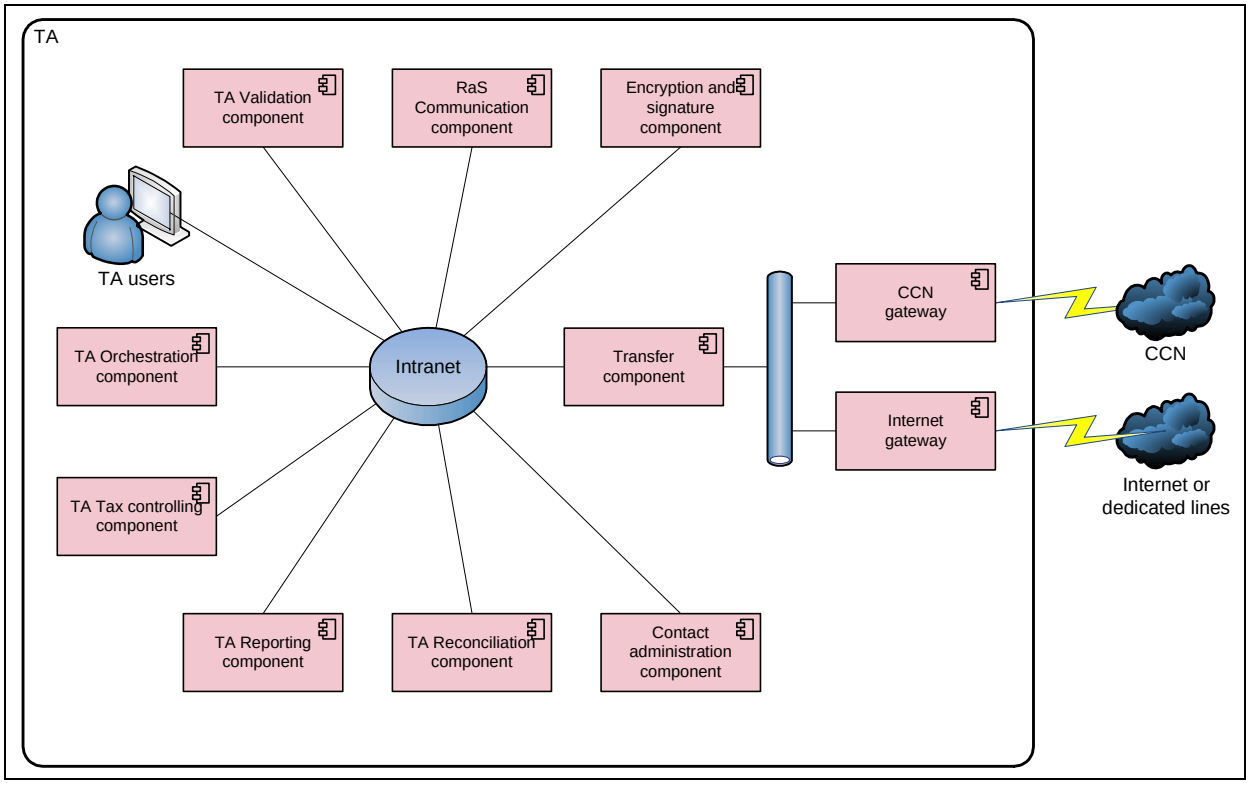


Figure 21: Logical application component overview of a TA

335. **AI Architecture.** Analogous to the illustration above, the following figure depicts the different identified logical application components used by an AI to facilitate the participation in a standardised relief at source system.

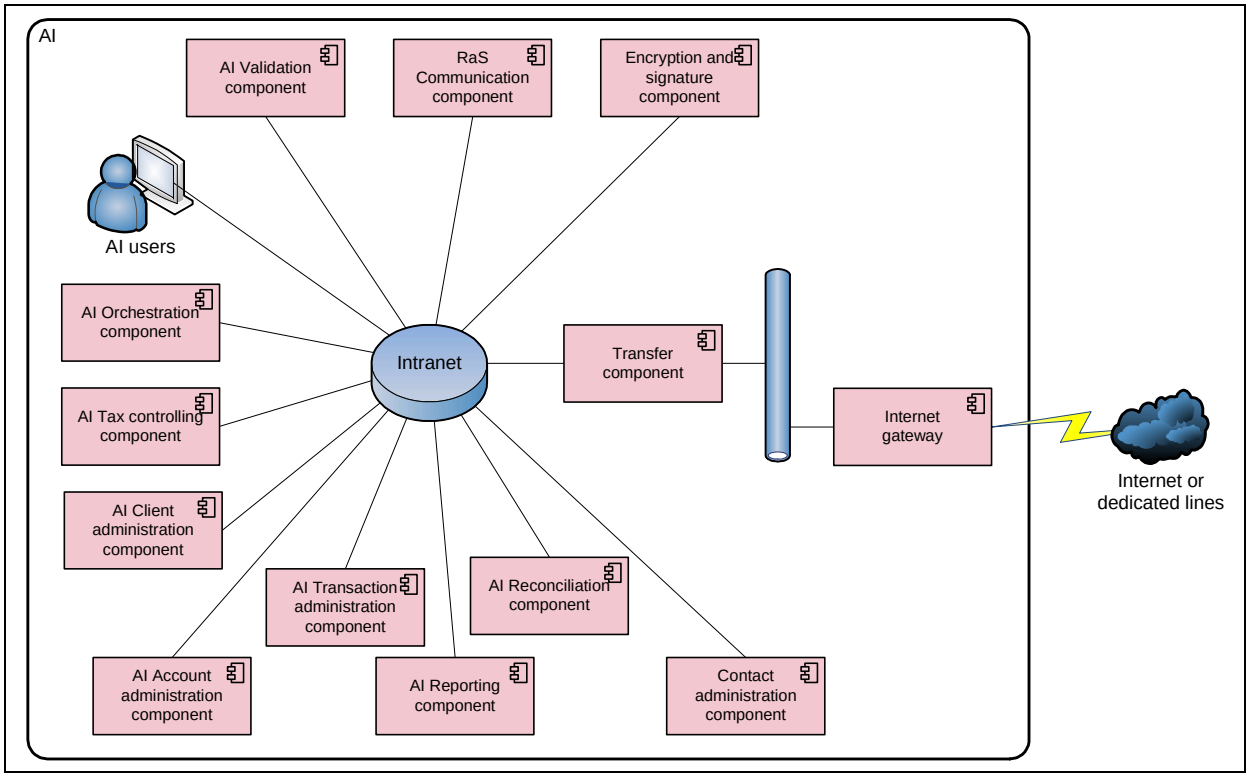


Figure 22: Logical application component overview of an AI

336. **Detailed architecture.** More detailed architecture posters containing the logical application components, including their IT functionality provided, interfaces and information objects provided/exchanged, can be found in Appendix 17.

337. **Evaluation of the Standardised Relief at Source Architecture**. This study also provides an evaluation of the standardised relief at source architecture. It focuses on (1) the coexistence of Models, (2) the integration with an AI's or TA's back-office systems and (3) the integration of third countries. The evaluation, described in Appendix 30, leads to the following result:

- **Coexistence of both Models:** The architecture can support the coexistence of both Models as it is derived from the process flows and descriptions of both Models.
- **Implications for the physical architecture:** Special care has to be taken when the logical architecture is translated into a physical architecture to ensure that the IT solution properly supports the coexistence of different Models and reporting systems. Subsection 10.3.2 elaborates on differentiating factors between both Models when translating the logical architecture, developed by this study, into a physical architecture.
- **Integration with Back-Office IT systems:** The architecture supports the integration with the existing Back-Office IT systems of TAs and AIs through conceptual integration patterns

- **Common Communication Network.** From an IT perspective, the architecture leverages the CCN and supports the integration of a third country. Currently several third countries are already connected to CCN:
  - **Via CCN gateway:** Turkey, Switzerland, Norway, Croatia
  - **Via VPN access ("SPEED"):** Russia
- **Encryption and e-signature standards.** No pan-European encryption and e-signature standards are currently available for the exchange of data between AIs and TAs. Hence, under the SC Model, a third country has to ensure the proper IT support for the different national encryption and e-signature standards used by other participating MSs as the SC Model provides the data exchange between TAs and non-resident AIs. This leads to an additional burden.

10.2.2 A WAY FORWARD TO IMPLEMENT THE ARCHITECTURE

338. **Implementation of the Standardised Relief at Source Architecture**. To enable a comprehensive comparison of both Models from an IT architecture point of view, this study takes also the implementation of the standardised relief at source architecture into account. The study describes the implementation of the IT solution on a high-level with the help of a way forward. The way forward is independent from the Model and is leveraged during the Model comparison to make an initial estimate of the implementation costs of the IT solution.

339. **Strategic Implementation Aspects**. To identify this way forward, the study uses two strategic implementation aspects to identify a mutually exhaustive and exclusive set of hypothetical ways forward. The two strategic implementation aspects are independent from the aspect whether to implement the AIC or the SC Model.

340. **Ideal Way Forward**. Based on the evaluation of the strategic implementation aspects, the study identifies "leveraging the IT systems used to exchange tax information under the current Savings Directive while collaboratively developing the IT solution" as the ideal way forward.

10.2.2.1 A MUTUALLY EXHAUSTIVE AND EXCLUSIVE SET OF HYPOTHETICAL WAYS FORWARD

341. **Two Strategic Implementation Aspects To Keep In Mind**. The study identified two Model-independent strategic implementation aspects which will shape the different hypothetical ways forward.

- **Strategic Implementation Aspect 1: Leveraging vs. Not Leveraging the IT systems used to exchange tax information under the current Savings Directive.** The standardised relief at source architecture has a lot in common with the IT systems used by the MS for the current Savings Directive. Under the current Savings Directive, TAs already receive tax information from AIs and, when needed, exchange the information with peer TAs.

Hence, MSs participating in the current Savings Directive will probably opt to reuse their current IT systems for exchanging tax information within the EU as much as possible. However third countries which currently do not participate in the current Savings Directive but want to join a standardised relief at source system don't have such IT systems yet. They have to build their IT solutions needed from scratch. Subsection 10.3.1 contains a more detailed comparison of both Models towards the IT systems used under the current Savings Directive and shows that the aspect of (not) leveraging the IT systems used under the current Savings Directive is independent from the decision of which Model to implement.

Therefore, the study models the option to leverage or not the IT systems used to exchange tax information under the current Savings Directive as a strategic implementation aspect to shape the way forward.

- **Strategic Implementation Aspect 2: Collaborative vs. Local Development.** A second strategic implementation aspect lies in the decision whether to develop the IT solution locally or collaboratively. Pursuing a way forward with local development implies that each MS has to design, develop and roll out the required IT solution on its own. Opting for collaborative development means MSs work together to reduce the effort required to implement the IT solution.

  There are many ways how the collaboration could look like. Three possibilities of collaboration could be:

  - **A joint programme –** A joint programme across MSs first designs and develops (parts of) the IT solution, keeping in mind that other MSs will reuse it. Each MS will then obtain the (parts of the) IT solution, incl. its source code and documentation. The MSs deploy and integrate the IT solution locally. A possibility could be that the European Commission (DG TAUXD) takes the lead for such a joint programme.

  - **A MS takes the lead –** One or two MSs develop (parts of) the IT solution and share it (incl. source code and documentation) with their peers.

  - **A working group –** A working group acts as (a) a platform for discussion and sharing. It also could act as a gatekeeper to harmonise the data exchange required under a standardised relief at source system.

342. **Collaboration.** The aspect of developing the IT solution needed for a standardised relief at source system locally or collaboratively is independent from the decision of which Model to implement. Hence, the study models the option to develop (parts of) the IT solution collaboratively or locally as a strategic implementation aspect to shape the ways forward.

343. **Assumption of a joint programme.** The study assumes that the way of collaborating will have the form of a joint programme.

344. **Identification of Four Ways Forward.** The study leverages these two strategic implementation aspects to define the following four mutually exhaustive and exclusive possible ways forward.

HYPOTHETICAL WAY FORWARD	STRATEGIC IMPLEMENTATION ASPECT 1	STRATEGIC IMPLEMENTATION ASPECT 2
1	Leveraging the IT systems used to exchange tax information under the current Savings Directive	Local development
2		Collaborative development
3	Not leveraging the IT systems used to exchange tax information under the current Savings Directive	Local development
4		Collaborative development

Table 23: Four possible ways forward to implement the IT solution needed

10.2.2.2 EVALUATION OF THE DIFFERENT WAYS FORWARD

345. **Evaluation of the Two Strategic Implementation Aspects.** To propose an ideal way forward to implement the IT solution needed for a standardised relief at source system, the two strategic implementation aspects are evaluated.

- **Strategic Implementation Aspect 1: Leveraging vs. Not Leveraging the IT systems used to exchange tax information under the current Savings Directive.** The comparison of whether to leverage or not the IT systems used under the current Savings Directive shows that leveraging the current IT systems is the preferred option.

  The following table depicts the evaluation results. It uses the following colour codes.

  - **Green –** This finding leads, in relative terms, to an advantage for an option compared to the other;
  - **Red –** This finding leads, in relative terms, to a disadvantage for an option compared to the other.

FINDING ID	FINDING NAME	LEVERAGING THE IT SYSTEMS USED TO EXCHANGE TAX INFORMATION UNDER THE CURRENT SAVINGS DIRECTIVE	NOT LEVERAGING THE IT SYSTEMS USED TO EXCHANGE TAX INFORMATION UNDER THE CURRENT SAVINGS DIRECTIVE
1	A smaller gap	Smaller gap and lower implementation effort	Bigger gap and higher implementation effort
2	Easier to obtain initial buy-in from AIs and MSs	Easier to start up the implementation	More difficult to start up the implementation
3	Lower risks to underestimate the required budget, resources, dependencies or complexity	Lower risks	Higher risks

Table 24: Comparison whether to leverage or not the IT systems used to exchange tax information under the current Savings Directive

- **Finding 1: A Smaller Gap.** If the IT systems used under the current Savings Directive are leveraged, less functionality needs to be developed. Reusing the current IT systems and their functionality leads to a smaller gap that needs to be bridged in order to properly support the information exchange under a standardised relief at source system. This reuse, compared to building the IT solution from scratch, lowers the implementation effort.

- **Finding 2: Easier to Obtain Initial Buy-In from AIs and MSs.** If the IT systems used under the current Savings Directive are leveraged, the initial buy-in from AIs and MSs can be more easily obtained. The current IT systems are already successfully in use. By reusing them, AIs and MSs leverage the investments they made previously. Hence, convincing AIs and MSs and getting their initial buy-in might be easier. This leads to lower initial barriers as less time and effort is needed to start up the programme.

- **Finding 3: Lower risks to underestimate the required budget, resources, dependencies or complexity.** If the IT systems used under the current Savings Directive are leveraged, chances of underestimating the required budget, resources, dependencies or complexity are lower. Reusing the current IT systems leads to a smaller gap and a lower implementation effort (Finding 1), making the implementation more manageable. Hence, the risks to underestimate the required budget, resources, dependencies or complexity are lower.

- **Strategic Implementation Aspect 2: Collaborative vs. Local Development.** The comparison of whether to collaborate or develop the IT solution locally shows that the collaboration of MSs is the preferred option.

  The following table depicts the evaluation results. It uses the following colour code.

  – **Green:** This finding leads, in relative terms, to an advantage for an option compared to the other;

  – **Red:** This finding leads, in relative terms, to a disadvantage for an option compared to the other.

FINDING ID	FINDING NAME	COLLABORATIVE DEVELOPMENT	LOCAL DEVELOPMENT
4	Smaller collective burden across MSs to start up the implementation	Lower collective burden across MSs to start up the implementation	Higher collective burden across MSs to start up the implementation
5	More time needed to start up the implementation due to the required initial alignment among MSs	More time needed to start up the programme	Less time needed to start up the programme
6	Lower development and maintenance costs	Less implementation effort required	More implementation effort required
7	More coordination effort due to the need for continuous consensus and alignment among MSs	More implementation effort required	Less implementation effort required
8	Risks are shared among MSs	Less implementation effort required	More implementation effort required

Table 25: Comparison whether to opt for collaborative or local development

  – **Finding 4: Smaller Collective Burden Across MSs to Start Up the Implementation.** If IT components are developed collaboratively, the required budget and resources to start up the programme are spread among MSs. Due to the collaboration, MSs face a smaller burden as each MS needs to allocate less budget and resources in order to start up the implementation.

  – **Finding 5: More Time Needed to Start Up the Implementation Due to the Required Initial Alignment Among MSs.** If IT components are developed collaboratively, MSs need to reach initial consensus and alignment to start up the programme. This leads to higher initial barriers as reaching this initial consensus and alignment takes time. However, this extra burden is smaller compared to the cost savings gained by the actual development work.

- **Finding 6: Lower Development and Maintenance Costs.** If IT components are developed collaboratively, they can be reused across MSs. The required budget and resources are spread among MSs, especially during the development phase. This leads to a more harmonised IT solution and a reduction of the overall related development and maintenance costs across MSs.

- **Finding 7: More coordination Effort Due to the Need for Continuous Consensus and Alignment Among MSs.** If IT components are developed collaboratively, MSs need to reach continuous consensus and alignment during the project due to the collaborative approach. This leads to a higher implementation effort in terms of time elapsed, budget and resources needed. However, this extra burden is, similar to Finding 5, smaller compared to the cost savings gained during the development phase.

- **Finding 8: Risks are shared among MSs.** If IT components are developed collaboratively, project development and implementation risks are not borne by each MSs separately but are principally addressed at EU level. This leads to lower risks.

10.3 COMPARISON BETWEEN THE AIC AND SC MODELS

346. **AIC Model as the Preferred Model**. Leveraging the developed standardised relief at source architecture and the identified way forward, the study compares the AIC and SC Models and determines the AIC Model as the preferred Model for a standardised relief at source system from an IT perspective.

347. **Common Architecture as a Comparison Criterion.** The architecture developed helps to structure the comparison. It supports the evaluation of the current IT systems of the MS against key elements the MSs need to implement in order to support the one or the other Model. For example, the effort needed to implement the IT functionality required to support the data transfers under the AIC Model is much lower than under the SC Model. Under the AIC Model, the data transfers of the IT systems used under the current Savings Directive can be reused. On the other hand, the SC Model requires the implementation of cross-border data transfers between TAs and non-resident AIs.

348. **Way Forward as a Comparison Criteria**. The comparison also takes the Model-independent way forward into account in order to compare, in relative terms, both Models with the help of an initial cost estimation for implementing the IT solution.

349. **Feasibility Maturity Model**. A major part of the comparison is based on a feasibility maturity model. This model uses interviews with IT representatives of participating MSs to assess qualitatively and quantitatively the maturity of MSs with regard to the implementation of a standardised relief at source system:

- **Gaps a MS Faces When Implementing the Architecture.** To determine the extent to which the current IT systems of a MS already cover the standardised relief at source architecture.

- **Challenges Faced by a MS When Implementing the Architecture.** To determine the barriers, dependencies and risks a MS faces when implementing the standardised relief at source architecture.

350. **Maturity Levels**. The feasibility maturity model can identify different levels of maturity among participating MSs. The awareness of whether different maturity levels exist or not, helps assess the demand for different implementation approaches per maturity level.

351. **Gaps and Challenges**. The rest of this chapter describes the results of the gaps and challenges a MS faces when implementing the architecture.

10.3.1 RESULTS ON THE GAPS A MS FACES WHEN IMPLEMENTING THE ARCHITECTURE

352. **Functional Domain Gap, Functional IT Gap and Gap Scores**. The results on the gaps a MS faces consist of three parts: a functional domain gap analysis with regard to the current Savings Directive, a functional IT gap analysis with regard to the current IT systems of MSs and the gap scores of participating MSs.

10.3.1.1 FUNCTIONAL DOMAIN GAP COMPARED TO THE CURRENT SAVINGS DIRECTIVE

353. **Gap Definition**. All MSs have implemented the current Savings Directive, which has a big overlap with both Models. A bigger overlap between the current Savings Directive and a Model implies a smaller gap between the current IT systems of a MS and the IT solution supporting the Model. The following gap analysis highlights which Model has a smaller gap towards the current Savings Directive. A smaller functional gap indicates a smaller gap score of a MS.

354. **Functional Domains**. To facilitate this comparison, the gap analysis divides the current Savings Directive into functional domains. The gap analysis then compares both Models per functional domain against the current Savings Directive.

355. **Smaller Functional Gap for the AIC Model**. The comparison shows that the AIC Model has a smaller functional gap with regard to the current Savings Directive than the SC Model as it does not require the TAs to communicate with non-resident AIs. Compared to the SC Model, the AIC Model can be viewed as a moderate extension to the IT systems used under the current Savings Directive.

356. **Functional Gaps Comparison**. The table below is based on the documentation of the respective operating models. The colours used for the AIC or SC Model indicate the relative size of the functional gap with regard to the current Savings Directive. The colours are based on the following colour codes:

- **Green –** Compared to the other Model, this Model has, in relative terms, a smaller functional gap with respect to the current Savings Directive;
- **Red –** Compared to the other Model, this Model has, in relative terms, a bigger functional gap with respect to the current Savings Directive;

- **Grey –** Both Models have a similar functional gap with respect to the current Savings Directive.

FUNCTIONAL DOMAIN	CURRENT SAVINGS DIRECTIVE	AIC MODEL	SC MODEL
AIs need to generate reports	One report for AIC	One similar report for AIC	One similar report for each impacted SC
AIs need to send reports	Only to AIC	Only to AIC	To each impacted SC
TA receive reports from AIs	Only from resident AIs	Only from resident AIs	From resident and non-resident AIs
TAs need to validate AI reports	Only from resident AIs	Only from resident AIs	From resident and non-resident AIs
TAs need to generate reports for their peer TAs based on the AI reports received	One report for each impacted RC	One similar report for each impacted SC or RC	One similar report for each impacted RC
TA receive reports from peer TAs	Only from each impacted AIC	Only from each impacted AIC	Only from each impacted SC
TAs need to validate reports received from peer TAs	Only from each impacted AIC	Only from each impacted AIC	Only from each impacted SC
TAs have to handle RFIs and requests for clarification to handle data quality issues	Only with impacted AICs, SCs and resident AIs	Only with impacted AICs, SCs, RCs and resident AIs	With impacted SCs, RCs, resident and non-resident AIs
AIs have to handle RFIs and requests for clarification to handle data quality issues	Only with impacted AICs	Only with impacted AICs	With impacted SCs, RCs

Table 26: Comparison of the functional gap between the two Models and the current Savings Directive

10.3.1.2 FUNCTIONAL IT GAP COMPARED TO MSS' CURRENT IT SYSTEMS

357. **Functional IT Gap Definition**. As for the functional gap, a smaller functional IT gap contributes to a smaller gap score.

358. **Similarity of the Current IT Systems in the Participating MSs**. The interviews with IT representatives of eight participating MSs indicate that the current IT systems of MSs are, from a logical architecture perspective, similar. The study uses this similarity to derive an overview of IT functionality which is, on average, available. It leverages the logical application components of the standardised relief at source architecture to compare the gap of the on-average-available IT functionality with either Model. The following table 28 illustrates this comparison.

359. **Smaller Functional IT Gap for the AIC Model**. As for the functional gap comparison in subsection 10.3.1.1 above, the AIC Model has a smaller functional IT gap than the SC

Model. Again this originates from the required cross-border communication between AIs and TAs.

The colours used in the table below indicate the degree of availability of the IT functionality per logical application component. The table uses the following colour codes:

- **Green:** Component is available; no or only minor configuration changes need to be conducted to support the Model;
- **Yellow:** Component is available; minor functionality changes need to be conducted to support the Model;
- **Orange:** Component is available; major functionality changes need to be conducted to support the Model;
- **Red:** Component is not available; component needs to be implemented to support the Model;
- **Grey:** No information is available.

LAC ID	LOGICAL APPLICATION COMPONENTS	AIC MODEL	SC MODEL
1	AI Client administration component	Current functionality is expected to be sufficient	Current functionality is expected to be sufficient
2	AI Account administration component	Current functionality is expected to be sufficient	Current functionality is expected to be sufficient
3	AI Transaction administration component	Current functionality needs to be extended to provide the right source data for reports	Current functionality needs to be extended to provide the right source data for reports
4	RaS Communication component	Proper IT support for the exchange and management of RFIs and requests for clarification is usually missing	Proper IT support for the exchange and management of RFIs and requests for clarification is usually missing + IT support must also enable the communication with non-resident AIs
5	TA Tax controlling component	n/a (out of scope)	n/a (out of scope)
6	AI Reporting component	Current functionality needs to be adapted to generate the required reports	Current functionality needs to be adapted to generate the required reports

LAC ID	LOGICAL APPLICATION COMPONENTS	AIC MODEL	SC MODEL
7	TA Reporting component	Current functionality needs to be adapted to generate the required reports	Current functionality needs to be adapted to generate the required reports + Handling of reports from non-resident AIs needs to be supported
8	AI Validation component	Current functionality needs to be extended to support higher data quality	Current functionality needs to be extended to support higher data quality + Validation of reports for foreign TAs needs to be supported
9	TA Validation component	Current functionality needs to be extended to support higher data quality	Current functionality needs to be extended to support higher data quality + Validation of reports from non-resident AIs needs to be supported
10	AI Reconciliation component	Functionality to reconcile reports is usually missing	Functionality to reconcile reports is usually missing
11	TA Reconciliation component	Functionality to reconcile reports is usually missing	Functionality to reconcile reports is usually missing
12	Encryption and signature component	Current functionality might have to be adapted	Current functionality might have to be adapted + Enable encryption and e-signatures with non-resident AIs or TAs
13	Transfer component	Current functionality needs to be adapted to handle the exchange of RFIs and requests for clarification	Current functionality needs to be adapted to handle the exchange of RFIs and requests for clarification + Data transfers with non-resident AIs needs to be implemented
14	Contact administration component	Component is usually missing	Component is usually missing

LAC ID	LOGICAL APPLICATION COMPONENTS	AIC MODEL	SC MODEL
15	AI Orchestration component	n/a	n/a
16	TA Orchestration component	Component is usually missing	Component is usually missing

Table 27: Functional IT gap analysis between the on-average-available IT functionality and both Models

360. **Based on qualitative feedback.** This comparison is based on the qualitative feedback gathered during interviews with IT representatives of the participating MSs. Appendix 21 contains the results of the interviews.

10.3.1.3 GAP SCORES OF PARTICIPATING MSS

361. **Feasibility Maturity Model Concept**. The study applies a feasibility maturity model. This model translates the results of the IT interviews conducted into gap scores per MS in order to evaluate quantitatively the extent to which the current IT systems of a MS already cover the standardised relief at source architecture. Appendix 20 describes the feasibility maturity model used with its objectives, criteria and measurements. It also contains a brief description of how the gap scores were deducted from the IT interviews.

362. **AIC Model as the Preferred Model**. Based on the gap scores, the study identifies the AIC Model as the preferred Model for the eight participating MSs.

363. **Baseline Scenario**. The feasibility maturity model uses a baseline scenario, which represents an ideal, hypothetical candidate. Using this baseline scenario as a reference, it derives several gap scores per MS. This is done by comparing the current IT systems of a MS with the baseline scenario by leveraging key aspects of the architecture developed. The gap scores are then aggregated to an overall gap score per MS. Hence the overall gap score highlights the gap between the current IT systems of a MS and the standardised relief at source architecture. As a consequence, a big gap observed results in a high overall gap score.

364. **Worst-Case Scenario**. The feasibility maturity model also uses a worst-case scenario. This worst-case scenario envisages, in contrast to the baseline scenario, a third country which has not yet implemented the current Savings Directive but wants to join a standardised relief at source system.

365. **Appendices.** Next to the feasibility maturity model, Appendix 20 also describes the baseline scenario and the worst-case scenario in detail. Appendices 21 and 24 contain the results from the interview with participating MSs and the resulting scores.

366. **Gap Scores for Each Model per MS**. Figure 23 illustrates the gap scores for each Model per MS.

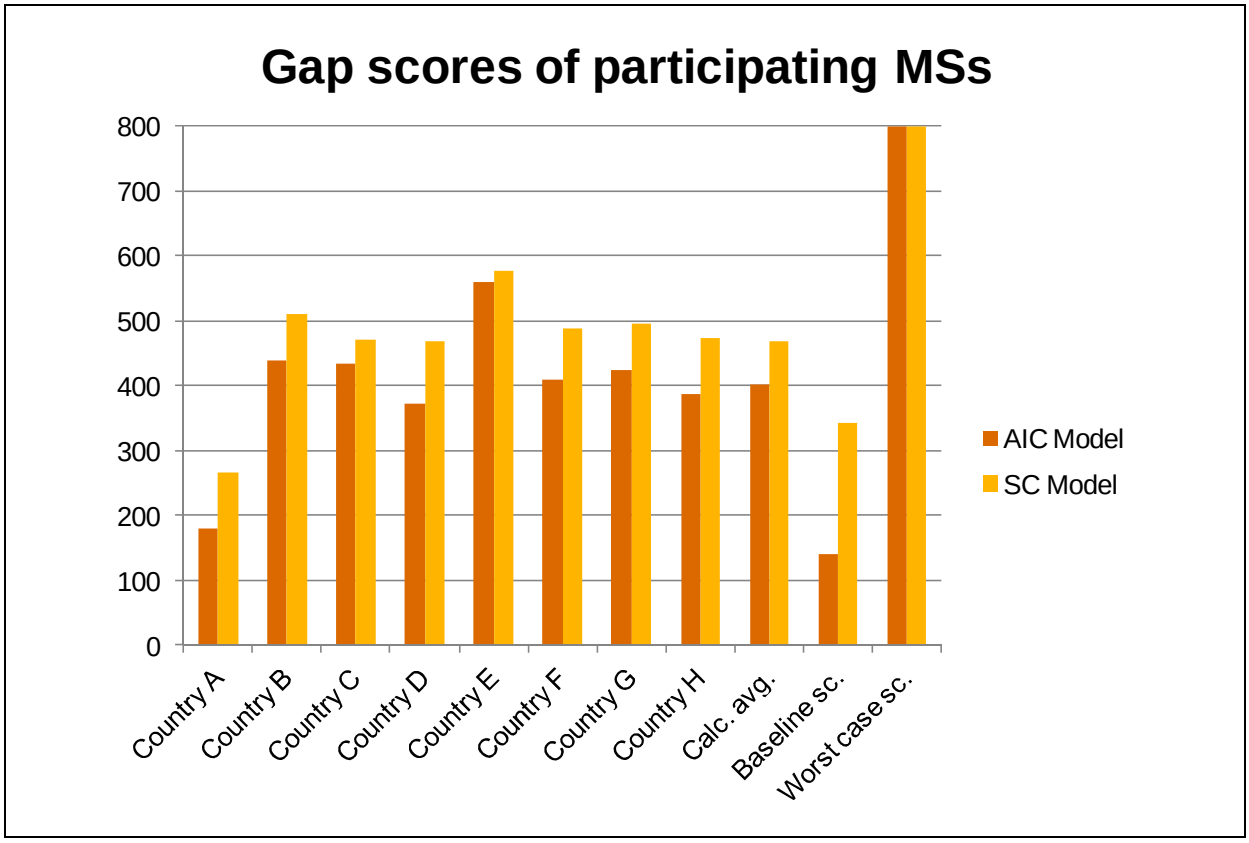


Figure 23: Gap scores of the feasibility maturity model

367. **Analysis of the Gap Scores**. The following can be derived from the gap scores:

- Compared to the SC Model, MSs have a lower gap score when implementing the AIC Model. The IT systems used under the current Savings Directive already support the data transfers required under the AIC Model. The data transfers according to the SC Model with non-resident AIs are not yet supported by the current IT systems of the MS and thus need to be designed, developed and implemented.

- All participating MSs end up with similar gap levels per Model as they all have implemented the current Savings Directive. The calculated average (401 for the AIC Model, 469 for the SC Model) shows a big overlap between the current IT solutions in place and the one needed to support the standardised relief at source system. This leads to one common maturity level from a gap point of view.

- The delta between the scores of MSs and the maximum gap score of 800 is based on two elements. First, the baseline scenario (140 for the AIC Model, 343 for the SC Model) resembles the IT functionality gap a hypothetical, ideal candidate needs to close in order to have a proper IT solution in place. Second, the difference between such a hypothetical, ideal candidate and the various MSs needs to be taken into account. This difference can be explained as follows:

- MSs do not have an IT solution in place to administer and maintain RFIs and requests for clarification;
- MSs lack the IT functionality for reconciliation or sophisticated validation activities;
- MSs lack the IT functionality to encrypt and sign digitally the reports exchanged;
- The IT functionality to monitor data transfers is not available;
- Files between AIs and TAs are exchanged manually via web portals.

- Of all interviewed MSs, MS A has the lowest functional gap. Compared to the MS with the highest gap score (MS E), MS A obtains a better score due to (a) the use of predefined RFI and request for clarification standards to communicate with its AIs, (b) the presence of an automated validation error notification mechanism and (c) the disposal of a workflow engine.
- The gap scores indicate the functional gap MSs need to close in order to have the right IT solutions for a standardised relief at source system in place. Hence the gap scores are an important input for the initial estimation of the implementation cost (subsection 13.3.2.4). The bigger the gap score, the more additional functionality (e.g. reconciliation of reports) needs to be developed or procured by a MS.

10.3.2 RESULTS ON THE CHALLENGES A MS FACES WHEN IMPLEMENTING THE ARCHITECTURE

368. **Challenges Faced by a MS**. The results for challenges faced by a MS consist of four parts: an analysis of differentiating implications for the physical architecture, an analysis of differentiating implementation aspects, the challenges scores of participating MSs and a comparison based on an initial estimation for the IT solution implementation cost.

10.3.2.1 IMPLICATIONS FOR THE PHYSICAL ARCHITECTURE

369. **Translation of the Logical Architecture into a Physical Architecture**. The standardised relief at source architecture can be used to implement an IT solution to support both Models. However, the translation of this logical architecture ('how?' clustering of the IT functionality) into a physical architecture ('with what': technologies/products to be used) will lead to significant differences between both Models. This subsection elaborates on these differentiating factors. It uses the European Interoperability Framework, illustrated in the figure below, to structure these factors.

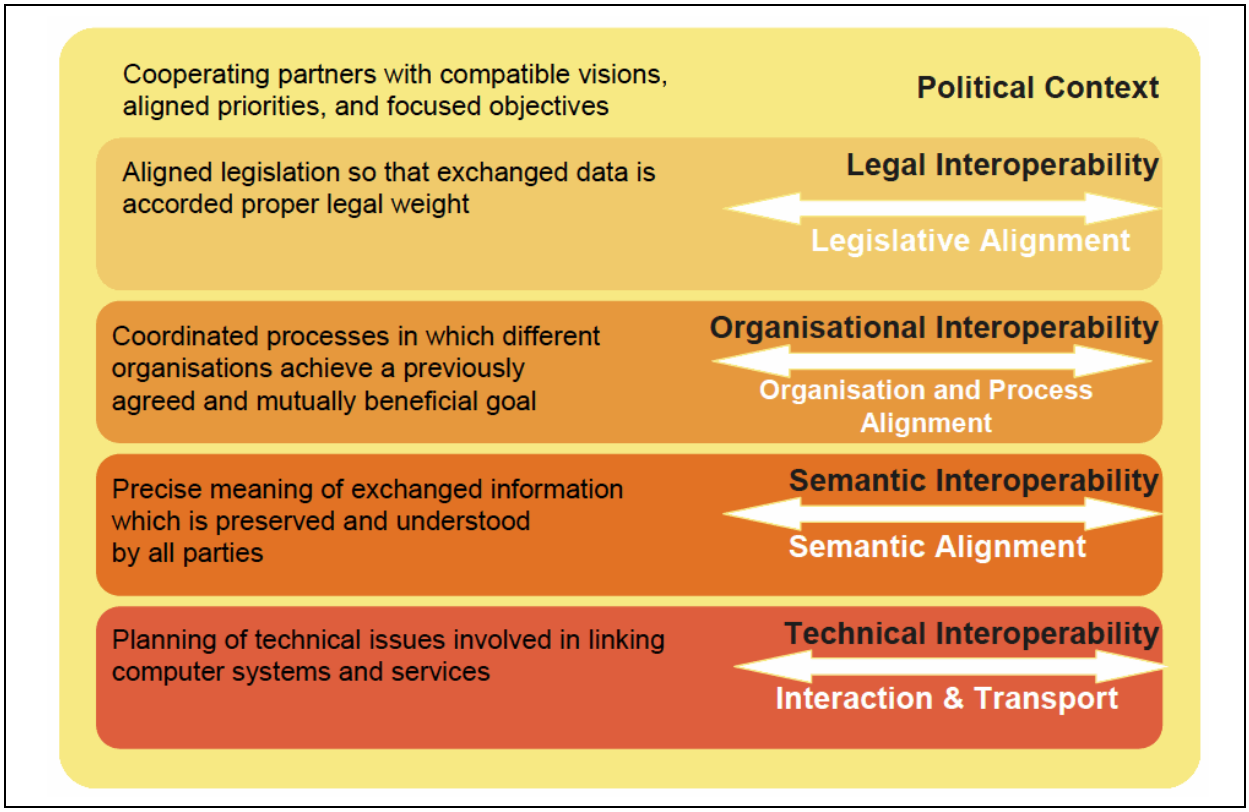


Figure 24: European Interoperability Framework

370. **ESUD Model Requires Less Effort to Implement the Physical Architecture**. The comparison of both Models with regard to the implications for the physical architecture shows that the AIC Model requires less effort to implement the architecture.

FINDING IDS	INTEROPERABILITY LAYER	AIC MODEL	SC MODEL
9 – 13	Political Context	Less implementation effort required	More implementation effort required
14 – 16	Legal Interoperability	Less implementation effort required	More implementation effort required
17 – 21	Organisational Interoperability	Less implementation effort required	More implementation effort required
22 – 23	Semantic Interoperability	Less implementation effort required	More implementation effort required
24 – 28	Technical Interoperability	Less implementation effort required	More implementation effort required

Table 28: Comparison based on implications on the physical architecture

371. **Detailed Findings**. The following findings support this comparison:

- **Political Context Related Differentiators**. The political context will influence or even drive several ICT-related decisions. The IT feasibility study identifies several differentiators at the level of political support and sponsorship.

  - **Finding 9. Higher Perceived Preference for the AIC Model.** Conversations with the participating MSs clearly show the preference of MSs for the AIC Model. Most of the interviewed IT experts perceive the AIC Model as an extension of the current Savings Directive. They expect the SC Model would result in much higher implementation, operation and maintenance efforts (dedicated time and budget).

  - **Finding 10. Limited willingness to communicate with non-resident AIs and TAs.** Currently almost no participating MS has established an automated data transfer for communicating with non-resident AIs. Under the SC Model, TAs and non-resident AIs would be in direct contact to exchange relief at source data. TAs and AIs would have to cope and interact with different linguistic, cultural, legal, and administrative environments. This exposure would lead to a higher burden the TAs and AIs want to avoid.

    During the interviews, no IT expert raised the concern that putting the AIC as a middleman between AIs and the SCs or RCs would be an unnecessary burden. Most of the IT experts perceive the AIC as enabling them not to have to communicate directly with non-resident AIs.

  - **Finding 11. Limited Willingness to Agree Upon Pan-European Encryption and e-Signature Standards.** Currently no pan-European encryption and e-signature standards are in place to support a TA's data exchange with AIs and peer TAs. In addition, there is a limited willingness to agree upon such pan-European standards. The lack of this willingness would have no impact on the AIC Model as TAs and AIs can leverage the existing national standards used under the current Savings Directive.

    However, this lack of willingness would cause an extra burden under the SC Model as TAs need to communicate with both resident and non-resident AIs. In the absence of pan-European standards, AIs and TAs would have to comply with each of the various national standards. This would lead to a bigger implementation and maintenance effort for both TAs and AIs.

  - **Finding 12. Limited Willingness of AIs to Comply with the Different Reporting Standards of Each MS.** Under the assumption that no pan-European reporting standards (e.g. deadlines, format, semantics and syntax) can be achieved, the annual information exchange under the AIC Model could be based on the reporting procedures of the current Savings Directive. In the case of the SC Model, AIs would be confronted with the different reporting standards of other MSs, leading to an additional burden. In the worst case, AIs and TAs have to comply with and maintain 27 different reporting standards. The TRACE group is currently developing a set of

XML Schemas to facilitate the reporting. These XML Schemas will contribute to harmonise the reporting. However, additional steps like the definition and acceptance of deadlines, procedures and responsibilities need to be taken in order to come to one pan-European reporting standard.

- **Finding 13. Limited Willingness of AIs to Split their Reports per MS.** Under the SC Model, AIs would have to generate reports for each applicable TA (maximum of 27 reports per participating AI) which would lead to additional efforts. This additional effort would be avoided under the AIC Model, as the splitting is done by the AIC (maximum of 2 reports per participating country). Hence, from a global perspective, the collective burden for AIs is bigger than the collective burden for TAs.

- **Legal Interoperability Related Differentiators.** This study identifies the following differentiators at the level of legislative alignment:

  - **Finding 14. No Legal Basis for Pan-European Encryption and e-Signature Standards.** There is currently no legal basis to introduce pan-European encryption and e-signature standards for exchange of data of TAs with AIs and peer TAs. As mentioned in Finding 11, under the SC Model, TAs and AIs would have to cope with the encryption and e-signature standards used by other MSs. This would lead to a higher implementation, operation and maintenance effort.

  - **Finding 15. No Pan-European Confidentiality, Integrity and Availability Classification of the Data Exchanged.** Under the SC Model, the current lack of standardised classification of the data exchanged exposes TAs and AIs to additional implementation and operation efforts when exchanging data across borders. AIs and TAs of a MS with less strict classifications need to implement sufficient mechanisms to exchange information in compliance with TAs and AIs of MSs which have stricter classifications. In contrast to the SC Model, the AIC Model does not require the communication with non-resident AIs. Hence the implementation of additional mechanisms to ensure compliance with different national rules for confidentiality, integrity and availability aspects is avoided by the AIC Model.

  - **Finding 16. More Difficult to Enforce Semantic and Technical Standards across Borders.** Under the assumption that the SC Model is not implemented via a Directive but via bilateral contracts, the enforcement of semantic, syntax and technical standards across borders is on a political level more cumbersome than under the AIC Model. The lack of enforcement of these standards leads to an additional burden as TAs and AIs would have to intervene to ensure the interoperability. The related difficulties on the semantic interoperability level are covered in Finding 22.

- **Organisational Interoperability Related Differentiators.** The organisation and process alignment needed under both Models is different, leading to the following organisational differentiators:

  - **Finding 17. Linguistic, Cultural and Legal Challenges of Cross-Border Data Exchange Procedures.** Under the SC Model, the data exchange procedures between AIs and TAs across borders will have to cope with different linguistic, cultural and legal environments. Currently most of the participating MSs do not have structured procedures in place to exchange data with non-resident AIs. These various challenges will lead to additional efforts for both AIs and TAs to implement and operate a standardised relief at source system compared to the AIC Model.

  - **Finding 18. More Challenges to Ensure Change Management.** During the implementation and operation of a standardised relief at source system, request for changes with regard to the operating model will be raised. Hence change management procedures need to be put in place. In the case of the SC Model, these change management procedures have to deal more with cross-border related requests. Again the SC Model brings more linguistic, cultural and legal challenges with it. Compared to the AIC Model, the SC Model requires several thousand additional information exchanges between AIs and TAs (see Finding 21). These additional cross-border information flows form additional challenges (complexity, required effort) to change management procedures. This leads to higher implementation and maintenance/operation efforts under the SC Model.

  - **Finding 19. More Challenges to Ensure Standard Cross-Border Reporting.** Under the SC Model, an AI would have to comply with the reporting standards of each MS leading to additional complexities. Different aspects, like frequency, granularity, accurateness and timing, of the various national reporting standards lead to higher efforts during the implementation and maintenance/operation of cross-border data exchanges for TAs and AIs.

  - **Finding 20. More Challenges to Ensure Proper Encryption and e-Signatures.** Under the SC Model, a TA or AI has to communicate with more parties due to the cross-border data exchange. In combination with Finding 14, an IT solution under the SC Model has to handle more certificates and/or keys to ensure a proper encryption and e-signature of the data exchanged. These certificates and/or keys need to be renewed on a regular basis. The maintenance of these certificates and keys like renewal and exchange procedures lead to an additional burden under the SC Model.

  - **Finding 21. More Interactions, Higher Workload.** The implementation of the SC Model will lead to a higher volume of exchanged reports. This increase in exchanged reports leads to a higher burden. The more information flows are needed and the more information objects are exchanged, the higher the error probability and the higher the overall effort needed to handle data corrections. The following figure 25 illustrates the information exchange under a standardised relief at source system.

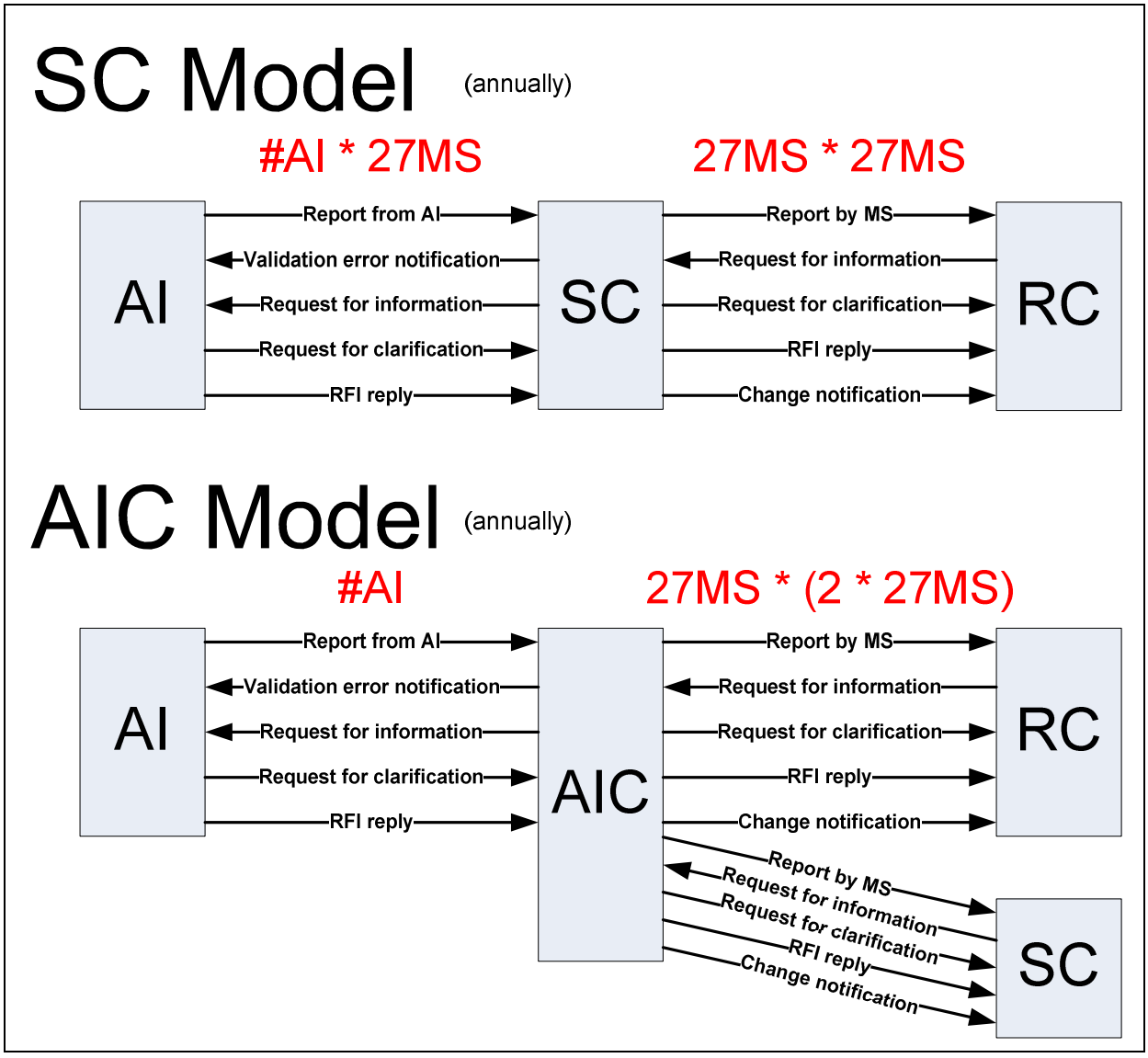


Figure 25: Information exchange overview in a standardised relief at source system

At a first glance the AIC Model might seem more complex as it contains more different types of information exchanges. However the SC Model is substantially more complex as it has to handle a significantly higher number of information channels. For illustration purposes only, the study uses the following assumption:

- In total 1.000 AIs and 27 MSs would participate in a standardised relief at source system;
- A SC or AIC would have to forward information to their internal departments and all other MSs.

This would lead to around 2.400 information channels under the AIC Model and 27,700 information channels under the SC Model. Hence the SC Model leads to a much higher

burden. The extra information channels of the AIC to communicate with both SCs and RCs (AIC Model) are much smaller than the number of information channels resulting from the SC's communication with non-resident AIs (SC Model).

Based on these illustrated information channels, a volumetric calculation gives a first idea on the expected volumetric of a standardised relief at source system.

INFORMATION CHANNEL TYPE	AIC MODEL	SC MODEL
Total amount of annual messages exchanged	3,843	43,003
Messages exchanged annually between AIs and AICs/SCs	1,550	41,850
Messages exchanged annually between AICs/SCs and SCs/RCs	1.153 (AICs – RCs) and 1.140 (AICs – SCs)	1.153 (SCs – RCs)
Total amount of messages exchanged compared to the 1,2 billion annual messages handled by CCN	0,0003%	0,0036%

Table 29: Volumetric calculation

The volumetric calculation, detailed in Appendix 27, shows that the AIC Model needs significantly less additional messages per year compared to the SC Model (3.843 vs. 43.003 messages). Compared to the annual load of messages the CCN is currently handling (1,2 billion messages), the additional messages needed under a standardised relief at source system (AIC or SC Model) are insignificant.

- **Semantic Interoperability Related Differentiators.** As defined by the European Interoperability framework, semantic interoperability *"enables organisations to process information from external sources in a meaningful manner. It ensures that the precise meaning of exchanged information is understood and preserved throughout exchanges between parties"*. The study identified the following differentiators:

  - **Finding 22. More Difficult to Ensure Semantic Interoperability.** Next to the difficulties on a political level (see Finding 16), difficulties with regard to semantic interoperability exist. Both Models should leverage one semantic dictionary to ensure the precise meaning of exchanged information is understood and preserved throughout exchanges. However, as the SC Model relies on the cross-border exchange of data between TAs and non-resident AIs, different linguistic, cultural, legal, and administrative environments need to be taken into account. The related efforts needed to define, agree on and implement the necessary semantic dictionary will be higher. Within the AIC Model, each TA and its resident AIs can rely on the current local standards, leading to less implementation effort per TA and AI.

  - **Finding 23. More Difficult to Ensure Syntactic Interoperability.** Both Models should leverage one set of XML Schemas to ensure the same format (grammar, format and tables) for data is used and preserved throughout exchanges. However, as the SC relies on the cross-border exchange of data between TAs and non-resident AIs, different linguistic, cultural, legal, and administrative environments need to be

taken into account. The related efforts needed to define, agree on and implement the necessary XML Schemas will be higher. Within the AIC Model, each TA and its resident AIs can rely on local standards, leading to less implementation effort per TA and AI.

- **Technical Interoperability Related Differentiators.** When considering the technical aspects of linking information systems, the study identifies the following differentiators related to interaction and transport:

  - **Finding 24. More Difficult to Cope with Higher Volumes.** As mentioned above in Finding 21, the cross-border data exchanges under the SC Model lead to an increase in reports exchanged per AI and TA. Hence, the following IT components need to cope with higher volumes under the SC Model:

    - RaS Communication components need to handle cross-border RFIs or requests for clarification related to non-resident AIs;
    - TA Reporting components need to handle relief at source reports related to non-resident AIs;
    - TA Validation components need to handle relief at source reports related to non-resident AIs;
    - TA Reconciliation components need to handle relief at source reports related to non-resident AIs;
    - Transfer components need to handle cross-border related documents like annual reports, RFIs and requests for clarification related to non-resident AIs;
    - Contact administration components need to handle contact details from non-resident AIs.

  - **Finding 25. Higher Volumes, Higher Probability of Errors, More Correction Work.** A higher volume in data exchanged will lead to more data errors which need to be handled. This results in additional operation efforts for both AIs and TAs to handle the data corrections.

  - **Finding 26. Unnecessary Additional RFIs and Requests for Clarification Due to Overlapping Data Validations.** Under the AIC Model, an initial data validation and the related correction activities are carried out by the AIC. This prevents an AI from receiving several RFIs from other TAs for the same issue (e.g. missing, wrong or unclear data) as the AIC and AI already addressed the data quality issue at an earlier stage of the operating model. However, under the SC Model, the AI would receive several RFIs for the same issue as the initial data validation of the AIC is missing. This leads to an additional burden.

  - **Finding 27. More Complex IT Components to Cope with Different Encryption and e-Signature Standards.** In addition to Finding 20, the IT components offering

encryption and e-signature functionality need to be implemented, integrated and maintained to ensure data can be exchanged in a proper way. As there is no pan-European standard, these IT components need to facilitate various national encryption and e-signature techniques under the SC Model. In the case of the AIC Model, these IT components only need to support national standards. Hence, the SC Model leads to higher implementation, integration and maintenance effort.

- **Finding 28. More Difficult to Implement IT Components for Data Transfers.** Under the AIC Model, the data transfer mechanisms of the current Savings Directive could be reused. Implementing the SC Model would make the IT components for the data transfer more complex as they need to be aligned with the current data transfer mechanism of other TAs and AIs. Leading to additional efforts to design, agree on and implement necessary cross-border interfaces and protocols. In addition, these cross-border data exchanges lead to a significant increase in the total number of connections between AIs and TAs. The implementation of a standardised data transfer from scratch would also result in additional design and implementation efforts. Finding 21 provides a first insight into the estimated information flows between AIs and TAs.

10.3.2.2 BARRIERS, DEPENDENCIES AND RISKS

372. **Implementation aspects**. In order to elaborate on the challenges faced by a MS when implementing the architecture, the study identifies several implementation aspects which have an impact on the implementation effort required by a MS. These implementation aspects are used by the feasibility maturity model as aspect criteria.

- **Barriers.** A barrier refers to an element that may prevent or hamper a MS from starting to implement the architecture. It reflects (a) the initial availability of budget and/or resources and (b) the required initial buy-in from interacting AIs and MSs for the MSs concerned as barriers.
- **Dependencies.** A dependency is defined as an element that can prevent or hamper a MS when implementing the architecture. Three types of dependencies are reflected in the model:
  - The required willingness of AIs and MSs to cooperate during the implementation;
  - The required negotiations with respect to standardisation of reporting formats and communication templates;
  - The continued availability of budget and resources during implementation.
- **Risks.** A risk is an unexpected factor that results in delaying or cancelling the implementation. This can be due to (a) an underestimation of the required expertise, (b) an underestimation of the dependencies or complexity or (c) budget and time overruns.

373. **Comparison of the Implementation Aspects between the AIC and SC Models**. The following comparison of the two Models with regard to these three implementation aspects indicates that the implementation of the AIC Model requires less effort from a MS.

FINDING ID	FINDING NAME	AIC MODEL	SC MODEL
29	No alignment with non-resident AIs is needed	Less implementation effort required	More implementation effort required
30	AIC Model is perceived as a small extension of the current Savings Directive	Less implementation effort required	More implementation effort required
31	No immediate resources and budgets are available	Less implementation effort required	More implementation effort required

Table 30: Comparison of both Models based on the implementation aspects

374. **Detailed Findings Addressing the Barriers, Dependencies and Risks.** The table 30 above is based on the following findings:

- **Finding 29. No Alignment with Non-Resident AIs Is Needed.** Under the AIC Model, no alignment between TAs and non-resident AIs is needed as the AIC acts as a middleman. The implementation of the AIC Model therefore has to take much less dependencies into account. In addition, the AIC Model drastically reduces the number of required information exchanges between TAs and AIs. On top of that, IT representatives of the participating MSs express their concerns to implement the SC Model. The most cited barriers, dependencies and risks relate to the necessary cooperation and communication with non-resident AIs. The MSs perceive the SC Model implementation as less efficient as the related cross-border aspects lead to higher efforts. The effort needed for the AIC Model implementation would be lower as its communication channels are similar to the ones existing under the current Savings Directive.

- **Finding 30. The AIC Model Is Perceived as a Small Extension of the Current Savings Directive.** During the IT interviews, most IT experts of the MSs mention that they do not expect major obstacles to implement the AIC Model as they perceive the Model as an extension of the current Savings Directive.

- **Finding 31. No Immediate Resources and Budgets Are Available.** A majority of the IT experts indicate that no immediate resources are available to implement either Model. Many MSs rely on external providers to implement the standardised relief at source system. Some MSs indicated that they already reserved some budget to do the implementation. However, MSs expect the implementation of the SC Model to be more expensive. Hence it will be easier to free up resources and budgets for the AIC Model.

10.3.2.3 CHALLENGES SCORES OF PARTICIPATING MSS

375. **Concept of the Challenges Score**. Like the gap assessment, the feasibility maturity model translates the interview results via the baseline scenario into challenges scores. It scores a MS on each implementation aspect. The more challenges a MS faces, the higher the score. The feasibility maturity model then aggregates these scores into an overall challenges score per MS. As a consequence, lower barriers and less dependencies and risks result in a lower challenges score.

376. **Appendices**. Appendix 20 describes the feasibility maturity model in detail. It also contains a brief description of how the challenges scores were gathered from the IT interviews. Appendices 21 and 24 contain the results from the interviews with participating MSs and the resulting scores.

377. **AIC Model as Preferred Model from a Challenge Perspective**. The study identifies the AIC Model as the preferred Model from a challenges perspective figure 26 below illustrates the challenges scores for each Model per MS.

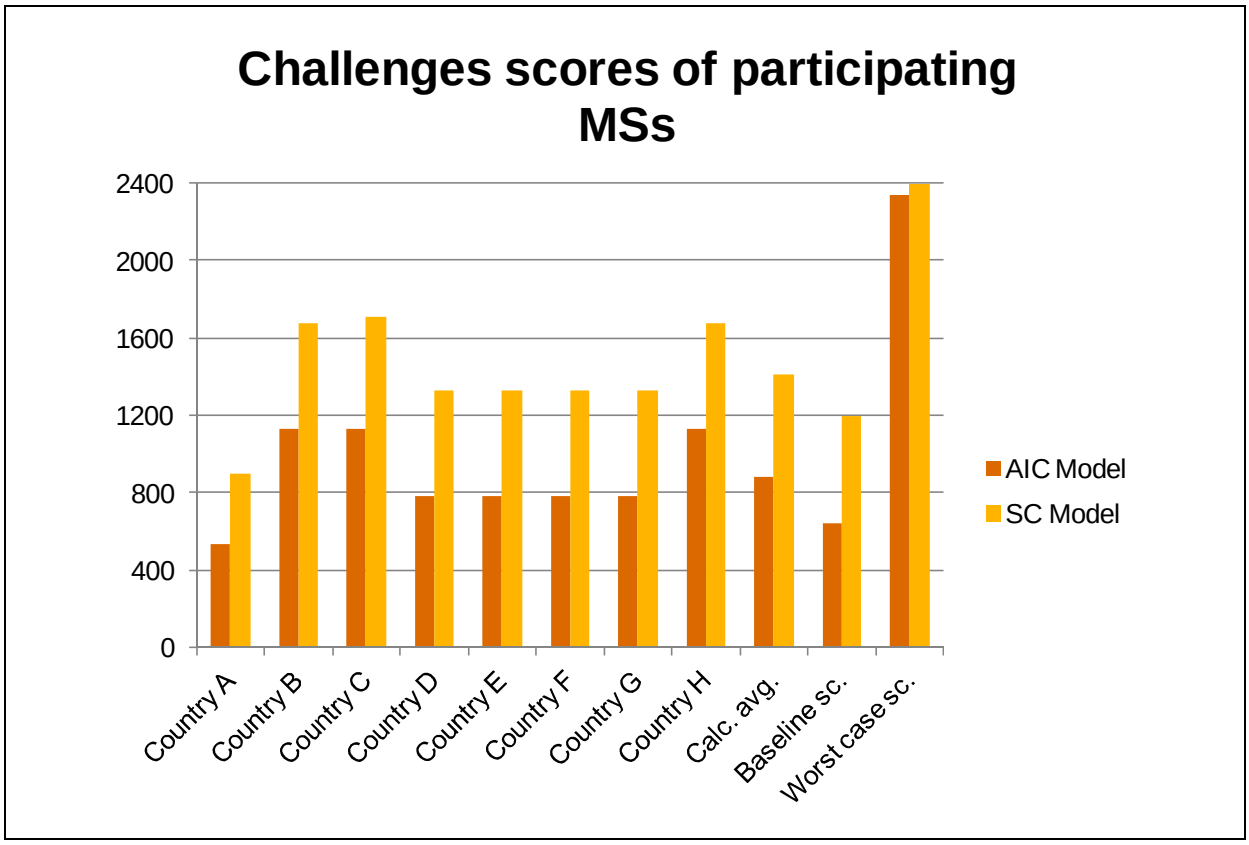


Figure 26: Challenges scores of the feasibility maturity model

378. **Analysis of the Challenges Scores**. The following can be derived from the challenges scores:

- Compared to the SC Model, the AIC Model offers a lower challenges score per MS. The implementation of the SC Model requires more alignment between all involved AIs and TAs due to the required direct communication between TAs and non-resident AIs.
- All participating MSs end up with similar levels of challenges per Model as they all have implemented the current Savings Directive. This leads to one common maturity level from a challenges point of view. They all face similar challenges.
- The delta between the scores of MSs and the maximum score of 2.400 is based on two elements. First, the difference between 2,400 and the baseline scenario (640 for the AIC Model, 1.196 for the SC Model) resemble the challenges a hypothetical, ideal candidate faces. Second, the difference between such a hypothetical, ideal candidate and the various MSs can be explained by (a) the unavailability of budget and resources and (b) the challenges of MSs related to the buy-in of AIs and other MSs. Hence these two aspects should be taken into account by the implementation programme for a standardised relief at source system, regardless of the Model to be implemented.
- Of all interviewed MSs, MSs B, C and H face higher barriers, dependencies and risks and thus have higher challenges scores. Compared to the MSs with the lowest challenges scores (MSs A, D, E, F and G), MSs B, C and H obtain better scores due to the availability of some budget.
- The challenges scores indicate the barriers, dependencies and risks (e.g. buy-in of AIs) MSs face when implementing the IT solutions required for participating in a standardised relief at source system. Hence the challenges scores are an important input for the initial estimation of the implementation cost (subsection 10.3.2.4). Higher barriers, dependencies and risks MSs face lead to a higher implementation effort for MSs to put the required IT solutions in place.

10.3.2.4 INITIAL COST ESTIMATION

379. **Initial Cost Estimation**. This study contains an initial cost estimation to provide insight into the implementation costs and maintenance/operation costs MSs and AIs face to participate in a standardised relief at source system.

380. **Cost Function and Man-Day Estimation**. This study uses a cost function to come up with a first estimate of the implementation cost for the standardised relief at source architecture. The cost function is based on the gaps and challenges scores of MSs and a "man-day" estimation per functional domain. It translates the determined scores for gaps, barriers, dependencies and risks with the help of the man-day estimation into an initial estimation of the implementation cost for the required IT solution. The cost function takes the degree of collaboration into account.

381. **Assumptions**. The cost function is based on the man-days estimated for designing, developing, deploying, integrating and testing the IT solution. With regard to IT infrastructure costs, the estimation includes man-days to set up the necessary development, testing, acceptance and production environment. However, it does not include other IT costs like the development or procurement of IT components. Other IT costs like software licenses or maintenance costs are also not taken into account. The estimated absolute amounts in euros should therefore be treated with the appropriate care.

382. **Appendices.** Appendix 23 describes the cost function used in detail. Appendix 22 contains the estimated man-days.

383. **Initial Estimation of Implementation Costs for a MS**. The cost function is used to come up with an initial cost estimation for implementing the IT solution. The following figure 27 illustrates these initial cost estimates for the participating MSs assuming the MSs develop the IT solutions locally.

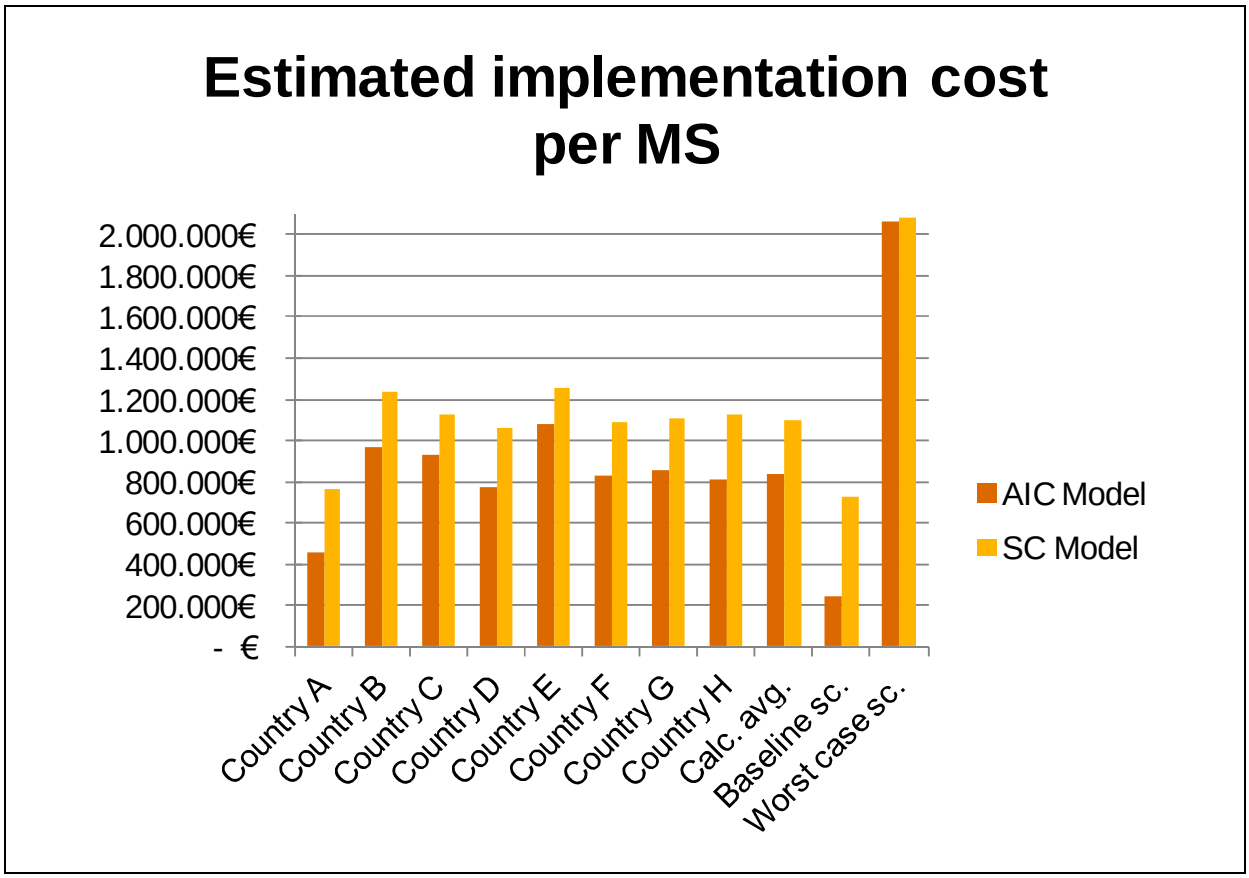


Figure 27: Initial estimated implementation cost of the IT solution per participating MSs

Two elements can be derived from the challenges scores:

- As a consequence of similar gaps and challenges levels in MSs, the estimated implementation costs are also similar. The AIC Model is regarded as relatively less expensive to implement. Like the previous subsections, the difference of the estimated

implementation costs between both Models can be derived from the required communication with non-resident AIs and the related extra alignment efforts.

- Under the assumption that (a) the eight participating MSs are representative for the 27 MSs and (b) the calculated average is used as input for the 27 MSs, the cost function provides an initial estimate of the implementation cost for an average MS under the AIC Model of 0,8 million EUR (1,1 million EUR for the SC Model). This leads to a total estimation of 22,6 million EUR for 27 MSs under the AIC Model (29,6 million EUR for the SC Model).

384. **Reduced implementation costs through collaboration.** These estimated implementation costs can be reduced when MSs collaboratively develop the IT solution. The following figure provides an initial range of the cost estimates based on the degree of collaborative development. These costs resemble the costs of an average MS which leverages its current IT systems. Collaboration can reduce the implementation costs for an average MS from 0,8 million to 0,4 million under the AIC Model (from 1,1 million to 0,6 million under the SC Model).

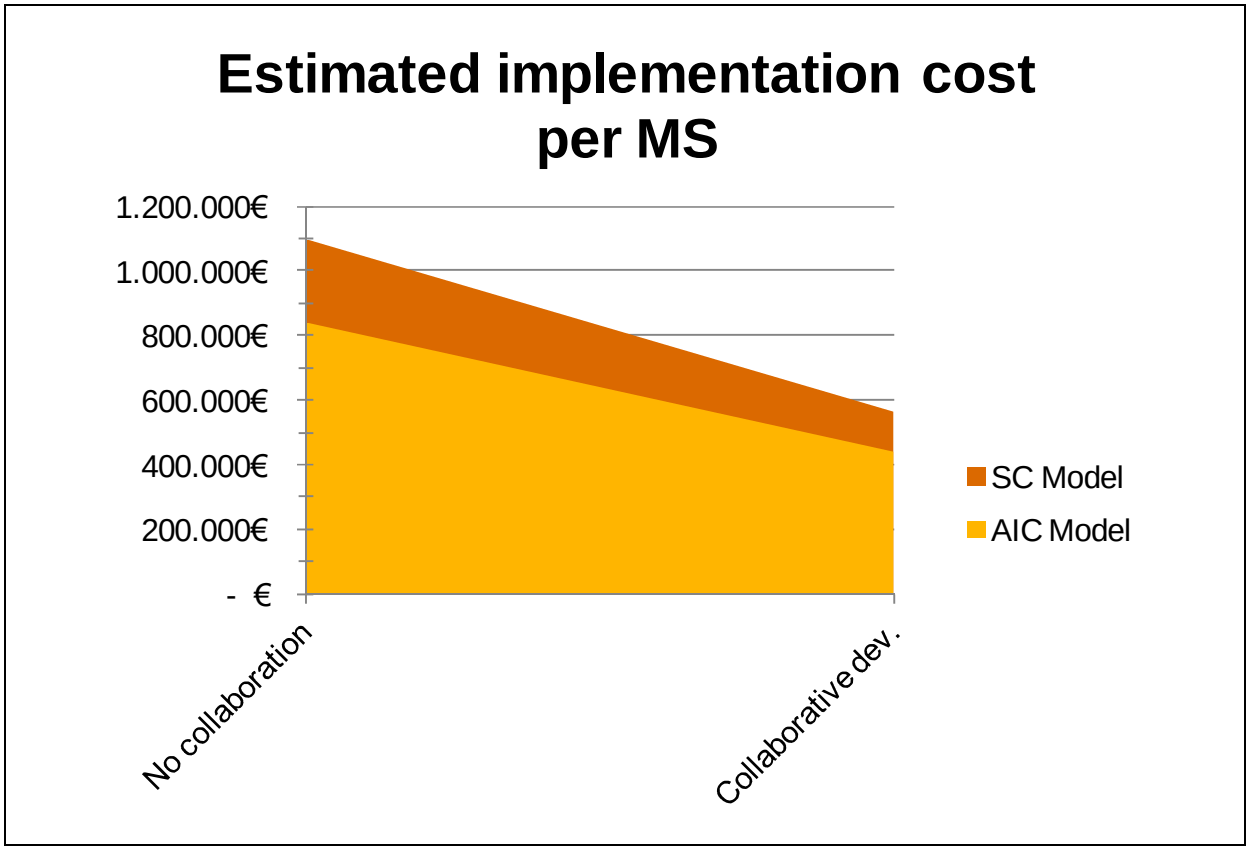


Figure 28: Implementation cost estimate with regard to the level of collaboration

385. **CCN2.** The European Commission is currently investigating the possibility of enhancing CCN with CCN2, a functional super-set of CCN. This enhancement could lead to additional cost savings if the IT solution for a standardised relief at source system is developed collaboratively.

386. **Comparison with the IT implementation costs of the current Savings Directive.** Comparing the initial estimates provided by this study with the costs (provided by DG TAXUD) for the MSs to implement the IT solution for the current Savings Directive is also difficult for the same reasons. The data provided by DG TAXUD lead to a range of 0,03 to 1,5 million EUR per MS and an average cost of 0,4 million EUR per MS.

387. **Initial Estimation of the Implementation Cost for an AI**. Although the IT part of this study focuses on the MSs, an initial estimation of the implementation costs for an AI is conducted. To participate in a standardised relief at source system, an AI needs (a) to generate and validate standardised relief at source system reports, (b) send them to the TA(s) and (c) handle RFIs and requests for clarification. The cost function provides an initial cost estimate for an AI to implement the IT solution for the AIC Model of 0,5 million EUR (0,8 million EUR for the SC Model) when the current IT systems are leveraged. In case the AI implements the IT solution from scratch (not leveraging the IT systems used under the current Savings Directive), it faces an estimated implementation cost of 0,9 million EUR for the AIC Model (1,1 million EUR for the SC Model). This cost estimate is based on the assumption that there is no collaboration between AIs to implement the IT solution.

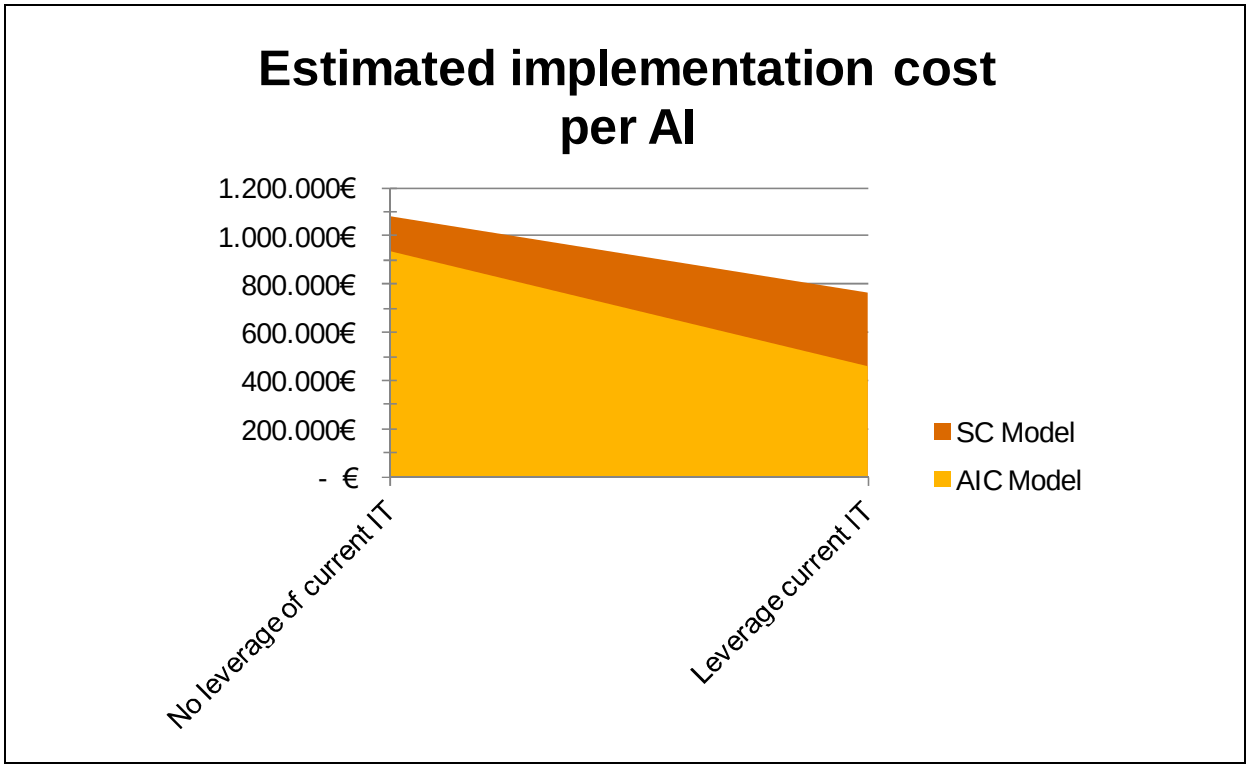


Figure 29: Implementation cost estimate with regard to the level of leveraging IT systems used under the current Savings Directive

388. **Implementation costs for AIs.** Based on the previous assumption (Finding 21) of a 1.000 participating AIs, the total implementation cost estimation for all AIs under the AIC Model would be 900 million EUR (1.100 million EUR under the SC Model).

389. **Initial Estimation of Operation and Maintenance Costs for a MS**. Based on data provided by DG TAUXD, the IT systems used under the current Savings Directive have an average operation and maintenance cost of 0,1 million EUR per MS. As the IT solution for the AIC Model is similar to the IT systems used for the current Savings Directive, a similar cost for operations and maintenance can be expected. The operation and maintenance cost for the SC Model should be higher as an IT solution of MSs (a) has much more interfaces due to the data exchange with non-resident AIs and (b) has to support the different national encryption and e-signature standards required by other MSs due to the missing pan-European standards.

However, as the data gathered on the operation and maintenance costs of MSs range from 3.000 to 270.000 EUR, the initial estimated operation and maintenance costs per MS should be treated carefully.

10.4 CONCLUSION

390. **AIC Model as the Preferred Model from an IT Architecture Perspective**. From an IT architecture point of view, this study identifies the AIC Model as the preferred Model. The AIC Model has a lower gap score as the IT solution needed is more similar to the IT systems used to exchange tax information under the current Savings Directive. In addition, the implementation of the AIC Model leads to a lower effort to implement the IT solution needed to support the information exchange in a standardised relief at source system.

391. **AIC Model avoids direct links with non-resident AIs.** Under the AIC Model, AIs exchange data with SCs and RCs through AICs. AIs only need to communicate with their resident TAs. Hence a direct information exchange between TAs and non-resident AIs (required under the SC Model) is not needed. AIs and TAs do not need to cope with the different national data transfer and encryption standards of other MSs. Hence less alignment effort is needed. The SC Model with its cross-border data transfers requires a higher implementation and operation effort. In addition, the SC Model would lead to a complex network in which TAs need to exchange data with all their peer TAs and all participating AIs.

10.4.1 ADVANTAGE OF THE STANDARDISED RELIEF AT SOURCE ARCHITECTURE

392. **Co-existence of Models**. This study describes a standardised relief at source architecture which can support – with some amendments – the coexistence of the AIC Model, the SC Model or other reporting systems (e.g. FATCA).

393. **Additional Advantages of the Standardised Relief at Source Architecture**. Furthermore, the architecture developed helps guide and facilitate the implementation of the IT solution needed. It offers a higher level of automation to reduce the manual workload and related amount of errors. Its validation and reconciliation components help increase the

quality level of data exchanged. The architecture also better addresses confidentiality, integrity and availability aspects of exchanged data like the encryption and digital signing of the files exchanged. The architecture would lead to a more standardised solution and therefore a better communication between AIs and TAs. Hence an IT solution based on the standardised relief at source architecture contributes to the success of a standardised relief at source system.

10.4.2 ADVANTAGE OF LEVERAGING THE IT SYSTEMS USED TO EXCHANGE TAX INFORMATION UNDER THE CURRENT SAVINGS DIRECTIVE

394. **Leveraging the IT systems used to exchange tax information under the current Savings Directive**. This studies identifies that leveraging the IT systems used under the current Savings Directive would close the gap towards the architecture by around 50% as the current Savings Directive and the AIC Model have a lot in common:

- AIs generate a report and send it to their resident TAs;
- TAs receive these reports and validate them;
- TAs generate a report for each peer TA impacted;
- TAs receive reports from peer TAs and validate them;
- TAs need to communicate with their peer TAs and resident AIs to solve data quality issues.

395. **Reuse.** Hence existing IT functionality like data transfers, report generation or data validation can be reused. However, the existing IT functionality needs to be extended and amended to fully fit the requirements of a standardised relief at source system.

10.4.3 ADVANTAGE OF DEVELOPING IT COMPONENTS COLLABORATIVELY

396. **Collaborative Development Approach**. The architecture for the annual information exchange under either Model is generic for every participating MS. Therefore, from a cost perspective, it is better to first collaboratively design and develop IT components and then deploy and integrate them locally. Such a collaborative development approach would reduce the implementation efforts of a specific component:

- Local dev.: $27 \times$ design, development, deployment and integration cost;
- Collab. dev.: $1 \times design\ \&\ dev.cost + 27 \times deployment\ \&\ integr.cost$.

397. **Cost Savings Linked to Joint Programme**. A collaborative approach, depending on the degree of collaboration, could lead to potential cost savings of up to 50%. The highest cost savings can be gained by using a joint programme to develop the IT solution. However, starting up such a joint programme might be difficult in practice as it needs the continuous buy-in and alignment of participating MSs.

398. **Other forms of collaborative development**. In case such a joint programme is not feasible, other forms of collaborative development could be used. For example, one MS could take the lead in developing (part of) the IT solution and then sharing it with its peers (incl. source code and documentation). Additional forms of collaboration like working groups, platforms to share and discuss, are also possible.

399. **Integration of Third Countries**. In case third countries plan to join the standardised relief at source system, the advantage of collaboratively developing the IT solution stands out even more as they can reuse collaboratively the IT components developed.

400. **Lower Maintenance Costs Associated with the Collaborative Approach**. Next to lower implementation costs, a collaboratively developed solution would lead to lower maintenance costs as future changes or fixes would not have to be implemented in 27 different IT solutions.

401. **Better Data Quality Associated with a Collaborative Approach**. In addition to lower implementation and operation costs, the collaborative development would facilitate the introduction of reporting and data quality standards and protocols at a European level. This would lead to better data quality of exchanged relief at source information.

402. **Candidates for collaborative development.** In case only missing IT components should be developed collaboratively, the study identifies the following potential components:

- TA Validation component, to support better data quality;
- TA Reconciliation component, to support better data quality;
- RaS Communication component, to support better handling of data quality issues;
- Contact administration component, to support better handling of data quality issues.

10.4.4 ADVANTAGE OF ENSURING SEMANTIC INTEROPERABILITY

403. **Semantic Interoperability**. The effectiveness of a standardised relief at source system stands and falls with the proper use of correct data. Therefore semantic interoperability is essential for a properly functioning standardised relief at source system. This study suggests ensuring semantic interoperability through the implementation of pan-European semantic and syntax standards like a common structure for the different types of reports (e.g. XML Schemas) and a common data dictionary. The XML Schemas developed by the TRACE working group should be leveraged.

In case different semantic and syntax standards are inevitable, the implementation programme should consider enabling their interoperability. This can e.g. be achieved by defining transformation rules and developing the necessary IT functionalities to support these transformation rules.

10.4.5 ADVANTAGE OF COLLABORATIVELY ADDRESSING LOW DATA QUALITY

404. **Data Quality Concern**. During the IT interviews conducted, the low quality of data under the current Savings Directive is stated as a prominent concern for all participating MSs. This is in line with a previous report of the European Commission (205).

405. **Causes for Low Quality of Data**. Although most of the participating MSs have some data validation functionalities in place, the quality of the data exchanged is perceived as low. The main cited causes are that (a) AIs are either unable to deliver the required data or send incorrect data, (b) MSs are unable to detect wrong, missing or unclear data records in a timely manner and (c) MSs are lacking a pan-European data quality standard with respect to the current Savings Directive reporting requirements.

406. **Data Quality Improvement Activities Examples**. Hence, this study suggests incorporating data quality improvement activities within the implementation programme for the standardised relief at source system. It identifies the following activities:

- Facilitate semantic and technical interoperability through pan-European semantic and syntax standards (e.g. one set of XML Schemas, a common data dictionary) across TAs and AIs;
- Investigate the main data quality issues in detail (e.g. missing TIN, outdated information, no use of standard values) and address these;
- Set up a pan-European data quality standard with respect to the reporting requirements under a standardised relief at source system to ensure a right level data quality;
- Provide AIs and TAs with standard IT functionalities to perform uniform data validation checks before exchanging reports;
- Ensure during the design phase that the IT solution incorporates user input validation features (e.g. automatic format validation of TINs) to support the end user;
- Establish the legal framework needed to enforce a defined level of data quality.

* *

*

205 The European Commission's report (COM/2012/65) on the results of the European Savings Taxation Directive.

CHAPTER 11 COST-BENEFIT ANALYSIS

Chapter 11 identifies and compares the costs and the benefits of the SC Model and the AIC Model vis-à-vis the current situation for different types of stakeholders: MSs, the financial sector, Investors and the EU budget.

The analysis of each of the stakeholders in the CBA demonstrates that the new system will be costly. However, many gains will be achieved and, depending on the stakeholders, should offset or partially offset the costs. But the most important point is probably the fact that the new situation will allow all Investors to benefit from a right formally given to them via DTTs, but which in practice they can hardly benefit from today, due to the many obstacles and barriers existing across the EU. Considering the reduced tax rate granted via the DTTs, the new system should implement an efficient and secure process to ensure that this WHT rate is applied correctly.

The answer to the second question differs more markedly, depending on the stakeholder category. Some people are in favour of the SC Model, others prefer the AIC Model. Generally speaking, there exists a preference for the AIC Model expressed by the stakeholders (e.g. EU budget will be lower if the AIC Model is implemented, lower cost for the MSs because no agreement with the FIs need to be formally signed).

At the same time, stakeholders express the importance of the Model's ability to easily integrate third countries (as in the SC Model). Also, the stakeholders are not in favour of running two systems in parallel as it leads to important additional cost. This is particularly true for the MSs and FIs. . In this respect, it is useful to mention that the AIC Model could be extended to third countries by means of bilateral of multilateral agreements signed between MS and third countries. Moreover, it is technically possible to extend the IT tools to be used in the AIC Model (notably the CCN mail communication infrastructure) to third countries. Should the AIC Model be implemented within the EU and the SC Model by third countries, the co-existence of these two Models is considered as potentially having a negative impact by the MSs and especially by the FIs, which are often located in different countries and continents.

Finally, it is important to highlight that, in their current version, both Models rely on the voluntary participation by the AIs in the system. Therefore, it is crucial that the financial services sector within the EU takes to heart the proposed Model. We advise the Commission to engage in discussions with the stakeholders and particularly the Financial Institutions.

* * *

11.1 OBJECTIVE

407. **Cost-Benefit Analysis**. In order to determine whether the advantages of a particular action (i.e. implementation of a new WHT relief at source system based on the guidelines of the FISCO Recommendation) are likely to outweigh its drawbacks, a CBA is performed. While not intended to be the only basis for decision making, a CBA can be a valuable aid to policy and decision makers.

408. **Definition of both Models and validity of the results**. The results and conclusions are based on the Models as currently defined and agreed with the EC. In the future, if procedures or governing principles of Models are modified, our conclusions may also need to be amended taking the new changes into consideration. An impact assessment would therefore be required to estimate the effect of the modifications and eventually conduct again some parts of the CBA to appropriately reflect these. Given the limited sample of the study's participants, the results from this analysis cannot be seen as representative for all stakeholders affected in Europe nor can be used for benchmarking purposes. The quantitative data are therefore rather presented in support of the qualitative analysis.

409. **Scope**. In a first part, the CBA identifies the macro-economic impact that the implementation of one or the other Model would have on the European GDP, as well as on the MSs and the Investors. Then, the CBA considers two Models: the AIC Model and the SC Model (206). Four groups of stakeholders constitute the stakeholder population under investigation: the EU MSs' tax administrations; the Authorised/Financial Intermediaries; the Investors; and the EU budget. The analysis focuses on three situations:

- the current situation, in which each MS deals with its own tax relief procedure;
- the future situation implying the implementation of the AIC Model;
- the future situation implying the implementation of the SC Model.

The CBA also involves the identification of advantages and disadvantages of the selected Models in terms of e.g. effectiveness and efficiency. Since the new relief at source procedure would probably be optional, special attention is paid to the consequences of operating two systems in parallel (i.e. one for the EU and one for third countries).

11.2 APPROACH

We have opted for a pragmatic approach as regards economic data collection and analysis.

410. **Pragmatic Approach**. A pragmatic approach is warranted in order to ensure the collection of relevant data of sufficient quality. This is especially important as our data collection is carried out on a voluntary basis by the majority of stakeholders. All data collection and subsequent analysis is rooted (as much as possible) in the proven methodology

206 We refer to the Chapter 4 addressing the governing principles for the detailed presentation of the two Models.

of the Standard Cost Model (SCM) which, in turn, draws inspiration from Activity-Based Costing. Although the research design is not likely to yield statistically relevant results, this allows for the drawing of inferences that are methodologically sufficiently robust. The details of the methodology used for each stakeholder and for each type of analysis performed are described in Appendix 25 of the final report.

411. In general, the respondents of the MSs involved in the study were in a position of representing their country at the FISCALIS Working Group. Given their hierarchal position, they are more involved in strategic decision-making than in the day-to-day operational processes. This means that they had to also collect data at a decentralised level (operational level). The same comment is applicable to the respondents of the FIs questionnaire.

412. The data collected from the questionnaires has been complemented by a literature review, which allowed for the collection of additional qualitative data for each stakeholder in scope.

Stakeholder Customised Approach. Each stakeholder group has particular concerns, which necessitates a more sophisticated approach to data gathering than a "one-size-fits-all" questionnaire. The approach used for the data collection has been adapted according to each stakeholder involved (i.e. MSs' tax administrations, Financial Institutions, Investors and EU). The situation of the Financial Institutions and the Member States has been analysed based on the data collected from a detailed questionnaire. In order to appreciate the impact on the EU budget, the European Commission has provided quantitative and qualitative data. For the Investors, the analysis is mainly based on a review of the literature and the results of a macroeconomic model. This model aims to assess the economic impact for the Investors and the MSs' tax administrations.

11.3 IMPACT ON MS'S TAX ADMINISTRATIONS

11.3.1 INTRODUCTION

413. **Scope.** This section will assess the cost impact of the implementation of a standardised relief at source system for the tax administrations. Data and useful information have been gathered via a questionnaire that has been sent to a selection of Member States which cooperated on a voluntary basis. A literature review complemented the data gathering. A macro model (see Appendix 30) is used to predict the potential gains (in monetised values) linked to the fact that the relief at source procedure will be facilitated/encouraged in the future situation. The assessment is based on the comparison of the two Models in scope of this study, being the AIC Model and the SC Model.

11.3.2 CURRENT SITUATION

414. The current situation is characterised by four separate processes that will be analysed from a CBA point of view:

1. Issuance of the Certificate of Residence;
2. Refund procedure;
3. Relief at source procedure;
4. Exchange of information under the current AIC Model.

11.3.2.1 ISSUANCE OF THE CERTIFICATE OF RESIDENCE

415. **Costs Borne by the RCs.** Currently, most of the MSs require a Certificate of Residence to grant a reduced tax rate based on a DTT (via a refund or a relief at source procedure). This document is generally issued by the tax administration of the RC (207). Without considering the relevance of such a document for the identification of the tax residence of an Investor (208), this requirement constitutes a cost for the RC, whereas the interest in such a document lies essentially on the SC's side (209).

416. **Limited Costs of the Issuance of Certificates of Residence**. According to the MSs, the issuance of the Certificate of Residence is currently performed at a local level (i.e. local tax offices) and by civil servants not specifically dedicated to this task. Indeed, the civil servants in the local tax offices perform several tasks that do not exclusively relate to the issuance of the Certificate of Residence. The automated process is perceived as rather straightforward automated, meaning that the qualifications of the staff are not expected to be high, and neither is the associated wage level. In general, no specific investment costs are incurred by the MSs because the data necessary to issue a Certificate of Residence is already included in a general database that exists for other purposes.

Moreover, the process is defined as very rapid and automated, so the time spent in issuing the Certificate of Residence is estimated at a maximum of 15 minutes. One of the MS interviewed mentioned a time of 5 minutes linked to a cost per Certificate of Residence of EUR 2.

417. **Amount of Certificates of Residence Issued Unknown**. As Certificates of Residence can be issued for several other reasons than granting a reduced tax rate based on a DTT, it is not possible for the MSs to estimate the number of certificates annually issued for that purpose. As a result, the total cost at an EU level cannot be estimated or extrapolated.

---

207 Some MSs do not request a Certificate of Residence but a specific form, attesting the Investor's eligibility to a reduced tax rate. This form needs to be signed by the tax administration of the RC and is considered equivalent to a Certificate of Residence as the check performed by the SC is globally limited to the tax residency of the Investor.

208 The value of which is questionable (cf. ICG Report, p. 33).

209 Apart from the fact that, when an Investor requires a Certificate of Residence from his RC, the RC has the opportunity to investigate the purpose of such certificate (and can thus complete the Investor's tax file).

11.3.2.2 REFUND PROCEDURE

418. **Dedicated Refund Team.** The refund procedure is generally centralised in a specific department within the tax administration and the Financial Intermediaries. Specialised employees are dedicated to the processing of refund requests.

419. As the size of the economy of the MSs interviewed differ, it can be stated that the organisational structure is not directly linked to the economic weight of the stakeholders in the financial market. However, the specific knowledge required for dealing with the actual refund procedure can be seen as a more important factor.

420. **Main Cost Drivers.** Based on the data collected from the MSs interviewed, the following cost elements have been identified:

- **The number of Full-Time Equivalents (FTE)([210])** – Within tax administrations, the number of FTEs varies from 6 to 24. Of course, the number of FTEs is linked to the workload (mainly the amount of refund claims received and the various tasks required to handle a claim) and the level of automation, which varies from one MS to another.
- **IT investment costs** – MSs indicate that IT investment costs are important for the refund procedure (e.g. some of them have invested in IT systems that offer the possibility to deal with electronic and paper refund requests). Some MSs enhanced their refund procedure by increasing the level of automation, allowing for electronic refund and grouped requests.
- **Training costs**. Moreover, MSs have incurred training costs for their dedicated civil servants (e.g. for the use of new IT systems).

421. **Cost/Time Estimation for MSs**. In terms of cost estimation, two factors will influence the cost from the MSs' perspective: the verification of the validity of the request (upon each request vs. spot checks) and the level of detail of the checks. The tax administration can face a cost of EUR 70 per request (which is a maximum according to the sample in scope). The automation of the procedure can lead to a significant cost decrease for a tax administration: for example, the cost is estimated at less than EUR 1 per request for a fully automated process. Note that this cost only concerns the staff cost. The IT investment and maintenance cost are not included.

422. **Number and Amount of Refund Claims**. The number of refund requests handled by MSs interviewed varies from 20.000 to 220.000 on an annual basis. Many factors have an influence on the number of refund requests received by a MS, two major ones being the total amount of income distributed by the companies of the MS and the local tax regulation of this MS. But the fact that certain MSs allow grouped requests for refund also has a direct impact on the number of claims received. It appears that some MSs that are economically important

210 Essentially, if a person works only half time on the refunds requests and the tax relief at source requests, it corresponds to ½ FTE (i.e. 0,5). If a person is entirely dedicated to those tasks, but only works 4 days per week, it corresponds to 4/5 FTE (i.e. 0,8)

in the EU receive a very low number of refund requests, while the value of the amount refunded is similar to that in other MSs.

The value of the refund requests varies from EUR 120 million to EUR 1.250 million on an annual basis according to the MSs interviewed. It is influenced, amongst other factors, by the total value of the cross-border investments, the fact that a MS allows relief at source, the difference between the standard rates and the reduced rates applied, and the accessibility and efficiency of the process for each Investor type (especially small Investors).

423. **Lack of Data Quality**. The quality of the data included in the refund requests is considered a major issue by the MSs. One of the MSs interviewed indicates a rejection rate of 25%, which leads to an additional burden for the tax administration (need for additional investigation, contacting Investors or their FIs, etc.). The data quality also has an impact on the time it takes for refund requests to be granted, especially when additional information is required from Investors.

424. **Time of the Refund Procedure**. Differences are observed across MSs in terms of time spent on processing a refund request: from 17 to 110 minutes for a standard procedure. Most of the time goes to verification (more than 50% of the total time spent). MSs with a lower total time spent on the process devote proportionally less time to the verification activity. So in order to decrease the time spent on the process, they mainly reduce the time devoted to the verification activity. In particular cases, the total time estimate decreases to less than 1 minute when the procedure is electronic.

A short time between the submission of the refund request and the cash credit is a high incentive to Investors in order to claim their refund (even if the amount is low). Consequently, such MSs have to deal with more requests than others in comparable situations because they process the requests more rapidly than other MSs. However, only few MSs provide a refund within a 3-month period and, where this is the case, an electronic refund procedure is often applied. On the other hand, some MSs postpone completing the processing of requests for up to several years. This is confirmed by the FIs.

11.3.2.3 RELIEF AT SOURCE PROCEDURE

425. **Two Relief at Source Process Types**. Currently, when a MS offers a relief at source service, the procedure is either:

- entirely undertaken at the FI level, implying that the tax administration of the SC does not intervene in the process itself but only at a post-audit level. In this context, at the time when the tax administration checks the validity of the relief at source request, it has already been granted; or
- the MSs intervene in the process ex-ante (ex-ante authorisation should be requested by the Investors). This second type of relief at source offers the tax administration the possibility to verify the Investor's eligibility to the reduced tax rate before the payment of any income. However, it adds an administrative step in the process.

426. **Lack of Controls on the Part of Tax Administrations**. The first type of relief at source procedure, and to a lesser extent the second one, offers fewer possibilities in terms of controls by tax administrations, as the procedures are mainly administered by FIs. However, this is counterbalanced by the liability that tax administrations may impose on the FIs. Indeed, the fact that the AI may be held liable in case of under-withholding is described by the MSs as a sufficient guarantee for the SC.

In particular, according to the Implementation Package, the liability of the AIs is extensive and is not limited to mistakes made by the AI in applying the WHT relief procedure (e.g. in checking the ISC against KYC rules and determining the correct WHT rate to be applied to its investors), but also includes cases where the under-withholding is not a consequence of a mistake made by the AI.

427. **Amount of the Relief at Source Requests**. It is very difficult for a MS to estimate the amount (i.e. value) of relief at source granted to Investors. This is explained by different factors. Many MSs developed a relief at source process similar to the first type, delegating all the steps of the procedure to the FIs. Therefore, tax administrations have no accurate view of the amount of relief granted. Moreover, they often do not receive statistics but limit their controls to periodic or spot checks. In other MSs, an ex-ante check of the Investor's eligibility to relief at source makes it possible to identify the number of Investors who request to qualify for the procedure, but it still does not provide information on how much income actually benefits from relief at source. Consequently, the cost of this process for the MSs varies considerably, without even considering the cost variation due to the process efficiency itself.

428. **Cost of the Relief at Source Procedure**. Not all the MSs offer a relief at source service and there is still a high level of diversity between the various relief at source procedures applied within the EU. Moreover, MSs are often unable to estimate the number of relief at source requests granted on an annual basis as well as the cost of the related process. As a result, it is not possible to extrapolate a cost for the relief at source process that would be relevant at EU level. However, one MS estimated that the activities performed as part of the relief at source process take 6.000 hours on an annual basis and represent an annual cost of EUR 150.000. This cost, which only includes the staff cost, cannot be considered representative for all MSs and cannot be considered an EU average either. Apart from the direct staff cost, no additional costs (i.e. acquisition or IT investment costs etc.) have been mentioned by the MSs.

11.3.2.4 EXCHANGE OF INFORMATION UNDER THE CURRENT EUSD

429. **Importance of Data Quality**. Currently, MSs already exchange tax information in the context of the current EUSD. Having more data on their residents is welcomed by the MSs but they particularly mention the importance of data quality. As mentioned in the Commission's report on the results of the current EUSD(211), the feedback from the MSs on data quality is twofold:

211 Commission Staff Working Document presenting an evaluation for the second review of the effects of the Council Directive 2003/48/EC accompanying the document Report from the Commission to the Council in

- the MSs are really in favour of receiving such data and they confirmed that the quality of the data received via the current EUSD systems is higher than that of data received via bilateral agreements (which is mainly due to the structured format and its standardisation); while

- the MSs still highlight data quality as the major concern regarding this exchange of information. As described in the chapter on Effectiveness (Cf. Chapter 8), some fields, such as the TIN, are often left blank while they could clearly improve the automation of the processing of such data.

The data quality raises the question how effective the system actually is, which was already examined in the effectiveness analysis, but it also points to a lack of efficiency, which has a financial impact on the MSs. The reasoning here is that, if the MSs want to make effective use of the data and take advantage of all the benefits offered by the system, poor data quality will increase the number of manual checks and investigations required, and, accordingly, the administrative cost of data processing.

Even if the exchange of information is mainly organised between MSs, they are dependent on the information provided by the FIs.

430. **Effective Use of the Feedback Loop**. Most of the MSs confirmed that they do not send any feedback, not even when some required data is missing. As explained in Chapter 8, the main reasons are the fear to impose extra work on tax administrations of other MSs and the lack of internal resources to process all that information. Some MSs explicitly advised that they would not send any feedback unless providing feedback is mandatory. Others confirmed that they prefer to concentrate their efforts on the largest amounts. The feedback loop is really important to improve the data quality and create a virtuous circle, but it is linked to an increase of the administrative work for the RC's and AIC's tax administration, especially in the first years. Moreover, sufficient incentives should be put in place in order to encourage FIs to enhance the data provided to MSs and collected from Investors.

To remedy this weakness of the Savings Directive, it is strongly recommended to implement a feedback loop according to the following principles:

- The feedback is mandatory for SC and RC, which must always provide feedback, even if the information included in the reporting is considered as being right. For instance, if a RC considers that all the information is right and complete, the feedback still has to be sent to the SC via the AIC as it is important for the SC to know that its tax administration can rely on the information provided;

- The feedback must include all the information considered as being unclear or wrong. This includes of course the tax residency, which is crucial to allow the SC to determine if the Investor was indeed entitled to a reduced tax rate, but also all the other information (TIN, address, etc.).

---

accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments, 2 March 2012

431. **Cost of the Exchange of Information under the Current EUSD**. Depending on the position of the MS (AIC or RC), the time and cost linked to the exchange of information process differ. According to the data collected, it appears that the time devoted to the process is estimated at:

- Around 30 min to receive and verify the report quality (this amount should be multiplied by the number of FIs) – cost of EUR 16;
- Around 40 min to prepare and send the report to all the RCs (to be multiplied by the number of participating countries) – cost of EUR 26;
- Around 120 min for receiving and processing of a request sent by a RC when data is inaccurate or incomplete – cost of EUR 77,5. The number of requests is variable.

For the processing of a report received from a participating country, a RC needs 200 min (including the data quality check) – cost of EUR 129.

11.3.3 FUTURE SITUATION

432. In the future situation, under the AIC or SC Model, the data collected shows that MSs predict a cost variation due to the implementation of the Models. The objective of this section is to estimate this variation and identify the various cost types for each process assessed. Next, the reasons will be discussed.

11.3.3.1 TYPES OF COSTS AND BENEFITS RESULTING FROM MODELS' IMPLEMENTATION

433. **Various Costs Resulting from Models' Implementation**. All MSs agree that, whichever Model is adopted, they will have to incur significant investment costs to meet the new system requirements. The difference between both Models relates to:

- IT investments,
- workload increase, and
- organisational and structural changes.

434. **IT Investments**. Incurring IT investment related costs is necessary to be able to process and exchange the information received. These are the minimal investments that have to be implemented. Moreover, as a RC, MSs also need to be able to confirm whether the Investors included in the reporting are really tax residents of the RC. This is the second level of IT investments. Finally, to be able to correctly use the data received via the system, MSs should also develop one or more IT applications enabling an effective cross-check between the data included in the reporting, on the one hand, and the information included in the various local databases, on the other.

435. **Workload Increase**. In both Models, the MSs have to handle an important volume of data and the activities are generally similar in both Models, the main difference being the stakeholders performing them. The difference between the workload resulting from each

Model according to the MSs is described in the following subsection, but an important factor for the workload increase is the IT investments dedicated to the implementation. This is because the workload is dependent on the level of automation within tax administrations. The option to reduce the IT budget without compensation in terms of workload is often possible but will compromise the realisation of the benefits offered by the system.

436. **Organisational and Structural Changes**. Both Models require significant changes in terms of organisation and structure. The new communication flows, the feedback loop, the IT architecture and other aspects imply that the staff will be given new responsibilities/tasks (e.g. people currently working on the refund procedure will perform tasks relating to the processing of the reporting, meaning that additional training should be provided). The adaptation to the new processes and the use of IT systems has been highlighted as an important issue for the MSs and FIs. Not only the IT system represents a cost, but also the qualified (internal or external) people who will implement and manage the IT tools do. Moreover, civil servants need to be trained to be able to use new IT systems/tools.

437. **Benefits from the Fight against Fraud**. It is also important to mention that these costs will be balanced by some benefits. The ability of the system to effectively reduce the amount of fraud depends on different variables, as demonstrated in the fraud analysis (cf. Chapter 9). However, if this objective is achieved, it could generate significant benefits for the tax administrations. These amounts are unfortunately not quantifiable due to the lack of accurate statistics on fraud and the uncertainty regarding the various recommendations formulated on this aspect.

11.3.3.2 EXCHANGE OF INFORMATION UNDER THE SC MODEL

438. **IT Investments**. As demonstrated by the IT analysis, the IT investments linked to the implementation of the SC Model by all the MSs is estimated at EUR 17,2 million. Moreover, it should be noted that the IT architecture provided for in the SC Model relies also on standardisation of the format used by the AIs across the EU. Indeed, as SCs will receive reports from AIs across all EU, the format used must be standardised at EU level for MSs and AIs. If standardisation is not achieved, this means that the additional costs will have to be borne by the AIs and/or the MSs:

- **The AIs** - If the various SCs use different formats and require receiving the information in their own format, AIs will have to develop functionalities to communicate with all the SCs; and/or
- **The MSs** - If the AIs or the MSs use different formats, all the MSs will have to develop additional functionalities to receive the reporting from the AIs, send it to the RCs, and receive other reporting from the SCs).

439. **Workload Increase**. An important workload increase will ensue from the SC Model implementation as the SCs will deal with an important quantity of data received from AIs and to be filtered and sent to the RCs according to the terms and conditions defined in the Memorandum of Understanding. This would entail an additional workload for the MSs and,

as for the IT investments, the importance of this workload is linked to the utilisation of a standardised format by the AIs, the SCs and the RCs.

440. **Cost Increase by Process for MSs**. MSs have provided some data to estimate the cost increase or decrease that each step of the exchange of information under the SC Model would entail, in comparison with similar activities performed in the context of the current AIC Model.

- **Receipt and processing of report by SC** – As a SC, the time dedicated to the activities linked to the receipt of the report from the financial intermediary is expected to increase by 43,5% on average according to the MSs. The time required for the receipt of the reporting is estimated at around 15 min by reporting and at 22 min for the verification of the report quality (completeness and format but no content check). Needless to say, this time must be multiplied by the number of AIs having a contractual agreement with the SC, which will significantly increase the time devoted to this process;

- **Sending of report by SC to RCs** – The creation and sending of the report to RCs will cause a workload increase of 18% on average according to the MSs. This task should take around 48 minutes and should generally be multiplied by the number of participating countries. However, some MSs have already partially automated this process, and do not have to repeat the procedure for all the RCs. This reduces the total time spent (in the current and future situation) but it has no impact on the percentage of increase, which remains at 20%.

- **Receipt and analysis of report by RC** – This step includes checking at central level but not checking at the level of local authorities. It is expected to increase by 13% on average, reaching a total of 180 minutes by report received. This is logically a minor increase as the only increase relates to the amount of data, as the number of reports received remains unchanged in comparison with the current AIC Model (from a RC perspective).

- **Formulation and sending of feedback to SCs** – This step constitutes the highest increase, 55% on average, representing a time of 62 minutes by report. This increase is explained by the formalisation of a report in the future situation while providing feedback is optional in the current exchange of information.

- **Receipt and processing of feedback received by SC** – In respect of the activities that relate to the receipt and processing of feedback from the RCs in the case of inaccurate data, the MSs expect on average a workload increase of 12,5%. This time spent on this process is, however, difficult to estimate as it will vary according to the number of requests to be sent to the AIs. This increase could be more important, considering that a question on one Investor will be sent to and processed by the various SCs impacted and that each SC will send requests for information to AIs across the EU.

11.3.3.3 EXCHANGE OF INFORMATION UNDER THE AIC MODEL

441. **IT Investments**. The IT investments linked to the implementation of the AIC Model by all the MSs is estimated at EUR 13,4 million. The difference of EUR 3,8 million with the SC Model is mainly due to the ability for the AIC approach to capitalise on the existing systems of the current AIC Model. Indeed, these systems have already been operational for 7 years and their weaknesses and defects have been corrected since their implementation. Several MSs explicitly mentioned the need to capitalise on this existing tool in order to ensure economies of scale.

As for the SC Model, the IT investments could also vary according to the level of standardisation of the format. However, contrary to the SC Model, a lower level of standardisation is required. Indeed, if the format used by the MSs has to be the same to facilitate the exchange of information between tax administrations, the format used by the AIs could be standardised at national level only. As an AI will only deal with its own tax administration, it is important that the tax administration and the AI agree on a format, but it does not matter if this format used for communication between AIs and tax administration is different in another MS. Even if a fully harmonised format at EU level (which intervenes in the AIs and the AICs and between the AICs and the SCs/RCs) is not required, it will certainly facilitate the exchange of information in both Models.

442. **Workload Increase**. As for the SC Model, an important workload increase will result from the AIC Model implementation. Some MSs highlighted the fact that adding an intermediary (the AIC) in the process is expected to increase the total workload required for the exchange of information. However, as pointed out by other MSs, consideration should be also given to the fact that the work performed by the AIC could enhance data quality.

Other MSs also mention that they appreciate being in contact with their national AIs and not directly with foreign AIs, as this should facilitate communication. According to the MSs, communication with AIs would be less onerous under the AIC Model due to the involvement of the AIC, which is closer to the AIs and the Investors.

443. **Organisational and Structural Changes**. Both Models require organisational and structural changes. As for the SC Model, MSs expect that their internal organisation will be changed if the AIC Model is implemented. They could once again capitalise on the current organisation and structure handling the exchange of information under the current AIC Model. However, as the future AIC Model will require adaptation to the current situation, this should also be considered a one-time cost for the MSs.

444. **Cost Increase by Process**. According to the data provided by some MSs, the time required to perform each step will increase or decrease as follows, in comparison with similar activities performed in the context of the current EUSD.

- **Receipt and processing of report by AIC** – The time devoted to receiving and processing the reporting from the various AIs is expected to increase by 13,5% on average. The timing dedicated to these activities is therefore estimated at 11 minutes for

receipt and at 18 minutes for verification of content and data quality check, which amounts of time need to be multiplied by the number of AIs. This increase is limited by the fact that the AIC will only receive reports from AIs located in its territory. It should therefore ease the process in terms of number of reports received and communication with AIs.

- **Sending of report by AIC to SC and RCs** – The creation and sending of the report to both SCs and RCs is expected to represent 18% on average, so around 48 minutes to be multiplied by the number of participating countries. MSs that provided data do not expect any difference compared to the SC Model. This aspect is interesting considering that, in the AIC Model, the AIC will have to send the report to RCs, as in the SC Model, but also to SCs. So this difference is not expected to create extra workload, probably all the more as this process has been partly automated in some MSs.

- **Receipt and analysis of report by RCs and SCs** – As previously mentioned, this step does not include any checking at the level of local authorities. According to the data received, it should increase the workload by 9,5%, representing a total of 175 minutes by report received. This is a minor increase; even less than the 13% increase expected from the SC Model. This difference is justified by some MSs by the pre-analysis and the filtering exercised by the AIC which is in a better position than the SC to carry out this activity. It is also important to note that MSs responded assuming that they will still receive one report from each MS, so one report bundling the data received as a RC and as a SC.

- **Formulation and sending of feedback to AICs** – As for the SC Model, this step constitutes the highest increase, 55% on average, reaching a time of 62 minutes per report. It is interesting to note that if providing feedback was mandatory for all information considered as missing, incomplete or wrong, the increase would be 60%, so only 5% higher than a mandatory feedback limited to the tax residence, reaching a time of 64 minutes. This distinction was recommended to improve data quality, as explained in the effectiveness analysis (cf. Chapter 8).

- **Receipt and processing of feedback received by AIC** – The receipt and processing of feedback from RCs and SCs is expected to cause a workload increase of 7% on average. This is significantly less than the 12,5% increase expected to occur by the MSs if the SC Model is implemented. This difference could be explained by the fact that the AIC communicates only with AIs located in the AIC, which should ease the process as explained in the effectiveness analysis (cf. Chapter 8). Once again, this increase will vary according to the number of requests to be sent to the AIs.

11.3.3.4 COMPARATIVE OVERVIEW

445. **Summary Table of the Increase under Both Models**. The following table provides an overview of the average time increases estimated for the different parts of the process according to the data received from MSs. The percentages represent an increase in comparison with the identical sections of the process under the current EUSD.

PART OF THE PROCESS	INCREASE UNDER THE AIC MODEL (%)	INCREASE UNDER THE SC MODEL (%)
Receipt and processing of reporting sent by AIs	13,5%	43,5%
Sending of report to other participating countries	18%	18%
Receipt and analysis of report sent by other participating countries	9,5%	13%
Formulation and sending of feedback to other participating countries	55%	55%
Receipt and processing of feedback from other participating countries	7%	12,5%

Table 31: Overview of the average time increase per process part for the AIC and SC Models

446. **More Important Workload Increase under the SC Model**. Out of the five different sections of the process, one is similar and four are more important in the SC Model. From the data, it appears that the MSs expect a more significant increase of workload if the SC Model is implemented vis-à-vis the AIC Model.

447. **Positive Role of the AIC**. This estimation seems to contradict the initial fear of MSs that the AIC Model, and the role of the AIC, would result in a workload increase. The problem of the lack of direct motivation of the AIC should be balanced by its positive role within the process. It will generate an efficiency gain, at least at Model level.

11.3.3.5 EXCHANGE OF INFORMATION IF BOTH MODELS ARE ADOPTED SIMULTANEOUSLY

448. **Additional Costs.** From a general point of view, running two systems in parallel will lead to additional costs at least in terms of:

- **training** – Civil servants need to be trained in order to apply both Models in parallel;
- **IT systems** – MSs need to invest in IT tools and systems to ensure the correct use of both Models. In that respect, the magnitude of the cost incurred will depend on the practical functionalities of both Models and on how a central IT system can be implemented so as to support all the functionalities;
- **organisational structure** – MSs will define a new internal organisational structure in order to efficiently support the implementation of both Models. This implies that, structurally speaking, organisational changes will be made. Additionally, there may be shifts in the responsibilities of the civil servants who are tasked with the application of both Models.

449. **Increase of Implementation Costs**. The implementation of both Models will clearly increase the implementation costs for several reasons. The timing of the implementation will probably not be harmonised, the legal basis should be different, the procedures will not be the

same, and no IT harmonisation for the two Models has been planned so far. In this context, the implementation of the second Model should be able to capitalise on the implementation of the first one, but the economies of scale will not prevent a significant increase in implementation costs.

Moreover, the co-existence of the two Models could even become a constraint for the implementation of the second. Some measures or procedures may have to be adapted in order to limit the number and size of redundancies that could result from double reporting. In this perspective, co-existence would create additional tasks, which would not be required if only one of the Models were implemented.

450. **Increase of IT Investments**. Potentially, the increase of IT investments could lead to the simple addition of the cost resulting from each Model. However, this is the worst scenario and could easily be avoided. Indeed, as demonstrated by the IT analysis, the functionalities required by both Models are mainly common. The logical IT architecture is even similar. Economies of scale in the development phase should therefore easily be achieved if the requirements of both systems, as currently defined, are not totally amended.

451. **Standardisation of the Format**. To fully maximise the economies of scale, the objective must be standardisation of the format for reporting and feedback. This standardisation will of course reduce the IT investment costs as only one format will need to be developed instead of two. Moreover, one of the main impacts will be in terms of workload, organisation and training for MSs and AIs. The use of a single system, with similar interfaces and procedures, will allow both reports to be handled by the same civil servants with a limited amount of training. When everybody uses the same system and format, it will increase the mobility of the people.

452. **Increase of Workload**. The workload is likely to increase. Even if this increase is limited by the development of a standardised format, as highlighted in the previous paragraph, additional steps will be required to ensure the interoperability of the Models. For example, where a participating country receives a report from an AI under the AIC Model and a report from another AI, located in a different country, under the SC Model, the tax administration has two options to process the information received:

- **Send a separate report –** The tax administration sends one report to the participating countries under the AIC Model and a different report to the participating countries under the SC Model. Countries participating in both Models receive two reports.
- **Consolidate the information –** The tax administration consolidates the information received from the various AIs and sends the relevant information to the participating countries according to the respective requirements of each Model.

In both scenarios, the processes have to be carried out in parallel, or additional steps have to be included to develop synergies between the Models.

453. **Development of an Interoperability Framework at Local and International Level**. As demonstrated in the preceding paragraphs, the focus should be on the development of an

interoperability framework in terms of IT systems, format or procedures. This framework has to be developed at two different levels:

- **At international level** – All the considerations about the IT systems and the format standardisation will have to be agreed at international level, between all the countries that participate in both Models. Moreover, some practices could also be defined to avoid information duplication. This is because the same transactions could be included in the report sent to the AIC under the AIC Model and in the report sent to the SC under the SC Model. Such redundancies increase the workload, could cause errors and decrease the efficiency of both Models. Practices to avoid this duplication have to be defined at international level to be applied by the AIs participating in both systems.

- **At local level** – As demonstrated in the example of a MS receiving two reports from two different AIs and under the two Models, some synergies will have to be developed at a local level and could generate a higher efficiency in the co-existence of the two Models within some MSs than in others.

The development of an efficient interoperability framework is a *conditio sine qua non* to reduce the amount of additional costs resulting from the co-existence of the two Models. This objective seems reasonable from a technical perspective. However, the main obstacle will be the difficulty to reach a political agreement between the countries that participate in both Models. This political agreement is the key factor to develop economies of scale and reduce the final cost.

454. **Common Agreement Limiting the Number of Systems to be Used**. It appears that it is not possible to estimate the extra costs that would result from the application of both Models. Indeed, it is mandatory to develop an interoperability framework, and this framework will determine the additional costs. If both Models are developed without considering interoperability, this will lead to the rejection of one or both systems. Most stakeholders insisted that developing two different systems should be avoided.

11.3.4 CURRENT VS. FUTURE SITUATION

455. This section details the various factors that will generate the qualitative impacts on the various stakeholders. The factors are briefly explained and the consequences are described for the MSs.

11.3.4.1 IDENTIFICATION OF THE INVESTORS

456. **From Certificate of Residence to Self-Certification.** A Certificate of Residence is currently required in most of the cases in order to benefit from a reduced tax rate based on a DTT. In the future situation, the Certificate of Residence will be replaced by a self-declaration signed by the Investor only. It will lead to simplification impacts at various levels (similar in both Models):

- **Tax administration of the SC**. While the issuance of a Certificate of Residence is the responsibility of the RC, the SC receives it and has to check its validity. As each country

has currently different forms and procedures for the issuance of Certificates of Residence, checking their validity can require some specific experience and abilities. With the exchange of information as provided in both Models (and especially considering the feedback loop), the RC will have to confirm the validity of the tax resident status of the Investor, freeing the SC from that check. Therefore, the work for the SC will be both simplified and reduced while the quality of the result of controls applied will increase.

- **Tax administration of the RC**. During the last years, the increase in the number of cross-border investments has resulted in an increase in the number of Certificates of Residence. For example, the US Internal Revenue Service processed 2,4 million Certificates of Residence for the fiscal year ending 30 September 2007, over a 60% increase from just a few years earlier (212). To avoid an increase in the administrative cost of handling such requests, some MSs charge the Investor a fee to issue a certificate. So while it is difficult to estimate the total cost of the Certificate of Residence for the RC, abandoning the issuance of such document for granting a reduced tax rate would generate an indirect economy for the RC because local tax administrations will continue to issue such documents for other purposes; consequently, only the frequency of the process will decrease, meaning that additional time will be freed up for local civil servants, who will be able to devote more time to other activities. However, no direct cost decrease is expected because the staff will stay in place and the databases/IT tools currently used will be maintained because the process itself will not disappear.

Moreover, moving from the Certificate of Residence to a self-certification principle is a factor that will also comprise a constraint (similar in both Models). As the RC will have to confirm that the Investors mentioned in the reporting provided by the SC (SC Model) or the AIC (AIC Model) are really tax residents of the RC, the workload generated by this check may undo the benefits from abandoning the issuance of Certificates of Residence. This constraint should be mitigated by two elements. In order to check the tax residence of an Investor, the RC should have at its disposal (or develop) an automated matching system, thereby reducing the administrative burden. In addition, such matching system will in any case have to exist in order to ensure tax compliance in the RC (cf. the second report on the Savings Directive, which mentions that a structured process of the dissemination of data from the receiving unit to the tax collection services in the MSs, and the latter's service feedback on the use of data, could improve the efficiency of the use of data).

11.3.4.2 GENERALISATION OF RELIEF AT SOURCE

457. **Increased Volume.** The introduction of the contemplated Models will increase the number of relief at source requests (especially considering that many countries do not currently apply any DTT relief at source procedure), as mentioned by the MSs interviewed.

212 Report of the informal consultative group on the taxation of collective investment vehicles and procedures for tax relief for cross-border investors on possible improvements to procedures for tax relief for cross-border investors, OECD, 12 January 2009

The increased relief at source volume (and correlative reduction in the number of refund requests ([213])) will certainly drive some inherent factors of simplification for the SC.

In both Models, there is no intervention of the SC upon application of relief at source as such task is carried out by the sole WA based on the information received from the AIs (TRI). It is only in a second stage that the SC will be in a position to use its oversight power (after having received the Investor information from the AIs). In that view, no impact on the operational cost is expected for the MSs that already have this level of intervention. However, for the MSs that intervene in the relief at source process, operational costs should be reduced.

Under the contemplated models, the MSs anticipate a decrease in the number of refund requests in favour of the relief at source request. As the intervention of the SC is more important under the refund procedure, the direct cost should decrease. The magnitude of the expected cost decrease will depend on the involvement of each stakeholder. However, as the future relief at source process will be more efficient, it will automatically incentivise Financial Institutions and Investors to opt for relief. The refund will then be seen as a safety net for Investors who have exceeded the period open for benefiting from relief at source.

11.3.4.3 POOLED INFORMATION

458. **Simplification via the provision of pooled information**. For the MSs not yet offering the opportunity to benefit from relief at source, the development of a relief at source system will allow the manual and administrative work to be reduced from an operational perspective (even though some investment costs, e.g. training, should be expected to be incurred), as it was previously mentioned. In addition, for the MSs that have already developed the possibility to benefit from a reduced tax rate via relief at source, the communication of tax rates on a pooled basis coupled with an annual exchange of information could also result in some economies:

- For countries where the procedure involves a breakdown of Investors (possibly with some documents) to be sent before each payment of income, this means that some administrative tasks have to be performed each time income is paid. Even if the associated tasks are not complex as such, it could represent a heavy workload when a dividend is paid by a major company.
- With the implementation of the pooled information, all the administrative work needed to identify Investors and check the validity of their requests is centralised annually in one reporting, dispatched in electronic format, and could easily be automated. In addition, the tax residence verification is strengthened by the checking done by the RC.
- It should also be noted that some countries have implemented relief at source systems that do not include administrative tasks each time income is paid. For those MSs, the pooled

213 The refund claim will survive the implementation of the new model, but it will remain a second choice for cases where relief could not be granted (e.g. in the case of a late trade). It is therefore important to encourage the development of a standardised refund procedure.

information will probably not generate an economy but it should not increase the administrative work either.

However, before receiving the annual report from the various AIs, the tax administration of the SC will not be able to verify whether the Investor who benefited from relief at source was really entitled to the reduced tax rate.

As the annual reporting will, by definition, always provide the information after the tax relief at source request has been granted (also in the event of fraud or a processing error), the SC will have to recover the amount, while it would have received more information before granting the DTT benefits in the current situation. For tax administrations, the trade-off between reducing the operational cost and increasing the level of the data quality is always in the centre of the debate.

11.3.4.4 PROCEDURES AND DATA STANDARDISATION

459. **Inconsistency.** Currently, the procedures for refund and relief at source differ from one SC to the other, and even from one product to the other for a given SC. As every MS has developed its own procedures, the level of data requested as well as the format of the data can differ between them. The lack of homogeneity in the current refund and relief procedures in the EU has an impact on the SC. This is because it increases the administrative work as Investors are more liable to make errors in their requests and SCs have to request additional information and/or reject requests. Moreover, it can make communication between MSs more difficult.

MSs interviewed have mentioned the importance of ensuring the compatibility of data formats in order to facilitate the exchange of information between MSs under both Models and under other information exchange programmes (FATCA, current AIC Model, etc.). The standardisation of the procedure should be accompanied by a standardisation of the data format in order to ensure the efficiency of the Models.

11.3.4.5 INFORMATION EXCHANGE VIA ELECTRONIC FORMAT

Electronic Format. The abolishment of paper forms to allow intermediaries to pass on beneficial owner information to the local WA in electronic format will have considerable impacts in terms of simplification opportunities for the SC. The development of electronic forms based on standardised procedures should ease the process and allow its partial/total automation leading to economies in terms of human resources. This will obviously depend on the maturity level of the IT architecture of the tax administration and its ability to allocate effort and budget to this project. Depending on how the IT structure will be designed and put in place, a relatively important investment cost (IT and training costs as a minimum) should be borne by the MSs. Furthermore, the archiving cost should also be reduced.

11.3.4.6 CHECKING OF THE TAX RETURNS

460. **Tax Compliance in the RC.** In the framework of the cross-border securities income, one of the main challenges for tax administrations is to ensure that their tax residents include all such income in their tax returns.

Integration of the data received under the contemplated Models with local databases should allow for several improvements. First, local tax inspectors should receive the information on Covered Payments that were credited to tax residents' foreign accounts. Second, this would enable them to cross check the information included in the report with the amount mentioned in the tax return. Finally, depending on the maturity of the IT solutions, it should also be possible to automatically operate a matching between some information included in the report and some information included in the tax return.

However, as highlighted by the second review of the Savings Directive, many MSs have not yet implemented an IT architecture allowing them to really integrate the information from the report into the tax checking procedure. This will result in an important investment cost that MSs should consider in terms of the IT solutions and tools needed to benefit from all the potential benefits offered in the future situation. A maintenance cost should also be considered.

11.3.4.7 POSSIBILITY TO OFFER RELIEF AT SOURCE TO FOREIGN INVESTORS

461. **Relief for Foreign Investors**. If the possibility to offer relief at source to foreign Investors is efficiently put in place, MSs would expect an increased amount of requests. This will imply that the number of data treated and exchanged will increase.

11.3.4.8 EU LEGAL FRAMEWORK

462. **Need for Specific Cases.** The existing EU legal framework offers many legal tools to fight fraud. The Directive on Administrative Cooperation and the Recovery Directive are good examples of such instruments available to MSs. However, to apply the Recovery Directive, one first needs to identify the amount to be recovered. So without information, it is not possible to take advantage of this instrument.

With the exchange of information, the tax administration will receive sufficient (214) information to demand compliance with the above Directives. The system will therefore strengthen the efficiency of the tools already existing in the EU tax framework.

11.3.4.9 WORKLOAD RESULTING FROM REPORTING

463. **Mandatory Reporting.** The tax administrations will automatically receive the reporting from other MSs, which is positive, but they also have to provide a reporting to the other MS and implement processes including appropriate controls to ensure that the reporting includes all the data received and is sent to the relevant MSs. The MSs interviewed mention the importance of having a high-performing IT system that allows for processing all the data received and setting up necessary ex-ante filters in order to minimise the administrative cost for tax administrations and to allow an efficient follow-up of the information provided. This will necessarily lead to important IT costs, which are described as heavily burdensome for the MSs that are facing budget constraints.

Furthermore, the workload resulting from the reporting will lead to a new organisation structure within their tax department. The new flows of information and the new responsibilities to be assumed will lead to newly defined responsibilities for staff (e.g. civil servants currently working on refund requests will probably be given new tasks).

11.3.4.10 AUDITS

464. **New Audit Cases.** Depending on the scenarios and Models, AICs, RCs and SCs will have the opportunity or the obligation to carry out some audits (spot checks in general, extensive review in some cases). Human resources will therefore have to be dedicated to the audits. In that respect and as opposed to the SC Model, AICs are expected to face additional costs related to their involvement in the audit procedure, should the AIC Model be implemented. As audits will often take place within foreign FIs, MSs will need to consider additional costs in order to perform them: travel allowance, time of their civil servants (preparing and carrying out the audit), training cost (one-time and recurring cost), IT costs in order to set up an internal follow-up tool. Of course, working with independent reviewers' reports will be less expensive for the MSs. However, in such case, an additional administrative burden will need to be considered due to the designation of the reviewer and the analysis of the report issued.

11.3.4.11 LIABILITY OF THE AI

465. **Extensive Liability.** Both Models have a broad understanding of the AI liability. The various procedures impose on the AI some specific checks and at the same time authorise the FI to rely on certain sources. However, the purpose of all these procedures is to improve the security of the system, but not to decrease the liability of the AI. As a result, in case of under-withholding, an AI may be held liable by a SC even if it has correctly applied all procedures and, therefore, the under-withholding is not a consequence of a mistake it made (e.g. in case

214 When DTT relief is requested.

of fraud committed by an Investor). When the SC uses that possibility, it is then up to the AI to take all the relevant actions to get this amount back from the Investors.

For the MSs, this liability is a clear advantage of the Models. Indeed, the SC has the guarantee that, if fraud was committed, whatever the effective responsibility of the AI in the fraudulent behaviour, the SC will easily recover the amount unduly received.

11.3.4.12 IDENTIFICATION OF THE APPLICABLE TAX RATE

466. **Responsibility of the AI.** Both Models consider that the AI that originally pools the information has to be able to determine the applicable tax rate for the Investors that could benefit from relief at source. The FI has therefore the responsibility to identify the tax rate for all its DAHs and IAHs (holding their securities via one or more CIs).

The Implementation Package suggests, as a possible solution, that tax administrations cooperate with AIs by making public all relevant information and guidance on their websites. This will reduce the workload for AIs but increase the workload and cost for tax administrations. Indeed, it is in tax administrations' interest to guarantee that all necessary tools are in place in order to ensure correct information for the AIs (e.g. creation and/or update of a web portal).

11.3.4.13 MANAGEMENT OF THE CONTRACTUAL AGREEMENTS

467. **New Service within Tax administrations and AIs.** In the context of the SC Model, the SCs will enter into an agreement with the various AIs. This implies the signature and the follow-up of potentially several hundreds of contractual agreements. This responsibility cannot be simply added to those of an existing team. Tax administrations will have to create specific services or at least allocate additional staff to an existing service to assume this new responsibility. This will lead to additional costs and will require specialised staff. The MSs pointed out the importance of properly managing these agreements in order to ensure efficient cooperation and exchange of information.

This constraining factor should impact the AIC Model to a lower extent given that, under this Model, SCs should not sign any agreements with FIs and that the recognition of the AIs would be done through an administrative procedure based on common conditions and requirements agreed between all MSs

11.3.4.14 MANAGEMENT OF THE DATABASES

468. **Responsibility of the AI.** The content of the reports is similar in the SC Model and the AIC Model and requires detailed information. Moreover, the information is disseminated over several different databases and so the systems will have to be able to extract and potentially match/compare information from different locations.

As it was demonstrated through various chapters of this study, the management of the databases is a major challenge for tax administrations as they will have to cross-check the information in the reporting with their own databases to confirm the tax residence of

Investors, but they also need to cross-check the content of the reporting with other databases such as the information included in tax returns. These investments will determine the ability of participating countries to benefit from the Model.

11.3.5 MACRO IMPACT AT MSS LEVEL

469. This section analyses the economic impact that the new system could have on the tax revenue for the EU MSs. This analysis considers the differences between dividends and interest as well as the differences that could arise from the local tax regulation.

470. According to the macro model (see Appendix 30) and based on the various macro statistics collected, the following figures have been calculated and will be further analysed.

	CROSS-BORDER INVESTMENTS	CLAIMABLE WHT	UNCLAIMED WHT
DIVIDENDS	2.656,40	3,74	0,933
INTEREST	6.313,85	12,52	3,13
TOTAL	**8.970,25**	**16,28**	**4,07**

Table 32: Overview of the impact of the Models on the tax revenue at EU level (in billion EUR)

471. **Impact on Tax Revenue for Participating MSs**. If, in the future situation, the Investors effectively claimed the amount of EUR 4,07 bn of unclaimed WHT, this amount would represent an equivalent decrease of tax revenue for the tax administrations of the participating countries. However, this amount cannot be assimilated as a loss resulting from the new system because the loss results from the various DTTs agreed bilaterally between the MSs. The fact that administrative barriers or an administrative burden prevent that all the Investors benefit from these DTTs is in contradiction with the political decision materialised in these DTTs. In addition, tax and administrative barriers like those are not aligned with the Internal Market and therefore hamper the smooth functioning of the Internal Market It is therefore very important not to see the amounts detailed in this section as an extra gesture of the MSs towards foreign Investors. It is only reflecting potential amounts credited to the tax administrations while they should be credited to the Investors, according to the DTTs (215).

472. **Disparity between MSs.** Moreover, this total amount at EU level does not reflect the great diversity existing between MSs. This is because countries having a domestic tax rate lower than or equal to the treaty rate should not face any loss of tax revenue. On the contrary, countries applying a domestic tax rate significantly higher than the treaty rate will be more impacted. These differences can be observed on dividends and on interest.

Three main factors influence the amount of claimable WHT:

215 On the contrary, the MSs will benefit through the exchange of information.

- **The amount of dividends** – Logically, the sum of all the dividends paid in the MS during the year has a big impact on the amount of WHT. This explains why the MSs having the higher unclaimed amounts are often major economies within the EU.

- **The local tax regulation** – The local tax regulation has an impact at two levels. First, it determines the difference between the domestic WHT rate and the reduced WHT rate according to DTTs. Where this difference is significant, the claimable WHT amount will increase while a low difference could considerably reduce the claimable amount, even for a major economy. This explains why some MSs should not face any decrease in WHT if their domestic WHT rate is equal to or lower than the various DTT rates. Second, it creates a context that attracts foreign Investors or motivates companies and financial services to establish investment structures/products in this MS.

- **The procedure to benefit from a reduced WHT rate** – The complexity of the refund or relief at source procedure to benefit from a reduced tax rate under a DTT has an important impact on the amount of unclaimed WHT. Of course, if a MS offers the opportunity to benefit from relief at source without administrative burden, it is likely that the rate of unclaimed WHT will be lower than in another MS offering only refund on the basis of more complex procedures. However, as MSs have no accurate statistics on this factor, it has been neutralised via the application of an average rate of 25% as calculated by Goal Group

473. **Unclaimed WHT on Dividends.** The total amount at EU level is estimated at around EUR 0,933 bn (216), but there are major disparities between MSs.

MEMBER STATES	TOTAL UNCLAIMED AMOUNTS (MILLION EUR)
AUSTRIA	17,007
BELGIUM	44,181
BULGARIA	0,000
CYPRUS	0,000
CZECH REPUBLIC	0,488
DENMARK	10,793
ESTONIA	0,000
FINLAND	90,615
FRANCE	273,451 **(1)**
GERMANY	173,092
GREECE	0,943
HUNGARY	0,830
IRELAND	0,000 **(2)**
ITALY	55,024
LATVIA	0,000
LITHUANIA	0,355

216 The exchange rate used is EUR 1 = US$ 1,3252, which is the average exchange rate for the year 2010 (source: European Central Bank).

MEMBER STATES	TOTAL UNCLAIMED AMOUNTS (MILLION EUR)
LUXEMBOURG	0,542
MALTA	0,000
NETHERLANDS	19,351
POLAND	7,207
PORTUGAL	75,669
ROMANIA	0,138
SLOVAKIA	0,000
SLOVENIA	0,043
SPAIN	54,616
SWEDEN	108,969
UNITED KINGDOM	0,000 **(3)**
TOTAL loss for MSs	**933,3145**

Table 33: Total WHT claimable amounts (million EUR)

- **(1)** The impact on France is important, around EUR 0,27 bn. It is not surprising as France is an important economy and it applies a domestic rate of 25%, so 11,25% higher than the average 13,75% WHT rate granted in the various DTTs.
- **(2)** In Ireland, no withholding tax is levied if the recipient is a company which is resident in another EU Member State or in a tax treaty country and which is not controlled by Irish resident persons. The same rules are in place for non-resident individuals.
- **(3)** There is no claimable amount of dividends in the UK as no WHT tax on dividends is applied there.

474. **Unclaimed WHT on Interest**. The impact on interest is more important than on dividends, even if it is probably overestimated, as already mentioned. The main reason is the difference in the amount of the cross-border investments: EUR 4,38 bn in equities and EUR 14,69 bn in bonds (217). Moreover, many MSs granted a total exemption on government bonds in their DTT, in order to increase the attractiveness of the national debt. Therefore, it increases the difference between the domestic WHT rate and the WHT rates included in the DTTs.

However, it should be noted that 16 MSs have a domestic WHT rate on interest equal to or lower than the WHT rates included in the DTTs. So these MSs should not face any loss of tax revenue on interest. This means that the EUR 3,13 bn decrease in tax revenue on interest would be supported by 11 MSs, among which Spain for EUR 0,8 bn, Italy for EUR 0,94 bn, and the UK for EUR 0,8 bn.

217 IMF's Coordinated Portfolio Investment Survey" (CPIS)

MEMBER STATES	TOTAL UNCLAIMED AMOUNTS (MILLION EUR)
UNITED KINGDOM	**806,32 (218)** [(1)]
ITALY	**936,68** [(1) (2)]
SPAIN	**795,41** [(1)]
PORTUGAL	**310,95**
BELGIUM	**124,53**
POLAND	**106,79**
CZECH REPUBLIC	**23,82**
SLOVAKIA	**18,69**
SLOVENIA	**10,91**
BULGARIA	**0,39**
LITHUANIA	**0,03**
TOTAL loss for MSs	**3.134,52**

Table 34: Total amounts of unclaimed WHT on interest

- **(1)** Statistics on the rate of unclaimed tax amounts on Spanish, Italian and British bonds are not available so the rate of 25% was applied to estimate these amounts. Nevertheless, it is likely that an efficient procedure to benefit from a reduced tax rate on bonds (even only government bonds) should result in a low rate of unclaimed WHT and so reduce the impact of the new system on tax revenue on interest. Moreover, exemptions for certain types securities in certain Member States have not been considered. Consequently, these figures should be treated with caution.

- **(2)** The simplified Italian relief at source procedure on bonds has been considerably successful in the last four years. It is therefore likely that the percentage of unclaimed WHT should be lower than the 25% used for this estimation.

475. **Partial Compensation of the Tax Revenue Decrease**. The direct tax revenue decrease faced as a SC will be partially compensated by secondary tax entries as a RC. This is because the relief at source will increase the amount of income paid to Investors and this income will in many cases increase the taxes that Investors will pay to the RC's tax administration. However, this would not be the norm. A contracting state would not give credit for the domestic rate in another contracting state, but would limit it to the treaty rate regardless whether the treaty rate was applied or not (at source or by refund).

However, it is very difficult to estimate the amount of this secondary entry for RCs as it will depend on the domestic tax law, which could be very complex, depending on the Investor type. Two examples illustrate this secondary tax.

218 As around 40% of the debt securities in UK are related to Eurobonds (see IMF CIPS database) and those securities are subject to a specific exemption, the data obtained via the model is reduced by 40%.

- In Belgium, the Investor must pay a tax of 25% on his net cross-border dividends[219]. As demonstrated below, if the SC faces a decrease of EUR 10 (25-15) following the application of the reduced WHT rate, the RC will gain EUR 2,5.

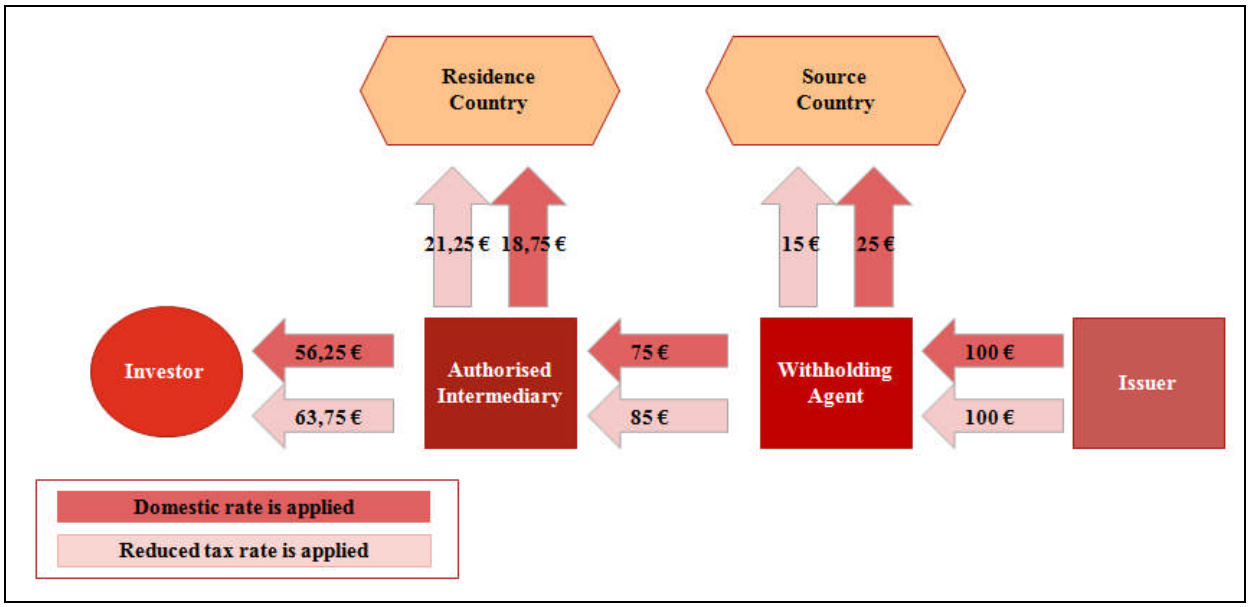


Figure 30: Example of Partial Compensation of the Tax Revenue Decrease

For dividends, the sum of the additional taxes received if all Investors request to benefit from the Models is EUR 11,20 million, while the direct decrease would be EUR 44,18 million. So the net impact on WHT from dividends for the Belgian tax administration would be EUR 32,99 million.

- The Netherlands apply a different taxation system. They do not calculate the tax to be paid on cross-border income but on the principal amount. Profits made by capital invested are taxed at a rate of 30%. Profits are calculated with a theoretical yield of 4% (deemed profit) and they are applied based on the value of the shares. The effective rate is 1,2%. Considering the above example, the Investor will increase his capital of EUR 10 following the application of the reduced tax rate. 4% of EUR 10 will be taxed at a rate of 30%, so the tax amount is EUR 0,12, giving an effective rate of 1,2%. Out of EUR 10 not received by the SC, the Dutch tax administration will receive EUR 0,12. However, it will receive the amount every year while the EUR 2,5 received by the Belgian tax administration is a one-shot revenue.

  If all Investors request to benefit from the Models, the additional taxes generated by the system for the Dutch tax administration would be EUR 0,83 million, while the direct loss would be EUR 19,35 million. So the net impact on WHT for the Dutch tax administration would be EUR 18,52 million. Moreover, as mentioned above, this amount should also generate additional taxes in the following years.

219 This tax is automatically deducted by the financial institution closest to the investor if this institution is located in Belgium.

These two examples demonstrate that the impact of the system on the tax amount collected by the MSs will vary according to the ability of the local tax regulation to levy secondary taxes on such cross-border income. Some MSs, applying a domestic tax rate lower than or equal to the WHT rates included in their DTTs could even see their tax revenue increase. The following theoretical example illustrates this statement:

> If a country X applies a WHT rate of 10%, while the reduced WHT rate is 15%. Clearly, nobody will ask for the reduced WHT rate as it is higher than the standard WHT rate. As a result, if a standardised relief at source system is implemented, it will not cause any decrease in country X tax revenue.
>
> On the opposite, if country X applies (as Belgium does) a tax rate on net cross-border dividends paid to its tax residents, it will benefit from this system. Indeed, its tax residents will increase their net income as they will be able to claim for a relief at source on their cross-border dividends. The increase of the net cross-cross border income will automatically increase the revenue resulting from the 10% WHT.
>
> Conclusion, there is no loss for country X while its tax revenue increase with secondary tax entries.

11.3.6 CONCLUSION

476. **Summary Table.** The table below summarises the findings in terms of simplification and constraining factors. To show whether a specific element tends to be rather simplifying or constraining compared with the current situation, the following scale was used:

- Factor ---: The stakeholder expects a very negative impact
- Factor --: The stakeholder expects a negative impact
- Factor -: The stakeholder expects a rather negative impact
- Factor =: The stakeholder expects no differences
- Factor +: The stakeholder expects a rather positive impact
- Factor ++: The stakeholder expects a positive impact
- Factor +++: The stakeholder expects a very positive impact

The results mentioned in the summary table represent a averages. Sometimes, they do not reflect the high diversity in the results obtained via questionnaires and interviews.

SIMPLIFICATION FACTORS	SC	RC	AIC
Identification of the Investor (from CoR to ISD)	+	+	=
General implementation of relief at source	+	=	=
Pooled information	+/- (220)	=	=
Procedures and data standardisation	=	=	=
Information exchange via electronic format	++	=	=
Control of tax returns	=	++	=
Possibility to offer relief at source to foreign Investors	=	=	=
EU legal framework	+	+	=

Table 35: Summary Table - Simplification Factors

CONSTRAINING FACTORS	SC		RC		AIC	
	SC	AIC	SC	AIC	SC	AIC
Workload resulting from the reporting	--	-	--	-	=	-
Audits	-	=	=	=	=	-
Liability of the AI	++	++	=	=	=	=
Identification of the applicable tax rate	=	=	=	=	=	=
Management of the Contractual Agreements	-	=	=	=	=	=
Management of the databases	-	-	--	-	-	-

Table 36: Summary Table - Constraining Factors

11.4 IMPACT ON FINANCIAL INSTITUTIONS

11.4.1 INTRODUCTION

477. **Scope.** This section will assess the cost impact of the implementation of a standardised relief at source system for the Financial Institutions. The data have been gathered via a detailed questionnaire that has been sent to the voluntary Financial Institutions. Furthermore, this exercise has been complemented by a literature review. The assessment is based on the comparison of the two systems in scope of this study, being the AIC Model and the SC Model.

220 Two estimations are mentioned here to reflect two different realities of this issue: one positive, the simplification of the procedures and the decrease of the administrative burden; one negative, the fact that AIs will have to contact their clients to obtain this ISD, and the new responsibility of AIs, especially in the context of their extended liability.

11.4.2 CURRENT SITUATION

478. For the Financial Institutions, the current situation is characterised by three separate processes that will be analysed from a CBA point of view:

1. Refund procedure;
2. Relief at source procedure;
3. Exchange of information under the current AIC Model.

479. As for the MSs, the underlying processes imply some costs for the Financial Intermediaries. The analysis of the three processes results from the data collected from questionnaires sent to the FIs and information collected through a literature review. This section identifies and estimates the main cost elements for each process.

11.4.2.1 REFUND PROCEDURE

480. **The number of employees.** The number of FTEs is also a major cost driver for the FIs. Indeed, a specific team is typically dedicated to the processing of the refund requests. For example, a FI indicates that dedicated staff is responsible for each market within the refund team. Moreover, considering the heterogeneity of the financial market and of the procedures within the EU, senior and experienced employees need to be hired in the dedicated team within a FI.

481. **Cost/Time Estimation.** The table below shows the estimation of the time range per production step undertaken by the FIs according to the data collected in the questionnaire. Note that these estimations have been made without the outliers (i.e. the FIs that have provided the maximum and the minimum values).

PRODUCTION STEPS	TIME ESTIMATION
Data *processing, which includes data mining, data uploading, data maintenance, and administration.*	Range: [0min;42min] Average: 20 min
Printing *of physical forms, current quality checks, and sending to customers and/or to local tax offices.*	Range: [2min;120min] Average: 28 min
Processing *of incoming mail from customers and from local tax offices.*	Range: [5min;60min] Average: 20 min
Dispatching*, i.e. forwarding completed physical forms to the relevant tax office of the source country or to the upper tier*	[5min;60min]

depositary.	Average: 20 min
Booking, *i.e. monitoring of claimed tax credits, reconciliation of payments received, and booking of incoming payments.*	[2min;30min] Average: 16 min
Reporting*, i.e. process maintenance, executing change management as the case arises, attending to client queries, and reporting.*	[5min;60min] Average: 24 min
Updating*, i.e. follow-up of the tax new regulations in the various Member States, updating the system and internal tax databases, and informing the tax teams.*	[5min;60min] Average: 21 min

Table 37: Time Estimation per step undertaken by FIs

In general, the majority of the FIs indicate that the most burdensome activities are those related to "Data", "Processing" and "Reporting". Although no precise cost can be estimated for the refund process on the part of the FIs, the majority of the respondents mention that the refund process is an unprofitable procedure, implying that the internal costs borne by the FIs are higher than the fees charged to their clients. Some FIs charge a standard price, which varies from EUR 40 to EUR 120 per claim. Other FIs apply a fee based on the time and effort spent on the request. Furthermore, external charges dependent on local market requirements are invoiced to the FIs' clients (e.g. the involvement of local tax specialists is sometimes required considering the complexity of the financial market and the financial operations).

From the FIs side, the number of refund requests is first dependent on the minimum threshold for Investors to claim a refund. Some FIs accept refund requests only if the reclaimable amount covers their costs or they set an arbitrary minimum amount. Moreover, all the FIs apply a fee for handling refund requests. This is considered as an implicit threshold. Considering the uniqueness of each FI (in terms of threshold and fees applied), no general trend can be derived from the data collected for the FIs, apart from the difficulty to benefit from a reduced tax rate for small income.

482. **Lack of Data Quality**. As already mentioned in the previous section, the quality of the data included in the refund requests is considered a major issue for the MSs. This also entails a negative impact for the FIs: poor data quality implies additional administrative costs for them because they have to liaise with Investors in order to complete a request or provide additional information/forms to the SC's tax administration.

11.4.2.2 RELIEF AT SOURCE PROCEDURE

Procedure undertaken by the FIs. When a relief at source service is put in place in a MS, the procedure can be entirely undertaken at the FI level, implying that the tax administration of the SC does not intervene in the process itself but only at a post-audit level. In that case,

the FIs are more involved in the procedure and they have to devote more time and resources to treat the procedure. Next to this, tax administrations may impose the liability on the FIs.

According to the Implementation Package, the liability of the AIs is extensive and is not limited to mistakes made by the AI in applying the WHT relief procedure (e.g. in checking the ISC against KYC rules and determining the correct WHT rate to be applied to its investors), but also includes cases where the under-withholding is not a consequence of a mistake made by the AI.

From the FIs' perspective, this liability is accepted as a legitimate concession, as long as it is limited to mistakes that they have made. Moreover, some of them are of the opinion that FI should assume liability only for checking ISC against KYC rules and not also for assessing the reduced rate of withholding tax to be applied. In general, to counterbalance the risk they assume, FIs would like Tax administrations to be cooperative and issue detailed guidance on the tax treatment to be applied to certain entities.

Amount of the Relief at Source Requests. Although the FIs can easily access information on the number of relief at source requests processed on an annual basis, this number is a function of various factors (including, but not limited to, client profile, any threshold applied, and pricing of service offered). Consequently, a comparison based on the number of requests does not yield much added value as it depends strongly on the availability of the relief at source service and on the type of FIs (Retail Banking may be different from Private Banking).

Cost and Time of the Relief at Source Procedure. The time spent by each FI interviewed on the seven activities included in the relief at source process varies. However, the FIs indicate that the processing of data is the most burdensome activity. This is because verification of the data provided by the clients and/or collected by the FI directly is a time-consuming activity. As the relief at source procedures are not harmonised at EU level, FIs offering relief at source in several MSs need to invest in specialised staff (for tax and corporate tasks). This leads to a higher cost.

PRODUCTION STEP	TIME ESTIMATION
Data *processing, which includes data mining, data uploading, data maintenance, and administration.*	[20min;120min] Average: 30 min
Printing *of physical forms, current quality checks, and sending to customers and/or to local tax offices.*	[10min;60min] Average: 9 min
Processing *of incoming mail from customers and from local tax offices.*	[10min;60min] Average: 23 min
Dispatching*, i.e. forwarding completed physical forms to the relevant tax office of the source country or to the upper tier depositary.*	[3min;120min] Average: 32 min
Booking, *i.e. monitoring of claimed tax credits, reconciliation of*	[5min;30min]

payments received, and booking of incoming payments.	Average: 13 min
***Reporting**, i.e. process maintenance, executing change management as the case arises, attending to client queries, and reporting.*	[5min;30min] Average: 20 min
***Updating**, i.e. follow-up of the tax new regulations in the various Member States, updating the system and internal tax databases, and informing the tax teams.*	[5min;60min] Average: 21 min

Table 38: Time Estimation per step undertaken by MSs

The cost incurred by the FIs in handling the relief at source requests is often passed on to the Investors, or to their clients. In general, the clients are charged a fee based on the time and effort spent by the FIs. Furthermore, external charges are also invoiced to the Investors by the FIs. These external charges mainly include any fees charged by the tax administrations (e.g. for the issuance of a Certificate of Residence), by sub-custodians or by external contractors. In any case, the relief at source process is not profitable for the majority of the FIs.

11.4.2.3 EXCHANGE OF INFORMATION UNDER THE CURRENT EUSD

483. **Cost of the Exchange of Information under the Current EUSD**. The IT cost seems to be the most important cost driver for FIs in the current exchange of information implementation and maintenance phases. However, no accurate IT cost estimation can be provided at this stage.

11.4.3 FUTURE SITUATION

484. The purpose of this section is to understand to potential impact for the FIs under the implementation of the SC Model and AIC Model in terms of exchange of information. Moreover, qualitative feedback is provided regarding the future situation from the financial sector's point of view.

11.4.3.1 EXCHANGE OF INFORMATION UNDER THE SC MODEL

485. **Cost Element for AIs**. The IT investment related cost for the AIs is by far the most important cost (as it should represent up to 80% of total one-time cost for certain FIs). The share of the total cost allocated to IT maintenance remains relatively important (up to 70%, but for most of the AIs interviewed, the share is estimated at around 30% of total cost). Second, the training cost is perceived as burdensome for the AIs (up to 60% of one-time costs for some AIs and up to 60% of recurring costs). Finally, AIs also consider a cost impact due to a change in the operating model. However, this one-time cost represents only 10 to 25% of the total one-time cost expected by the AIs. The recurring cost related to the operating costs is also mentioned by the AIs (up to 70% of total recurring costs for one AI interviewed).

11.4.3.2 EXCHANGE OF INFORMATION UNDER THE AIC MODEL

486. **Cost Element for AIs**. As for the SC Model, the AIs expect to incur important IT costs in the implementation phase (one-time costs) as well as in the maintenance phase (recurring costs). Those IT costs represent up to 80% of total cost. Second, the training cost is perceived as important for the AIs (up to 60% of one-time costs for some AIs and up to 80% of recurring costs). Third, the AIs also consider a cost impact due to a change in the operating model. However, this one-time cost represents only 10 to 30% of the total one-time cost expected by the AIs. The recurring cost related to the operating costs is also mentioned by the AIs (up to 70% of total recurring costs for one AI interviewed).

11.4.3.3 EXCHANGE OF INFORMATION IF BOTH MODELS ARE ADOPTED SIMULTANEOUSLY

487. **Important cost impact expected.** The major findings of the analysis performed for the MSs' tax administrations are applied to the financial sector (section 11.3.3.5).

Common Agreement Limiting the Number of Systems to be Used. As for the MSs, the interoperability is crucial for the FIs. Most FIs insisted that developing two different systems should be avoided. Especially, the Financial Institutions clearly indicated that only one system should be developed. Given the evolution on FATCA (cf. Joint Statement, section 6.2) and the existence of the current AIC Model, several financial institutions mentioned that the AIC approach should be explored first. That said, the last Joint Statements with Switzerland and Japan mitigate this perspective. Other FIs expressed a preference for the SC Model by pointing out that this Model is suitable to build a global system, not limited to the EU only. This aspect is indeed very important for FIs. If the new system is only applied by EU MSs and cannot be open to third countries, many FIs will have to deal with the two systems, one for the EU MSs and another for non-EU countries. This is not acceptable for many FIs and it is a weakness often attributed to the AIC Model. However, as demonstrated in section 6.3, the integration of third countries to the AIC Model is possible as long as it is in place in the common regulation.

These warnings should be heeded, especially as both Models, in their current version, rely on the free decision of the AIs whether or not to participate in these systems. There are already other exchange of information initiatives in the international context, especially the multiplication of the communication channels organised at global level by the various Joint Statements on FATCA. So if the Models make the existing situation more complex rather than simplify it, the Models will risk being successful to a limited extent only – if not totally rejected by the financial sector.

11.4.4 CURRENT VS. FUTURE SITUATION

11.4.4.1 IDENTIFICATION OF THE INVESTORS

488. **Self-Certification.** Moving from the Certificate of Residence to a self-certification principle is a factor that will have simplification impacts at various levels (similar in both Models). The tax services will not have to provide Certificates of Residence or other administrative forms to confirm the tax residence of their client. The collection of such

documents is time-consuming for the tax departments, and an economy can be envisaged from that point of view. So most of the financial institutions believe that the impact of the ISD will be positive.

On the contrary, a self-certification principle is a factor that will also comprise a constraint (similar in both Models):

- First, the validity of the ISD – If this document is not valid for minimum five years, the administrative workload resulting from its renewal will significantly reduce the positive impact of the ISD.
- Second, the lack of controls – Some FIs consider the ISD too risky in the context of the AI's liability. While the ISD is positive as such, with the potential decrease in administrative burden, some FIs would prefer to still request Certificates of Residence in order to minimise their liability in the case of fraud organised by an Investor. The fact that the AI could be liable even if it applied the procedures and acted according to best practices makes the use of the ISD very risky. However, the issue raised by these FIs is more about the AI's liability than about the ISD itself.

These negatives aspects (especially the second one) are very important for some FIs. This explains why the ISD is met with some reservations by the financial sector, even if the general feeling is positive rather than negative.

The ISD represents also a constraint for the FIs. Indeed, each Investor who wants to benefit from relief at source will have to provide such declaration. This means that FIs will have to contact all their impacted clients to have them complete, sign and, when applicable, update (221) this form. This kind of processes could have an impact on some clients' relationships especially as many clients will be located in a country other than the country of their FI (Reversed Cross-Border Scenario and Triangular Scenario). Some FIs fear being faced with too burdensome a process, but this could be avoided if two conditions are fulfilled: validity for a 5-year period as a minimum, as already mentioned, and electronic signature. The second aspect is particularly important as it would allow Investors to update themselves the changes in their status/personal data.

11.4.4.2 GENERALISATION OF RELIEF AT SOURCE

489. **Increased Volume.** The introduction of the contemplated Models will increase the number of relief at source requests (especially considering that many countries do not currently apply any DTT relief at source procedure), as mentioned by the MSs interviewed. The increased relief at source volume (and correlative reduction in the number of refund

221 Experience with the QI regime shows that the requirement to obtain valid Forms W-8BEN or acceptable documentary evidence has consistently proved to be a significant operational challenge for financial institutions with failure documentation rates at audit frequently in excess of 10%. Accordingly, the introduction of ISD is likely to be impacted by similar challenges. Key to the efficiency of the certification process will be the extent to which institutions are allowed to cure minor administrative errors in the completion of ISDs by reference to existing customer documentation as opposed to the need to systematically revert to the customers.

requests (222)) will certainly drive some inherent factors of simplification for the financial sector as a whole.

490. All the FIs expect a very positive impact from a general implementation of relief at source. The operational cost for a refund claim is in principle much higher than for relief at source. There are many reasons for this, including, but not limited to, the following:

- The refund procedure involves several paper forms, often a Certificate of Residence.
- The refund procedure requires administration of evidence (which can often be critical due to omnibus accounts, etc.).
- In many cases, the refund procedure requires a follow-up of the request for several months or years.
- The receipt of the cash amount is credited to the Investor via some additional transactions (debit from the tax administration's account, credit to the FI, debit from the FI, and credit to the Investor) that would have been avoided with relief at source.

Like the tax administrations, the FIs will have to process more relief at source requests and fewer refund requests. Consequently, the contemplated Models should substantially reduce the marginal cost per transaction subject to DTT benefits.

11.4.4.3 POOLED INFORMATION

491. **Facilitation of the exchange of information**. The provision of pooled information instead of specific Investor information is also a factor of simplification for the financial sector. Some MSs already offer the opportunity to Investors and FIs to benefit from a reduced tax rate at source. However, in such cases, the FIs will generally have to provide information on all Investors who are allowed to benefit from this reduced rate (non-pooled basis). Moreover, some MSs will request this information each time income is paid (implying a recurring burden). As the information will often differ from one MS to another or from one type of income to the other, it is difficult to automate such functions and it forces FIs to maintain important tax services to perform administrative and repetitive tasks. Globally, FIs anticipate a positive impact from the pooled information. Providing pooled information should result in an economy in terms of effort in comparison with most of the existing procedures and should not generate additional constraints for participating countries that already provide this possibility.

Moreover, some FIs believe that the pooled information is a guarantee in terms of confidentiality of the data provided to other FIs.

222 The refund claim will survive the implementation of the new model, but it will remain a second choice for cases where relief could not be granted (e.g. in the case of a late trade). It is therefore important to encourage the development of a standardised refund procedure.

11.4.4.4 PROCEDURES AND DATA STANDARDISATION

492. **Inconsistency.** Standardisation of relief at source procedures is unanimously welcomed as a very positive element by the financial sector. Indeed, the great diversity between the various forms and procedures from one SC to the other currently requires experience and knowledge of all procedures (hence the need for FIs to maintain highly experienced back-office personnel to fill in administrative forms). Moreover, this lack of homogeneity in the current refund procedures is a factor of back-office errors, which increases the administrative work for FIs. Standardisation of relief at source procedures should thus *a priori* reduce the back-office workload by increasing process efficiency. This should also facilitate job rotation within FIs.

However, it should be borne in mind that the Models as they currently stand only standardise the relief at source procedure while some other elements have in practice not yet been standardised at all (treaty rates, definition of Covered Payments, definition of person and resident in the various DTTs). Considering that the Model will offer the possibility for FIs to apply treaty benefits for more countries than it is currently the case, this diversity will even increase.

11.4.4.5 INFORMATION EXCHANGE VIA ELECTRONIC FORMAT

493. **Electronic Format.** The abolishment of paper forms to allow intermediaries to pass on beneficial owner information to the local WA in electronic format will have considerable impacts in terms of simplification opportunities the financial sector.

All FIs expect a positive impact from the exchange of information in electronic format. The development or update of IT systems should significantly decrease the manual work to be performed by the back-office personnel of the FIs, but will cause an investment cost. The magnitude of this investment cost would depend on new formats and on the IT systems already in place. An institution with a strong IT architecture and efficient tax administration could develop a system where the forms would be automatically (pre-)filled in. No FI mentioned the IT investments as a barrier high enough so as to undo the benefits from a general implementation of electronic forms.

In addition, many FIs confirmed that it should speed up the process. This is especially relevant for countries currently having relief at source procedures. Indeed, cross-border investments often involve several intermediaries and passing on information along the chain of intermediaries in paper form can take a long time. In some cases, there is not enough time, once the income is announced, to have all the relevant documents in place before the payment date, which means that it is not possible to benefit from the relief at source procedures even if it is legally permitted. This implies that Investors should be able to benefit from the reduced rate more often.

Finally, the electronic format will also reduce the archiving costs in comparison with paper documents.

11.4.4.6 POSSIBILITY TO OFFER RELIEF AT SOURCE TO FOREIGN INVESTORS

494. **No Relief for Foreign Investors**. Currently, some FIs offer the relief at source and refund services only to Investors having their tax residence in the FIC. They consider the administrative work involved in providing the relief at source service to foreign Investors too onerous. Indeed, it would require FIs to contact the administrations of the various RCs, sometimes at local level, to obtain all the required forms, such as the Certificate of Residence.

For FIs that are not already offering the relief at source service, this aspect is positive. FIs will be able to offer the relief at source service to foreign Investors without facing important additional costs. Indeed, the ISD and the pooled information will not generate more workload for a resident Investor than for a foreign Investor. However, the identification of the proper tax rate will require an analysis of the various tax rates, activities that could be burdensome and should be carried out by people with relevant experience.

11.4.4.7 WORKLOAD RESULTING FROM REPORTING

495. **Mandatory Reporting.** The application of the contemplated Models entails some mandatory reporting FIs. The reporting will require administrative work for its generation but also during the year (data collection, creation and maintenance of various databases, data storage, data review, etc.). This workload will vary from one AI to the other, depending on the IT solutions available and the level of automation of those activities. All the AIs expect a negative impact from the Models in terms of workload resulting from the reporting.

Most of the FIs (67%) do not distinguish between the SC Model and the AIC Model in this respect. However, 33% expect the AIC Model to generate less workload than the SC Model. This constraint is expected to increase under the SC Model as each AI will have to send a report to each SC that granted its clients relief at source based on pooled information.

Finally, the FIs also fear the negative impact that the mandatory feedback will have in terms of workload.

11.4.4.8 AUDITS

496. **New Audit Cases.** The application of the contemplated Models entails additional audits from independent reviewers. In addition to the costs of the independent reviewer, there is additional workload in preparing and supporting the audit process (carried by the independent reviewer or by the tax administrations). All the FIs highlighted the negative impact that these additional audit requirements will generate. Some FIs, already previously submitted to a regular audit according to their local regulations, insist on the possibility to have these audits carried out at the same time to reduce the costs.

From a general perspective, the fact that one is audited is not identified as an issue as big as the costs that will result from these audits. Some FIs suggest that the tax authorities should audit them in order to reduce the costs, but this option is not welcomed by all FIs.

11.4.4.9 LIABILITY OF THE AI

497. **Extensive Liability.** Both Models have a broad understanding of the AI liability. The various procedures impose on the AI some specific checks and at the same time authorise the FI to rely on certain sources. However, the purpose of all these procedures is to improve the security of the system, but not to decrease the liability of the AI. As a result, in case of under-withholding, an AI may be held liable by a SC even if it has correctly applied all procedures and, therefore, the under-withholding is not a consequence of a mistake it made (e.g. in case of fraud committed by an Investor). When the SC uses that possibility, it is then up to the AI to take all the relevant actions to get this amount back from the Investors.

The liability of the AI is the biggest issue for the FIs and its impact is considered as very negative. Some FIs even mentioned that the liability of the AI is so extensive that the financial risk it represents could be considered as too high and persuade FIs not to participate in the Models.

FIs do not want to shirk their responsibilities but they insist that they should only be liable for a shortcoming in their behaviour or processes and not for an error or a fraudulent act attributable to an Investor, for example. If an Investor provided valid information but did not advise its AI of an update, the AI should not be held liable for this, unless it did not request the renewal of the document/form required once it expired. The FIs' liability should be applied in the context of the KYC rules but should not be further extended.

11.4.4.10 IDENTIFICATION OF THE APPLICABLE TAX RATE

498. **Responsibility of the AI.** Both Models consider that the AI that originally pools the information has to be able to determine the applicable tax rate for the Investors that could benefit from relief at source. The FI has therefore the responsibility to identify the tax rate for all its DAHs and IAHs (holding their securities via one or more CIs).

From a global perspective, FIs expect a rather negative impact from the identification of the applicable WHT rate. A general implementation of relief at source will accelerate the process to benefit from a reduced tax rate. Coupled with the implementation of the standardised relief at source process, it will allow the FIs to extend their relief at source services to potentially all the MSs and to Investors from all the participating countries. This means that the tax services of the AIs will have to be able to determine the tax rate applicable in, potentially, all the MSs and third countries participating in the system. Given that the applicable tax rate could vary from one Investor type to the other, as well as from one income type to the other, the determination of these tax rates requires an extensive knowledge of the tax regulations applied in the various MSs.

The new system will not simplify the identification of the exact WHT rate that should be applied to an Investor. Many FIs have highlighted the difficulties and the costs resulting from the analysis of specific local tax regulations in the current situation. Given the liability of the AI described in both future Models (cf. above), this task will require FIs to maintain in operation teams of people with a broad tax experience, which can be expected to entail a cost

in terms of human resources and training. In addition, sometimes they will have to bear costs of local tax consultants or lawyers.

There is a great disparity in the perception of this issue across the financial sector. Some FIs mention that they do not consider this aspect as problematic. However, many FIs have clearly stated that they expect a very negative impact from this factor. This negative perception is related to the liability of the AIs in a context of greater complexity. It is therefore highly important that the Models include communication tools providing clear guidelines by Tax administrations and these guidelines are updated on a regular basis. AIs should be allowed to rely on this information and should not be held liable for a wrong WHT rate, if they can demonstrate that they have acted in accordance with these guidelines.

11.4.4.11 MANAGEMENT OF THE CONTRACTUAL AGREEMENTS

499. **New Service within AIs.** In the context of the SC Model, the SCs will enter into an agreement with the various AIs. This implies the signature and the follow-up of potentially several hundreds of contractual agreements. This responsibility cannot be simply added to those of an existing team. This will require specialised staff.

This constraining factor should impact the AIC Model to a lower extent given that, under this Model, SCs should not sign any agreements with FIs and that the recognition of the AIs would be done through an administrative procedure based on common conditions and requirements agreed between all MSs

11.4.4.12 MANAGEMENT OF THE DATABASES

500. **Responsibility of the AI.** The content of the reports is similar in the SC Model and the AIC Model and requires detailed information. Moreover, the information is disseminated over several different databases and so the systems will have to be able to extract and potentially match/compare information from different locations. All the FIs expect a negative impact from the Models in terms of database management. The FIs's position currently varies considerably in this respect. Some FIs have already developed complex and exhaustive databases and should not face major investment costs to implement the new Models. However, others still have a lot of information on paper or have not standardised the format of their databases. For such institutions, the implementation of the new systems could represent an important cost.

11.4.5 CONCLUSION

501. **Summary Table.** The table below summarises the findings in terms of simplification and constraining factors. To show whether a specific element tends to be rather simplifying or constraining compared with the current situation, the following scale was used:

- Factor ---: The stakeholder expects a very negative impact
- Factor --: The stakeholder expects a negative impact
- Factor -: The stakeholder expects a rather negative impact

- Factor =: The stakeholder expects no differences
- Factor +: The stakeholder expects a rather positive impact
- Factor ++: The stakeholder expects a positive impact
- Factor +++: The stakeholder expects a very positive impact

The results mentioned in the summary table represent averages. Sometimes, they do not reflect the high diversity in the results obtained via questionnaires and interviews. The first table does not differentiate between the SC Model and the AIC Model as most of the elements are common to the two Models.

SIMPLIFICATION FACTORS	FI
Identification of the Investor (from CoR to ISD)	+
General implementation of relief at source	+++
Pooled information	++
Procedures and data standardisation	+++
Information exchange via electronic format	++
Control of tax returns	=
Possibility to offer relief at source to foreign Investors	++
EU legal framework	=

Table 39: Summary Table - Simplification Factors

CONSTRAINING FACTORS	FI	
	SC	AIC
Workload resulting from the reporting	--	-
Audits	--	--
Liability of the AI	---	---
Identification of the applicable tax rate	-	-
Management of the Contractual Agreements	-	=
Management of the databases	-	-

Table 40: Summary Table - Constraining Factors

11.5 THE IMPACT ON INVESTORS

11.5.1 INTRODUCTION

502. The following analysis is aimed at evaluating the impact for the Investors due to the implementation of the AIC or SD Model. So the analysis hereafter is mainly focused on the future situation for the investors. Moreover, a macro model (see Appendix 30) is used to predict the potential gains (in monetised values) linked to the fact that the relief at source procedure will be facilitated/encouraged in the future situation.

11.5.2 CURRENT VS. FUTURE SITUATION

503. **Current situation.** The investors can benefit from a refund and/or a relief at source procedure. Putting in place those procedures does not mean for the Investors that they will effectively use it. It appears that certain Investors do not claim the reduced tax rate for several reasons (e.g. complexity of the procedure, small amount of money invested). The literature review performed does not allow an accurate estimation of the cost incurred by the Investors in the current situation.

504. **Future situation**. In the future situation, the Investors will be affected, as the other stakeholders, by the implementation of the Models. The following analysis addresses the potential impacts, from a qualitative point of view, for the Investors. Only the positive impacts for the Investors are described below (i.e. if no impact is expected for a particular point, it has not be further addressed).

11.5.2.1 IDENTIFICATION OF THE INVESTORS

505. **From Certificate of Residence to Self-Certification.** Moving from the Certificate of Residence to a self-certification principle is a factor that will have simplification impacts for the Investors. Indeed, for countries charging their tax residents for the issuance of a Certificate of Residence, the new system will generate an economy corresponding to the fee applied. Moreover, it will save time for Investors residing in a country where, in the current situation, the Certificate of Residence or the applicable document cannot be delivered to the FI but only to the Investor directly.

However, the self-certification system can also comprise a constraint (similar in both Models) for the Investors. Indeed, each Investor who wants to benefit from relief at source will have to provide such declaration. Moreover, in order to limit the cost for the FIs, this process can include a condition implying that Investors will be required to update themselves the changes in their status/personal data.

11.5.2.2 GENERALISATION OF RELIEF AT SOURCE

506. **Increased Volume.** As the introduction of the contemplated Models will increase the number of relief at source requests (especially considering that many countries do not currently apply any DTT relief at source procedure), AIs will bear an operational cost. In general, this cost is finally borne by the Investors in that some fees will be deducted from the

tax amount refunded. The amount of the original securities income thus has to be relatively important to make a refund claim worthwhile from an Investor's perspective (223).

The relief at source provided in both Models being lighter in terms of workload, the cost per transaction for AIs should be lower (if not marginal), meaning that the fees deducted from the tax amount refunded should be marginal, too. In practice, it should enable Investors to benefit from DTT benefits on almost any cross-border securities income (interest/dividends), whatever its gross amount. Some FIs confirm that, in the context of the Models, the fees and the threshold to benefit from relief at source would be lowered, if not removed.

Another important advantage for Investors is the timing. The relief at source procedure will allow Investors to receive their cash on payment date while the refund procedure may require up to several years before the cash is actually credited to the beneficial owner's account. Therefore investors won't suffer anymore cash-flow disadvantages.

11.5.2.3 POSSIBILITY TO OFFER RELIEF AT SOURCE TO FOREIGN INVESTORS

507. **Relief for Foreign Investors**. Currently, some FIs offer the relief at source and refund services only to Investors having their tax residence in the FIC. They consider the administrative work involved in providing the relief at source service to foreign Investors too onerous. Indeed, it would require FIs to contact the administrations of the various RCs, sometimes at local level, to obtain all the required forms, such as the Certificate of Residence. If the relief at source procedure is open to all Investors, i.e. the resident and non-resident, the Investors will have a benefit.

11.5.3 MACRO IMPACT AT INVESTORS LEVEL

508. This section analyses the economic impact that the new system could have on the tax revenue for the Investors. This analysis considers the differences between dividends and interest as well as the differences that could arise from the local tax regulation. The model itself and the methodology used is described in Appendix 30.

11.5.3.1 OVERVIEW OF THE MACROECONOMIC IMPACT

509. **Increase of the Income.** The decrease of tax revenue on the side of MSs corresponds to an increase of the net income paid to Investors. As highlighted for the impact on MSs, the direct financial impact of EUR 4,07 bn will be mitigated by secondary taxes applied by the RCs. However, the annual gain for Investors is significant.

510. **0,05% of Investors' Portfolio.** For Investors, the loss resulting from the unclaimed WHT amount corresponds to 0,05% of the cross-border investment portfolio. At first sight, this amount could appear relatively low and could raise the question of the interest of a system with such low return. However, this return and the amount it represents, EUR 4,07 bn, should be balanced with the total cost that will result from this system. It is not possible at this

223 Not considering the fact that, where the refundable amount is not sufficient, tax administrations are often allowed not to grant any refund at all (minimum threshold for refund).

stage to calculate the final implementation cost of both Models, but it is clear that, even considering the development, implementation and maintenance costs, they will not exceed this amount of EUR 4,07 bn per year. Moreover, this amount is likely to increase given the increase in the amount of cross-border investments observed in the last decade.

	CROSS-BORDER INVESTMENTS	CLAIMABLE WHT	UNCLAIMED WHT	UNCLAIMED WHT VS. INVESTMENT
DIVIDENDS	2.656,40	3,74	0,933	0,04%
INTEREST	6.313,85	12,59	3,13	0,05%
TOTAL	**8.970,25**	**16,28**	**4,07**	**0,05%**

Table 41: Overview of the impact at investor level (bn EUR)

511. **Distribution by MSs**. As for the repartition of the amount of unclaimed WHT, the distribution of the cross-border income by the Investors' country of origin is impacted by the economic weight of the country and the local tax regulations.

- **Economic weight**. MS having a more significant economic weight are part of the biggest cross-border Investors' countries and there is a logical correlation between the GDP of a MS and the cross-border investments of its tax resident (individual and companies). It is therefore not surprising that the major economies of the EU appear in the first rows of the table.

- **Local tax regulations**. The local tax regulation also has an impact. A favourable tax regime attracts financial institutions and funds management firms. The funds and other CIVs located in these MSs will considerably increase the cross-border investments from these countries. This explains the third and fourth position of Ireland and Luxembourg. However, these structures are investment firms and have often tax specialists among their employees. So, when they are entitled to a reduced tax rate, they usually already benefit from it in the current situation as they have the expertise and the resources required to effectively request authorisation to apply the DTT (224). Consequently, it is likely that the figures mentioned in the below table are too high, as the rate of unclaimed WHT is lower than the average 25% used for this calculation.

224 On the other side however CIVs do not always benefit from access to treaty rates, or only partially. In that respect, please refer to the section 3.2 Assumptions (paragraph 15 and to the OECD study "The granting of treaty benefits with respect to the income of collective investment vehicles" (2010).

INVESTORS' RC	UNCLAIMED WHT FROM DIVIDENDS	UNCLAIMED WHT FROM INTEREST	TOTAL UNCLAIMED WHT
AUSTRIA	17,191	84,055	101,246
BELGIUM	42,530	59,656	102,186
BULGARIA	0,212	0,570	0,782
CYPRUS	0,304	7,222	7,526
CZECH REPUBLIC	2,600	5,411	8,011
DENMARK	15,321	17,992	33,313
ESTONIA	0,608	0,725	1,333
FINLAND	33,155	26,001	59,156
FRANCE	117,109	945,917	1063,026
GERMANY	79,839	617,979	697,819
GREECE	0,620	35,527	36,147
HUNGARY	2,121	0,147	2,268
IRELAND	135,103	366,932	502,034
ITALY	47,789	73,138	120,927
LATVIA	0,186	0,154	0,340
LITHUANIA	0,274	0,413	0,687
LUXEMBOURG	129,172	332,266	461,437
MALTA	0,047	3,815	3,862
NETHERLANDS	60,871	214,329	275,200
POLAND	0,748	0,028	0,776
PORTUGAL	6,127	24,827	30,954
ROMANIA	0,265	0,151	0,416
SLOVAKIA	0,266	16,878	17,145
SLOVENIA	0,754	3,483	4,237
SPAIN	25,826	104,510	130,337
SWEDEN	43,341	18,939	62,280
UNITED KINGDOM	170,936	173,456	344,392
TOTAL	**933,315**	**3134,522**	**4067,837**

Table 42: Overview of the impact at investor level - Distribution per MS (million EUR)

Contrary to the repartition of the tax revenue decrease, all the MSs are impacted by the increase of the net income paid to Investors. The reason for this is that, while a favourable tax regime could increase the amount of cross-border investments from a country, a less favourable regime cannot bring it to zero as Investors will still look to diversify their portfolios geographically. The Investors from all the MSs will therefore benefit from a standardised relief at source system.

11.5.4 CONCLUSION

512. **Summary Table.** The table below summarises the findings in terms of simplification and constraining factors for the Investors. As mentioned above, only the simplification factors that lead to a real positive impact for the Investors have been analysed in details. In the below table, all the potential simplification factor are indicated, even those with no real impact for the Investors. To show whether a specific element tends to be rather simplifying or constraining compared with the current situation, the following scale was used:

- Factor ---: The stakeholder expects a very negative impact
- Factor --: The stakeholder expects a negative impact
- Factor -: The stakeholder expects a rather negative impact
- Factor =: The stakeholder expects no differences
- Factor +: The stakeholder expects a rather positive impact
- Factor ++: The stakeholder expects a positive impact
- Factor +++: The stakeholder expects a very positive impact

The results mentioned in the summary table represent averages. Sometimes, they do not reflect the high diversity in the results obtained via questionnaires and interviews. The first table does not differentiate between the SC Model and the AIC Model as most of the elements are common to the two Models.

SIMPLIFICATION FACTORS	INV.
Identification of the Investor (from CoR to ISD)	+
General implementation of relief at source	+++
Pooled information	+
Procedures and data standardisation	+++
Information exchange via electronic format	=
Control of tax returns	=
Possibility to offer relief at source to foreign Investors	=
EU legal framework	=

Table 43: Summary Table - Simplification Factors

CONSTRAINING FACTORS	INV.	
	SC	AIC
Workload resulting from the reporting	=	=
Audits	=	=
Liability of the AI	=	=
Identification of the applicable tax rate	=	=
Management of the Contractual Agreements	=	=
Management of the databases	=	=

Table 44: Summary Table - Constraining Factors

Logically, both Models present operational simplification and constraining factors for the various stakeholders. The assessment of such balance between simplification factors and constraining factors will be further addressed later on in the study in the framework of the cost-benefit analysis.

11.6 THE EU BUDGET IMPACT

11.6.1 INTRODUCTION

513. **Scope.** This section will assess the cost impact of the implementation of a standardised relief at source system on the EU budget. This means that only the future situation is analysed on the basis of data collected from the Commission via a questionnaire and interviews. The assessment of the EU budget is based on the comparison of the two systems in scope of this study, being the AIC Model and the SC Model.

514. **Investment phase vs. operational phase.** In order to make the impact assessment on the EU budget, a distinction between the set-up and development phase (phase 1) and the maintenance phase (phase 2) has been made as the cost impact will differ according to these two successive phases:

- The set-up and development phase, hereinafter referred to as "the investment phase" (phase 1): the Commission, in consultation with the other stakeholders, will invest in developing and launching the new system. The costs related to this phase are considered as one-time costs.

- The maintenance phase, hereinafter referred to as "the operational phase" (phase 2): it will be include all the major costs that the Commission will have to bear to keep the system operational. The costs related to this phase are called recurring or operational costs.

515. **Estimated duration between six and seven years**. It can be expected that the first phase will last approximately between 18 months and 24 months, depending on the meetings with the different MSs and the agreements that will be reached. For the purpose of the study, a duration of 18 months has been considered as an assumption for the calculations. In regards the second phase, a period of five years has been used to estimate the recurring or operational

costs that relate to this project. Please note that both time-periods are elapsed time estimates and that the effective duration of each phase can be shorter.

11.6.2 MAJOR COST IMPACTS ON THE EU BUDGET

516. **Cost elements.** Different types of cost are considered: IT, staff, meetings, training and external service providers. These cost elements will be discussed in more detail in the following sections.

11.6.2.1 IT COSTS

517. **IT cost components.** The IT costs can be broken down into a number of components as presented in the below table for each Model in scope. If the cost components are the same under both models, the implementation of the SC Model will imply an extra test platform. This platform will be aimed at testing the relations between all the AIs and the SCs (i.e. MSs). This will have an effect on all the IT cost components:

IT COMPONENTS	AIC MODEL	SC MODEL
Specifications	The specifications of the systems will be discussed and agreed by the different MSs through a number of meetings.	The extra test platform will need to be discussed and agreed in a number of meetings with the MSs and the Commission.
Development	The Commission develops the systems that are under its responsibility (in reference to this project, this will mainly be the development of a test and support platform).	The additional test platform will need to be developed by the Commission.
Maintenance	In the maintenance step, the Commission will maintain the systems (e.g. the helpdesk and the test and support platform).	Due to the fact that the platform will be designed to support the SCs (i.e. MSs) and the AIs, and that there is currently no relation between these two parties, an extra effort in respect of the maintenance of the platform can be expected.
Support	Support offered to the different stakeholders (i.e. MSs, AIs, FIs etc.).	Due to the new platform and the fact that there is currently no direct relation between the AIs and the SCs (i.e. MSs), it is expected that the support unit need to be increased in order to cover all the problems and that it

IT COMPONENTS	AIC MODEL	SC MODEL
		will be kept operational beyond the investment phase.
Conformance testing	Integration test with the different stakeholders (i.e. MSs, AIs, FIs etc.)	Due to the extensive number of relationships (i.e. all the AIs with the SCs), it is expected that the conformance testing costs will increase.
CCN and support (ITSM)	CCN and support by ITSM, the contractor of the Commission that is in charge of the operations of all the Taxation and Customs Trans-European Systems and Applications.	The network will be used more and there is also the issue of protecting the information.

Table 45: The IT cost components under the two models

518. It should be noted that costs such as licences for software, servers and IT materials are not included in the IT Costs. This also pertains to costs for IT personnel, as far as they are part of the internal Commission staff, and costs for training of personnel as they are taken into account in other sections of this analysis.

519. Based on the previous assumptions (i.e. mainly the fact that the SC Model will require an extra test platform), the following multiplication factors for the different IT costs components will be applied in case the SC Model is adopted in reference to the AIC Model (225).

IT COST COMPONENTS	MULTIPLICATION FACTOR FOR THE SC MODEL
Specifications	1,3
Development	1,3
Maintenance	1,5
Support	2
Conformance testing	2
CCN and support by ITSM	1,3

Table 46: SC multiplication factors according to the IT cost components

225 The value of the multiplication factors have been communicated by the European Commission.

520. **In the investment phase**. The impact of the IT cost components on the EU Budget in the investment phase are presented in the following table.

PHASE 1: SET-UP AND DEVELOPMENT	MULTIPLICATION FACTOR	0 – 6 MONTHS	6 – 12 MONTHS	12 – 18 MONTHS
Implementing the AIC Model				
Specifications		180.000€	120.000€	120.000€
Development		0€	55.000€	55.000€
Maintenance		0€	10.000€	10.000€
Support		0€	5.000€	5.000€
Conformance testing		0€	0€	0€
CCN and support by ITSM		0€	0€	0€
TOTAL		**180.000€**	**190.000€**	**190.000€**
TOTAL of Phase 1 - AIC adoption				**560.000€**
Implementing the SC Model				
Specifications	1,3	234.000€	156.000€	156.000€
Development	1,3	0€	71.500€	71.500€
Maintenance	1,5	0€	15.000€	15.000€
Support	2	0€	10.000€	10.000€
Conformance testing	2	0€	0€	0€
CNN and support by ITSM	1,3	0€	0€	0€
TOTAL		**234.000€**	**252.500€**	**252.500€**
TOTAL of Phase 1 - SC adoption				**739.000€**

Table 47: IT investment costs in case the AIC Model or the SC Model is implemented (Set-up & development)

521. **Major impact of per type of component**. The previous table shows that the specifications component will have the biggest cost impact during the investment phase of the project. In the specifications component, the MSs and the Commission will identify the specific needs (i.e. functional and technical requirements) of the systems and what is necessary in order to build such systems. Therefore the first half year of the investment phase will only consist of the specifications cost component. Another (major) cost impact, as from the second half year, is the development of the systems.

522. **Lower cost resulting from the AIC model in the first phase**. Even if there is no relative difference between the AIC Model and the SC Model, there is an important cost difference in absolute terms as the SC Model would imply a cost increase of 32% compared to the AIC Model.

523. **In the operational phase**. The Commission anticipates the following costs in the second phase of the project: maintenance, support, conformance testing and common communications network and support. It should be noted that in the operational phase, no costs are foreseen in reference to the specifications and development cost components, because these cost components are entirely related to the investment phase.

PHASE 2: MAINTENANCE	MULTIPLICATION FACTOR	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
Implementing the AIC Model						
Specifications		0€	0€	0€	0€	0€
Development		0€	0€	0€	0€	0€
Maintenance		50.000€	10.000€	10.000€	10.000€	10.000€
Support		10.000€	15.000€	5.000€	5.000€	5.000€
Conformance testing		400.000€	150.000€	50.000€	50.000€	50.000€
CCN and support by ITSM		240.000€	480.000€	480.000€	480.000€	480.000€
TOTAL		**700.000€**	**655.000€**	**545.000€**	**545.000€**	**545.000€**
TOTAL of Phase 2 - AIC adoption						**2.990.000€**
Implementing the SC Model						
Specifications	1,3	0€	0€	0€	0€	0€
Development	1,3	0€	0€	0€	0€	0€
Maintenance	1,5	75.000€	15.000€	15.000€	15.000€	15.000€
Support	2	20.000€	30.000€	10.000€	10.000€	10.000€
Conformance testing	2	800.000€	300.000€	100.000€	100.000€	100.000€
CCN and support by ITSM	1,3	312.000€	624.000€	624.000€	624.000€	624.000€
TOTAL		**1.207.000€**	**969.000€**	**749.000€**	**749.000€**	**749.000€**
TOTAL of Phase 2 - SC adoption						**4.423.000€**

Table 48: IT investment costs if the AIC Model or the SC Model is implemented (Maintenance)

524. **Major impact of the conformance testing and CCN**. The table above shows that, in the first operational year, the conformance testing costs will be the biggest part of the total cost. The systems that are specified and developed in the investment phase will be extensively tested. In the following years, the Commission expects that the CCN and support will bear the largest proportion of the total cost. Moreover, the Commission will be responsible for supporting the different stakeholders in order to keep the system operational and to guarantee the proper functioning of the system. The maintenance and support costs represent only a small part of the total cost.

525. **Lower cost resulting from the AIC model in the second phase**. Even if the conformance testing component represents a major cost in the second phase, the cost impact would be higher under the SC Model (48% higher in terms of total cost incurred over five years). The main reasons for this difference relate to the increase in testing demand if the SC Model is implemented, and the necessity to develop an additional platform, as described above. For both the Models the first year of the operational phase will be the most burdensome for the Commission. Due to the multiplication factor of two for the CCN cost component in case the SC Model would be adopted, the cost will be 70% higher compared to the AIC Model in the first operational year.

526. **Quality assurance cost**. The quality assurance cost can be important and should be considered. It is an important element of the methodology used to deploy the customs/taxation systems. This cost is not included in the analysis.

11.6.2.2 STAFF COSTS

527. **Staff costs.** Our understanding of staff costs relate to the human resources (internal staff) that are necessary to perform the tasks identified in the different phases when a standardised relief at source system (i.e. AIC Model or SC model) would be implemented. In order to set up, develop and maintain the IT-systems discussed in the previous section, it is important to have sufficient and qualified staff. Therefore, the implementation of the selected Model will be supported by a balanced mix of six different functions and levels of expertise that will devote time to the project. Depending on the Model that is adopted, the time spent of the staff will differ as represented in the following table.

INVESTMENT PHASE		
Profile	***AIC***	***SC***
Business Project Manager	40%	40%
Technical Business Manager	40%	60%
IT Project Manager	40%	60%
Technical IT Manager	40%	100%
Administrative support (Assistant)	20%	40%
Administrative support (Secretary)	20%	40%
OPERATIONAL PHASE		
Profile	***AIC***	***SC***
Business Project Manager	16,66%	16,66%
Technical Business Manager	16,66%	25%
IT Project Manager	16,66%	16,66%
Technical IT Manager	16,66%	25%
Administrative support (Assistant)	16,66%	25%
Administrative support (Secretary)	16,66%	25%

Table 49: Time spent (%) if the AIC and if the SC Model is implemented

528. **In the investment phase.** Based on the time spent percentages in the previous table and the annual gross wage levels of the different functions, the expected staff costs in the investment phase are as follows.

Phase 1: Investment phase	% of FTE	Duration (months)	Duration (years)	Annual gross wage level	Total Cost
Implementing the AIC model					
Business Project Manager	40%	4,8 months	1,5 year	96.00 €	57.600€
Technical Business Manager	40%	4,8 months	1,5 year	96.000€	57.600€
IT Project Manager	40%	4,8 months	1,5 year	96.000€	57.600€
Technical IT Manager	40%	4,8 months	1,5 year	72.000€	43.200€
Administrative support (Assistant)	20%	2,4 months	1,5 year	48.000€	14.400€
Administrative support (Secretary)	20%	2,4 months	1,5 year	48.000€	14.400€
TOTAL					**244.800€**
Implementing the SC model					
Business Project Manager	40%	4,8 months	1,5 year	96.000€	57.600€
Technical Business Manager	60%	7,2 months	1,5 year	96.000€	86.400€
IT Project Manager	60%	7,2 months	1,5 year	96.000€	86.400€
Technical IT Manager	100%	12 months	1,5 year	72.000€	108.000€
Administrative support (Assistant)	40%	4,8 months	1,5 year	48.000€	28.800€
Administrative support (Secretary)	40%	4,8 months	1,5 year	48.000€	28.800€
TOTAL					**396.000€**

Table 50: Staff cost if the AIC Model or the SC Model is implemented (Investment phase)

529. **Cost impact of the staff costs in the investment phase.** During the set-up and development of the different IT-systems in the investment phase, it is estimated that the technical profiles will devote 40% of their time, in case the AIC Model would be adopted. If the SC Model would be adopted, it is estimated that staff will devote more time to the set-up and development of the different IT-systems due to the extra test platform that needs to be developed. This results in a (internal) staff cost of EUR 244.800 if the AIC Model is adopted, and of EUR 396.000 if the SC Model is adopted (i.e. a staff cost increase of 62%).

530. **Additional costs in the operational phase.** As the adopted system needs to be maintained and kept operational by the Commission, additional staff costs needs to be accounted for. The number and the qualifications of the employees already included in the investment phase remains the same. However, the percentage of their working time will decrease (i.e. 17% under the AIC Model and 17 to 25% under the SC Model).

The total staff cost is EUR 380.000 under the AIC Model and EUR 490.000 under the SC Model. This implies a 28% higher 'operational' cost if the SC Model is implemented. This is due to the fact that the Commission will be more closely involved in testing the system and offering support to the MSs and AIs. The Commission expects that the link between the AIs and the SCs and the relations between SCs and RCs, in case the SC Model is implemented, will raise a number of questions and will involve testing requirements. Therefore the Commission estimates that the test and support platform will not be limited to the investment phase in order to solve the problems and issues for the different stakeholders (mainly the AIs).

531. **Organisational structure.** No any major impact on the organisational structure expected. This is because the units and/or departments that are already in place will stay in place, unchanged, and will be able to work on the implementation of a standardised relief at source system as the current internal human resources already have the knowledge and capabilities to lead the project.

However, it clearly appears that, if the amount of internal human resources is not expected to be changed, there will be a prioritisation of the projects led by the DG TAXUD. This means that certain other projects would be postponed or cancelled to concentrate the efforts of the staff on the standardised relief at source system. This represents an opportunity cost for the Commission that is not subject to cost estimation at the moment.

11.6.2.3 MEETING COSTS

532. **Meetings with MSs and other stakeholders**. A series of meetings with the different MSs and other stakeholders will need to be organised by the Commission in order to manage and assist the development and maintenance of the selected model to be implemented (226). Of course the number of meetings will have an impact on the total cost. It should be noted that the costs that are reported in this section are the maximum costs (i.e. maximum occurrence of the meetings multiplied by the cost of the meeting).

There are two types of meetings that will be organised by the Commission in the two phases analysed:

- **CACT working group meeting or similar working group meetings -** regular meetings with representatives of every Member State to discuss the project. The total cost for this type of meeting is estimated at EUR 12.800 based on the information provided by the Commission.
- **Project group meetings** - the project group consists of a limited number of MSs that volunteered to participate to a certain project. The project group can prepare and facilitate the work of the CACT or other similar working group in order to speed up the process. The total cost for this type of meetings is estimated at EUR 8.450 based on the information provided by the Commission.

533. **Estimated cost for the investment phase**. In the investment phase, the Commission expects a total cost of EUR 170.250 for the AIC Model and EUR 225.550 for the SC Model. This cost difference is explained by the higher number of meetings required under the SC Model (in reference to the AIC Model) to ensure that:

- functional and technical specifications of the extra test platform are produced;
- the extra test platform can appropriately be tested;

226 It should be noted that Council Meetings in reference to discussing possible proposals are not included in the Meeting Costs.

all means are in place for proper communication between the different relationships (i.e. the AI and the SC, and between the SC and the RC). As the number of meetings necessary if the SC Model is implemented will be one third higher, this model entails a cost increase of 32% for the Commission.

PHASE 1: INVESTMENT PHASE	OCCURRENCE	COST PER MEETING	TOTAL COST (MAX)
Implementing the AIC Model			
CACT working group	8-10	12.800€	128.000€
Project group	5	8.450€	42.250€
TOTAL			**170.250€**
Implementing the SC Model			
CACT working group	10-13	12.800€	166.400€
Project group	6-7	8.450€	59.150€
TOTAL			**225.550€**

Table 51: Investment meeting costs if the AIC Model or the SC Model is implemented

534. **Estimated meeting costs in the operational phase.** If the AIC Model is adopted, the Commission will organise two meetings – that are supported by the FISCALIS programme – during the operational phase. Next to these meetings, the Commission will also organise every year two CACT working group meetings. If the SC Model would be adopted, we assume that the number of meetings will be one third higher in reference to the adoption of the AIC Model to ensure that the extra test platform is tested, as well as to ensure that all means are in place for proper communication between AI and SC, and between SC and RC. This causes a total meeting cost of EUR 338.000. As for the operational phase, the number of meetings under the AIC Model is one third higher for the SC Model. This results in a total cost of EUR 481.400 as presented in the below table.

PHASE 2: MAINTENANCE	OCCURRENCE	COST PER MEETING	TOTAL COST (5 YEARS)
Implementing the AIC Model			
CACT working group	10	12.800€	128.000€
FISCALIS seminar	2	105.000€	210.000€
TOTAL			**338.000€**
Implementing the SC Model			
CACT working group	13	12.800€	166.400€
FISCALIS seminar	3	105.000€	315.000€
TOTAL			**481.400€**

Table 52: Recurring meeting costs if the AIC Model or SC Model is implemented

11.6.2.4 TRAINING COSTS

535. **Training developed by the Commission**. The Commission will provide a number of training sessions in order to inform internal and external parties of the functionalities of the system that will be implemented.

536. **Training costs in the investment phase**. In the investment phase of the project, the Commission will develop the e-learning module to be used in the operational phase to inform and train internal and external parties. If the SC Model would be adopted, an additional e-learning module will need to be developed in order to train the AIs (in reference to the adoption of the AIC Model). Based on a similar study that has been recently carried out, the average cost of developing an e-learning module is EUR 40.000. Consequently, the training costs under the SC Model would amount to EUR 80.000, compared to EUR 40.000 under the AIC Model.

537. **Training costs in the operational phase**. Only during the first year of the operational phase are training costs foreseen for the two 'train-the-trainer' sessions that will be organised by the Commission. Based on a study that has been recently carried out, the average cost of a 'train-the-trainer' session is EUR 10.000. If the SC Model would be adopted, we foresee that the Commission will have to organise four 'train-the-trainer' sessions due to the additional e-learning module for the AIs. The total cost in this second phase is then estimated at EUR 20.000 under the AIC Model and at EUR 40.000 under the SC Model.

11.6.2.5 COMMUNICATION/EDUCATION/PROMOTION COSTS

538. **Communication, education and promotion costs.** The Commission will be responsible for organising a series of communication channels in order to inform the businesses and the European citizens of the impact of the Model that will be adopted. An example of a communication channel is the Commission's website or a website that is built with the aim of informing citizens (it should be noted that if a website is built, this will have a significant impact on the communication, education and promotion costs). In general, besides the ones mentioned above, no additional substantial costs in reference to the communication and promotion costs are expected.

11.6.2.6 EXTERNAL PROVIDERS' COSTS – THIRD-PARTY CONTRACTORS

539. **Use of external contractors**. In order to support the Commission in developing and implementing the selected Model, a number of external contractors will be associated with the effort. In the previous sections of this chapter, the Commission has already estimated the cost of external providers regarding IT, training and communication costs. Therefore, this section will only focus on other forms of support from external contractors, such as preliminary studies and assessment studies. It should also be noted that, apart from the cost invoiced by the external provider itself, the Commission will need to devote time (and thus human resources) to the preparation of the terms of reference and the selection of the offers finally submitted, next to the management of particular contractors.

540. **External providers' costs in the investment phase.** In the investment phase of the project, it is expected that one or two ex-ante studies will be needed if the AIC Model or the SC Model is adopted. These studies will focus on legal studies and/or studies designed to gather the necessary quantitative data to support an impact assessment.

541. **External providers' costs in the operational phase.** For the operational phase, there is no involvement of external providers expected.

11.6.3 OTHER IMPACTS ON THE EU BUDGET

542. **No additional major impac**t. It can be expected that no major additional investment costs in reference to this project are expected due to the fact that, at the moment, the AIC Model, SC Model or both are already integrated completely or partly at the different levels of stakeholders (i.e. MSs and AIs).

11.6.4 COMPARISON BETWEEN THE AIC MODEL AND THE SC MODEL

543. **Advantages of the AIC model**. As regards the technical format and specifications underlying the exchange of information, the AIC Model offers clear advantages compared to the SC Model:

- The AIC Model has already been developed by the tax administrations.
- The format and specifications have already been specified.
- The AIC Model has been used for several years, meaning that the stakeholders have already become acquainted with it to a certain extent.
- The format seems to work very well.

The AIC Model will be more efficient and less costly as it will not have to be tweaked to match the Savings Directive requirements whereas, under the SC Model, the format has not yet been specified (although work has already been carried out by TRACE Group).

11.6.5 IMPACT OF RUNNING TWO SYSTEMS IN PARALLEL

544. **Sum of the costs of both models**. The impact of both Models running in parallel on the EU budget should be estimated by adding up the costs of both models in order to obtain the total cost on the EU budget. The Commission also points out that there will be few possibilities for capitalisation, and no major economies of scale are anticipated.

11.6.6 CONCLUSION

545. **Higher cost for the SC Model than for the AIC Model**. The impact on the EU budget of implementing the AIC or SC Model has been quantified in the previous sections. Based on the cost estimations of the Commission regarding a number of major cost impacts, the conclusion can be drawn that the SC Model will have a bigger impact on the EU budget. The main cause for this higher impact is the more extensive requirement for testing if the SC

Model is adopted. The SC Model has more relationships that need to be tested through the direct link of all the AIs with the various SCs.

546. **42% higher cost for the SC Model in the first phase**. The following graphs summarise the costs related to each cost driver that has been discussed in the previous sections.

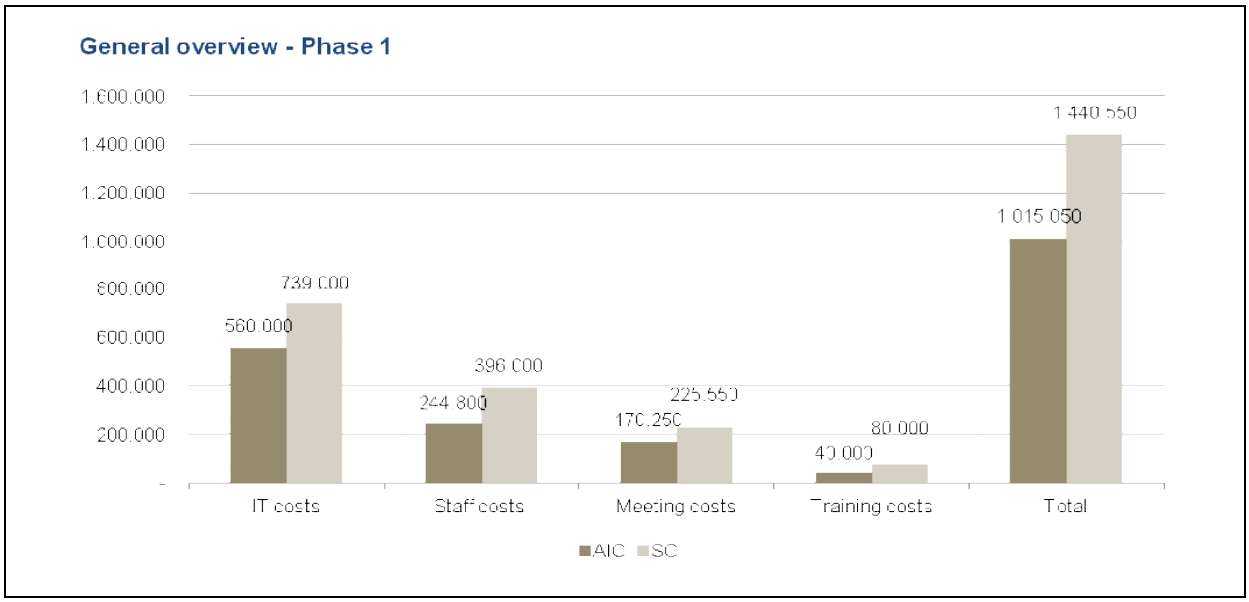


Table 53: General overview of phase 1 (Investment phase)

Based on the input of the Commission, the SC Model will have a 42 % higher impact on the EU budget, compared to the AIC Model. In absolute figures, the difference between the two models amounts to EUR 425.500 and the main contributors to this higher absolute figure are the IT costs and, to a lesser extent, the staff costs. The graph also shows that, for every cost driver identified, the SC Model has a higher cost in the investment phase, compared to the AIC Model.

547. **Prevalence of the IT costs**. The biggest impact on the EU budget in the investment phase will come from the IT costs that relate to the "implementation of a standardised relief at source system". The IT costs represent more than 50% of the total cost, and they represent the specifications and development of the system that will be adopted. Also, the staff costs will have an important impact on the EU Budget as they represent about 25% of the estimated total cost.

548. **46% higher cost for the SC Model in the second phase.** The following table shows that the total cost for the SC Model is 46% higher than for the AIC Model. The total cost difference in absolute figures is EUR 1.706.400, which is mainly due to the higher IT costs under the SC Model. The absolute difference in IT costs is EUR 1.433.000 or 84% of the total cost difference in absolute figures between the implementation of the AIC Model and the SC Model. Therefore, we can conclude that the biggest impact on the EU budget in the operational phase will come from the IT costs. To a lesser extent, the staff and meeting costs will also have an impact on the EU budget.

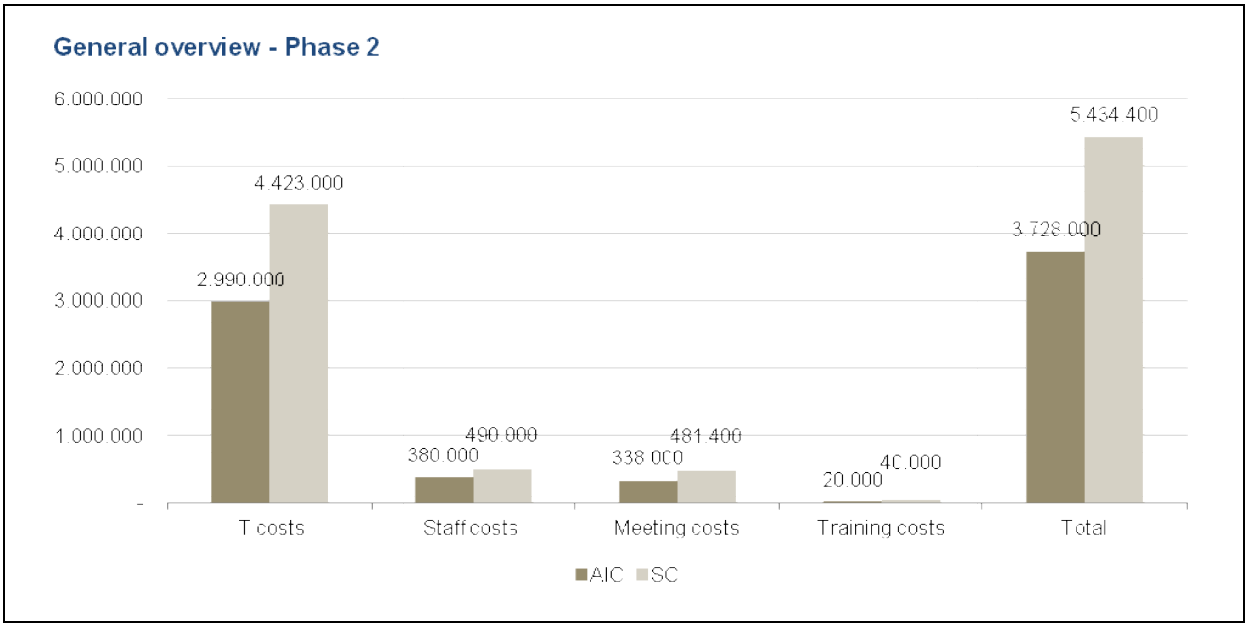


Table 54: General overview of phase 2 (Operational phase)

11.7 CONCLUSION

549. **Interest of the Standardised Relief at Source System vs. the Current Situation**. The CBA demonstrates the utility of having a standardised relief at source system, whichever the Model, compared to the current situation. The CBA highlights the various cost impacts that will have to be borne by the various stakeholders (the tax administrations of the MSs, the AIs or the Commission) as well as the potential gains (mainly from a qualitative perspective).

- **For the Tax administrations of the MSs**. Despite the great diversity of procedures available to apply the reduced tax rate under a DTT, it appears that the tax administrations will not have to act directly in the process to grant relief at source. However, this workload decrease (and corresponding cost reduction) can be expected to be, at least partially, offset by the workload increase resulting from the processing of the reporting and the feedback loop. Considering, in addition, the investment costs (IT, training, organisational and similar costs), MSs will not likely save money by implementing one of the contemplated Models. For example, the time to formulate and send the feedback to the other participating countries should increase by 55%.

  More than the costs related to the implementation and additional workload, some MSs fear the impact a general implementation of relief at source may have on their tax revenues. At EU level, MSs could face a decrease of EUR 4,07 billion in case all the cross-border Investors request to effectively benefit from it. However, this may not be considered as a loss resulting from the system as it results from the DTTs and the WHT rates granted and which Investors are entitled to. Actually, the MSs renounced this theoretical amount when they signed the DTTs. This amount of EUR 4,07 billion should in theory be redistributed to the Investors. MSs cannot count on the complex procedures for applying the WHT DTT rates to increase their tax revenue.

The MSs may obtain three main benefits. The first one is specific to the RCs and it relates to the verification of the validity of the request, the tax residence check being performed directly by the tax administration of the RC. The second is the receipt of detailed data on cross-border investments. The quality of the data should be higher than in the current EUSD if the appropriate level of filters is included in the IT solutions and if feedback remains mandatory for the tax administrations. This is useful for SCs but especially for RCs as they will be able to compare the data with the information included in the tax returns. This should generate a benefit for MSs, but it is difficult to value this benefit at this stage as it will mainly depend on the IT investments made by the MSs. Finally, the GDP increase of 0,016% at EU level will generate benefits for all stakeholders and should especially enable the MSs to generate additional tax revenue via other taxation tools.

- **For the Financial Sector**. The main interest for the financial sector is the simplification and the standardisation of the procedures that should allow the AIs to considerably reduce the average time spent on one request for refund/relief. Moreover, other operational gains can be achieved, including but not limited to, the reconciliation process or the credit of the amount refunded. From a purely operational perspective, these benefits should weigh up against the costs resulting from the IT implementation (up to 80% of the total one-time cost estimated).

  A few aspects deserve particular attention. First, the liability of the AI is seen as a liability and considered as too expensive as not limited to an error that could be attributed to an AI. A second obstacle is the audit by external auditors that generates additional costs. Finally, as the reduction of the time period and the simplification of the procedure should extend access to relief at source so as to include smaller Investors, it is possible that the volume increase mitigates the workload decrease.

- **For Investors**. They are the biggest beneficiaries of the new Models. Indeed, the Models should remove the time limitation as regards the time within which Investors can benefit from a reduced tax rate. And the simplification of the procedure should decrease the threshold applied by FIs to decide whether or not to apply for relief at source. As a consequence, more Investors will benefit from the reduced tax rate and they will receive their income within a shorter time. At EU level, if all the entitled Investors effectively request relief at source, they would receive US$ 6,32 billion based on 2010 figures.

- **For the EU**. It is difficult to pinpoint unequivocal benefits for the EU, apart from the fact the Models will contribute to the smooth functioning of the Internal Market. The EU needs to pay particular attention to the three main objectives: the Model implemented must ensure a smooth and fair communication between the various stakeholders; the Model must be simple and cost effective for businesses and the investors; the Model must be secure from fraud. At the same time, it is expected that the Commission will have to incur costs in contributing to the definition of the new Models (meetings, working groups etc.), in supporting the legislative work and the IT development, and in providing the required information to the local MSs' tax administrations. The cost incurred in the future situation varies from EUR 1 to 1,4 million for the investment phase and from EUR 3,7 to 5,4 millions.

550. **The Future Situation Is the Best Option**. The analysis by stakeholders demonstrates that the new system will be costly. However, the majority of the expected benefits (mainly analysed from a qualitative perspective) will more than likely be achieved and should compensate, or, depending on the stakeholders, partially compensate the costs. More importantly, the new situation will allow all Investors to benefit from a right that was formally awarded to them via DTTs, but which in practice they can hardly benefit from due to the many obstacles and barriers existing across the EU. Considering the reduced tax rate granted via the DTTs, the new Model should implement an efficient and secure process to ensure that this WHT rate is correctly applied. Moreover, it could certainly facilitate the cross-border provision of services by EU FIs.

551. **Interest of the AIC Model vs. the SC Model**. Some stakeholders are in favour of the SC Model, while others prefer the AIC Model. Generally speaking, there exists a preference for the AIC Model.

- **For the Tax administrations of the MSs**. The main differences between the SC Model and the AIC Model are the communication channels and the addition of another intermediary in the chain of the AIC Model, being the AIC. For many MSs, the addition of another intermediary having no direct interest would logically result in an increase of the total workload. However, the analysis of the expectation of the MSs in terms of workload increase demonstrated that the time devoted to the new process is considered by the MSs as lower under the AIC Model than under the SC Model.

  Moreover, a number of MSs highlighted the advantages that the AIC may derive from its functions and the improvement in terms of data quality that should result from its actions and checks. The AIC should also increase the centralisation and rationalisation of the feedback loop, which could be potentially burdensome if it is not handled efficiently.

  Finally, the implementation costs of the AIC Model should be mitigated by the capitalisation on existing infrastructures and processes, especially the current EUSD, while the SC approach requires laying a new basis (IT and processes).

- **For the Financial Sector**. The representatives from the financial services sector all highlight the importance of having only one Model and of avoiding the proliferation of reporting channels and mechanisms. Considering the current EUSD and recent FATCA developments, many FIs expressed a preference for the AIC approach, which would facilitate technical interoperability of the systems. Only a few FIs indicated a preference for the SC approach, based on the fact that the SC Model is the more suitable one to build a global system.

  Many FIs expressed a preference to maintain in contact with their own tax administration, rather than having contact with the tax administrations of all the SCs. In addition to the cultural, linguistic and legal difficulties, they point to the workload that would result from such communication channels.

- **For Investors**. For Investors, the fact that one or the other system is applied should not have a real impact, as long as the model is applied effectively by the various MSs. For Investors it is key to know which Model is the most likely to be applied by all the MSs vs. one which is only adopted by some MSs.

- **For the EU**. The impact on the EU budget would be 45% higher if the SC Model is implemented instead of the AIC Model. This difference is explained by the inability of the Commission to capitalise on the current EUSD to implement the SC Model, and by the fact that the SC approach would require standardisation between the MSs but also between the MSs and the AIs across the EU. This implies additional testing and development work.

552. **AIC Model Privileged**. Generally speaking, the AIC approach is preferred by most stakeholders. However, the ability to easily integrate third countries, as in the SC Model, is an aspect that needs to be considered and addressed in the future situation.

553. **Only One Model**. The problem of the integration of third countries is linked with another important aspect mentioned by all stakeholders, namely the importance of working with one Model. It is important that the selected Model demonstrates its ability to be adopted globally, and not only at EU level. This should be possible if MSs sign bilateral or multilateral agreements with third countries. Moreover, form an IT perspective, there are no technical obstacles for third countries to join the communication system already in use within the EU (CCN mail). The possible co-existence of the two Models is considered as viewed as negative by the MSs and especially by the FIs, which are often located in different countries and continents.

554. **Buy-in of the MSs and the Financial Sector**. Finally, it is important to highlight that both Models (in their current format) rely on the free participation of the AIs in the system. Therefore, it is crucial that the financial services sector across the EU supports the proposed Model. Some FIs find that the two Models are not acceptable, especially because of the extensive liability on the part of the AI. We recommend that the Commission does not limit its contacts to the business representatives that have been involved so far in the EU and OECD work in this area, but engage in further discussions with relevant stakeholders.

* * *

CHAPTER 12 HIGH-LEVEL IMPLEMENTATION PLAN

Based on the results from the previous phases, a high level implementation plan can be developed.. This implementation plan describes a suggested methodology and the various stages and phases to implement a standardised relief at source system, and provides an estimate of what seems to be realistic in terms of timing. The work plan also includes the actors and their roles in each of the phase. At the end of each stage, the outcome expected is mentioned. Each phase is described briefly to understand the activities that will need to be carried out. Similarly to the recommendations highlighted in the various sections of the current study, a pragmatic approach has also been used for the development of the implementation plan to allow prioritisation in terms of implementation.

* * *

12.1 METHODOLOGICAL GUIDELINES

555. **Transform Methodology.** The following figure illustrates the Transform Methodology and provides an overview of the different stages and dimensions used to implement the standardised relief at source system.

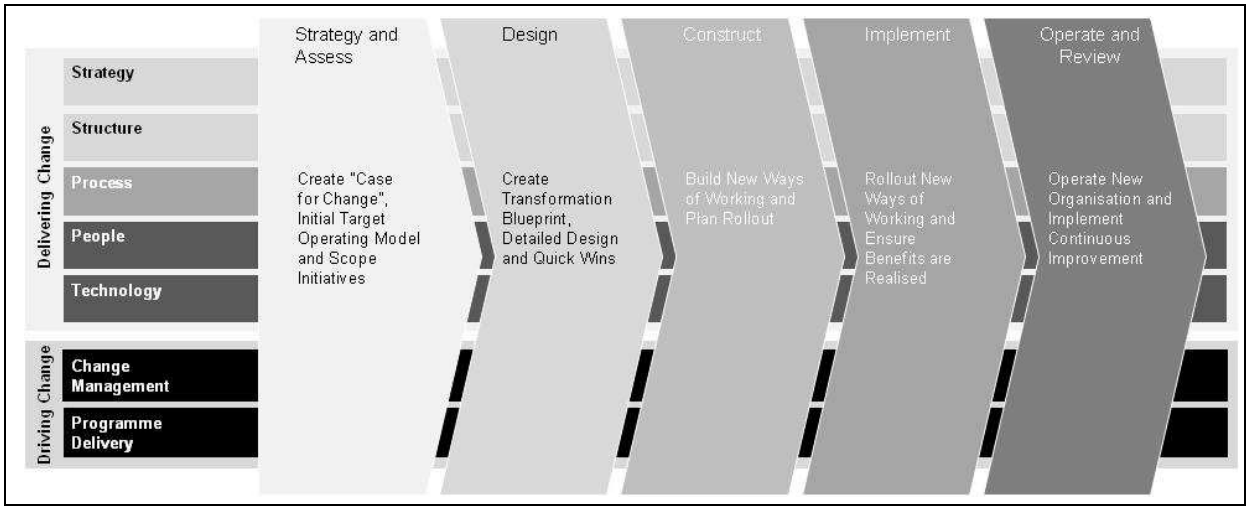


Figure 31: High-level view of "Transform", PwC's methodology for transformation programmes

556. **Five Stages**. The Transform methodology has five stages: Strategy and Assess, Design, Construct, Implement and Operate and Review. Each stage is subdivided into a step-by-step approach that has been adapted to fit the relief at source system .

- **Strategy and Assess**. This stage is about working out what the various stakeholders want to achieve from a standardised relief at source study, finding the most simple and effective Model for achieving the most efficient results in terms of cost and fight against fraud. A first high-level business case will be created;
- **Design.** In this stage, the concepts for the new and improved relief at source system will be designed, and the best way to make it happen will also be developed. A more detailed business case by way of support will also be drafted taking into account how long each step will take, what it will involve, and how much it is likely to cost, along with the expected benefits for the various stakeholders;
- **Construct.** This is the stage between designing the model for the standardised relief at source system and implementing it, where the detailed functional and technical designs and plans for putting it all into action are prepared. The legal texts are written, processes are defined in detail and the IT solution is developed and tested;
- **Implement.** The implement stage is when all the different parts of the roadmap are put into action for the first time. Participants, users and various other stakeholders will be trained to make the change stick;

- **Operate and Review**. This stage is about making sure that the change sticks over time, and that the Model implemented for a standardised relief at source system is continuously performing better and better.

557. **Dimensions.** Throughout the transformation, it is important to deliver and drive the change to make it stick.

- **Delivering Change.** The methodology looks at the bigger picture considering all the dimensions of strategy, structure, people, processes and technology at every stage.

- **Cross-Life Cycle Activities**. In addition to the five stages, there are tasks within the Transform framework that do not easily fit into a single stage. These tasks are referred to as *"Cross-Life Cycle"* activities and are either ongoing tasks around project and change management (such as communications and stakeholder engagement management) or tasks that need to be started early in the change initiative but cannot be completed until later in the programme. An example of the latter type of task is the benefits realisation process. The steps related to achieving the planned benefits are incorporated within the overall project plan, from project inception, but the detailed tasks and steps to realise the benefits will largely not be taken until the post-implementation phases are initiated.

12.2 HIGH-LEVEL WORK PLAN FOR THE STANDARDISED RELIEF AT SOURCE SYSTEM

558. **Timing.** The implementation plan, depicted in figure 29, estimates an elapse time of approximately 6 years to implement the standardised relief at source system (the system being live the first time). The last stage, "Operate and Review", is estimated to take between 18 months and 24 months to gain maximum benefits from the Model implemented. In total, the elapse time to implement the relief at source system is estimated to take between 3 years and a half to 4 years.

It is important to note that there are a lot of factors that cannot be estimated at this stage as they will strongly depend on the Model to be implemented, on the time it will take to obtain the buy-in from all stakeholders and on political motivation, priorities and decisions. As a consequence, the elapse time may take longer than what is currently assumed.

Some MSs and FIs mentioned that the SC Model could be implemented in a shorter time than the AIC Model, due to the fact that the unanimity of all MSs (inherent condition to the use of a Directive) is not required for the implementation of the SC Model, rather based on bilateral agreements. However, the OECD might wish to consider possible amendments to the Implementation Package with a view to reflecting the new context drawn by FATCA and the agreements that MSs and third countries are likely to sign with the US in the coming months. Moreover, this feasibility study provides some recommendations to increase the efficiency of the Model, which the OECD may wish to consider. Therefore, it does not seem very likely, that the SC Model would be implemented on a short-term basis, even if it could potentially be done in a shorter time than the AIC Model.

559. **Caveats.** In order to correctly interpret the implementation plan and understand the underlying risks, certain attention points need to be highlighted.

- **Unanimity and Political Agreement**. Referring to Chapter 6 dealing with the EU legal tools available, a Directive turned out to be the most appropriate binding legislative way to implement the AIC Model across the EU. If a Directive had to be chosen, it would have to be sufficiently detailed in order to ensure the uniformity required for a relief at source and exchange of information system to be efficient. It should, however, be noted that unanimity would need to be reached in order to adopt such a Directive, as tax policies require the special legislative procedure, which will most certainly need a lot of debate and negotiations. Experience shows that such kind of negotiations could take a very long time (Phases I.4 and II.1 in the roadmap depicted in figure 29);

- **System Efficiency**. Besides the long time it may require, a Directive may also lead to compromises between MSs limiting the efficiency of the overall system. However, even if unanimity could not be achieved within a "reasonable period by the EU as a whole", the possibility of having recourse to Enhanced Cooperation could be explored, both from a legal and from a political perspective;

- **Project and Change Management**. The cross-life cycle activities depicted in figure 29 have not been highlighted in figure 30, but these project and change management activities will be crucial to ensure the success of the project and ensure that benefits driven from the Model implemented, irrespective of the Model, are maximised. The experience shows that a lack of attention to these steps, although the solution implemented is appropriate and relevant, usually jeopardises the success of the project and leads to project failure. Change management procedures and Board will be designed to ensure that new changes and requirements (being business or IT related) are appropriately addressed and that the solution is in line with the strategy and the objectives of the standardised relief at source system;

- **Ongoing Tasks**. There are phases or tasks that are occurring at several stages of the whole implementation process. Indeed, there are tasks that need to start early in the change initiative but cannot be completed until later in the programme. There is a phase called "develop business case" in the first stage of "Strategy and Assess" (Phase I.2), but that will be further developed and fine-tuned in the "Design" stage in phase II.2 "Update the business case", where there will be additional information and indications to show the costs, benefits and time required for the various stakeholders.

- **Impact of an Error on the System**. In both Models contemplated, if one MS commits an error, is facing a technical issue or is not willing to cooperate as it should, such behaviour may have a huge impact on the other participating countries and on the data quality that is fed into the system. As a consequence, there are a lot of critical activities that will need to take place even after the system has become operational. These activities will be dealt with in the "Operate and Review" stage, which may take several years.

- **Data Quality**. The SC Model, the AIC Model or any other alternative will only be efficient provided that sufficient data quality is delivered. This has been confirmed by several FIs and MSs. The tax and legal and operational provisions (liability of the AI, mandatory feedback etc.) and IT supporting solutions (whatever the IT architecture put in place, it will have to contain sufficient filters and coherence controls to ensure that the information fed into the system, if not correct, is at least consistent in terms of format and coherence) will contribute to enhancing data quality. However, particular attention should be paid to this point through the various stages of the implementation plan and ultimately during the Operate and Review stage. The more and earlier focus on the data quality in the process, the less time and costly it will be in the Operate and Review stage and the more effective will be the standardised relief at source system.

- **Collaboration.** No decision on the collaboration between MSs during the implementation of a standardised relief at source system is taken. At this stage it is not clear (a) how the implementation will be guided and (b) how far the collaboration will reach (e.g. common XML-schemas or joint development). Hence the implementation plan is set up in such a way that it can facilitate the different possible forms of collaboration between MSs.

12.3 DESCRIPTION OF THE MAIN PHASES OF THE WORK PLAN

The following figure depicts the work plan. It provides an overview of the five stages with their different phases and the estimated elapse time.

560. **Actors and Roles**. The work plan also includes the actors and their roles in each of the phase. The European Commission, the FIs, TAs and the OECD have all been identified as being the major stakeholders in the implementation of the standardised relief at source system. The "Investors" will not be explicitly involved in the implementation of the system, but they will need to be trained and kept informed in due time. These training and information sessions will have to be conducted either by the European Commission (i.e.: through the website for instance), or the FIs/TAs.

For each actor whose involvement is required for the completion of a designed phase, a specific role has been assigned to the stakeholder. In a nutshell:

- **L** (Lead) refers to who is responsible for leading the phase;

- **A** (Active involvement) refers to the actors who will be actively involved for the completion of the phase;

- **I** (In the loop) refers to the actors who need to be kept informed during the phase.

The purpose is to give an indication of who will be responsible for doing what.

If we take the Phase I-3- Define the Model Governing Principles as an example, the European Commission will be in the lead for defining these objectives, consulting and involving the MSs, TAs and the OECD.

If we take the Phase II-6- Design Required XML Schemas, should the AIC Model be implemented, it is assumed that the European Commission will have a leading and supervisory role, but the TAs and FIs will be actively involved in the design of the XML Schemas. They will also consult with the OECD to leverage the OECD works already performed in that respect.

		Stakeholders Involvement			
High Level Implementation Plan for a Whithholding Relief at Source System		Commission	TAs	FIs	OECD
Stage I	**Strategy and Assess**				
	I-1- Define Objectives	L	A	A	A
	I-2- Develop Business Case	L	A	A	
	I-3- Define the Models Governing Principles	L	A	A	A
	I-4- Obtain the Buy-In from the Various Stakeholders	L	A	A	A
	I-5- Launch Required Impact Assessments	L	A	A	I
	I-6- Determine the physical IT Architecture	A	L	L	
	I-7- Determine the Logical Applications Components to be Developed	A	L	L	
Stage II	**Design**				
	II-1- Draft the Legal Instrument Texts	L			
	II-2- Update Business Case	L	I	I	
	II-3- Design the Future Desired Situation	L	A	A	I
	II-4- Develop Implementation Strategies	L	A	A	I
	II-5- Select Technology Provider		L	L	
	II-6- Design Required XML Schemes	L	A	A	A
	II-7- Execute Architecture Conformance Testing		L	L	
	II-8- Perform Software Analysis and Develop Software Design	I	L	L	
	II-9- Set Up Development and Testing Environment		L	L	
Stage III	**Construct**				
	III-1- Validate the Legal Instrument Texts	L	A	A	I
	III-2- Develop and Procure Required Components		L	L	
	III-3- Execute Architecture Conformance Testing		L	L	
	III-4- Test Required Components		L	L	
	III-5- Draft the Business Processes		L	L	
	III-6- Construct Talent Management and Organisational Related Changes		L	L	
	III-7- Perform Software Analysis and Develop Software Design		L	L	
	III-8- Develop Implementation Plan	I	L	L	I
Stage IV	**Implement**				
	IV-1- Train all Stakeholders		L	L	
	IV-2- Coordinate IT Releases		L	L	
	IV-3- Implement the New Processes		L	L	
	IV-4- Implement the New Organisational Changes		L	L	
	IV-5- Implement the New Architectural and Technology Solutions		L	L	
Stage V	**Operate and Review**				
	V-1- Track Benefits and Take Corrective Actions	A	L	L	I
	V-2- Prepare and Launch Continuous Improvement Programme	A	L	L	I

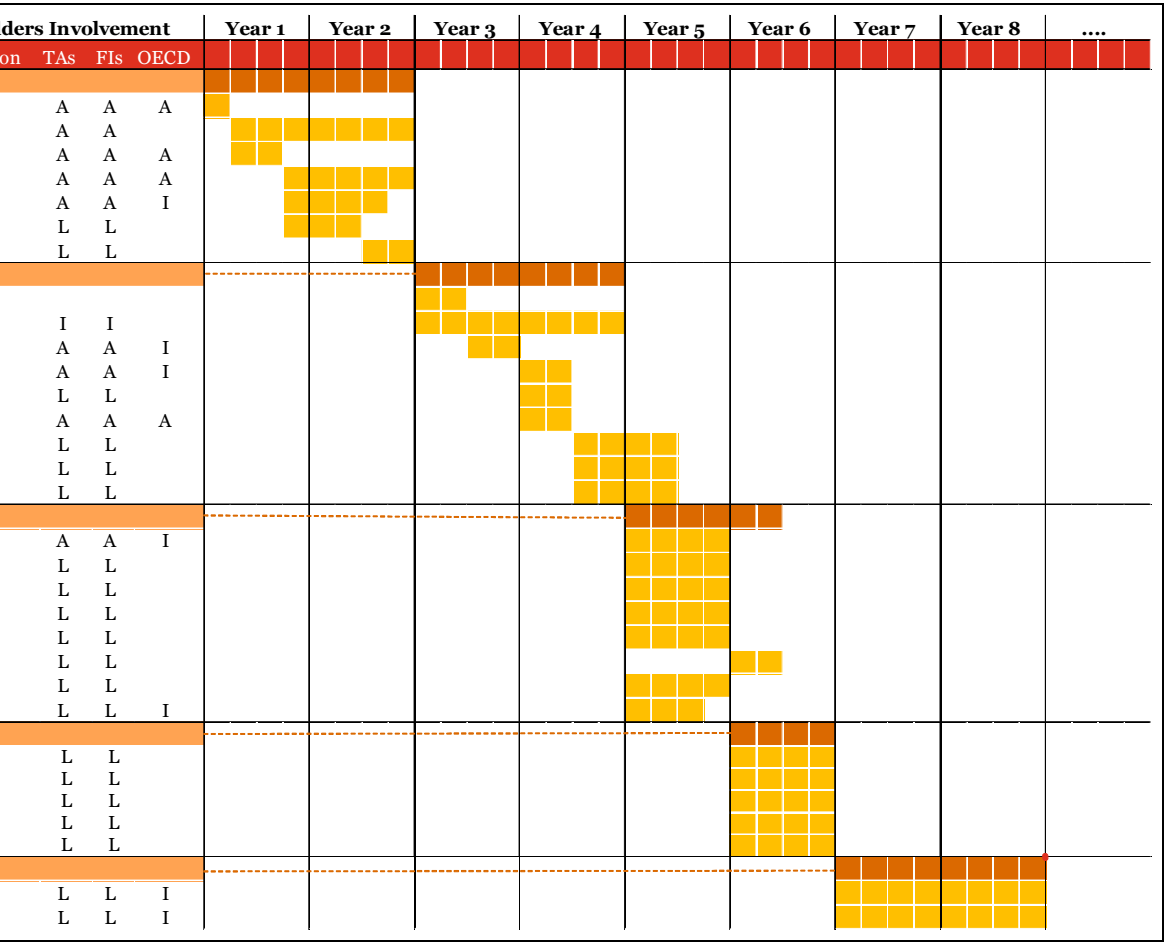


Figure 32: High Level Implementation Plan for a Withholding Relief at Source System

561. **Interdependencies.** A detailed look at the implementation plan shows that there are several interdependencies that will need to be managed to ensure a successful delivery of the standardised relief at source system. These dependencies may have an impact on the estimated timing.

- **Phases required to be completed before others can start**. There are some Phases that cannot start before others are completed.
  - The European Commission cannot start the definition of the Governing Principles (Phase I-3) before the objectives of the standardised relief at source system have been defined (Phase I-1).
  - Another example would be the launch of required impact assessments (Phase I-5). Phase I-5 will clearly be important for developing the business case (Phase I-2), but may certainly also be useful for convincing the various stakeholders and obtaining their buy-in (Phase I-4).
  - Some interdependencies create an iterative process: the IT components that will be developed and/or procured (Phase III-2) will have to be tested (Phase III-5), but according to the results of the testing, we may be in a situation where one will have to develop or procure other equipments that will need to be tested again.
  - Etc.
- **Trans European Project**. The implementation of a WHT relief at source system is a Trans European project, having a considerable impact on 27 MSs (within the EU), thousands of AIs and additional third Countries, whom may wish to join. The involvement of all these stakeholders will be crucial to reach an efficient Relief at Source System and will have to be coordinated to ensure the implementation timing is properly managed. As an example, let's take Phase III-1- Validate the Legal Instrument Texts: the European Commission will clearly be supervising the negotiations with the TAs and FIs, but outputs and progress strongly depend on the MSs and FIs willingness, interests, etc.
- **Regulatory developments need to be closely followed up.** FATCA and, in particular, the Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA (Model 1) that the US developed with five EU MSs have to be closely monitored to ensure the dependencies with the standardised relief at source system are identified and carefully analysed.
- **Other External Factors** such as the political motivation, MSs priorities and decisions, etc.

12.3.1 STRATEGY AND ASSESS (STAGE I)

562. **Phase I.1 – Define Objectives.**

In this phase, activities are undertaken to confirm the business drivers and the vision and objectives for the standardised relief at source system.

- **Alignment of the Strategy and the Standardised Relief at Source.** The strategy of the stakeholders (MSs, FIs, Investors and EU) is reviewed to ensure that there is a clear linkage and alignment between the objectives and the envisaged standardised relief at source system. Where the review of the strategy identifies weaknesses, additional business strategy development work may need to be carried out. In parallel to these activities, a problem statement or hypothesis is developed to ensure a clear understanding of the challenges or issues the organisation is trying to resolve through the standardised relief at source and to identify initial improvement opportunities.

- **Objectives Definition and Clarification**. The high-level objectives (aligned with the objectives of the FISCO Recommendations) have already been defined and are common to both Models. This phase is mainly intended to formulate proposals for improving the way tax administrations could grant WHTs relief at source rather than apply refund procedures, and to define the best Model that would support such system. In this phase, the various objectives will have to be considered, assessed and further defined. The Model implemented should be simple, cost-effective, and secure against fraud, ensure tax compliance and smooth and equitable communication, etc. One should consider what the acceptable cost is and what the acceptable fraud risk is. Is there a trade-off to be made between user friendliness and costs?

  Some compromises will need to be reached in order to balance objectives such as cost effectiveness and fight against fraud. Indeed, some recommendations have been formulated in order to enhance the resilience of the Models with respect to the fraud risks (cf. Chapter 9), but these recommendations would result in additional costs for some of the stakeholders. A pragmatic approach will have to be used to ensure that all objectives are clearly defined, prioritised and addressed using Pareto considerations (i.e.: what could be done to achieve 80% of the results while using 20% of the efforts?)

Complexity of this Phase. This review may lead to the need to clarify the objectives and potentially redefine the programme scope and parameters, depending on questions or issues that arise.

563. **Phase I.2 – Develop Business Case.**

A strategic business case will need to be developed. The Strategic Business Case is used to provide the business justification for the initial Strategy and Assess stage and to create buy-in to commence the subsequent stages of the programme. It will already include a high-level definition of the expected business outcomes and benefits.

In the context of the SC Model, no business case was developed as this project was requested by the business and discussed with interested countries. There was therefore no need to demonstrate to the stakeholders what the interest of such system was. For the AIC Model, a business case will have to be developed to present and support this programme to the EU institutions and EU decision makers, if the AIC Model has to be adopted.

564. **Phase I.3 – Define the Models Governing Principles.**

This phase is a crucial step for the rest of the implementation plan. This is because it needs to be decided which Model will be implemented, the AIC Model or the SC Model, both, or an alternative? The conclusions of this report highlighted the advantages and disadvantages of both Models enabling the various stakeholders to opt for the most appropriate model. This feasibility study is clearly part of this phase. That said and as already mentioned in various parts of the study, although there may be a Model that is better than another from a specific perspective, both Models would require amendments and specific new legislation to be adopted. So, in that sense, the Phase I-3 is applicable irrespective of the Model implemented.

- **Possibility to Amend the Structuring Principles.** As both Models are still under development, it is still possible and recommended to amend the structuring principles to improve their performance and to respond to the objectives that have been refined in the first phase. This phase is also crucial and is a pre-requisite to the IT architecture because the stability of the IT architecture and the IT requirements will be derived from the governing principles that will have to be agreed upon.

- **Governing Principles to be Agreed Upon**. The purpose of the current paragraph is to list a series of governing principles for which an agreement will need to be found. This list is not an exhaustive list, but highlights at least the challenges of some of the most important components.

  - **Identification of the Legal Tools –** As mentioned in the analysis of the interactions between the EU laws and the Models, it appears clearly that the new system, the SC Model as well as the AIC Model, will need to be integrated into a complex legal structure. A key question is what the legal instrument is that could best support the new system. Would that be a Directive? Would a Memorandum of Understanding be required (especially if the SC Model is selected?

  - **Definition of the Communication Channel –** Would it be the communication channel defined under the AIC Model or under the SC Model? Do TAs need to communicate with non resident AIs?

  - **Content of the Reporting –** What is the information that needs to be added and that will add value (in terms of fraud detection or tax calculations), taking into account the additional workload it would imply? Would the value of the Investor portfolio on 31 December and/or AIIN be acceptable? Would that be sufficient?

  - **Format of the Reporting –** The idea here is to consider what needs to be formatted in the reporting in order to avoid, as much as possible, free text format and hence

avoid errors, while making the analysis and review of the information and report exchanged more effective.

- **Mandatory Aspect or not of the Reporting –** One of the recommendations as regards tax evasion is to make the exchange of information mandatory, or partially mandatory, even for Investors who did not request the application of a DTT or signed an ISD. Some recommendations that need to be analysed and discussed have been highlighted in Chapter 9 (i.e. exchange of beneficial owner details and the account numbers for non-resident Investors, regardless of the question whether or not they agreed to benefit from the system). Of course, this is not achievable via a contractual agreement as it could only be implemented via domestic law (or a common regulation transposed into the local legal framework).

- **ISD –** The various stakeholders need to assess what should be in the ISD to ensure mitigation of fraud risks. One of the measures suggested in the current study is the addition of the beneficial owner details for entities requesting relief at source so as to determine the underlying beneficial owners.

- **Liability of the AI –** Both Models (the AIC Model following the SC Model on that point) provide that the liability of the AI will remain, even if the AI complied with all the procedures and guidelines defined in the Model. It appeared from the questionnaires and interviews held with the FIs and/or federations, that it will be hard to get this approved by the business, or that at least they would then expect extensive guidance on what is exactly requested from them. That point will need to be discussed to be agreed upon.

- **Pooled Information –** A recommendation from the fraud analysis part aims to provide pooled information to the WA but splitting it by AIIN number. This would enable the tax administration of the SC to easily develop an automated matching between the information provided by the WA and the information from the various AIs. This needs to be analysed and investigated to determine whether or not this would be part of the governing principles of the model that will be implemented.

- **Audit –** The whole debate around the audits should also be cleared. Who should carry out the audits: the tax administrations or external audit firms? Who should pay for these audits? Indeed, some FIs clearly stated that they preferred their tax administrations to carry out these audits to avoid paying for them (while the stakeholders having a real interest in the system are the Investors), while others prefer not having their tax administration digging into their business and would rather choose external audit firms.

- **Timing –** The timing for reporting and exchange of information should be clearly determined to ensure tax compliance. This agreement will have to take into consideration the MSs calendar, while consulting the business. The financial sector is indeed concerned by the fact that they would have to provide a reporting more important than the existing one under current Savings Directive in a shorter period.

565. **Phase I.4 - Obtain the Buy-in from the various Stakeholders.**

The governing principles need to be re-discussed, assessed and potentially redefined taking into account the various stakeholders' motives in order to find compromises. Indeed, as indicated above, some stakeholders may have conflicting interests.

566. **Phase I.5 - Launch Required Impact Assessments.**

The current feasibility study will be key for discussions with the various MSs and FIs. However, the feasibility study had to consider a definition of both Models to be able to compare them with each other. As some recommendations have been formulated to enhance, among other things, their performance against major fraud risks that have been identified, it should be noted that these specific recommendations are not part of the Model and would require the structuring principles to be amended accordingly. Before amending the Models, further analysis should be carried out to have more insights on their impact on the various dimensions of the Models, and understand their implications for the various actors of the system.

From an IT perspective, the focus of this study lies on examining the feasibility for the tax administrations to cope with the IT architecture implied by both Models. Although the conceptual architectural requirements towards AIs have been described in the Chapter 10, the feasibility of the AIs to cope with these requirements has not yet been examined in detail. A first step has already been taken by conducting a questionnaire with business representatives. This questionnaire can be used as a basis to conduct a more thorough IT impact assessment for AIs. Indeed, it is important to verify that the impact, and more specifically the costs, borne by the AIs will not discourage the financial sector from participating in the system.

A first assessment on the data quality will need to be performed and according to the results, corrective actions will have to be defined. These actions will be taking place during the various stages of the implementation.

567. **Phase I.6 - Determine the Physical IT Architecture.**

Before the IT architecture can be finalised, the recommended logical IT architecture (i.e.: required IT components) needs to be translated into a physical IT architecture (i.e.: which technology components need to be used?). However, the physical IT architecture depends on the MSs' and AIs' current IT investments and technologies used. While determining the physical IT architecture, account needs to be taken of aspects like (a) the MSs' and AIs' current IT investments and technologies used, (b) developing a future-proof and easily extendable solution, (c) collaborative or local development, and (d) IT budget.

568. **Phase I.7 - Determine the Logical Applications Components to Be Developed.**

Once the physical IT architecture has been determined, it has to be decided which of the required IT components will be developed (Collaboratively and locally), and which ones need to be adapted or re-used. For example, certain components, such as the file transfer

component between tax administrations, already exist (CCN), while others might need key upgrades or do not yet even exist (i.e. reconciliation component, validation component, etc.).

Note that Phases I.6 and I.7 need to start in the strategy and assess stage, where a description of the as-is will be made and required impact assessments are launched. It will be nevertheless further worked out and refined in the Design stage.

569. **Outputs of the Strategy and Assess Stage.** At the end of the Strategy and Assess stage, a series of achievements should be realised and clear outputs be issued:

- An outline **business case** should be drafted. It will show what the work will achieve, what it will cost, and what benefits will be achieved;
- There should be a clear definition of the strategy and the **objectives**, including what will need to happen to make it possible and how the objectives will be tracked throughout the project;
- A **project charter** will be defined showing who will do what and by when, what the various stakeholders and actors will need, and how they will work;
- One should start to see what the future **operating model** will look like (which Model is going to be implemented and, more importantly, what the underling structuring principles of the Model are);
- A translation of the IT architecture into a **physical IT architecture** will be made;
- A list of the **logical applications components** to be developed will be drafted;
- A **strategy for change management** will be developed; and,
- There should be a **clear view on what everyone affected will need to know and what they will need to do** to handle their part.

12.3.2 DESIGN (STAGE II)

570. **Phase II.1 – Draft the Legal Instruments Texts.** Once the legal instrument has been identified and once all stakeholders have agreed on the governing principles of the Model that will be implemented, the European Commission and/or the relevant stakeholders should start drafting the Directive project and/or the example of contractual agreement and/or the Memorandum of Understanding, the latter being required if the Model that will be implemented is close to the SC Model (227). Once the legal instrument text has been drafted, it needs to be shared and accepted by all MSs in order to obtain a political agreement. Moreover, it should be verified that potential amendments to the legal instrument during the

227 The contractual agreements and an example of MoU have already been drafted in the context of the OECD work. However, as mentioned earlier, the international context will most likely impose some amendments on the SC Model. The contractual agreements and the MoU will therefore have to be amended once the governing principles of the Model are definitely agreed.

legislative process do not constitute a barrier that would result in the financial sector rejecting the system.

571. **Phase II.2 - Update Business Case.** The objective of this phase is to update the initial business case developed in phase I.2 based on the design work completed during this phase. It is mainly limited to the AIC Model in the context of the legislative process. This Phase would not be required for the implementation of the SC Model (See Phase I-2 Develop Business Case).

The finalised detailed business case will support the initiative and enable benefits realisation to make change stick. The detail business case:

- Contains the strategic objectives of the standardised relief at source study and of the Model implemented;
- Confirms the economic and financial costs, which requires a clear definition of benefits and risks;
- Ensures that key stakeholders are engaged in the process; and,
- Provides a document and process that ensure compliance with governance requirements.

It will also highlight the dependencies and timing pressure faced due to recent regulatory developments (FATCA) which are closely linked to the FISCO project. The detailed business case will provide a clear definition of the planned business outcomes, the benefits to be gained, and the benefits measures to be used to ensure that the end results are achieved.

572. **Phase II.3 – Design the future desired situation.** The objective of this phase is to define (at high level) the new processes, the IT solution (based on the information and data that need to be exchanged), the human resources and organisation aspects, etc.

573. **Phase II.4 - Develop Implementation Strategie**s. This phase will focus on defining the implementation strategy by exploring the implementation alternatives and selecting the approach. Several questions may be raised and need to be addressed: Would it be decided to use the cutover approach (also called "big bang") where all countries will need to participate? What about using pilot countries (approach adopted by the OECD)? If it has been decided to use pilot countries, how many countries will be selected as pioneers? Will it be done on a "willingness to participate basis" or will one wish to gather at least nine countries to fall under the strengthened cooperation?, etc.

One may also consider implementing a Model with some of the mandatory structuring principles and improving it as time goes by with the principles that will have been classified as secondary or nice to have. Should the SC Model be implemented, there will also be questions around the implementation strategy, but the questions above mainly refer to the situation where the AIC Model would be implemented. All these questions will have to be addressed by the European Commission once the legal instrument texts have been drafted.

574. **Phase II.5 - Select the Provider for Developing and Testing the Solution (Technology Provider).** Before the software analysis and design activities of the design stage can start, the different suppliers for the IT solutions development and testing have to be determined and on-boarded. To avoid conflict of interests, it has to be ensured that a supplier developing a certain IT component is not allowed to test IT.

575. **Phase II.6 - Design Required XML Schemas.** Based on the benefits and wide acceptance of XML as a standard to exchange information between systems in machine-readable format, XML should be used to exchange the required IOs. The XML Schemas for each IO described in the recommended IT architecture need to be defined. Existing standards like FISC153 and the work done by the TRACE group should be leveraged.

576. **Phase II.7 - Execute Architecture Conformance Testing.** On a regular basis, architectural conformance checks should be conducted to ensure that the IT solution's design is in line with the recommended IT architecture. In case of misalignment between architecture and design, the necessary alignment actions are identified and allocated.

577. **Phase II.8 - Perform Software Analysis and Develop Software Design.** For all required IT components to be developed, software analysis and design activities need to be conducted. These should lead to a set of detailed functional and technical design documents for all these IT components.

578. **Phase II.9 - Set up Development and Testing Environment**. Before the Construct stage can start, the development and test environments have to be set up. All necessary elements to enable the development and testing of the IT components need to be installed. Dummy data and dummy interfaces should be created to facilitate development and testing.

579. **Outputs of the Design Stage.** At the end of the Design stage, a series of achievements should be realised and clear outputs be issued:

- A **business case and target operating model in finer details**;
- A **blueprint** for each of the parts that will be affected by the new Model supporting the standardised relief at source system;
- A clear view on how the new Model and required work to achieve the objective will affect/impact **operations, processes, roles and structures, as well as people management**;
- A **software architecture and design**, including XML Schemas, derived from the IT components and their IOs and ITFs. This software architecture and design is needed to effectively guide the development of the IT solution.

12.3.3 CONSTRUCT (STAGE III)

580. **Phase III.1 – Validate the Legal Instruments Texts.** The European Commission and/or the relevant stakeholders have drafted the text of the legal instrument they opted for (e.g. a Directive; a contractual agreement plus a Memorandum of Understanding) and the purpose of this phase, crucial for the rest, should be to get the validation of the text by the various stakeholders. The validation of a Directive by all stakeholders (unanimity of the MSs) will definitely take more time than the adoption of domestic law coupled with the conclusion of MoUs (less parties involved in the validation process).

581. **Phase III.2 – Develop and Procure Required Components.** Based on the developed set of detailed functional and technical design documents, the IT components should be developed/procured and configured. At the end of this activity, IT components are ready for testing.

582. **Phase III.3 – Execute Architecture Conformance Testing.** Like during the design stage, architectural conformance checks should be conducted on a regular basis in order to ensure that the IT solution is in line with its design. In case of misalignment between architecture and design, the necessary alignment actions are identified.

583. **Phase III.4 – Test Required Components.** After the IT components have been developed, they have to be tested. The testing contains unit tests, component integration tests and system tests. The tests have to be based on an agreed test strategy and agreed test plans.

584. **Phase III.5 – Draft the Business Processes.** In this phase, the new or amended processes are constructed. The purpose is to develop the business processes to the lowest level of detail required for implementation: how will relief at source be requested? Who is entitled to it? Who is responsible for doing what? Who is accountable for what? What needs to be requested, delivered? And, what is the timing? ... It is also recommended that the detailed business intent behind each of the processes is fully understood. To ensure that all risks are managed and addressed as efficiently as possible, and to avoid burdensome controls, processes and controls should be designed simultaneously. In ideal cases, and where required, an information and/or key performance indicator (KPI) plan is defined. This provides a clear understanding of the various processes of the measures of success and how they will be monitored. Finally, process acceptance and testing are conducted as all new processes should be submitted to user validation and acceptance.

585. **Phase III.6 – Construct Talent Management and Organisational Related Changes.** It is fundamental to a sustained change initiative to ensure that people are successfully transitioned from old to new ways of working. If this is not done effectively, the new processes may be circumvented, which could prevent benefits from being realised. The capability and skills framework is defined and used as a basis for assessing the existing capabilities, defining the existing gaps, and developing a plan to address and close those gaps, including a cost estimate. Human resources and talent management policies and procedures are revised, involving for example role adjustment, recruitment, training and development strategy. Shifting the work of the team from the refund process towards the relief at source

process (the first one being used for specific cases where relief was not possible/successful) may also have an impact not only on people but also on the organisation.

586. **Phase III.7 - Perform Software Analysis and Develop Software Design.** Refer to Phase II.8. As the processes are developed at the lowest level of details in Phase III.5, there may be some changes that will require a software analysis to make sure that the IT solution can sustain and address the business process changes.

587. **Phase III.8 – Develop Implementation Plan.** This is the phase where final decisions are made. This is the phase where detailed plans necessary for the implementation are developed. The detailed implementation plans are discussed and agreed with respect to various dimensions; structure, processes, technology and organisation. Risks will be reassessed along with dependencies and priorities. The results of the pilot, if any, will be key in this reassessment.

This plan includes clear milestones for the various stakeholders, but the milestones will most likely be limited to some key elements that should be available for the Implement phase (e.g. the ability of an AI to generate the report and have the relevant information in their databases, or the ability of a tax administration to be able to process the information received and send the required information to the other participating countries). So each actor will have to develop its own implementation plan to be able to reach the objectives assigned to him in the global implementation plan.

588. **Outputs of the Construct Stage.** At the end of the Construct stage, a series of achievements should be realised and clear outputs be issued:

- An **update of the target operating model** so as to include the changes from the Design stage. It should for example integrate the changes that could occur during the legislative process;
- A **detailed view on what and how** the tax administrations, AIs etc. should adapt to integrate the new way of granting relief at source;
- A **clear view on what is needed** from process, information, technology and data for the implement stage;
- **Detailed plans** for moving from the current situation to the future situation of the relief at source system;
- Design and piloting of a **capability development roll-out plan** with training courses.

12.3.4 IMPLEMENT (STAGE IV)

The Implement stage is when all the different parts of the implementation are put into action for the first time and the training is run.

589. **Phase IV.1 – Train all Stakeholders.** This is the phase where required training will be provided to make the change stick. Training sessions are delivered. Ongoing course maintenance processes and responsibilities are defined.

590. **Phase IV.2 – Coordinate IT Releases.** The development of the IT solution leads to different releases. As a consequence, their roll-out needs to be coordinated within and across MSs.

591. **Phase IV.3 – Implement the New Processes.** The new processes have been drafted (Phase III.5) and the training courses have been given (Phase IV.1). This is the phase where people concretely will start using the new processes for granting relief at source, performing the new controls, etc.

592. **Phase IV.4 – Implement the New Organisational Changes.** This is the effective implementation of what has been decided in phase III.6, where human resources and organisation aspects have been analysed and addressed.

593. **Phase IV.5 – Implement the New Architecture and Technology Solutions.** The IT solution is installed and integrated. The development and test environments should be used to ensure a proper integration of the developed and tested IT components into a MS's IT architecture. After a successful integration, the IT solution should be deployed in the acceptance and production environment for its final acceptance and operation.

594. **Outputs of the Implement Stage.** At the end of the Implement stage, a series of achievements should be realised and clear outputs be issued:

- The **new business model**/way of operating will be in place;
- **People will have been trained and incentivised** to work in the new way;
- People will be **adopting the new working processes**;
- **New standards, practices and procedures will have been documented** and be available to those that need them;
- There will be ways of **monitoring the effectiveness of the new ways** with a view to tweaking and refining the operations; and
- **Benefits will be being tracked** with early wins having been communicated widely.

12.3.5 OPERATE AND REVIEW (STAGE V)

595. **Phase V.1 – Track Benefits and Take Corrective Actions.** The purpose of this phase is to track benefits realisation following the implementation of the new relief at source system and, where required, corrective actions are determined, discussed, agreed and implemented. If expected benefits are not being achieved, the root cause will be identified and, where appropriate, action taken to get benefit realisation back on track. Typical activities will consist of checking and assessing the accuracy and reliability of the data collected, assessing whether the process flows (being IT or business processes) have been adhered to, auditing the IT solutions, etc.

The Operate and Review can take place at various moments after the implementation:

- Once the relief at source system is live for the first time, immediate issues may be identified and they need to be corrected;
- After the first reporting has been issued and therefore the first largest data transfer has taken place, issues may be detected that relate to the capture of data, data quality, technical issues etc. If the reporting is done annually, these errors should be detected within a year after the relief at source system goes live;
- Finally, and this may be linked to the next phase, i.e. V.2, building on the Savings Directive experience, where every three years the system performance is reviewed, the Operate and Review phase is an ongoing and continuous component ensuring that the benefits are managed over time.

596. **Phase V.2 – Prepare and Launch Continuous Improvement Programme.** This phase consists in developing a continuous improvement programme. Continuous improvement is a structured way of continuously identifying and understanding issues so as to prioritise and address them in an efficient way. As illustrated in the figure below, performance levels can be identified at two levels: after having changed processes or technology, performance levels should be enhanced; another set of improvements can be realised over a longer term if a specific continuous improvement programme is implemented. The continuous improvement programme will go beyond the focus put on achieving specific programme goals over a specific period of time.

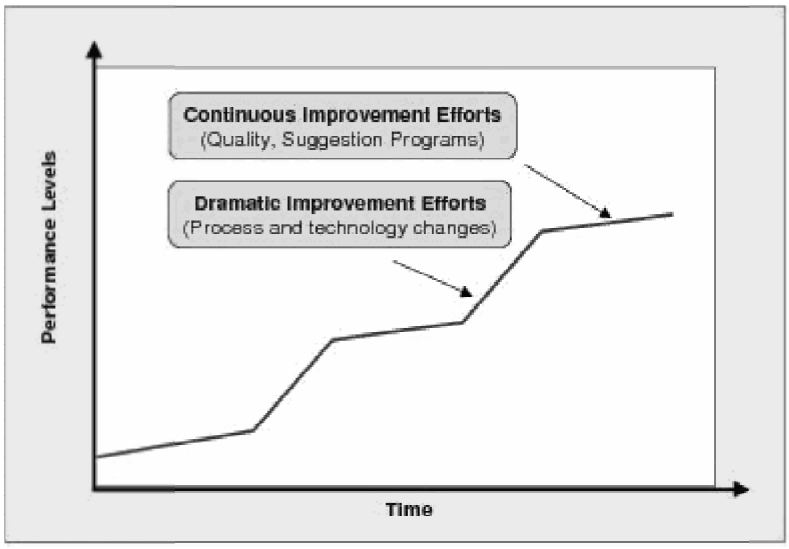


Figure 33: Continuous improvement process

597. **Outputs of the Operate and Review Stage.** At the end of the Operate and Review stage, a series of achievements should be realised and clear outputs be issued:

- The **new ways of working will be embedded** into the organisations and be considered as the only ways of working;
- The **benefits have been delivered** as anticipated;
- There will be a **continuous improvement mechanism** that helps refine and fine-tune the ways of working;
- **Quality reviews** will have been conducted by the various stakeholders and contractors, and realised benefits will have been acknowledged.

* *

*

CHAPTER 13 GENERAL CONCLUSION

598. **Summary table**. The following table sets out an overview of the advantages and disadvantages of both Models. Each rate is based on several factors developed through the various chapters. So it cannot be taken as a complete summary of the analysis, given all the aspects covered in this study, but it is rather a good indicator to highlight the main strengths and weaknesses of each Model.

599. **Interest for the Models**. All the stakeholders agree that the Model and its objectives should have a positive impact. The impact differs from one actor to another but globally, both Models should generate benefits, as demonstrated in the cost-benefit analysis. First, the generalisation of the relief at source system and standardisation of the procedures will generate concrete benefits for the financial sector and especially for the Investors. The latter will indeed be able to benefit from a right recognised since the ratification of the various DTTs but which is sometimes not applicable in practice. Second, both Models offer quite some guarantees to tax administrations that they will not grant a reduced tax rate to an investor who is not entitled to. Finally, they will receive more information than they ever received before.

	SC Model			AIC Model		
	MSs	AI	Inv	MSs	AI	Inv
Contractual agreement						
Easy to implement	+	++	=	n.a.	n.a.	n.a.
Flexibility	+	+	=	n.a.	n.a.	n.a.
Lack of consistency/coherence	--	--	=	n.a.	n.a.	n.a.
Ease the integration of third countries	++	+++	+	n.a.	n.a.	n.a.
Management of the contractual agreements	-	-	=	n.a.	n.a.	n.a.
Need to be completed by MoU	--	=	=	n.a.	n.a.	n.a.
Common regulation (directive)						
Heavy legislative process	n.a.	n.a.	n.a.	-	--	=
Lack of flexibility	n.a.	n.a.	n.a.	-	-	=
Robustness/consistency	n.a.	n.a.	n.a.	+++	++	=
Complex integration of third countries	n.a.	n.a.	n.a.	--	--	-
Generalisation of the simplified relief at source						
Timing	=	+++	+++	=	+++	+++
Electronic format	++	++	+	++	++	+
Procedures and data standardisation	=	+++	+++	=	+++	+++
Pooled information	-	++	+	-	++	+
System available to non-domestinc Investors	=	++	++	=	++	++
Liability of the AI						
Extensive liabilityof the AI	++	---	=	++	---	=
Identification of the Investor (ISD vs. CoR)	+	+/-	+	+	+/-	+
Identification of the applicable WHT rate	=	---	-	=	---	-
Fraud						
Validity of relief at source granted	++	+	n.a.	++	+	n.a.
Ensure tax comliance	+	n.a.	n.a.	++	n.a.	n.a.
Fight against tax evasion	=	n.a.	n.a.	+	n.a.	n.a.
Implementation						
Cost	-	-	n.a.	+	+	n.a.
Timing	+	+	n.a.	-	-	n.a.
Capitalise on existing legal framework	-	-	n.a.	+	+	n.a.
IT analysis						
Functional domain gap to current EUSD	+	+	n.a.	++	++	n.a.
Functional IT gap to MSs current IT systems	+	+	n.a.	++	++	n.a.
Challenges MSs face	--	--	n.a.	=	=	n.a.
Initial Cost estimations	-	-	n.a.	+	+	n.a.

	RC	SC	AIC	AI	Inv	RC	SC	AIC	AI	Inv
Reporting										
Workload	-	--	=	--	n.a.	-	-	--	-	n.a.
Timing	-	+	-	=	n.a.	+	-	+	=	n.a.
Content	-	=	-	=	n.a.	+	=	+	=	n.a.
Data quality	-	=	-	=	n.a.	+	=	+	=	n.a.
Management of databases	--	-	-	-	n.a.	-	-	-	-	n.a.
Feedback loop										
Workload	-	--	n.a.	--	n.a.	-	-	--	-	n.a.
Timing	-	+	n.a.	=	n.a.	+	-	+	=	n.a.
Data quality	+	+	n.a.	=	n.a.	+	+	+	=	n.a.
Audit										
Independent reviewer	=	+	n.a.	-	n.a.	=	+	+	-	n.a.
Spot checks	-	+	n.a.	-	n.a.	+	+	=	-	n.a.
Cost/workload	=	-	n.a.	--	n.a.	=	=	-	--	n.a.
Adjustment of under- over-withholding										
Flexibility	n.a.	=	n.a.	+	n.a.	n.a.	=	n.a.	+	n.a.
Transparency	n.a.	-	n.a.	=	n.a.	n.a.	-	n.a.	=	n.a.
Contact with tax administrations	n.a.	+/-	n.a.	+/-	n.a.	n.a.	+/-	+/-	+/-	n.a.

Table 55: Advantages and Disadvantages of both Models per actor

600. **AIC Model, a variation of the SC Model.** As already mentioned in the report, the AIC Model has been defined based on the work already carried out by the OECD and on the principles described in the Implementation Package, with a major deviation, being the channel of communication of the Investors' information. This deviation requires some additional changes to the governing principles of the AIC Model which have been defined in the study. The AIC Model, as defined in this study, is therefore a variation of the SC Model. The principles of the AIC Model are still subject to changes as they have been defined only for the purposes of conducting the study and will have to be discussed and agreed with all EU MSs.

601. **Preferred Model**. Out of the Models analysed and in their current state, to be able to identify the most efficient one, one needs to consider the elements (in the table above) where there is a difference between the AIC and SC Models and to look at these "differentiating factors" per MS.

- **Legal Basis**. On the one hand, the contractual agreement offers more flexibility and could be easily implemented, but more importantly globally. The ability of the SC Model to be easily extended to third countries constitutes a strong advantage highlighted by various stakeholders. On the other hand, the underlying instrument to provide for information exchanges between TAs is very likely to be a MoU. This could motivate some participating countries, especially larger economies having a strong contractual power, to slightly amend the contractual agreement or the MoU. If this is not done immediately, this could happen in the future, generating a lack of coherence of the system.

  The AIC Model will require a common regulation to be adopted. This is obviously more complex as it will require some time for the negotiation and legal procedures. However, this initial delay is compensated by the strong coherence of the system and the ability to modify the system and its scope in the future years. To be an advantage and not a barrier, this common regulation will have to take into account the integration of third countries in the system.

- **Fight against Fraud and Tax compliance**. Both Models do not differ fundamentally in terms of fight against fraud. Both offer guarantees that Investors claiming for a wrong tax rate will be identified. However, the analysis highlights an advantage of the AIC Model due to the communication between AIC – AI, that should be more efficient than a communication SC – AI. Moreover, these guarantees could easily be improved by some recommendations (highlighted in section 9.4). An important point to note though is that none of the Models mitigates the risk of tax evasion that remains beyond the scope of these systems (i.e. Investors who don't ask for the application of WHT relief at source).

  The tax compliance also reveals an advantage for the AIC Model. In the SC approach, the RC should receive the information according to a MoU. This mechanism could lead to different processes and a lack of standardisation in terms of timing and content. Moreover, it is not binding. These weaknesses are solved in the AIC Model where the RC receives the same information and at the same time than the SC. But, none of the Models will enable all the MSs to calculate the amount of tax due by an Investor as it is not possible to

exchange all the required information and as many transactions are beyond the scope of the Models.

- **Implementation**. In terms of implementation, the SC Model offers the advantage of the timing, as a contractual agreement could be quickly signed by both parties. This advantage is mitigated by the need of a MoU with all the participating countries. The AIC approach requires more time as an agreement between MSs would need to be reached but it is the most cost efficient as it will be possible to capitalise on existing infrastructures and processes.

- **Reporting**. The quality of the reporting is expected to be quite similar. The main difference is due to the intervention of the AIC in the AIC Model. While some stakeholders point out the lack of direct interest of the AIC as source of delays and of negligence in the treatment of the reporting, others highlight its positive impact in terms of data quality control and rationalisation of the information flows.

  An interesting outcome of the analysis is the contradiction between the additional workload to treat the reporting expected by the MSs if the AIC Model is adopted, while the increase in terms of workload is clearly higher for the SC Model when they provide estimation at the level of activities.

- **Feedback Loop**. As for the reporting, the main factor of differentiation relates to the communication channels. Depending on the actors, the analysis varies. Some prefer the direct contact with the AI and vote for the SC Model while other show their preference for rationalising the query via the AIC, which should have a better communication with the AIs.

- **Audit**. The impact of the audit in the comparison of both Models is relatively limited, the main difference being the possibility for an RC to participate into a joint audit in the AIC Model. However, the RC is not the actor having the biggest interest in the audit of a relief at source process. Its concern would be mainly limited to the identification of Investors.

Going through these differentiating factors highlighted above and as illustrated in table 53, it appears in many cases that the Model preference changes according to the priority of the MSs. That said, from a global perspective, the analysis demonstrates that the AIC Model, based on the criteria applied, offers more advantages and more guarantees to reach the objectives assigned to the system.

602. **Limit of the Models**. The AIC Model is preferred; it does not mean that it should be adopted as such. Both Models suffer from some weaknesses and some of these weaknesses raise the issue of the objectives of the Models. The current system is limited to a standardised relief at source system and would therefore require amendments to fight against tax evasion, as illustrated in the Chapter 9 dedicated to the Fraud Analysis.

603. **Recommendations**. The various chapters of this feasibility study contain recommendations. Some of these recommendations are going further than the current scope of the Model and are closely related to the question of the objective of the system. They should

be considered as some way forward to strengthen the effectiveness and efficiency of the Model to be adopted.

- **Mandatory feedback**. To create a virtuous circle in terms of data quality, the feedback should be mandatory for all the information mentioned in the report, for which the RC or SC is able to check the information.

- **Reporting Obligation.** The reporting could be extended to Investors who did not provide an ISD. In such case, the level of the information exchange could be similar to the other transactions or limited to the Investors details and the account number.

- **Content of the Reporting**. The volume of the information exchange generates a complexity to be balanced with the interest it represents for the various stakeholders. One item of information could be added to the reporting: the value of Investor portfolio on 31 December. This should help the countries applying the tax on the principal and not on the income to estimate the tax amount due.

- **Amendment to the Pooled Information.** The pooled information offers the possibility to reconcile the data received from various stakeholders. However, this work could be used by adding the AIIN in the TRI (allowing an automated matching by SC at AI level) or by making the data anonymous. It is no longer pooled information but communication is based on account numbers. This is the easiest solution for SC but it increases the burden significantly.

- **Adjustment by the AI.** The current flexibility is interesting for the financial sector but it could easily hide some fraudulent behaviours. This could be improved by two amendments: first, to correct a transaction, the AI and the WA must make one correction for each error and should clearly include the reference of the transaction corrected, and second, an obligation to mention any correction processed in the reporting more than one month after the payment date.

- **Qualification of the Income Type.** To ease the identification of the applicable tax rate and limit AI's liability, the responsibility of the qualification of the income type could be transferred to the Issuers.

- **Identification of Entities.** In the ISD, it could be envisaged that entities add all the shareholders holding more than a determined threshold of the shares.

- **Exchange of Information when SC = RC.** These transactions could possibly create some issues in terms of data protection and are not relevant in terms of fight against fraud and tax compliance.

604. **Way Forward**. The Models are still under discussion and it is likely that they may be amended several times before one of them is implemented. In addition to that, to be able to choose one Model or another, some additional work will be required to further investigate the options and some key elements (i.e.: impact assessments may therefore be required). In this perspective, some key elements must be reminded:

- **Buy-in of the Various Stakeholders**. All the stakeholders must be associated to the discussion and a large consultation of the financial sector must take place before its implementation. Indeed, in the current situation, the participation of AIs is a free decision so they need to have an interest in the system.

- **Question of the Liability of AIs**. Some FIs clearly mentioned that as it is currently described, they would not accept to participate in the system due to the extensive liability of AIs. The financial sector is open to a discussion to determine a framework and some tools that should limit AI's liability or balance this liability among the different actors.

- **One Model**. All the stakeholders and especially the FIs, emphasised the importance of limiting the amount of systems, reporting obligations and frameworks. It is therefore strongly recommended to develop only one Model and to ensure that this Model can be extended to third countries.

* *

*

European Commission

Taxation and Customs Union DG

SUBJECT: Feasibility Study on a Standardised "Relief at Source" System Implementing the Principles of the FISCO Recommendation

Addendum

CHAPTER 14 INTRODUCTION

This chapter provides an overview of the purpose and scope of the Addendum as well as its context, main assumptions and constraints. It also presents the structure of the Addendum as well as the reference and applicable documents, and the acronyms and definitions that are used throughout.

* * *

14.1 PURPOSE AND SCOPE OF THIS ADDENDUM

This report ("Addendum") updates the main findings, conclusions and recommendations of the final report to the feasibility study on a standardised relief at source system ("the feasibility study"), which the European Commission's Directorate-General for Taxation and Customs Union (DG TAXUD) has commissioned from PwC. The objective is to present the main outcomes of the analysis conducted.

14.2 CONTEXT

This Addendum is part of the work that DG TAXUD decided to carry out to follow up on the European Commission's Recommendation on Withholding Tax Relief Procedures of 19 October 2009 (228). PwC submitted the final report on the feasibility study to the Commission on 21/12/2012. However, the recent developments concerning FATCA may have changed the general picture in which the relief at source system examined in the feasibility study has to be placed. In the light of these changes, DG TAXUD has requested PwC to examine, in this Addendum, whether the conclusions included in the feasibility study with respect to the preferred Model to channel investor information to the SC and the RC are still valid or need to be revised.

Although we hope that this Addendum will be helpful to the European Commission in deciding how to best follow up on the work in this area, it has to be stressed that it is without prejudice to any decisions that the European Commission might take. The European Commission has not yet decided whether or not to launch any initiative in this area.

14.3 DEVIATION FROM TEMPO

There is no major deviation from TEMPO (229) in this report, unless justified by readability considerations.

14.4 ASSUMPTION AND CONSTRAINTS

This Addendum further examines certain aspects of the feasibility study so as to enable the European Commission to take an informed decision, as the case may be, with respect to which routing system(s) should be applied within the EU and for which purpose. General knowledge of the EU framework in terms of exchange of information and legal tools and practices is needed to have a good understanding of the various problems raised. In addition, familiarity with the FISCO/TRACE work (230) is required to have an in-depth understanding of both Models and be able to place them in their historical context. Finally, it is important to read the main conclusions (at least) highlighted in the feasibility study and follow the recent developments in the administrative cooperation framework (especially FATCA) to be able to understand the context and analysis performed in the current Addendum.

228 C(2009)7924 of 19.10.2009.

229 See list of abbreviations under the "Terminology" heading.

230 See Chapter 2 of the final report to the feasibility study.

14.5 STRUCTURE

The Addendum is made up of **7 chapters** besides the executive summary and the study overview. They are organised as follows:

- **The present chapter** presents the characteristics of the Addendum, including an overview of its structure.
- **Chapter 15** presents the background, scope and impacts of the recent developments on the study.
- **Chapter 16** analyses the Most-Favoured Nation (MFN) clause provided for in Art. 19 of the DAC in the light of the bilateral agreements under negotiations under FATCA (the Model 1 and 2 IGAs).
- **Chapter 17** analyses the relevance of residence-country (RC) reporting under a Relief at Source System.
- **Chapter 18** analyses the possibilities of simplifying the source-country (SC) reporting under a Relief at Source System and the related aspects.
- **Chapter 19** analyses whether the generalised adoption of an Authorised Intermediary Country (AIC) routing for the purpose of SC reporting would be efficient for AICs and financial intermediaries (FIs) and in addition analyses potential alignment of the information to be reported and timelines under the relief at source system proposed in the Implementation Package with the information to be reported and timelines under FATCA and the EU Savings Directive.
- **Chapter 20** presents the overall conclusions from the Addendum.
- **Appendix 31** presents the recent developments on FATCA, including an explanation of the final regulations, of Model 1 and 2 IGAs and of the links to the QI regime.

14.6 TERMINOLOGY

This section provides a list of all abbreviations, acronyms and definitions used in the document.

14.6.1 ABBREVIATIONS AND ACRONYMS

ABBREVIATIONS/ ACRONYM	TERM
AI	Authorised Intermediary
AIC	Authorised Intermediary Country
AIIN	Authorised Intermediary Identification Number
AH	Account Holder

ABBREVIATIONS/ ACRONYM	TERM
Art. / Arts.	Article / Articles
CCN	Common Communication Network between EU MSs' Tax Administrations
CI	Contractual Intermediary
CIV	Collective Investment Vehicle
DAC	Directive on Administrative Cooperation (Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC)
DAH	Direct Account Holder
DG TAXUD	Directorate General Taxation and Customs Union (European Commission)
DTT	Double Tax Treaty
FATCA	Foreign Account Tax Compliance Act (US legislation)
FDAP	Fixed, Determinable, Annual, Periodical
FI	Financial Institution
FFI	Foreign Financial Institution
FISCO	European Commission's Clearing and Settlement Fiscal Compliance ("FISCO") expert group
IAH	Indirect Account Holder
ICG	Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors (Organisation for Economic Cooperation and Development)
IF	Interface (231)
INV	Investor
IO	Information object (5)
IRS	US Internal Revenue Service
ISD	Investor Self-Declaration
ISMS	Information Security Management System
ISO	International Organisation for Standardisation
ITF	IT functionality (5)
KYC	Know Your Customer
LAC	Logical application component
LTC	Logical technology component
MFN	Most Favoured Nation clause set out in Art. 19 of the DAC
MS	Member State
OECD	Organisation for Economic Cooperation and Development
OPJ	Other Partner Jurisdiction
PQP	Project Quality Plan
PS	Platform service
QA	Quality Assurance

231 This abbreviation will only be used within the IT analysis; it will not be used as a standard abbreviation.

ABBREVIATIONS/ ACRONYM	TERM
QC	Quality Control
QI	Qualified Intermediary (US legislation)
RC	Residence Country
RFC	Request for clarification (5)
RFI	Request for information
RP	Reportable Payment
Savings Directive	European Union Savings Directive (Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments)
SC	Source Country
T-BAG	Tax Barriers Business Advisory Group of the European Commission
TEMPO	TAXUD Electronic Management of Projects Online
TFEU	Treaty on the Functioning of the European Union
TIEA	Tax Information Exchange Agreement
TIN	Taxpayer Identification Number
TOGAF	The Open Group Architecture Framework
TRACE	Treaty Relief and Compliance Enhancement Group of the OECD
TRI	Tax Rate Information
UC	Use case
UCI	Undertakings for Collective Investment
UCITS	Undertakings for Collective Investment in Transferable Securities
VAT	Value Added Tax
WA	Withholding Agent
WHT	Withholding Tax

Table 56: Abbreviations and Acronyms

14.6.2 DEFINITIONS

TERM	DEFINITION
Authorised Intermediary	Any Intermediary that is recognised by the Competent Authority (on a contractual or another legal basis) as an Authorised Intermediary and is therefore authorised, under certain terms and conditions, to claim WHT relief on securities income on behalf of its Investors and on a pooled basis.
Account Holder	Any person that is a Direct Account Holder or an Indirect Account Holder and with respect to which the AI acts as an Authorised Intermediary.
Authorised Intermediary Identification Number	A unique combination of numbers assigned by the Source Country to an Authorised Intermediary.

TERM	DEFINITION
Contractual Intermediary	Any Intermediary that is neither an Excluded Intermediary with respect to the Source Country nor acting as an Authorised Intermediary and with respect to which the AI has received a valid Intermediary Declaration (original or copy) for Contractual Intermediaries: • Certifying that the Intermediary is subject to Know Your Customer Rules (except to the extent that it is an Intermediary only by reason of being a Fiscally Transparent Entity) with respect to the Account Holders for which claims are made through the AI; • Authorising the disclosure of the declaration to relevant tax administrations in accordance with its terms; and • Agreeing to specified procedures for the recovery of under-withheld tax.
Competent Authority	Competent Authority has broadly the same meaning irrespective of the international exchange of information instrument (e.g. DTT, Directive on Administrative Cooperation, Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters): According to the OECD Model Tax Convention, the term "Competent Authority" recognises that, in some OECD member countries, the execution of DTTs does not exclusively fall within the competence of the highest tax authorities; some matters are reserved or may be delegated to other authorities. Each Contracting State can thus designate one or more authorities as being competent (Commentaries on Art. 3 of the OECD Model Tax Convention). For the purposes of the Directive on Administrative Cooperation, the term "Competent Authority of an MS" means the authority which has been designated as such by that MS (Art. 3.1 of the DAC). The same applies in relation to the Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters.
Covered Payment	Any payment of dividends or interest arising in the Source Country received by the AI with respect to an account that has been designated by the AI accordingly as one for which it is acting in its capacity as an Authorised Intermediary, but only to the extent that the Covered Payment • is paid directly, or indirectly through one or more Contractual Intermediaries, to another Authorised Intermediary acting in its capacity as an Authorised Intermediary, or • if not so paid, is either – paid, directly or indirectly, to a person who is a resident of the Source

TERM	DEFINITION
	Country for tax purposes or – a payment that qualifies for a reduction or exemption from withholding tax in accordance with Paragraph 6 of the Agreement.
Direct Account Holder	Any person (including another Intermediary) who has an account directly with an Authorised Intermediary.
Excluded Intermediary	An Intermediary that has been designated as such by the Competent Authority.
Fiscally Transparent Entity	An entity or arrangement with respect to which, under applicable tax treaties or the domestic law of the Source Country, the partners, beneficiaries or similar persons are treated for tax purposes as the owners of the income received by the entity or arrangement.
Indirect Account Holder	Any person who receives amounts that have been paid through an Authorised Intermediary but who does not have a direct account relationship with the Authorised Intermediary. For example, a person that has an account with a foreign Intermediary which, in turn, is a Direct Account Holder of the AI is an Indirect Account Holder. A person is an Indirect Account Holder even if there are multiple tiers of Intermediaries (each of which would also be a Direct or Indirect Account Holder of the Authorised Intermediary) between the person and the Authorised Intermediary. If a Fiscally Transparent Entity acts as an Intermediary under these Procedures by making claims on behalf of its partners, beneficiaries or similar persons, each such partner, beneficiary or similar person will be treated as an Account Holder.
Information object	Any data sets or reports used as input and/or output during a process step. They can be generated, used or processed by IT functionalities.
Interface	A tool and concept that refers to a point of interaction between two IT functionalities or logical components. Interfaces are used to exchange information objects between IT functionalities or logical components.
Investor	Any person that receives a Covered Payment and that is not acting as an Intermediary with respect to that Covered Payment.
Investor Self-Declaration	The certification, in one of the forms set out, provided by an Account Holder to an Intermediary: • Certifying that the Account Holder is the beneficial owner of the income to

TERM	DEFINITION
	be paid or credited to the account(s) to which the certification relates; • Providing certain additional information relevant to determining the appropriate rate of withholding to be applied to the income to be received; • Authorising the disclosure of the declaration to relevant tax administrations in accordance with its terms; and • Agreeing to specified procedures for the recovery of under-withheld tax.
IT functionality	A certain functionality provided by an IT system. IT functionalities are used to describe the software capabilities of a logical application component.
Know Your Customer	Customer due diligence and record-keeping requirements relating to the opening and maintenance of accounts with financial services firms that are based on the relevant principles established by the Financial Action Task Force, including in particular Recommendations 4-11 of the 40 Recommendations relating to measures to prevent money laundering and terrorist financing and the nine Special Recommendations on terrorist financing as they relate to financial institutions (found at www.fatf-gafi.org).
Logical application component	A product- and technology-neutral description of an IT component which resembles part of an IT system. It provides information objects and IT functionalities to the user or other IT systems.
Logical technology component	A product- and technology-neutral description of an IT component which resembles part of an IT infrastructure. It provides platform services to other IT systems.
Payer	Any person that makes a Covered Payment, directly or indirectly, to an Authorised Intermediary.
Platform service	A certain functionality provided by an IT infrastructure component. Platform services are used to describe the software capabilities of a logical technology component.
Reportable Payment	Except to the extent modified by the Agreement, any Covered Payment, but only to the extent that the Covered Payment: • is paid directly, or indirectly through one or more Contractual Intermediaries, to another Authorised Intermediary acting in its capacity as an Authorised Intermediary; or • if not so paid, is either: – paid, directly or indirectly, to a person who is a resident of the Source

TERM	DEFINITION
	Country for tax purposes; or – a payment that qualifies for a reduction or exemption from withholding tax in accordance with Double Tax Treaties.
Residence Country (232)	Country where the investor has its tax residence.
Source Country (8)	The country from which dividends and interest payments arise.
Standard Transmission Format	A unique combination of letters or numbers, however described, assigned by a country or other taxing authority to its residents and used to identify the residents in the course of collecting taxes.
Tax Rate Information	Pooled information provided by an Authorised Intermediary to a Payer regarding the withholding rate to be applied to a payment.
Withholding Agent	The person who is required, under the laws of the Source Country, to withhold tax on a Cover Payment and remit it to the Source Country. The term includes an Authorised Intermediary that has also been authorised to assume withholding responsibility.

Table 57: List of definitions

14.7 REFERENCE, APPLICABLE DOCUMENTS AND SPECIFIC STANDARDS

Reference and applicable documents can be found in Appendix 29.

* *

*

232 Note that these definitions will have to be refined and detailed according to the legal aspects they cover.

CHAPTER 15 BACKGROUND, SCOPE, OVERVIEW AND ASSUMPTIONS OF THE ADDENDUM

The objective of this chapter is to set the scene of the feasibility study and enable the interested reader to understand the reason for conducting the Addendum, given the quickly moving international exchange of information environment.

To reach its informative objective, this chapter will present, on a high-level basis, the recent developments in the administrative cooperation framework (second section) and the impacts they have on the feasibility study (third section).

The fourth section of this chapter also presents the overall scope of the feasibility study (i.e. the list of questions that need to be addressed) and describes the assumptions applying to the Addendum.

* * *

15.1 BACKGROUND: THE FEASIBILITY STUDY

15.1.1 CONTEXT OF THE STUDY

605. **The FISCO Recommendation**. The feasibility study has to be put into the context of the work being done by the Commission to follow up on the Recommendation on withholding tax relief procedures (the "FISCO Recommendation") (233). This Recommendation suggests to MSs possible ways to improve their procedures for granting withholding tax relief (pursuant to double tax treaties and domestic law) on cross-border securities income earned by EU investors. It invites MSs to grant withholding tax relief at source and designs the general framework of a system that would allow foreign AIs established within the EU and approved by the SC to claim exemptions or reduced rates of withholding taxes on behalf of their investors and on a "pooled" basis. Moreover, under this system, investors would be able to indicate their entitlement to exemptions or reduced rates of withholding tax by providing an investor-self-declaration (rather than having to wait to receive residence certificates from their tax administrations).

To counter-balance the risk of tax evasion arising from the pooling of information and from the abolition of certificates of residence, the Recommendation invites MSs to explore the scope for implementing new channels of information reporting/exchange aimed at providing both source and residence MSs with investor-specific information:

- To ensure correct application of the relief at source, the information collected and exchanged should allow an SC to check whether the WHT relief has been correctly granted and enable the RC to confirm to the SC whether an investor who purported to be tax resident in that country is effectively resident there for tax purposes.

- Moreover, this would enable the RC to check whether that investor has declared and paid the tax due in his/her RC on cross-border securities income that is subject to reporting.

The Recommendation does not specify precisely how this information should be provided but suggests that the system for reporting to both source and residence countries could be modelled on the reporting system in use under EU legislation, particularly the Savings Directive (234).

The principles outlined in the Recommendation largely correspond to the approach being taken by the OECD in its TRACE work in the same area and that led to the release, in January 2013, of the TRACE Implementation Package for the Adoption of the Authorised Intermediary System i.e. a Standardised System for Effective Withholding Tax Relief Procedures for Cross-border Portfolio Income (the "Implementation Package") (235). In particular, as far as information reporting/exchange is concerned, the Implementation Package

233 C(2009)7924 of 19.10.2009. More information can be found at the following link: http://ec.europa.eu/taxation_customs/taxation/personal_tax/taxation_securities/index_en.htm.

234 Directive 2003/48/EC.

235 http://www.oecd.org/ctp/exchangeofinformation/TRACE_Implementation_Package_Website.pdf.

requires an AI that wants to claim benefits not just to pass the information up the chain on a pooled basis but also to provide SC tax administrations (on an annual basis) with investor-specific information regarding the beneficial owner of income. Once it received the information, the SC would be expected to provide it to the government of the investor's RC via automatic exchange of information programmes. Ideally, the RC would notify the SC reasonably soon thereafter if the investor who purports to be its resident in fact is not.

15.1.2 CONTENT OF THE FEASIBILITY STUDY

606. **Two Models**. The feasibility study examines the assessment of two main Models that, in the remainder of this document, are referred to as the "AIC Model" and the "SC Model." These two approaches differ mainly on the routing of the information from the AIs to the SC and the RC. In a nutshell, these two Models can be described as follows:

- **SC Model.** The AI closest to the beneficial owner reports the information to the source MS, which then provides this information automatically to the residence MSs; and
- **AIC Model.** The AI closest to the beneficial owner would report the information to the MS where it is established, which would then pass the information automatically to both source and residence MSs.

607. **Multifold Comparison.** The comparison between the SC Model and the AIC Model considers several aspects. The comparison encompasses: an analysis in terms of interaction with the EU and International Administrative Cooperation framework; an analysis from a legal perspective (i.e. legal tools available in the EU to implement the proposed system and data protection issues); an analysis of tax compliance; fraud (i.e. including an assessment of the risks of tax fraud and the identification/evaluation of mitigation measures to tackle identified risks); effectiveness; and simplification. The Study also looks at the IT issues linked to implementation of the proposed system and includes a cost/benefit analysis for all stakeholders involved.

608. **Twofold purpose.** Both Models had to be analysed considering their twofold purpose:

- Granting WHT relief in the Source MS (including checking the residence status with the relevant Residence MSs, if need be); and
- Ensuring compliance in the Residence MS.

15.1.3 METHODOLOGY

609. **Methodology.** The methodology followed in carrying out the feasibility study varies depending on the subject covered. In a nutshell, it is based on:

- Research and analysis done by PwC;
- Input provided by the Commission;
- Input provided by the 11 Member States participating in the FISCO Project Group, set up by the Commission under the Fiscalis programme;
- Input provided by various business representatives, mainly through questionnaires and also with follow-up calls.

15.1.4 FINAL OUTCOME

610. **Final Report.** On 21 December 2012, PwC submitted a final report on the feasibility study to the Commission.

15.2 RECENT DEVELOPMENTS IN THE FRAMEWORK OF THE ADMINISTRATIVE COOPERATION FRAMEWORK

15.2.1 FATCA

611. **Context change in the Administrative Cooperation Framework**. The administrative cooperation framework has changed tremendously over the last year, under the influence of FATCA as well as the alternative Models to implement FATCA that have been developed by the IRS (Appendix 31 presents and analyses FATCA and its regulations in more detail).

In chronological order, the following events are illustrative of this context change:

- **Introduction of FATCA provisions**. On 27 October 2009, members of the U.S. Senate Finance Committee and the U.S. Ways and Means Committee unveiled the Foreign Account Tax Compliance Act of 2009 ("FATCA"), which was a comprehensive proposal to clamp down on U.S. tax evasion and improve taxpayer compliance by providing the Internal Revenue Service ("IRS") with new administrative tools to detect and deter offshore tax abuses. The provisions of FATCA were ultimately enacted on 18 March 2010, as part of the Hiring Incentives to Restore Employment Act of 2010 (236), (the "Act"). Section 501(a) of the Act added chapter 4 (sections 1471-1474) to Subtitle A of the Internal Revenue Code. Chapter 4 expands the previous U.S. information reporting regime by imposing documentation, withholding and reporting requirements in respect of payments received or made by Foreign Financial Institutions ("FFIs") and Non-Financial Foreign Entities ("NFFEs").

236 Pub. L. 111-147 (H.R. 2847)

- **Additional guidance on how FATCA's provisions would operate.** FATCA's statutory provisions were broad but the U.S. Department of the Treasury ("Treasury") and the IRS were given discretion to narrow its scope and introduce variation in the implementing regulations. Notice 2010-60, released in August 2010, provided the first directional thinking on how the provisions of FATCA would operate. Treasury and the IRS subsequently issued two additional Notices (collectively, these three Notices are referred to as the "Notices"), which provided additional guidance on how FATCA's provisions would operate.

- **Proposed regulations.** On 8 February 2012, Treasury and the IRS issued proposed regulations that provide details on many of the principles introduced in the Notices. The proposed regulations also incorporate some of the ideas and suggestions received from various stakeholders. The regulations also include several provisions that were not included in the Notices.

- **First Joint Statement (France, Germany, Italy, Spain and the United Kingdom)**. Simultaneously with the issuance of the proposed regulations, the governments of the United States, France, Germany, Italy, Spain and the United Kingdom released a joint statement announcing that they were exploring a common approach to FATCA implementation through domestic reporting and reciprocal automatic information exchange (other MSs subsequently publicly expressed their intention to follow the same route). The joint statement also emphasises the willingness of the United States to reciprocate by automatically collecting and exchanging information on accounts held in U.S. Financial Institutions by residents of each of the respective countries (237).

- **Two other Joint Statements (Japan, Switzerland).** On 21 June 2012, the governments of Japan and Switzerland released joint statements with the US government regarding their intention to explore and negotiate intergovernmental agreements to facilitate the implementation of FATCA(238) (239). These statements with Japan and Switzerland contain the same broad principles, especially in the area of income tax withholding. However, there are significant differences between the three joint statements on matters related to tax information routes, registration requirements with the IRS, account due diligence and information exchange.

  In particular, the two latter statements indicate that financial institutions in each jurisdiction would be required to report directly to the IRS and not to their respective governments (a different routing of information compared to that in the first joint statement).

237 http://www.treasury.gov/press-center/press-releases/Documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf.

238 http://www.treasury.gov/press-center/press-releases/Documents/FATCA%20Joint%20Statement%20US-Japan.pdf.

239 http://www.treasury.gov/press-center/press-releases/Documents/FATCA%20Joint%20Statement%20US-Switzerland.pdf.

- **Model 1 IGA.** On 26 July 2012 the US Treasury released the First "Model Intergovernmental Agreement" to Improve Tax Compliance and Implement FATCA (below, the "*Model 1 IGA;"*) (240).

- **US-UK IGA.** On 12 September 2012, the US and the United Kingdom signed the first reciprocal agreement in this respect (241). As anticipated, the agreement follows the Model 1 IGA. Annex II to the agreement specifically identifies the UK institutions and products that are agreed as presenting a low risk of being used to evade US tax and they will, therefore, be effectively exempt from FATCA requirements.

- **IRS Announcement.** On 24 October 2012, the Internal Revenue Service released Announcement 2012-42 relating to the implementation of various provisions under FATCA.

- **Press Release issued by the US Department of the Treasury.** On 8 November 2012, the US Treasury issued a press release announcing that it is working with more than 50 countries and jurisdictions around the world to improve international tax compliance and to efficiently and effectively implement the information reporting and withholding tax provisions of FATCA.

  According to the Treasury, this development "*marks an important milestone in establishing a common intergovernmental approach to combating tax evasion*." The press release lists jurisdictions in which the Treasury is in the process of finalising an intergovernmental agreement (242), those in which it is actively engaged in dialogue,(243) and those it is working with to explore options (244).

- **Model 2 IGA.** On 14 November 2012, the US Treasury published the **Second Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA** (below, the ***"Model 2 IGA"***) (245).

  In the meantime, the Treasury has released an updated version of the first model intergovernmental agreement to integrate some of the changes and/or variations that

240 Two versions of the Model 1 IGA were issued, a reciprocal version and a non-reciprocal version. See: http://www.treasury.gov/press-center/press-releases/Pages/tg1653.aspx; http://www.treasury.gov/press-center/press-releases/Documents/reciprocal.pdf; http://www.treasury.gov/press-center/press-releases/Documents/nonreciprocal.pdf.

241 http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Agreement-UK-9-12-2012.pdf.

242 Including: France, Germany, Italy, Spain, Japan, Switzerland, Canada, Denmark, Finland, Guernsey, Ireland, Isle of Man, Jersey, Mexico, the Netherlands and Norway.

243 Including: Argentina, Australia, Belgium, the Cayman Islands, Cyprus, Estonia, Hungary, Israel, Korea, Liechtenstein, Malaysia, Malta, New Zealand, the Slovak Republic, Singapore and Sweden.

244 Including: Bermuda, Brazil, the British Virgin Islands, Chile, the Czech Republic, Gibraltar, India, Lebanon, Luxembourg, Romania, Russia, Seychelles, Sint Maarten, Slovenia and South Africa.

245 http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Model-2-Agreement-to-Implement-11-14-2012.pdf.

appeared in the different signed IGAs (i.e. those signed with each of the UK, Mexico and Denmark) (246).

- **IGAs Signed with Mexico and Denmark.** On 19 November 2012, the Treasury released IGAs signed with Mexico (the US/Mexico IGA) and on 15 November 2012 with Denmark (the US/Denmark IGA). Although the IGAs between the US and each of Mexico and Denmark follow the Model 1 IGA, some differences do exist. Moreover, as expected, the most significant differences are contained in Annex II, which is customised to identify the local entities, accounts and products that present a low risk of being used by US persons to evade US tax.

- **Spanish, Irish and Swiss announcements.** After signature of the Mexico agreement, the governments of Spain, Switzerland and Ireland announced agreement on the terms of separate IGAs with the US Treasury. The Irish IGA contains most of the provisions of the updated Model 1 IGA. The Swiss IGA is based on Model 2 IGA. In the case of Spain (agreement based on Model 1 IGA), no signed IGA had been published at the time of completion of this Addendum.

- **UK Draft regulations.** On 18 December 2012, HM Treasury and HMRC released the draft International Tax Compliance Regulations 2013 ("UK Draft Regulations") to implement the UK-US IGA and simultaneously released draft guidance notes and a summary of responses to an earlier public consultation which sought views on the UK Government's plans to legislate to deliver on the commitments made in the UK-US IGA. Responses were invited by 13 February 2013.

- **The US-Ireland IGA.** On 21 December 2012, the US and Ireland signed an intergovernmental agreement (the US-Ireland IGA). As anticipated, Annex II of the US-Ireland IGA specifically identifies the Irish institutions and products that are to be excluded from the FATCA requirements because they are seen as presenting a low risk of being used to evade US tax.

- **Final FATCA regulations.** On 17 January 2013, the long-awaited final regulations were released by the IRS. FATCA's statutory provisions were broad but the U.S. Treasury and the IRS were given powers of discretion in promulgating the regulations. This narrowing of the scope reflects most of the comment letters that were received by the U.S. government. As highlighted in the next section, the Treasury and the IRS have addressed certain of the comments received by taking steps aimed at reducing the burden that FATCA would impose on the financial industry (e.g. more reliance on documents

246 In this respect, it is useful to mention that Article 7 of the Model 1 IGA and article 6 of the Model 2 IGA provide for a kind of most-favoured nation clause named "Consistency in the Application of FATCA to Partner Jurisdictions." According to this clause, a "*[FATCA Partner] shall be granted the benefit of any more favourable terms ... of this Agreement relating to the application of FATCA to [FATCA Partner] Financial Institutions afforded to another Partner Jurisdiction under a signed bilateral agreement pursuant to which the other Partner Jurisdiction commits to undertake the same obligations as [FATCA Partner] ..., and subject to the same terms and conditions as described therein ....*"

collected for AML/KYC purposes). On the other hand, it appears clearly that certain comments were intentionally not addressed in the final regulations in order to encourage the negotiations and signing of other IGAs around the globe.

- **Swiss IGA.** On 14 February 2013, the US and Switzerland signed an IGA. This bilateral agreement was highly anticipated as Switzerland is the only country (along with Japan) that had announced its intention to conclude a Model 2 IGA with the United States. The draft Swiss legislation was released shortly after publication of the IGA.

- **German IGA initialled.** On 22 February 2013, the German Federal Ministry of Finance ("Bundesministerium der Finanzen") published a press release announcing that the United States and Germany had initialled an intergovernmental agreement ("IGA") on the implementation of FATCA. The agreement is apparently based on the Model 1 IGA and provides that the German government will implement local legislation to collect information to be shared with the IRS automatically. No text was publicly available at the time of completion of this Addendum.

- **UK IGAs with Isle of Man, Guernsey and Jersey.** On 19 February 2013, the United Kingdom agreed with the Isle of Man on an IGA including an automatic tax information exchange agreement (everything aside from the jurisdiction-specific Annexes) and the setting-up of a disclosure facility (247). Under the automatic exchange agreement, a wide range of financial information on UK taxpayers with accounts in the Isle of Man will be reported to HMRC automatically each year. It follows the UK-US IGA closely. On 15 and 20 March 2013, respectively, the governments of Guernsey and Jersey together with the government of the United Kingdom announced that they were finalising similar agreements on information exchange modelled on the IGAs being advanced in response to the U.S. FATCA regime (248) (249).

- **Cayman IGA.** On 15 March 2013, the Cayman Islands Government announced that it would adopt a Model 1 IGA.

- **Offshore Leaks.** On 4 April 2013, the International Consortium of Investigative Journalists (ICIJ) published "*Secrecy for Sale: Inside the Global Offshore Money Maze,*"(250) a multi-publication special news report based on what the ICIJ claims is the largest trove of leaked documents in history. The "Secrecy" report said that between USD

247 http://www.hm-treasury.gov.uk/press_12_13.htm#primaryContentFull
http://www.hmrc.gov.uk/offshoredisclosure/isleofman.htm.

248 The statement of the Chief Minister is available here:
http://www.guernseyfinance.com/press-room/news/2013/03/guernsey-to-agree-package-of-tax-measures-with-the-uk/.

249 The statement of the Chief Minister is available here:
http://www.gov.je/SiteCollectionDocuments/Tax%20and%20your%20money/ID%20UKTaxPackageChiefMinStatement%2020130327.pdf.
The text of the agreement is available here:
http://www.gov.je/TaxesMoney/InternationalTaxAgreements/IGAs/Pages/UKIGA.aspx.

250 http://www.icij.org/offshore.

1 trillion and USD 1.6 trillion linked to financial crimes crosses international borders each year. That report cited research by a former chief economist at McKinsey & Co., who estimated that wealthy individuals hide as much as USD 32 trillion in offshore havens (251).

- **Statement by Commissioner Šemeta on fighting tax evasion.** On 8 April 2013, Commissioner Šemeta issued a statement on fighting tax evasion, in which he mentioned that *"Recent developments, fuelled by the outcome of the Offshore Leaks, confirm the urgency for more and better action against tax evasion. The Commission has long advocated more transparency and stronger common tools to fight fraudsters, discourage evaders and ensure fair burden-sharing in taxes. Indeed we put a comprehensive package of measures on the table last December to achieve this, and have been working closely with international partners for stricter and more effective international standards. We know what is needed to better fight against fraud and evasion. We need automatic exchange of information to be widely applied, as this is the most effective way of allowing countries to collect the taxes they are due. We need a tough common stance against tax havens, including sanctions against those who facilitate evaders. And we need to block off the pathways to aggressive tax planning and close opportunities for abusive tax practices. All the tools to achieve these goals are on the table, ready to be seized. I am very pleased to see that, over the past few days, many of the MSs have reviewed where they stand on these issues and intensified their political will to act. Now it is time to put words into action. I hope to see rapid adoption of our proposals for a stronger EU stance against tax fraud and evasion."*(252)

- **Five MSs Announce Multilateral Automatic Information Exchange Pilot.** In a letter to Commissioner Šemeta dated 9 April 2013 France, Germany, Italy, Spain and the United Kingdom announced their agreement to work on a "pilot" automatic information exchange facility based on the IGAs entered into under FATCA.

  "We believe these agreements represent a step change in tax transparency, enabling us to clamp down further on tax evasion," wrote the five MSs. *"We will be looking to promote these agreements as the new international standard, including through the various international fora, with the ultimate aim of agreeing a multilateral framework."*

  The five MSs invited other MSs to join and urged progress on the implementation of Art. 8 of the DAC (which provides for mandatory exchange of information) and on the amending Savings Directive to better facilitate information exchange among the MSs and with third countries.

  In response to this letter, Mr Šemeta welcomed the pilot program and called for automatic exchange of information to become a global standard.

251 Tax Analysts, *Reports Highlight Offshore Money Flow and U.S. Taxpayer Burden*, 5 April 2013, W. Hoffman and L. McPherson.

252 http://europa.eu/rapid/press-release_MEMO-13-314_en.htm.

"This initiative is a very clear sign that the automatic exchange of information, which has been the long-time EU standard, is the only way forward," said Mr Šemeta. *"The recent evolution of the US approach further confirms this."*(253)

- **Informal Ecofin Council.** At the informal Ecofin Council, on 12-13 April 2013, Belgium, the Czech Republic, the Netherlands, Poland and Romania expressed an interest in joining the pilot initiative.

- **Ecofin Council.** At the Ecofin Council held on 14 May 2013, the MSs agreed to give a negotiating mandate to the Commission to improve the EU's savings taxation agreement with Switzerland, Liechtenstein, Monaco, Andorra and San Marino so as to reflect the changes included in the revised Savings Directive. On that occasion, MSs also adopted Council conclusions on tax evasion and tax fraud (254).

- **Norwegian IGA.** Norway's Finansdepartementet released the final IGA between that country and the United States on 15 April 2013.

- **G20 Meeting.** In their communiqué of 19 April 2013, the G20 made the following statement with respect to the exchange of information in tax matters: *"More needs to be done to address the issues of international tax avoidance and evasion, in particular through tax havens, as well as non-cooperative jurisdictions. We welcome the Global Forum's report on the effectiveness of information exchange. We commend the progress made by many jurisdictions, but urge all jurisdictions to quickly implement the recommendations made, in particular the 14 jurisdictions where the legal framework fails to comply with the standard. Moreover, we are looking forward to overall ratings to be allocated by year end to jurisdictions reviewed on their effective practice of information exchange and monitoring to be made on a continuous basis. In view of the next G20 Summit, we also strongly encourage all jurisdictions to sign or express interest in signing the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and call on the OECD to report on progress. We welcome progress made towards automatic exchange of information, which is expected to be the standard, and urge all jurisdictions to move towards exchanging information automatically with their treaty partners, as appropriate. We look forward to the OECD working with G20 countries to report back on the progress in developing of a new multilateral standard on automatic exchange of information, taking into account country-specific characteristics. The Global Forum will be in charge of monitoring..."* (255).

253 Tax Analysts, *5 EU Members Announce Multilateral Automatic Information Exchange Pilot*, 10 April 2013, David D. Stewart. The letter can be found here: http://www.bundesfinanzministerium.de/Content/DE/Pressemitteilungen/Finanzpolitik/2013/04/2013-04-09-PM25-anl1.pdf?__blob=publicationFile&v=2.

254 9549/13

255 Communiqué, Meeting of Finance Ministers and Central Bank Governors, Washington, 18-19 April 2013; The full communiqué is accessible at the following address: http://en.g20russia.ru/load/781302507.

The Vice-President of the European Commission and member of the Commission responsible for Economic and Monetary Affairs and the Euro, Olli Rehn, made the following statement on behalf of the European Commission: *"We particularly welcome today's endorsement of automatic exchange of information, and look forward to working with the OECD and G20 countries on developing new international standards on this. The EU has a wealth of experience in this area. The Commission looks forward to contributing this practical experience and expertise to the international debate."* (256).

- **Luxembourg Announcement.** On 21 May 2013, Luxembourg announced it had chosen the Model 1 IGA (257)

- **European Council.** On 22 May 2013, the European Council adopted conclusions on taxation in which, inter alia, it called for rapid progress on extending the automatic exchange of information at the EU and global levels.

  "At the level of the EU, the Commission intends to propose amendments to the Directive on administrative cooperation in June in order for the automatic exchange of information to cover a full range of income. At the international level, building on on-going work in the EU and on the momentum recently created by the initiative taken by a group of Member States, the EU will play a key role in promoting the automatic exchange of information as the new international standard, taking account of existing EU arrangements. The European Council welcomes on-going efforts made in the G8, G20 and OECD to develop a global standard"(258).

- **German IGA.** On 31 May 2013, the German IGA was released on the website of the German Ministry of Finance (259).

15.2.2 MFN CLAUSE IN THE DIRECTIVE ON ADMINISTRATIVE COOPERATION

612. **Wider Cooperation.** Several MSs have stated (publicly or at meetings) that they intend to sign, or are at least considering the possibility of signing, IGAs with the US on FATCA. The signature by MSs of IGAs with the US providing for government-to-government cooperation could have important implications for the EU administrative cooperation framework. This is because, under Art. 19 of the DAC (260), *"where a Member State provides a wider cooperation to a third country than that provided for under this Directive, that Member State may not refuse to provide such wider cooperation to any other Member State wishing to enter into such mutual wider cooperation with that Member State."*

256 Speaking Points by Vice-President Rehn at the EC-ECB Press Conference, Reference: SPEECH/13/344, Event Date: 19/04/2013; http://europa.eu/rapid/press-release_SPEECH-13-344_en.htm.

257 http://www.mf.public.lu/publications/divers/facta_francais_210513.pdf

258 EUCO 75/13

259 http://www.bundesfinanzministerium.de/Content/DE/Standardartikel/Themen/Steuern/Internationales_Steuerrecht/Staatenbezogene_Informationen/Laender_A_Z/Verein_Staaten/2013-05-31-FATCA-einvernehmenserklaerung.html?source=stdNewsletter.

260 Directive 2011/16/EU.

It is worth analysing whether signing an IGA with the US would constitute the "*wider cooperation provided to a third country"* that triggers an obligation for the MS concerned to provide such wider cooperation to any other MS wishing to reciprocate. Chapter 16 analyses this question thoroughly.

15.3 IMPACT OF RECENT DEVELOPMENTS ON THE FEASIBILITY STUDY

15.3.1 RESULTS INCLUDED IN THE FEASIBILITY STUDY

613. **Single Routing.** As mentioned in the feasibility study, for obvious reasons linked to efficiency and standardisation, a single routing system should ideally be applied for granting WHT relief in the SC and for ensuring compliance in the RC through exchange of information between tax administrations, and this should be done worldwide or at least within the EU.

614. **Preferred Model.** As illustrated in the general conclusion of the feasibility study, it appears in many cases that the preference for either the SC Model or the AIC Model changes according to the priority of the MSs. That said, from a global perspective, the analysis demonstrates that, based on the criteria applied, the AIC Model offers more advantages and more guarantees of fulfilling the objectives of the system, at least within the EU. However, the recent developments concerning FATCA may have changed the general picture in which the relief at source system examined in the feasibility study has to be placed.

15.3.2 MORE INFORMATION TO RCS AS A RESULT OF FATCA

615. **MSs to Deal With FATCA Bilaterally**. Every MS will have to deal with FATCA in the short term. In particular, due to FATCA, MSs will have to decide whether they want to enter into an agreement whereby local financial institutions report certain information concerning US citizens to their respective national tax administrations, followed by automatic exchange of such information by tax administrations to the US under existing DTTs or TIEAs. More importantly, MSs will in any case have to adapt their domestic laws according to the choice they make.

616. **Enhancement of the Administrative Cooperation Between MSs.** We can therefore assume that the IGAs to be signed between MSs and the US will enhance administrative cooperation between these countries and will result in a situation where more information will be available to the US and the MSs about income earned by their citizens/residents abroad.

617. **Enhancement of Automatic Exchange of Information.** Moreover, the implementation of FATCA could pave the way for a global enhancement of automatic exchange of information. In effect, if countries have to adopt domestic laws obliging their financial institutions to report on the accounts of US persons, these countries should be able to extend the laws to require reporting of information about all non-residents. In that way, the tax administrations of these countries would be in a position to automatically exchange this information with the tax administrations of all other countries concerned. While global automatic information exchange is currently only a possibility, it may be that, within the EU, MSs may be legally obliged to offer other MSs the same level of cooperation offered to the

US under FATCA bilateral agreements. In effect, therefore, the signing of IGAs between MSs and the US on FATCA could trigger application of the MFN Clause of the Directive on Administrative Cooperation, which could result in a general increase in the amount of information that MSs have to make available to each other for RC tax compliance purposes (see Chapter 16 for more details on this analysis).

This could therefore have an impact on the relief at source system as foreseen in the Implementation Package.

15.3.3 FFIs to Report to Their Tax Administrations for FATCA Purposes Under Model 1 IGA

618. **Parallel Between Model 1 IGA and the Savings Directive.** Another important development brought about by FATCA is that FFIs established in countries that sign a Model 1 IGA will report the information required by FATCA to their own tax administrations, rather than directly to the US (as provided in the original FATCA legislation). The tax administrations concerned will then provide this information to the US on an automatic basis.

We can today confirm that, amongst MSs, the reporting of information from the country of establishment of the financial institution to the country of residence of the investor (i.e. the US, at least in the first instance) will further expand (routing of information similar to the Savings Directive).

We can therefore conclude that, in the near future, due to the combination of the Savings Directive and FATCA (as implemented under the Model 1 IGA approach), RC reporting using a routing passing through the tax administrations of establishment of the financial institutions will become more generalised.

619. **Impact of a Generalised Adoption of the AIC Routing for RC reporting on the Relief at Source System.** The Savings Directive, FATCA and the relief at source system provided for under the Implementation Package involve reporting by financial institutions with respect to their account holders and exchange of such information between tax administrations, but the regimes have different objectives. Not all the stakeholders involved in the reporting and exchange under the relief at source system will be required to report under FATCA and vice-versa (261). The information to be reported under each of these regimes is similar but not identical, given that it serves different purposes. Given that standardisation of reporting requirements is very important for both financial institutions and tax administrations, for cost-savings and efficiency reasons, and given the possible burden on AICs, it is worth considering the impact that a generalised adoption of the AIC Routing for RC reporting purposes could have on the proposed relief at source system. In this respect, consideration should be given to the possibility to increase efficiency from the perspectives of both the financial institutions required to report the data and the tax administrations having to extract the data and exchange it. Therefore, it is interesting to explore to what extent it is still

261 With the exception of fiscally transparent entities, all intermediaries under the FISCO/TRACE system will also be subject to reporting under FATCA. However, the number of intermediaries covered by FATCA is certainly much larger than the number of intermediaries under FISCO/TRACE.

realistic, from the perspectives of both AICs and FFIs, to have all reporting done via the AICs. That could in future mean that AIs/FFIs would have to report to their local tax administrations for the purposes of: FATCA, the Savings Directive, the new reporting arrangements that may have to apply between MSs under MFN Clauses as a result of the adoption of IGAs, the automatic exchange of information provided for under Art. 8 of the DAC, any possible new FATCA-style arrangements that other third countries might introduce, the relief at source system provided for under the Implementation Package, and domestic reporting regimes.

620. **Combination of AIC and SC Reporting**. If AIs were to report directly to SCs for the purpose of the relief at source system in combination with reporting to their local tax administrations under the Model 1 IGAs for the purpose of RC reporting, it would also be useful to analyse whether it would relieve the burden on AICs without creating an important additional burden for AIs and how this combination might or might not entail duplication of efforts and reporting or a requirement to prepare different data.

15.4 SCOPE AND ASSUMPTIONS OF THE ADDENDUM TO THE FEASIBILITY STUDY

15.4.1 SCOPE OF THE ADDENDUM TO THE FEASIBILITY STUDY

621. **Addendum Request.** In the light of the above considerations, the Commission has requested PwC to examine, in a short Addendum to the feasibility study (the "Addendum"), whether the conclusions included in the feasibility study with respect to the preferred Model to channel investor information to the SC and the RC are still valid or need to be revised.

622. **List of Questions Examined.** Below is a list of questions covering the main areas that the Commission has asked PwC to address:

- **Question 1: Trigger Events for the MFN Clause.** Would the FATCA bilateral agreements under negotiation (i.e. assumed to be the Model 1 IGA or Model 2 IGA) between MSs and the US trigger the application of the MFN Clause included in the Directive on Administrative Cooperation?

- **Question 2: Level of Cooperation under the MFN Clause.** Will there be a difference in terms of cooperation that an MS could require from another MS, depending on the type of Model IGA agreement (i.e. Model 1 or Model 2) that will be signed, or other possible solution chosen by a given Member State (i.e. assuming it would be possible, what would be the implications of the mere adaptation of the legislation of the Member State so as to enable the FFIs located therein to exchange information to the US without formally entering into a Model IGA)?

- **Question 3: RC Reporting under the relief at source system provided for in the Implementation Package.** Given that FATCA, the bilateral agreements to implement it and the potential future MFN effects, could result in a generalised increase in the information available to RCs for their tax compliance purposes, are the features of the

relief at source system that are primarily focused on residence-country compliance still needed? In particular, is it necessary, given FATCA and the MFN effect, to keep in the relief at source system the requirement for SCs to provide information automatically to RCs on residents of the RCs claiming relief from the SCs?

- **Question 4: Amendments to the relief at source system provided for in the Implementation Package.** Should the answer to question no. 3 be "no", how could the original relief at source system be modified/simplified to reflect this context change? In particular:

  a. **Pooled Information.** Would the provision of pooled information be sufficient, as under the QI system?

  b. **Minimum Level of Information.** If the provision of investor-specific information by SCs to RCs is no longer necessary, what kind of information, if any, should SCs provide to RCs in order to ensure proper application of both relief at source and the RC's taxation rules?

  c. **Feedback.** Should the RC still be required to provide feedback to the SC?

  d. **Duplicate Reporting.** How otherwise could duplication of reporting be avoided?

  e. **Entry into Force.** Would it be necessary to link the entry into force of the relief at source system with the generalised application of the enhanced RC reporting system brought about by FATCA?

- **Question 5: SC Reporting under the AIC Model.** Could the potential generalised adoption of an AIC Model for the purpose of RC reporting also justify use of the AIC Model for the purpose of SC reporting, under the relief at source system? In particular:

  a. **Data Flows and Type of Reporting.** How do the data flows and type of reporting required for compliance in the RC under FATCA compare with the data flows and type of reporting required for WHT relief in the SC under the relief at source system?

  b. **Efficiency for Financial Institution.** Would such a solution be the most efficient from the perspective of the financial institutions, considering the various reporting obligations they have under domestic and EU law and corresponding IT systems?

  c. **Efficiency for AICs.** Would such a solution be the most efficient from the perspective of the tax administrations of the AICs, considering that they would have to extract the data received and send it to different countries at different times for different purposes? What role do IT considerations play in this respect?

  d. **Duplicate Reporting.** Would such a solution reduce or increase duplication of reporting?

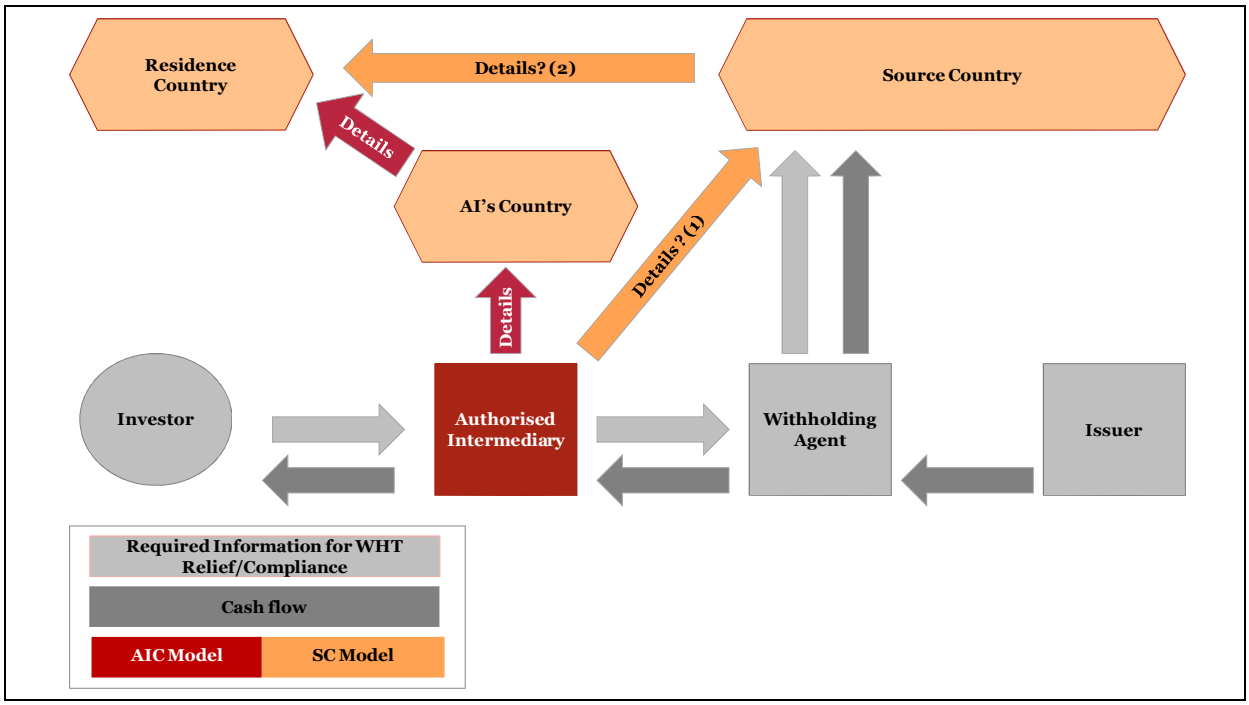
- **Question 6: AIC Model for SC Reporting: Content and Timing of Reporting under the AIC Model, the Savings Directive and FATCA.** Should the answer to question no. 5 be "yes", would it be possible and desirable to align the information to be reported under the relief at source system with the information to be reported under FATCA and the Savings Directive? And the timelines for reporting? In particular:

  a. **Aggregate Amounts.** Would it be reasonable to require AIs to report under the relief at source system only aggregate amounts of dividends and interest rather than individual dividends and interest payments (on the basis that the SC could, in cases of doubt, request detailed information from the AIs or the AICs)?

  b. **Other Elements of Information.** Are there other types of information that could be aligned?

  c. **Timeline.** Should the timeline for reporting under FATCA, the Savings Directive and the relief at source system be aligned?

- **Question 7: Purpose-Specific Model:** Should the answer to question no. 5 be "no", would a solution whereby different routing systems are used for different purposes (see illustration below) and, therefore, whereby information is provided in different ways, depending on the purpose for which it is provided (i.e. to satisfy the information needs of the SC or of the RC) be more efficient than a solution based on a single routing system to achieve different purposes?



In particular:

a. **Description.** How would this solution work in practice (description of the main principles underlying the solution)?

b. **Reporting to SC.** Under such a separate routing system for FATCA v. the relief at source system provided for in the Implementation Package, would the provision of investor-specific information by AIs to SCs still be necessary? If not, what kind of information should be provided? Would the provision of pooled information be sufficient, as under the QI system?

c. **Reporting to RC by the SC.** Under such a solution, would the provision of investor-specific information by SCs to RCs still be necessary? If so, what kind of information should SCs provide to RCs?

d. **Feedback from the RC to the SC.** Should the RC still be required to provide feedback to the SC?

e. **Entry into Force.** Would it be necessary to link the entry into force of the two systems? What are the risks of having the relief part of the system in force before the RC compliance part? And what about the opposite solution?

f. **Interactions.** How would such a solution interact with the Savings Directive, the Directive on Administrative Cooperation and FATCA?

g. **Legal Instruments.** What legal tools would be necessary to implement such a solution (contracts/EU legislation)?

h. **Extension to Third Countries.** Would it be easier or more difficult to implement such a solution with respect to third countries compared to the relief at source system implemented under the AIC Model?

623. **Conclusion Chapter**. A conclusion is included at the end of the Addendum to illustrate the main conclusions of the analysis made. This chapter refers to the main conclusions of the feasibility study and explains whether, to what extent and how those conclusions should be revised in light of the context change considered in the Addendum.

15.4.2 ASSUMPTIONS

624. **Assumptions of the Final Report to the Feasibility Study.** On top of the assumptions already detailed in the final report to the feasibility study, the following additional assumptions apply to the Addendum.

625. **Tax and Legal Analysis.** The Addendum only focuses on the tax and legal aspects. Where the analysis of these aspects has given rise to related IT aspects (covered in Chapter 10 of the feasibility study) the latter is also briefly covered. The IT analysis is only performed to the extent that it is necessary to answer the questions listed below and is based on the

assumption that the IT format that would be used by financial institutions and tax administrations to report/exchange information for the purposes of FATCA is compatible with the IT format currently used for the purposes of the Savings Directive (FISC 153).

626. **Out of Scope.** The other aspects covered by the feasibility study, such as a description of the operating models, data protection issues, cost-benefit analysis or high-level implementation plan, are not dealt with in the Addendum.

627. **Theoretical Analysis**. Unlike that which was done for the feasibility study, the present Addendum focuses on a theoretical analysis only, based on an assessment of the existing and future relevant legislation in the area under examination. Note that some aspects covered and views gathered in the feasibility study (e.g. in Chapter 8 "Effectiveness and Tax Compliance") were based on answers to questionnaires provided by and interviews with representatives of participating financial institutions and tax administrations. The positions that are taken in the Addendum consequently need to be balanced as they have not been checked with business and tax administration representatives.

* *

*

CHAPTER 16 MOST-FAVOURED NATION CLAUSE

In this chapter, the scope and application constraints of the MFN Clause provided in Art. 19 of the DAC are addressed. Then the MFN clause is analysed in the light of the recent FATCA developments.

Two questions are addressed: (1) Would the FATCA bilateral agreements under negotiation (i.e. assumed as being the Model 1 or 2 IGAs) between individual MSs and the US trigger application of the MFN Clause included in Art. 19 of the DAC? and (2) Will there be a difference in terms of cooperation that a MS could require of another MS, depending on the type of Model IGA agreement (i.e. Model 1 or Model 2) that is signed, or other possible solution chosen by a given MS (i.e. assuming it would be possible, adaptation of the legislation of the MS so as to enable the FFIs located there to provide information to the US without the MS formally entering into an IGA)?

* * *

16.1 BACKGROUND AND QUESTIONS

628. **Agreements between MSs and the US on FATCA and Wider Cooperation.** As already mentioned in the feasibility study (para. 130) and recalled in Chapter 15, the fact that several MSs have signed or are going to sign bilateral agreements (IGAs) with the US on FATCA means that these MSs will most probably enter into a "wider cooperation" as regards exchange of information with the US, as provided under Art. 19 of the DAC. As a result, that wider cooperation could have to be extended to other MSs wishing to enter into it (as a result of the "Most-Favoured Nation" – MFN Clause).

629. **Questions.** In this chapter, the MFN Clause is further analysed in the light of the bilateral agreements currently being negotiated under FATCA (Model 1 IGA and Model 2 IGA). In particular,

- **Events Triggering the MFN Clause.** Would the FATCA bilateral agreements under negotiation (i.e. assumed as being the Model 1 IGA or Model 2 IGA) between individual MSs and the US trigger application of the MFN Clause included in Art. 19 of the DAC?
- **Level of Cooperation under the MFN Clause.** Will there be a difference in terms of cooperation that a MS could require from another MS, depending on the type of Model IGA agreement (i.e. Model 1 or Model 2) that is signed, or other possible solution chosen by a given MS (i.e. assuming it were possible, adaptation of the legislation of the MS to enable the FFIs located there to provide information to the US without the MS formally entering into an IGA)?

16.2 ANALYSIS OF THE MFN CLAUSE OF THE DIRECTIVE ON ADMINISTRATIVE COOPERATION

16.2.1 EVENT TRIGGERING THE MFN CLAUSE

630. **MFN Clause.** To recall, Art. 19 of the DAC states that: "*Where a Member State provides a wider cooperation to a third country than that provided for under this Directive, that Member State may not refuse to provide such wider cooperation to any other Member State wishing to enter into such mutual wider cooperation with that Member State.*"

631. **Rights of the MSs.** This MFN Clause basically creates a right, the beneficiaries of which are the various MSs (and not taxpayers).

This statement is strengthened by recital number 22 of the DAC, which confirms the intention of European law (our underlining) "*<u>It should also be made clear that</u> where a Member State provides a wider cooperation to a third country than is provided for under this Directive, it should not refuse to provide such wider cooperation to other Member States wishing to enter into such mutual wider cooperation.*"

632. **Cooperation provided for under the Directive on Administrative Cooperation.** To assess whether the cooperation provided for under the Model IGAs (Model 1 IGA or Model 2 IGA) is wider than the cooperation provided for under the Directive on Administrative Cooperation, it is first necessary to assess the scope of the cooperation that the latter provides.

The various provisions of the Directive on Administrative Cooperation have already been described in Appendix 8 of the feasibility study. To recall, it covers the following aspects in particular:

- Exchange of information:
  - Exchange of information on request (with specific provisions with respect to procedure, administrative enquiries, time limits);
  - Mandatory automatic exchange of information;
  - Spontaneous exchange of information (scope and conditions, time limits);
- Other aspects of administrative cooperation:
  - Presence in administrative offices and participation in administrative enquiries;
  - Simultaneous controls;
  - Administrative notification;
  - Feedback;
  - Sharing of best practices and experience;
  - Conditions governing administrative cooperation (disclosure, limits, obligations).

The cooperation provided for in the Directive on Administrative Cooperation is thus not limited to exchange of information between competent authorities, but extends to many other forms of cooperation between MSs.

633. **Wider Cooperation.** The MFN Clause raises numerous questions of interpretation (some of which had briefly been touched upon in the feasibility study).

An important question is "when do we have wider cooperation?" We briefly discuss below the questions we consider of particular interest in this respect.

- **Field of Taxation.** The MFN Clause is part of the Directive on Administrative Cooperation, and so it should therefore, at least in part, be limited by its general scope (described in its recitals and Arts. 1 and 2 in particular). For instance, interpreting the MFN Clause to the extent that it applies beyond the field of taxation would be too far-reaching.

- **Taxes Excluded.** Having said that, there is a question whether the MFN Clause could apply, say, to taxes of any kind specifically excluded from the scope of the Directive on Administrative Cooperation such as social security contributions, customs duties, VAT, etc. In the framework of this study, this question should not be an issue given that FATCA (and the Model 1 and 2 IGAs) mainly concern direct taxation.

- **Elements of Cooperation Covered by the Directive on Administrative Cooperation.** With respect to elements of cooperation between MSs already ruled out by the Directive on Administrative Cooperation, one might ask whether it would be sufficient to exclude any wider cooperation when such an element of cooperation also exists, even if differently, in cooperation granted to a third country. In other words, the question arises whether the MFN Clause would be ineffective in the case of topics already covered by the Directive on Administrative Cooperation.

  For instance, the automatic exchange of information is covered by the Directive on Administrative Cooperation, so that any automatic exchange of information that might be granted by a MS to a third country would not be considered as wider cooperation according to the MFN Clause. In that case, "wider cooperation" would be limited to topics not yet covered – at all – in the Directive on Administrative Cooperation. We think, for instance, of the Model 2 IGA, where a MS would direct and enable its financial institutions to register and to enter into agreements with the IRS. Indeed, "mandatory registration by local financial institutions with foreign tax administrations" is not a topic covered by the Directive on Administrative Cooperation.

  In our view, this interpretation would be too restrictive: topics already covered by the Directive on Administrative Cooperation should in our view nevertheless be subject to MFN effects if the cooperation a MS grants to a third country in this respect is more efficient (e.g. broader scope of application, broader obligations, less-constraining limits, stricter time limits for exchange of information, etc.).

  For instance, (cf. para. 80 of the feasibility study for more information in this respect) the mandatory automatic exchange of information provided for in the Directive on Administrative Cooperation :

  – does not apply to dividends (262) and interest (263) and

  – only applies to information available in the respective MS (264).

262 Even if it could potentially be applied in the future as Art. 8.5 provides that the list of categories may be extended to include dividends. As a result, until July 2017, dividends are not in scope of the automatic exchange of information and no political agreement has been reached in this respect so far.

263 The Directive on Administrative Cooperation is silent on interest. This is due to the already existing Savings Directive, whose principal purpose is the automatic exchange of information, under specific conditions, as regards interest payments to individuals.

If a MS commits to obtain information about dividends and interest from its financial institutions (265) and to exchange it with the IRS, this should in our view be understood as wider cooperation within the meaning of the MFN Clause.

- **Detailed Comparison.** The comparison between the cooperation granted to MSs and to third countries could even potentially be assessed at a further detailed level: the question arises whether we should consider a cooperation agreement (e.g. a Model IGA) as a "package" or at the level of its various components.

  For instance, the mere timing under which information is provided could also possibly be considered as a point of comparison. Assuming the timing of the automatic exchange of information carried out by a MS to other MSs under the Directive on Administrative Cooperation were longer than that for the automatic exchange of information provided under the Model 1 IGA, then the other MSs could possibly consider the shorter timing as a form of wider cooperation.

  The same questions arise with respect to the content of the information exchanged, format, means of exchange of information (electronic or otherwise, etc.), penalties, tax administration audit procedures, due diligence requirements imposed upon FIs, etc. which could all be considered as points of comparison.

  As this has not been discussed in the preparatory works of the Directive on Administrative Cooperation, nor so far by legal writers, and considering there is as yet no case law available in this respect, this gives room for interpretation (266). This matter will most probably be a discussion point between MSs.

- **Consistency Clause of the IGAs.** Art. 7 of the Model 1 IGA and Art. 6 of the Model 2 IGA provide a specific clause named *"Consistency in the Application of FATCA to Partner Jurisdictions."*

  According to this *"Consistency clause,"* a *"[FATCA Partner] shall be granted the benefit of any more favourable terms ... of this Agreement relating to the application of FATCA to [FATCA Partner] Financial Institutions afforded to another Partner Jurisdiction under a signed bilateral agreement pursuant to which the other Partner Jurisdiction commits to undertake the same obligations as [FATCA Partner] ..., and subject to the same terms and conditions as described therein ...."*

---

264 It is indeed important to recall that the mandatory automatic exchange of information under the Directive on Administrative Cooperation is currently subject to information being available in the respective MS (Art. 8.1), which is clearly a limit on the exchange of information.

265 Including the commitment to request its FFIs to conduct certain due diligence procedures required by the third country, to collect account information such as account balances etc.

266 We are indeed in a "grey zone" but, in our view, application of the MFN Clause should cover any component of the cooperation, being the content of the information, the way it is exchanged, etc., which means that the requesting MS may ask equivalent or less information (but not more) under the same (or equivalent) conditions from a MS exchanging information with a third country.

Under the US-UK IGA, for instance, the United Kingdom is thus granted the benefit of any "more favourable terms"(267) under (Art. 4 or Annex 1 of) the US-UK IGA relating to the application of FATCA to UK FIs afforded to another Partner Jurisdiction ("OPJ") under a signed bilateral US-OPJ IGA pursuant to which the other Partner Jurisdiction commits to undertake the same obligations as the United Kingdom (described in Art. 2 and 3 of the US-UK IGA) and subject to the same terms and conditions (as described therein and in Art. 5 through 9 of the US-UK IGA). In other words, if an OPJ commits to the same obligations under the same terms and conditions as the UK, then the UK FIs could apply the more favourable terms included in the IGA between the US and that OPJ.

As a result, the exact level of cooperation that will be granted by MSs to the US based on the IGAs might still vary based on possible variations in the IGAs that will be entered into by the US with OPJs.

- **Cooperation provided by the MS.** It is important to note that the MFN Clause is applicable when an "MS" provides cooperation to a third country. The question arises whether wider cooperation granted to a third country in the sense of the MFN Clause could apply when the tax administration of a MS is not directly involved.

  For instance, in the Model 2 IGA, the MS has to direct and enable its FIs to register with the IRS and comply with the requirements of an FFI Agreement, including with respect to due diligence, reporting and withholding (268). In addition, with respect to Pre-existing Accounts identified as U.S. Accounts, the MS will also direct and enable its FIs to report the aggregate information required with respect to Non-Consenting U.S. Accounts annually to the IRS, in the time and manner required by an FFI Agreement and relevant U.S. Treasury Regulations (which will, in turn, give rise to group requests) (269).

  In such cases, the tax administration of the MS does not take part in the cooperation the MS grants to the third country (general rules applicable to New Accounts), or, at least, it does not participate in the initial delivery of information to the IRS (transitional rules applying to Existing Accounts).

267 Which most probably means providing "less" information (e.g. less categories of income), carrying out "fewer" due diligence checks, using "higher" thresholds up to which no information is reported, etc.

268 FFIs covered by a Model 2 IGA with the US will be required to implement FATCA in the manner prescribed by those regulations except to the extent expressly amended by the Model 2 IGA. To the extent MSs enter into an IGA based on Model 2, this could potentially import the entire US final regulations regime (including 1042 reporting) into the EU context through the MFN Clause.

269 Under the Model 2 IGA, the partner jurisdiction agrees to *"direct and enable all FFIs that are located in the jurisdiction ... to register with the IRS and report specified information about U.S. accounts directly to the IRS in a manner consistent with chapter 4 and these final regulations, except as expressly modified by the Model 2 IGA. In the case of certain recalcitrant account holders, the information reported to the IRS by FFIs covered by a Model 2 IGA is supplemented by government-to-government exchange of information."* (See page 16 of the final regulations).

In our view, the MS nevertheless grants cooperation to the US by enforcing legislation which "directs and enables" its FIs to register with the IRS and comply with the US regulations (270) (271).

It is interesting to note the difference in terms of wording used to define the cooperation provided under the two Model IGAs: whereas the Model 1 IGA aims to "implement" FATCA, the Model 2 IGA aims to "facilitate the implementation" of FATCA. In our view, however, it does not affect the fact that cooperation is granted by a MS to a third country.

- **Legal Instrument Providing the Cooperation.** As already mentioned in the feasibility study, it can be argued that the legal instrument providing for such wider cooperation should not be relevant. In our view, indeed, the key element is the existence of wider cooperation between an MS and a third country. This cooperation could be provided in an act (as in the Model IGA signed by the UK, where the intergovernmental agreement will be implemented through an Act voted by Parliament), a decree, a practice note issued by the tax administration, guidelines issued by an official body, etc.).

  According to the regulations, a Model IGA is defined (being Model 1 or 2) as "*an agreement or arrangement between the United States or the Treasury Department and a foreign government or one or more agencies thereof ....*" In our view, the method used to enter into the wider cooperation under a Model IGA (e.g. agreement or arrangement) and the parties involved (a government or an agency) should be irrelevant.

- **Unilateral and/or Non-Reciprocal Cooperation.** A specific piece of legislation or administrative practice from which it might result that an MS unilaterally (without entering into any Model IGA (272)) grants wider cooperation to a third country than that provided in the Directive on Administrative Cooperation, or grants such cooperation based on the "non-reciprocal" Model 1 IGA (or the Model 2 IGA) could also be considered as triggering potential application of the MFN Clause. In other words, the fact

270 The term Model 2 IGA means (our underlining) "*an agreement or arrangement between the United States or the Treasury Department and a foreign government or one or more agencies thereof to facilitate the implementation of FATCA through reporting by financial institutions directly to the IRS in accordance with the requirements of an FFI agreement, supplemented by the exchange of information between such foreign government or agency thereof and the IRS.*" (See page 157 of the final regulations, [§1.1471-1(b)(73)])

271 The cooperation is also granted where the MS removes domestic legal obstacles to compliance, such as in the Swiss agreement, where Art. 271 of the Swiss Criminal Code (Unlawful activities on behalf of a foreign state) is declared not to apply.
Art. 4 of the Swiss agreement (Enabling Clause) indeed states that "*Swiss Financial Institutions that, pursuant to applicable U.S. Treasury Regulations, enter into an FFI Agreement with the IRS or register with the IRS as deemed-compliant FFIs, are authorized and therefore not liable to any penalty according to Article 271 of the Swiss Criminal Code.*"

272 Thus without necessarily having recourse to a DTT, the Convention on Mutual Administrative Assistance in Tax Matters or any Tax Information Exchange Agreement.

that the cooperation granted to a third country might be unilateral or non-reciprocal is in our view irrelevant (273).

This interpretation is supported by an analysis of the legislative history of the Directive on Administrative Cooperation with respect to the MFN Clause.

- Indeed, at an early stage (274), the MFN Clause only stated that *"Where a Member State provides wider cooperation to a third country than is provided for under this Directive, it may not refuse to provide such wider cooperation to the other Member State."*

- It is only later on that the MFN Clause made reference to the mutual character of the wider cooperation, and this reference has only been made in the last part of the provision, i.e. the part dealing with cooperation between the MSs (cf. *"... to other Member States wishing to enter into such mutual wider cooperation").*

- This interpretation is in line with the "mutual assistance" fundamentals of the Directive on Administrative Cooperation (275) and is at least partly explained in the Report of 1 February 2010 on the proposal for a Council directive on administrative cooperation in the field of taxation (our underlining): "*With respect to the international aspects of the proposal, the rapporteur considers the introduction of a most-favoured-nation clause to be a very positive step so that the Member States guarantee, <u>between themselves</u>, the same level of cooperation as they have with third countries. This will mean that the Member States conduct all their cooperation relations in the field of taxation in the Community register."*(276)

- In other words, the fact that the wider cooperation with the third country is not reciprocal does not constitute an obstacle to application of the MFN Clause. This has to be distinguished from the wider cooperation between two (or more) MSs pursuant to application of the MFN Clause, which will in any case have to be "mutual"

273 This interpretation is upheld by the Directive on Administrative Cooperation, which considers that wider cooperation can be done by MSs not only based on bilateral or multilateral agreements, but also under their national law.
Recital 21 to the Directive on Administrative Cooperation indeed states that (our underlining) *"This Directive contains minimum rules and should therefore not affect Member States' right to enter into wider cooperation with other Member States <u>under their national legislation</u> or in the framework of bilateral or multilateral agreements concluded with other Member States."*

274 Proposal for a Council Directive on administrative cooperation in the field of taxation, Brussels, 4 February 2009, Interinstitutional File: 2009/0004 (CNS), 6035/09, FISC 16.

275 See *inter alia* recital number 1 *"The Member States' need for mutual assistance in the field of taxation is growing rapidly in a globalised era"* and recital number 2 *"There is a need for instruments likely to create confidence between Member States, by setting up the same rules, obligations and rights for all Member States."*

276 Report on the proposal for a Council directive on administrative cooperation in the field of taxation, 1 February 2010, PE 430.610v02-00, A7-0006/2010, (COM(2009)0029 – C6-0062/2009 – 2009/0004(CNS)), Committee on Economic and Monetary Affairs, Rapporteur: Alvarez
http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2010-0006&language=EN#title1.

(reciprocal). The requesting MS is indeed obliged to grant the same wider cooperation as that which is requested.

16.2.2 CONTENT OF THE WIDER COOPERATION BETWEEN MSS

634. **Such Wider Cooperation.** Another question is "how to apply" the MFN Clause?

The text of the Directive on Administrative Cooperation states that the MS granting wider cooperation to a third country may not refuse to provide "such" wider cooperation to any other MS wishing to enter into "such" mutual wider cooperation with that MS.

- **Exactly the Same?** Does it mean that the cooperation should be "exactly the same" as the cooperation granted to a given third country? In our view, this is not the case. The MS granting the wider cooperation to a third country cannot refuse to apply a similar form of cooperation.

  The French version of Art. 19 of the DAC is of particular interest here as it seems to provide some further guidance as to the interpretation that should be given to the MFN Clause. It states that (our underlining) "*Lorsqu'un État membre offre à un pays tiers une coopération plus étendue que celle prévue par la présente directive, il ne peut pas refuser cette coopération étendue à un autre État membre souhaitant prendre part <u>à une telle forme de</u> coopération mutuelle plus étendue*".

  Furthermore, as already mentioned in the feasibility study, to be effective, the MFN Clause should in our view be interpreted as enabling the cooperation to be tailored to the tax environment of the MSs concerned.

- **As Detailed?** Does it mean that the cooperation should be "as detailed" as the cooperation granted to a given third country? Again, in our view, this is not the case. We see the MFN Clause as providing a given "level" of cooperation, below which the MS granting the wider cooperation to a third country cannot refuse to go with another MS. It does not require that the mutual cooperation applied pursuant to the MFN Clause between MSs should necessarily be as detailed as the cooperation provided to the third country (277).

- **The Same Information?** As already discussed in the final report to the feasibility study (para. 130), FATCA basically requires reporting of the following particulars to the IRS, all defined under the US legislative framework (cf. Appendix 31 for more detail):

  - **For accounts held by specified US persons:** the name, address and TIN; the account number; the account balance or value of the account; the payments made with respect to the account during the calendar year (dividends, interest, etc.); other information as is otherwise required to be reported under the regulations;

277 Cf. in this respect the statement of the rapporteur quoted above stating that (our underlining) "*MSs <u>guarantee</u>, between themselves, <u>the same level of cooperation</u> as they have with third countries.*"

– **For accounts held by US-owned foreign entities:** the name, address and TIN of the US-owned foreign entity; the name, address and TIN of each substantial US owner of such entity; the account number; the account balance or value; the payments made with respect to the account during the calendar year (dividends, interest, etc.).

Both Model IGAs ultimately lead to the exchange of such particulars to the US tax administration.

If extension of the wider cooperation provided to the US under the Model IGAs had to consist of mutual exchange of the particulars provided in the FATCA legislation (278) irrespective of whether or not these particular elements are apt to allow the respective MSs to impose their tax laws on their own residents, then it would not enable the MFN Clause to be effective.

- **Objective-Based Interpretation?** The form and level of the mutual wider cooperation between MSs could thus potentially be the same as towards third countries by application of the MFN Clause, but it should nevertheless be tailored to actually meet the stated objectives of the clause.

  As already mentioned in the feasibility study, one of the main objectives of FATCA is to ensure that all FIs (including European ones), wherever based, collect and report certain information to the IRS so as to enable the US to impose its tax laws on US persons who could otherwise use foreign investments and foreign accounts to hide their income and assets abroad, and thus potentially evade their US tax filing and payment obligations.

  This objective of FATCA is endorsed by the MSs entering into IGAs with the US (279). As regards the form of cooperation to be applied, this objective is then added to differently depending on the Model IGA in question.

  Indeed, *"to overcome these legal impediments, the Treasury Department has collaborated with foreign governments to develop two alternative model intergovernmental agreements that facilitate the effective and efficient implementation of FATCA in a manner that removes domestic legal impediments to compliance, fulfils FATCA's policy objectives, and further reduces burdens on FFIs located in partner jurisdictions."*(280)

  "Both Model 1 IGAs and Model 2 IGAs ... contemplate that the partner jurisdiction will require all financial institutions that are located in the jurisdiction, and that are not otherwise excepted or exempt pursuant to the agreement, to identify and report information about U.S. accounts. In consideration of the full cooperation by the partner

278 Pushed to its limits, the interpretation based on content could even lead to exchanges of information on US persons between MSs – which is not of course the purpose of the Directive on Administrative Cooperation.

279 *"Whereas, the Government of [FATCA Partner] is supportive of the underlying policy goal of FATCA to improve tax compliance."*

280 Regulations, p. 15.

jurisdiction, the model agreements contemplate a number of simplifications and burden reductions associated with the application of FATCA in the partner jurisdiction."(281)

With respect to exchanges of information in particular (cf. Appendix 31 for more detail as regards the other characteristics of each Model IGA):

– **Model 1 IGA.** Where such information was initially expected to be provided directly by European FFIs to the IRS, the Model 1 IGA basically provides that the participating MSs of establishment of the FFIs collect such information from their local FIs and provide it to the IRS on an automatic basis (282).

  According to the regulations (p. 16), "*FFIs covered by a Model 1 IGA ... must identify U.S. accounts pursuant to due diligence rules adopted by the partner jurisdiction and report specified information about the U.S. accounts to the partner jurisdiction. The partner jurisdiction then exchanges this information with the IRS on an automatic basis. These standards ensure that the IRS will receive the same quality and quantity of information about U.S. accounts from FFIs covered by a Model 1 IGA as it receives from FFIs applying these final regulations."*

– **Model 2 IGA.** On the other hand, the Model 2 IGA provides for a two-step approach, according to which, with respect to "non-consenting US accounts" (which can only be pre-existing accounts), direct reporting of some particulars by FIs to the IRS is first carried out, which is then supplemented by an exchange of information based on group requests made possible by the first set of information exchanged (283) (284) (285). For all new accounts, or in the case of existing accounts in respect of which the

281 Regulations, p. 17.

282 "*Whereas, the Parties desire to conclude an agreement to improve international tax compliance and provide for the implementation of FATCA based on domestic reporting and reciprocal automatic exchange pursuant to the [Convention/TIEA] ...*"

283 "*Whereas, the Parties desire to conclude an agreement to provide for cooperation to facilitate the implementation of FATCA based on direct reporting by [FATCA Partner] financial institutions to the U.S. Internal Revenue Service, supplemented by the exchange of information upon request pursuant to the Convention ...*"

284 "*In the context of FATCA implementation, the U.S. Competent Authority may make group requests to the [FATCA Partner] Competent Authority based on the aggregate information reported to the IRS ... The information requested ... shall be considered information that [may be relevant]/[is foreseeably relevant]/[is necessary] for carrying out the administration or enforcement of the domestic laws of the United States concerning taxes covered by the Convention and under which taxation is not contrary to the Convention ...*"

285 The possibility to exchange information based on group requests has recently been included in the Commentary on Art. 26 of the OECD Model Tax Convention: "*The update explicitly allows for group requests. This means that tax authorities are able to ask for information on a group of taxpayers, without naming them individually, as long as the request is not a 'fishing expedition.' ... All OECD countries have endorsed this latest update.*" Press Release of 18 July 2012, Tax: OECD updates OECD Model Tax Convention to extend information requests to groups.
For more detail in this respect, see Update to Article 26 of the OECD Model Tax Convention and Its Commentary, Approved by the OECD Council on 17 July 2012, 18 July 2012, OECD, http://www.oecd.org/ctp/exchangeofinformation/120718_Article%2026-ENG_no%20cover%20(2).pdf.

consent of the account holder is obtained, direct reporting of detailed information from the FFIs to the IRS would be done, without any intervention by the MSs of establishment of the FFIs.

According to the regulations (p. 16), *"A partner jurisdiction signing an agreement with the United States based on the second model (Model 2 IGA) agrees to direct and enable all FFIs that are located in the jurisdiction ... to register with the IRS and report specified information about U.S. accounts directly to the IRS in a manner consistent with chapter 4 and these final regulations, except as expressly modified by the Model 2 IGA. In the case of certain recalcitrant account holders, the information reported to the IRS by FFIs covered by a Model 2 IGA is supplemented by government-to-government exchange of information."*

From this point of view, any MS "X" could require an MS "P" (for FATCA *Partner*) that has entered into an IGA with the US to provide the same level of cooperation to MS "X" so as to enable MS "X" to impose its tax laws on persons resident in MS "X" (or even on its nationals) who could otherwise use foreign investments and foreign accounts to hide their income and assets abroad, and thus potentially evade their MS "X" tax-filing and payment obligations. Only the actual means to achieve this goal is different.

Moreover, from this angle, Art. 19 of the DAC provides that the extension of such wider cooperation to EU MSs has to be "mutual", meaning that MS "P" could also require MS "X" to collect and report information aimed at enabling MS "P" to impose its tax laws on persons resident in MS "P" (or even on its nationals) who could otherwise use foreign investments and foreign accounts to hide their income and assets abroad, and thus potentially evade their MS "P" tax-filing and payment obligations.

16.2.3 APPLICATION OF THE MFN CLAUSE

635. **Bilateral Character.** The MFN Clause is, by nature, "bilaterally-minded": it seems to apply in each case only to the relationship between two MSs (although nothing precludes MSs adopting a coordinated solution).

It could thus lead to an uncoordinated development of automatic information exchanges with the EU: different types of exchange of information agreements could arise throughout the EU, each time on a reciprocal basis but nevertheless with the risk of containing mutual fundamental differences (differences in terms of content, timing, processes, etc.).

636. **Negotiation?** Numerous other questions could be raised with respect to actual application of the MFN Clause, *inter alia*:

- What happens if the requested MS does not agree to enter into a wider mutual cooperation with another MS?
- What happens if the requested MS does not agree to tailor the wider cooperation it is granting to a third country so as to match the needs of the other MS?

- Under what timeline should the MFN negotiations be conducted and finalised?
- How should the transitional periods provided in the wider cooperation agreement concluded with a third country be considered by the MS requesting the mutual wider cooperation? Similarly, what happens if the request comes after the transition period provided in a Model IGA has elapsed?
- Are there sanctions if a MS does not agree with or slows down the negotiation process? Can a MS make a complaint (arguing an infringement of the Directive on Administrative Cooperation)? Can the Commission have recourse to the infringement procedure? How should the Court of Justice of the European Union ultimately interpret the MFN Clause?
- Although both Model IGAs aim to achieve the same result, the methods actually provided for differ, in particular the channel of information. However, considering that the content of the information reported/exchanged is ultimately the same, one might wonder whether the channel of information could not be part of the negotiation as well.

637. **Communication.** It should be remembered that Art. 8.8 of the DAC states that *"where Member States agree on the automatic exchange of information for additional categories of income and capital in bilateral or multilateral agreements which they conclude with other Member States, they shall communicate those agreements to the Commission which shall make those agreements available to all the other Member States."*

Considering the Model IGAs deal with other categories of income than those listed in Art. 8.1 of the DAC (dividends in particular), the bilateral (or multilateral) agreements concluded between MSs pursuant to the MFN Clause would have to be communicated to the Commission and made available to all the other MSs.

16.3 Conclusion: Application of the MFN Clause in the Framework of FATCA

638. **Application of the MFN Clause.** Based on the above, we can conclude that entering into an IGA with the US (based on either the Model 1 IGA, reciprocal or not, or the Model 2 IGA) should trigger application of the MFN Clause included in Art. 19 of the DAC.

From a legal point of view, the MFN Clause creates a right for each MS to request an equivalent level of cooperation from other MSs that have signed an IGA with the US, regardless of Model, and even without an IGA in case of unilateral cooperation with the US.

639. **EU Only.** It is important to recall that the MFN Clause of course only applies within the EU and not with third countries. The reporting under the MFN Clause would thus be carried out by EU FIs only, and only with respect to EU investors.

640. **Clear Political Agreement Amongst MSs.** At a minimum, the potential application of the MFN Clause in each and every bilateral relationship between MSs that have entered into

an IGA with the US (potentially, all the MSs) should be understood as a clear political agreement, between MSs, to move towards wider cooperation in terms of RC reporting.

641. **Different Forms of Cooperation.** In our view, there would most probably be a difference in terms of cooperation that an MS could require from another MS depending on the type of Model IGA agreement (i.e. Model 1 IGA or Model 2 IGA). For instance, the channels of information used could differ, the exchange of information could be automatic or on request, and so forth.

The same conclusion could be drawn all the more if other solutions had to be chosen by a given MS (unilateral adoption of legislation authorising/forcing local FIs to report, directly or indirectly, to the IRS).

In our view, application of the MFN Clause should be interpreted in light of the objectives of FATCA (in broad terms: ensuring compliance in RCs) and should be tailored to the needs of the MSs participating in the wider cooperation (in terms of content of information provided in particular).

642. **Bilateral Negotiations.** MSs will be soon in a position to request other MSs with which they consider they have more interest to enter into bilateral negotiations to that end. It is likely that all these agreements will be made available to other MSs, creating a level playing field among MSs through peer pressure.

Potentially, in order to address the RC reporting needs of each and every RC MS within the EU (currently 27), and assuming every MS signs an IGA with the US, up to 702 bilateral agreements could be negotiated (27 * 26). Of course, in the short run, the MSs would most probably decide to enter into wider cooperation with other key MSs, but the system would not really be efficient until a sufficient number of agreements were signed.

643. **Need for Coordination.** Accordingly, the MFN Clause will be very difficult to apply on a large scale if no EU coordinated approach is taken.

In practice, indeed, actual implementation of the MFN Clause may encounter numerous issues. In particular, it is essentially of a bilateral character and has not been designed to implement an entirely new exchange of information system and cope with in-depth cooperation such as that provided in the IGAs (covering various aspects from due diligence procedure to sanctions in cases of non-compliance). Moreover, the bilateral character of the MFN Clause will ultimately, at best, lead to an uncoordinated framework.

In other words, although applicable, we do not see the MFN Clause as a tool to fully harmonising administrative cooperation in tax matters within the EU but more as a strong incentive for MSs to initiate discussions on the best way to achieve such harmonisation (cf. Chapter 19 for some thoughts on that aspect).

644. **New Rules of Engagement.** Thanks to the MFN Clause, focus in the EU should move from mere "conceptual" questions (do the MSs want to improve RC reporting, in particular

for, say, dividends? etc.) to "practical" questions (how to further extend RC reporting at EU level; are the existing channels of information still suitable? how to leverage on and align with the existing exchange of information systems, etc.).

645. **Intention to Amend the DAC.** As mentioned in Chapter 15, the European Council conclusions of 22 May refer to the Commission's intention "*to propose amendments to the Directive on administrative cooperation in order for the automatic exchange of information to cover a full range of income"*. The Commission has therefore decided to expand the scope of automatic exchange of information under the DAC so as to bring it into line with the standards that will apply in the future if the FATCA agreements enter into force. The Commission's proposal is expected to be presented in June.

* *

*

CHAPTER 17 RELEVANCE OF RC REPORTING UNDER A RELIEF AT SOURCE SYSTEM

This chapter takes a look in its first sections at the RC reporting provided for under FATCA assuming that the consequences of the MFN Clause are effective (i.e. in one way or another, the information is reported by FIs to MSs' tax administrations). Hence, it essentially focuses on the content of the reporting under FATCA compared to the content of the reporting under the Implementation Package. The conclusions drawn in that respect within the EU are then reassessed considering the interactions with third countries (section 3).

* * *

17.1 ASSUMPTION AND QUESTIONS

646. **Assumptions: MFN Clause Effective and IGAs based on Model 1.** In the previous chapter, we discussed potential application of the MFN Clause. As mentioned, we believe the MFN Clause is applicable when an MS enters into an IGA with the US. At this stage, although only a few MSs have actually signed IGAs with the US, it is likely that most (if not all) of them will do so, most probably under the Model 1 IGA (reciprocal version) (286).

Although fairly hypothetical in the absence of any coordinating tool within the EU, we assume in this chapter that the MFN Clause is likely to be effective, so that it will result in a generalised increase in the information available to RC MSs for their tax compliance purposes.

647. **Questions.** In this chapter, we address the question of whether the features of the relief at source system that are primarily focused on RC compliance are still needed. In particular, is it necessary to keep in the requirement for SCs to automatically provide RCs with information on residents of those RCs claiming relief from those SCs?

648. **Efficiency and Tax Compliance Aspects.** In this chapter, these questions are addressed only from efficiency and tax-compliance perspectives.

In other words, the question is whether, considering the MFN effects, the RC MSs already have at their disposal "sufficient" particulars so that the RC MSs would not need the information reported by the AIs (to the SC MSs) that should normally be passed on to the RC under the Implementation Package.

Whether or not the information provided under the MFN Clause will be "sufficient" from the RC MSs' perspective is dependent on the "expectations" those RCs have with respect to an automatic exchange of information system. In our view, "sufficient" information to ensure the compliance of investors in their respective RCs could range from

1. "encouraging compliance," to
2. "collecting sufficiently detailed particulars so as to automatically fill in the investors' tax returns."

Although essentially a political question, an automatic exchange of information system intended to serve the needs of many different RCs should in our view be realistically limited

286 As mentioned in the previous chapter, the MFN Clause would also apply where the Model 2 IGA was used by an MS as a basis for an IGA with the US, so that the final result would be roughly the same (based on the MFN Clause, the particulars requested from that MS would ultimately be exchanged). However, in that case, the need for cooperation within the EU would be even more important given the differences between the Model 1 and 2 IGAs (possibly leading to different channels of information for RC reporting within the EU). That said, at this stage, only a couple of MSs would consider the possibility of concluding an IGA with the US based on Model 2.

to the first objective set out above. This view has already been outlined at various instances in the feasibility study:

- Should the EU MSs want to adopt a coordinated approach, a directive is likely to be required (cf. para. 128 of the feasibility study). Unanimity should then be reached, which is likely to entail some debate and negotiation (albeit less than might have been expected before, thanks to the MFN effects). The compromises required to reach an agreement are likely to limit the level of detail in the information exchanged to its lowest common denominator. It should be noted in this respect that an agreement reached at, say, OECD level would most likely face the same kinds of issues and, moreover, would not be legally binding.

- Moreover (cf. para. 221 of the feasibility study), it seems very unlikely that a reasonable panel of information could be identified that would allow all tax administrations to compute the tax amount to be included by their tax residents in their tax returns (287). The reason for this is that there is no harmonisation at EU level with respect to taxable income, the definition of income, deductible items, computation of the tax base, consequences of FX differences, etc. (and, on top of that, different rules generally apply to different types of investors in the same country). Plus, income tax legislation changes over time, as do financial products, so that a detail that could be required to fill in a tax return at a given moment could turn out to be completely irrelevant after a law change.

The tax treatment of unit holders in CIVs is a good example in that respect. Although the regulatory regime of CIVs is comparatively harmonised in the EU (thanks to the UCITS Directive in particular) and their income tax treatment is also fairly similar across the EU (288), the tax treatment of their unit holders is not harmonised. As a result, important differences exist from MS to MS in terms of particulars required to ensure the correct taxation of investors. In many cases, CIVs should be able to provide their investors with breakdowns of the income collected during a given period (e.g. dividends, interest, WHT, costs, capital gains and losses, income from derivatives, etc.) so as to ensure correct tax treatment in their hands. Considering the fact that the income tax regimes of investors are not harmonised, the requirements in terms of reporting to be done by the CIVs vary tremendously from one MS to another. As a result, in the framework of information exchanges, agreeing a level of detail suitable for each and every case would be unrealistic (and experience shows that providing "options" is not a solution either as, then, the most detailed reporting is usually left aside so

287 As an extreme example, the Netherlands does not, as such, tax dividends and interest but uses a lump-sum method to tax income generated by portfolio investments, so that it does not need information on dividends and interest received, but does need information on principal amounts.

288 CIVs usually do not suffer income tax in their country of establishment (either because they are specifically exempt from income tax, are subject to income tax but on a reduced basis, or even are not considered as taxpayers due to their true nature, such as contractual CIVs in some MSs, for instance). This absence of taxation is usually supported by the idea that a CIV is just an intermediary vehicle and thus should not be taxed, so as to enable indirect investments ("investor – CIV – investment") benefiting from the same level of taxation as a direct investment ("investor – investment").

that, for the sake of consistency in the information reported amongst the various paying agents and MSs, the simplest solution is gone for).

Based on this, we decided to assess the information to be provided under the MFN Clause taking into account an objective of ensuring compliance by investors in their respective RCs by "encouraging" them to comply.

649. **Legal Aspects.** The questions posed above are not therefore addressed from the angle of the legal obligations potentially applicable to the MSs involved (i.e. is it needed/required, from a legal perspective, that information be exchanged with the RC MSs?).

In that respect, we refer in particular to the conclusion in section 5.1 of the feasibility study (para. 91), which was that, in the framework of a relief at source system, the SC MSs could be required by Art. 9.1(b) of the DAC to spontaneously exchange information with the various RCs, and RC MSs could, in turn, also be obliged to exchange feedback information with Source MSs (either applying the spontaneous exchange of information provided for in Art. 9.1(e) or replying to a request for information), for instance where the RC MS considers the residence status of an investor provided by the SC MS to be incorrect.

17.2 ASSESSMENT OF RC REPORTING PURSUANT TO THE MFN CLAUSE

650. **Expected Reporting Content to RC MSs Pursuant to the MFN Clause.** To recall, under FATCA, the reported information is basically as follows: besides identification of the Reporting Agent, it comprises the account number, account balance or value as of the end of the relevant calendar year, total gross amount of interest paid or credited (for a depository account), total gross amount of interest, total gross amount of dividends, total gross amount of other income generated and total gross proceeds from the sale or redemption of property (for a custodial account), and the total gross amount paid or credited including the aggregate amount of any redemption payment (for an "other" account such as some insurance operations). This reporting will concern a broad range of persons/entities (not limited to individuals).

In a nutshell, we can thus reasonably expect that RC MSs will be entitled to receive the following crucial particulars pursuant to the MFN Clause:

- identification of foreign accounts (including account number and identification of the FIs where the account is held);
- their balance at year end;
- the total gross amount of interest and dividends paid with respect to such accounts; and
- the total gross proceeds from the sale or redemption of securities held with the FIs.

651. **Compliance in the RC will Increase.** Looking at the content of the reporting that is going to be produced under FATCA (subject to some possible changes, of course, pursuant to application of the MFN Clause), it is thus likely that RC MSs will collect sufficient particulars to ensure a considerable increase in terms of tax compliance by their resident investors with respect to income paid through EU FIs.

652. **Possibilities Created by the Information provided under the MFN Clause/MFN Effects are sufficient.** The particulars provided under the MFN Clause do indeed create a lot of possibilities for the RC receiving it, including:

- **Request for Information from the Taxpayer.** Based on the particulars exchanged pursuant to the MFN Clause, RC MSs are likely to have sufficient particulars to request further information from taxpayers if they need to. This could apply, say, when the gross amounts of income reported by the taxpayer do not match with (especially, are lower than) the gross amounts reported by the MSs of establishment of the reporting FIs.

- **Request for Information from the MS of Establishment of the FI.** The information reported would also enable RC MSs to issue requests for information to the MSs of establishment of the reporting FIs when needed (the bank, the bank account and the investors are identified, so that there is no doubt that a request for information could be issued in the framework of a tax audit carried out in the RC).

- **Potential Assessment Tool.** Although the purpose of an information exchange pursuant to the MFN Clause is mainly, in our view, to encourage compliance by the taxpayer, it could also potentially constitute a "default" assessment basis in specific cases, for instance:

  - **Mismatches between Gross Amounts.** When a taxpayer does not provide sufficient particulars explaining the mismatch between the gross amounts reported in his tax return (289) and the gross amounts reported by other MSs;

289 This ability to identify mismatches between reporting by a taxpayer in his tax return and information exchanged by foreign tax administrations is especially provided for under the US legislation. Pursuant to the "Foreign Bank and Financial Accounts (FBAR)" reporting, US persons are required to provide particulars with respect to their foreign account(s). In that respect, we refer to the IRS website, which says that *"If you have a financial interest in or signature authority over a foreign financial account, including a bank account, brokerage account, mutual fund, trust or other type of foreign financial account, the Bank Secrecy Act may require you to report the account yearly to the Internal Revenue Service by filing Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR). The FBAR is required because foreign financial institutions may not be subject to the same reporting requirements as domestic financial institutions. The FBAR is a tool to help the United States government identify persons who may be using foreign financial accounts to circumvent United States law. Investigators use FBARs to help identify or trace funds used for illicit purposes or to identify unreported income maintained or generated abroad"*. Cf. http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Report-of-Foreign-Bank-and-Financial-Accounts-(FBAR). To effectively enable matching of information, reporting pursuant to the MFN Clause should be complemented locally by a similar type of reporting. This requirement is not part of the Model IGAs, and so the MFN Clause is not applicable to that aspect, and the tax return obligations are not harmonised within the EU.

  - **Tax Credits Insufficiently Documented.** When a taxpayer claims a tax relief in his RC MS (e.g. a foreign tax credit) but does not properly document it. The burden of proof in that respect generally lies with the taxpayer, so that, in the absence of sufficient documentation (bank affidavits, etc.), the tax administration of the RC could refuse to apply the tax relief (290).

  - **Allocation of the Burden of Proof between Taxpayers and Tax Administrations.** How the burden of proof generally works in RCs (i.e. the tax administration evidences the income, the taxpayer claims the tax relief or a reduction in his income tax base) also helps to demonstrate that receiving aggregate information should be sufficient for the tax administration of the RC MS.

- **Other Taxable Events and Other Fields of Taxation.** Furthermore, the information exchanged pursuant to the MFN Clause would have compliance effects not only with respect to interest and dividend payments but also with respect to other taxable events and fields of taxation (capital gains tax, net wealth tax, succession duties, etc.). Identification of FIs and bank account numbers, information on the balance of such accounts and on gross proceeds from sale are especially important particulars in that respect.

The particulars provided under the MFN Clause are thus likely to be sufficient to meet the objective of ensuring compliance in the RC. As a result, there are arguments to consider that reporting from SC to RC in the framework of the relief at source system is not strictly necessary (i.e. when DTT benefits are claimed).

More importantly, the absence of RC reporting when DTT benefits are not requested by the taxpayer was the major issue previously identified in the feasibility study with respect to tax compliance in the RC (cf. section 8.2 of the final report on the feasibility study). This issue is now resolved since the RC's compliance needs should be met in any case, regardless of whether DTT benefits have been claimed.

653. **MFN Clause not Applicable in Every Case.** In a number of cases, the MFN Clause will not be applicable, so that the question of the RC reporting under the relief at source system may still be relevant. Below are two examples where there is indeed no RC reporting under the MFN Clause, essentially because the FATCA legislation uses thresholds below which, under certain conditions, FIs do not have to report any information to the IRS.

290 Our assessment here is based on our general knowledge of the various tax systems in the EU. The actual ability to issue a tax assessment only based on information exchanged by other MSs depends on the procedures applicable in the respective MSs.

654. **Practical Examples.**

- **Example 1: Pre-existing or New Individual Depository Accounts.** Assuming a local WHT rate on interest of 25% in the SC, a maximum WHT rate of 15% on interest according to the DTT between the SC and the RC, a return on equity of 4% and an investment value not exceeding USD 50.000, we can conclude the following:

  - Investment value: USD 50.000;
  - Return on investment (gross amount of interest): 4% = USD 2.000;
  - Local WHT Rate: 25% = USD 500;
  - Reduced DTT WHT Rate: 15% = USD 300;
  - WHT Reduction according to DTT: 25% – 15% = 10% = USD 200;
  - Net Frontier Income after DTT: 1.700.

  Based on this example, the threshold of USD 50.000 for determining individual depository accounts not requiring to be reviewed, identified or reported would entail an absence of reporting of about USD 2.000 of income tax base in the RC (the impact on the effective tax due on this gross amount to be assessed based on local income tax rules taking into account the tax base computation methodology, scale of tax rates, tax credits, etc.).

  In Belgium, for instance, the tax risk due to the absence of automatic exchange of information in the above example would be limited to USD 1.700 (Net Frontier Income) * 25% = USD 425.

  We can therefore conclude that the impact of non-compliant behaviour on depository accounts is very limited in the RC (especially considering the interaction with the existing Savings Directive in such a case, where no such threshold is provided for anyway).

- **Example 2: Pre-existing Individual Custodial Accounts.** Assuming a local WHT rate on dividends of 25% in the SC, a maximum WHT rate of 15% on dividends according to the DTT between the SC and the RC, a return on equity of 4% and an investment value not exceeding USD 50.000 as of 31 December 2013 (291) BUT exceeding the latter

291 *"... [T]he following accounts are not required to be reviewed, identified, or reported as U.S. Reportable Accounts: Subject to subparagraph E (2) of this section, Pre-existing Individual Accounts with a balance or value that does not exceed $50,000 as of December 31, 2013."* Model 1 IGA, Annex I.II.A.1, p. 18.
The threshold of USD 50,000 does not apply to new individual custodial accounts opened on or after 1 January 2014, which is why we limit the second example to pre-existing custodial accounts.

threshold as per 31 December of any subsequent year to ultimately reach USD 1.000.000 (292) we can conclude the following:

- Investment value: USD 1.000.000;
- Return on equity (gross amount of dividends): 4% = USD 40.000;
- Local WHT Rate: 25% = USD 10.000;
- Reduced DTT WHT Rate: 15% = USD 6.000;
- WHT Reduction according to DTT: 25% – 15% = 10% = USD 4.000;
- Net Frontier Income after DTT: 34.000.

As we can see from this example, in the limited cases where custodial accounts with a value of USD 1.000.000 might not be reported (to recall, the account balance or value should not exceed USD 50.000 as of 31 December 2013) (291) an absence of reporting of about USD 40.000 of income tax base in the RC would result (the impact on the effective tax due on this gross amount to be assessed based on local income tax rules taking into account the tax base computation methodology, scale of tax rates, tax credits, etc.).

In Belgium, for instance, the tax risk due to the absence of automatic exchange of information in the above example would be limited to USD 34.000 (Net Frontier Income) * 25% = USD 8.500.

The risk outlined in this example may seem relatively large. However, it would only materialise in very limited cases (i.e. custodial account with a balance or value lower than USD 50.000 as per 31 December 2013, the value of which increases up to maximum of USD 1.000.000 as per 31 December of any subsequent year, and most probably only provided that no change of circumstances resulting in one or more U.S. indicia occur in the meantime) (293).

292 *"If a Pre-existing Individual Account is not a High Value Account as of December 31, 2013, but becomes a High Value Account* [viz. has a balance or value that exceeds USD 1,000,000] *as of the last day of a subsequent calendar year, the Reporting [FATCA Partner] Financial Institution must complete the enhanced review procedures described in paragraph D of this section with respect to such account within six months after the last day of the calendar year in which the account becomes a High Value Account. If based on this review such account is identified as a U.S. Reportable Account, the Reporting [FATCA Partner] Financial Institution must report the required information about such account with respect to the year in which it is identified as a U.S. Reportable Account and subsequent years on an annual basis"* Model 1 IGA, Annex I.II.E.2, p. 23.

293 *"If there is a change of circumstances with respect to a Pre-existing Individual Account that is a Lower Value Account that results in one or more U.S. indicia described in subparagraph B (1) of this section being associated with the account, then Reporting [FATCA Partner] Financial Institution must treat the account as a U.S. Reportable Account unless subparagraph B (4) of this section applies"* (Model 1 IGA, Annex I.II.C.(2), p. 20).

655. **MFN Effects Still Sufficient.** Even in the absence of RC reporting in these cases, our conclusion (cf. para. 652 above) remains the same, which is that there are arguments to consider that reporting from SC to RC in the framework of the relief at source system would not be strictly necessary. There are various reasons for this:

- first, given the fact that the thresholds used are quite low, the impact of not reporting to the RC in the framework of the relief at source system, coupled with the absence of voluntary reporting in a tax return by the taxpayer, should not be material;
- secondly, the use of thresholds essentially applies to pre-existing accounts (as outlined above with respect to Individual Accounts), as defined under the Model 1 IGA; exclusion of these accounts from reporting is optional (294), so that it might be that the impact of this deviation from the normal reporting rules would not be that important;
- third, we are of the view that RC and SC reporting systems are very different, so that it is preferable to have two different systems for two different purposes: this would indeed be much more straightforward and clear to every stakeholder, including business and EU citizens and, provided it is aligned to international developments, it could prove efficient and not too burdensome for business and tax administrations.

  As a result, this means that we should have:

  - on the one hand, RC reporting that takes the greatest account possible of international developments (to the extent these developments do not contradict EU law), including the FATCA regulation and the IGA models (bearing in mind the fact that FATCA is very broad and covers all interest and dividend payments, irrespective of whether DTT relief has been applied or not) and,
  - on the other hand, SC Reporting that could be based on the Implementation Package, irrespectively of the routing of the information exchanged (direct reporting by the AI or through the AIC).

  If introduced (or coordinated) within the EU, RC reporting could provide stricter regulations in terms of reporting than those provided under FATCA (e.g. by not using thresholds or by using lower thresholds than provided for by FATCA).

17.3 Added Value of RC Reporting under the Implementation Package when the MFN Clause Applies.

656. **Introduction.** Instead of being necessary, one might wonder whether reporting by an SC to an RC under the relief at source system could bring additional added value to the MSs involved (cf. paras. 657 and 658 below).

294 The thresholds apply *"[u]nless the Reporting [FATCA Partner] Financial Institution elects otherwise, where the implementing rules in [FATCA Partner] provide for such an election ..."* (Model 1 IGA, Annex I.II.A, p. 17; Annex I.III.A p. 23, Annex I.IV.A, p. 24).

The potential added value should then be assessed in light of the additional burden on each of the SC and RC to provide that information and process it (including the provision of feedback by the RC to the SC when required).

657. **Added value in the hands of the Residence MS?**

To assess the maximum potential added value of the particulars reported under the Implementation Package, we assume that the RC MS would receive the same level of information from the SC MS as the SC MS would from its various AIs (i.e. no filtering of information) (295). This basis for this assumption is to be found in the Implementation Package itself, according to which *"once* [the investor-specific information regarding the beneficial owners of the income] (296) *is received by the SC government, it is expected that the SC will provide it to the government of the investor's RC through automatic exchange of information programmes."*

On the one hand, the particulars provided under the MFN Clause with respect to dividends and interest would be the following:

- the information exchanged would only comprise aggregate amounts per category of income (dividends, interest) and no details per payment;
- these aggregate amounts would be limited to gross amounts, to the exclusion of any information with respect to WHT amounts, net amounts, whether or not a DTT has been applied;
- the reporting would not provide any information with respect to the issuer of the security or the actual SC, even in cases where the SC would be the RC.

On the other hand, under the Implementation Package, these details per payment would be made available, but only if a DTT were applied.

In our view, the added value seems fairly limited especially considering the allocation of the burden of proof between taxpayers and tax administrations (cf. para. 652).

658. **Added value in the hands of the Source MS?**

As mentioned in the feasibility study (para. 179), considering the quality of the information provided in principle by the AI (and the measures in place to ensure its compliance, such as the audit requirements, the risk of being excluded from the system, and its liability to the SC), the SC does not in the "first instance" (i.e. to check that the AI applied the right TRI based on the particulars at its disposal) need to receive information from the RC (except in order to

295 Please refer to Chapter 7 of the feasibility study, highlighting the data protection issues that such exchanges of information from SC to RC could raise.

296 Which would include details of the income received, name and address of the beneficial owner and, where the investor's residence country issues taxpayer identification numbers, that TIN, or such other identifying information as the residence country uses to identify individual taxpayers. See Implementation Package, p. 5.

check the residence of the Investor claiming the DTT benefits) (297) and therefore will not necessarily be encouraged to provide information to the RC (298).

As an example, and as mentioned in the ICG Report, *"the US QI regime does not require the QI to provide investor-specific information to the countries of residence of any investors other than US investors, nor to provide such information to the IRS for potential forwarding to the residence countries."* In the QI system, the IRS did not even want to receive any information on Investors, which shows that application of an efficient relief at source system can be totally independent from any exchange of information with RCs.

Of course, this all shows that the potential added value for the SC could then well lie in the possibility to check the residence status of the investor as available in the taxpayer's files in the RC. However, the added value of such confirmation should be fairly limited, especially considering the quality of the information provided by the AIs (indeed, the measures in place to ensure compliance by the AIs have been set so as to avoid the need to interact with RCs on an automatic basis, even though spot checks can be performed).

17.4 INTERACTION WITH THIRD COUNTRIES

659. **Introduction.** In this section, we take a broader view and consider the interaction with third countries in terms of RC reporting. This will enable us to balance the conclusions drawn earlier in this chapter.

660. **Selected Scenarios.** To this end, we take another look at the selected scenarios summarised in section 3.3 of the feasibility study and further explained in its Appendix 2, i.e. the cross-border scenario, the reversed cross-border scenario and the triangular scenario. The scenarios are summarised in Table 58, Table 59 and Table 60 below.

661. **Tables Presentation.** As can be seen, the columns named Issuer, WA, AI, Investor and Scenario are unchanged. The last two columns have been added to differentiate between whether or not the MFN Clause is applicable and DTT benefit might be claimed. Considering the dichotomy created by the possibility of applying or not applying a DTT in each case, the selected cases have been further broken down in two (a = with a DTT; b = without a DTT). The first column provides case numbers for ease of reference.

662. **Assumptions.** The tables below take the following assumptions into account:

- **Participants in the Reporting.** In the tables, we consider that the various participants in the reporting (Reporting Agent and investor, in particular) are the same both for reporting pursuant to the MFN Clause and for reporting under the Implementation Package.

  Accordingly, some important differences between the reporting systems are disregarded:

297 As provided by the Implementation Package, which states that *"Ideally, the latter country, to the extent it receives the information in a timely fashion, will inform the SC soon thereafter if the investor who purports to be a resident thereof in fact is not."* See Implementation Package, p. 5.

298 As the US QI model currently works as far as DTT relief is concerned.

– **Reporting Agents.** Under the implementation package, an FI is only a reporting agent provided it has opted to enter into the system (i.e. it has chosen to act as an AI). The situation is different under the MFN Clause, where the FI is not in a position to choose whether or not it wants to act as reporting agent (i.e. either an FI meets the conditions to be a reporting agent, whereupon it is required to act accordingly, or it does not meet these conditions and is not a reporting agent) (299).

  As a result of this difference, there can be more than one reporting agent per case, and these reporting agents can be established in different countries (300). Showing the cases where reporting agents under the MFN Clause and those under the implementation package would be different in the tables below would add additional layers of complexity without having a significant influence on our conclusions: the essential point to remember is that the MFN Clause is applicable only when the FI is established within the EU (besides the need of having an EU investor).

– **Reporting Subjects.** The person subject to reporting (account holder, beneficial owner, etc. whatever the actual name is according to the reporting system in question) is not necessarily the same, either. Under the Implementation Package, it will be the person that has benefited from the DTT application that is subject to the reporting. However, under the MFN Clause reporting, it could be the person that benefited from application of the DTT and/or (301) the owners of a substantial interest in the party (cf. the look-through approach) that is subject to the reporting.

  Here, again, showing the cases where the person subject to reporting differs in the reporting under the Implementation Package and in the reporting under the MFN Clause in the tables below would unnecessarily render the analysis more complex: in the framework of the study (dealing with the application of a DTT in the first instance), we believe it is sufficient to just consider direct investors, as they are normally those entitled to application of a DTT, hence one RC involved at a time.

  Furthermore, it should be remembered that it is not because a RC considers that its own resident "indirect" investors are beneficial owners of certain income (for instance

299 We refer to the high-level comparison between the Implementation Package and the MFN Clause (FATCA) under subsection 19.1.1 below for more details as to the definition of reporting agent in both systems.

300 On the one hand, an FI can be reporting agent under the MFN Clause without being a reporting agent under the Implementation Package: the FI can indeed choose to act as a contractual intermediary under the Implementation Package or even choose to remain outside the relief at source system. On the other hand, therefore, an FI can be a reporting agent under the Implementation Package without being a reporting agent under the MFN Clause: the FI can act as an AI for IAHs.

301 Depending on the way it would be implemented in the framework of a multilateral system: under FATCA, the US will receive the information with respect to Specified US Persons or with respect to foreign entities substantially owned by Specified US Persons. In a multilateral reporting system, the reporting about the foreign entities could be relevant both for the RCs of such foreign entities and for the RCs of their owners. Based on the MFN Clause, it could be argued that both reporting would ultimately have to be carried out (if each MS requests the two layers of information – with and without the look through approach – with respect to its own residents, then it should result in each MS providing the same two layers of information to the other MSs).

by application of a sort of CFC legislation) that the "direct" investors are necessarily not treaty-entitled in respect of that income.

In our view, even though the assumptions are fairly strong (i.e. reporting subjects and agents are the same across reporting systems), it is nevertheless possible to draw some conclusions from these tables.

- **Developments in terms of RC Reporting.**

  - The tables are presented such that it is assumed that the only tool which guarantees RC reporting for MSs is the MFN Clause (the "guarantee" being due to the binding effect of Art. 19 of the DAC on MSs), even though this would not be sufficient to ensure coordination (cf. above). In other words, we do not consider generalised RC reporting by third countries to yet be provided for (this assumption will have to be closely monitored in the future considering the pace at which the OECD in particular is working).

  - In addition, because the Implementation Package is not at this stage conditioned to the automatic exchange of information from SC to RC (302), we consider that, though such exchanges are more or less "provided for" in the relief at source system, they are certainly not "guaranteed" (hence the slightly different wording used in the table headings).

302 To recall, the Implementation Package does not submit application of an AI agreement between an SC and an FI to an effective exchange of information by the SC to the various RCs concerned by the movable income payments flowing through the AI and with respect to which a DTT relief at source has been applied (cf. section 8.1.1 of the final report).

663. **Tables.** The various scenarios are described in the following tables.

- **Cross-Border Scenario**

The various cases are summarised in the following table:

CASE NO.	ISSUER	WA	AI	INVESTOR	SCENARIO	MFN CLAUSE? (RC reporting guaranteed)	DTT (RC reporting provided for)
1.a	EU X	EU X	EU Y	EU Y	SC = WA's Country & AIC = RC	No	Yes
1.b							No
2.a	EU X	EU X	Non-EU Y	Non-EU Y			Yes
2.b							No
3.a	Non-EU X	Non-EU X	EU Y	EU Y			Yes
3.b							No

Table 58: Selected Scenarios: Cross-Border Scenario (AIC is RC)

As mentioned in the feasibility study (para. 76), compliance in the cross-border scenario in the RC does not in principle depend on information received from the SC as the RC should have sufficient investigative powers over the FIs established in its jurisdiction to collect the relevant investor-specific information (of course, this scenario presents the lower risk in terms of compliance in the RC).

The MFN Clause is not therefore relevant here (irrespective of the application of a DTT), just as the RC reporting under the Implementation Package is also not necessary.

- **Reversed Cross-Border Scenario and Triangular Scenario**

The various cases under the reversed cross-border scenario and triangular scenario are described in the following two tables. These tables are presented together, as the conclusions in terms of compliance in the RC are actually the same:

CASE NO.	ISSUER	WA	AI	INVESTOR	SCENARIO	MFN CLAUSE? (RC reporting guaranteed)	DTT (RC reporting provided for)
4.a	EU X	EU X	EU X	EU Y	SC = WA's Country = AIC	Yes	Yes
4.b							No
5.a	EU X	EU X	EU X	Non-EU Y		No	Yes
5.b							No
6.a	Non-EU X	Non-EU X	Non-EU X	EU Y		No	Yes
6.b							No

Table 59: Selected Scenarios: Reversed Cross-Border Scenario (WA and AI in SC)

CASE NO.	ISSUER	WA	AI	INVESTOR	SCENARIO	MFN CLAUSE? (RC reporting guaranteed)	DTT (RC reporting provided for)
7.a	EU X	EU X	EU Y	EU Z	SC = WA's Country	Yes	Yes
7.b							No
8.a	EU X	EU X	EU Y	Non-EU Z		No	Yes
8.b							No
9.a	EU X	EU X	Non-EU Y	EU Z		No	Yes
9.b							No
10.a	EU X	EU X	Non-EU Y	Non-EU Z		No	Yes
10.b							No
11.a	Non-EU X	Non-EU X	EU Y	EU Z		Yes	Yes
11.b							No
12.a	Non-EU X	Non-EU X	Non-EU Y	EUZ		No	Yes
12.b							No

Table 60: Selected Scenarios: Triangular Scenario (WA in SC)

- In these scenarios, provided the AIC is an EU MS then the MFN Clause should be sufficient to ensure compliance in the RC MSs (cases nos. 4.a, 4.b, 7.a, 7.b, 11.a, 11.b).
- In the other cases where MSs' revenue is at stake, the RC MSs will have to rely on the goodwill of the SC (cases nos. 6.a, 9.a, 12.a) or the AIC (cases nos. 6.b, 9.b, 12.b) to receive partial (DTT only) or full information, according to the case.
- Cases nos. 5.a, 5.b, 8.a, 8.b, 10.a, 10.b do not concern RC MSs but recall that compliance in the RC is also an issue in mirror situations (i.e. in the case of third countries acting as RCs).

664. **Necessity to keep RC Reporting Under the Relief at Source System (DTT Applied).**

- As mentioned earlier in this chapter, RC reporting under the relief at source system would thus be unnecessary if the AI and the Investor were established/residents of the EU as the MFN Clause applies in such cases (cases nos. 4.a, 7.a, 11.a).
- In all other cases where the relief at source is applied (i.e. in the absence of RC reporting pursuant to the MFN Clause), the EU AIs and/or source MSs need to maintain the appropriate resources and IT systems to ensure proper application of the RC reporting provided for in the Implementation Package:
  - **EU SC:** cases 2.a, 5.a, 8.a, 9.a ([303]) and 10.a;
  - **EU AI:** cases 3.a, 5.a, 8.a and 11.a.

  As can be seen, under cases 5.a and 8.a, both the SC and the AI will have to maintain appropriate resources and IT systems. In other cases, it is sometimes the SC (cases 2.a, 9.a and 10.a) and sometimes the AI (cases 3.a and 11.a) that will have to do this.

665. **Taxonomy.** The reasoning applied in this chapter is based on the assumption that the MSs can coordinate their actions in terms of RC reporting. The comparison is thus made between an EU situation comprising all the MSs, and third countries.

However, it should be pointed out that the same reasoning could apply if only part of the MSs were to coordinate their action. In that case, a comparison could be made between those MSs and another group of countries comprising the remaining MSs and third countries.

On the other hand, it would also be applicable if some or all of the MSs could coordinate their action with some third countries.

Indeed, if we consider that RC reporting is ensured by other means (e.g. within the EU, through a Directive or a coordinated application of the MFN clause; outside the EU, based on other legal instruments, whether or not at the initiative of the OECD), then our conclusions

303 This is a specific case as the RC is an MS, but, because the AI is in a third country, reporting under the Implementation Package would continue to be useful to ensure compliance in the RC.

with respect to the needs of RC reporting in the framework of the relief at source system, or with respect to possible simplification of SC reporting, would be applicable *mutatis mutandis*.

17.5 CONCLUSION

666. **SC to RC Exchange of Information under a Relief at Source System not strictly necessary within the EU.** The particulars provided under the MFN Clause are in our view likely to be sufficient to meet the objective of ensuring compliance in the RC. As a result, reporting from SC to RC in the framework of the relief at source system does not appear to be necessary within the EU.

More importantly, the absence of RC reporting when DTT benefits are not claimed by the taxpayer was the major issue previously identified in the feasibility study with respect to tax compliance in the RC (cf. section 8.2 of the final report on the feasibility study). This issue is now resolved given that RC compliance needs should be met in any case, regardless of whether DTT benefits have been claimed.

Even in the limited cases where there is no RC reporting under the MFN Clause, our conclusion remains the same, essentially because we believe that the RC and SC reporting systems are very different, so that it is preferable to have two different systems for two different purposes. The possible adoption (or coordination) of RC reporting within the EU could accommodate this by providing stricter regulations than those under FATCA (in particular by not using thresholds or by using lower thresholds than provided by FATCA), provided the rest of the reporting system applied within the EU remain aligned and consistent with international developments (cf. 643 above regarding the need for a coordinated approach).

667. **Reporting to RC nevertheless required from/to third countries.** When considering interaction with third countries, RC reporting nevertheless continues to be required in the absence of a generalised RC reporting system *per se* (MFN Clause not applicable), both in cases where the RC is an EU MS and where it is not.

668. **Global perspective.** Considering that, in principle, AIs and/or SC MSs' tax administrations would nevertheless have to maintain the appropriate resources and IT systems to ensure reporting in cases involving third countries, one might even consider keeping RC reporting within the EU to avoid creating different treatments according to the case, which might be difficult to implement.

* *

*

CHAPTER 18 SIMPLIFICATION OF SC REPORTING UNDER THE RELIEF AT SOURCE SYSTEM

This chapter sets out by setting the scene: the provision of investor-specific information by SCs to RCs is no longer necessary.

The second section addresses the question of whether the relief at source system provided for in the Implementation Package could be simplified to reflect the context change occasioned by application of the MFN Clause.

The third section analyses the kind of information that should be passed on from the SC to the RC to ensure proper application of both relief at source and the RC's taxation rules.

The fourth section analyses the need for feedback by the RC to the SC should the SC provide information to the RC. Sections five and six, respectively, look at the duplication of reporting and the need to align the timing of the reporting provided for in the Implementation Package with generalised application of the enhanced RC reporting system brought about by FATCA.

Finally, section seven revisits the conclusions in terms of SC reporting simplification by introducing third countries into the picture.

* * *

18.1 INTRODUCTION

669. **Necessity to Keep RC Reporting.** As mentioned in the previous chapter, RC reporting under the relief at source system would not be strictly necessary in our view where the AI and the Investor are established in/residents of the EU (see cases nos. 4.a, 7.a, 11.a under Table 58, Table 59 and Table 60 above).

670. **Questions.** In this chapter, we comment in such cases on whether the original relief at source system provided for in the Implementation Package could be modified/simplified in the EU to reflect the context change occasioned by application of the MFN Clause (sections 18.2 to 18.6). In particular:

a. **Pooled Information.** Would the provision of pooled information be sufficient, as under the QI system?

b. **Minimum Level of Information.** If the provision of investor-specific information by SCs to RCs is no longer necessary, what kind of information, if any, should SCs provide to RCs in order to ensure proper application of both relief at source and the RC's taxation rules?

c. **Feedback.** Should the RC still be required to provide feedback to the SC?

d. **Duplicate Reporting.** How could duplication of reporting otherwise be avoided?

e. **Entry into Force.** Would it be necessary to link the entry into force of the relief at source system with generalised application of the enhanced RC reporting system brought about by FATCA?

Interaction with third countries is then considered in section 18.7.

18.2 SIMPLIFICATION OF SC REPORTING

671. **SC Information Needs.** First of all, it is important to recall that the purpose of the detailed reporting provided by the various AIs in a chain of payment to the SC in the framework of the Implementation Package has been laid down, essentially, to enable the SC to receive the same level of information as if it had granted DTT benefits directly to the investor instead of on a pooled (i.e. anonymous) basis, even though improving compliance in the RC is also a stated objective.

Indeed, as mentioned in the ICG Report, *"although a country may be willing to provide benefits on the basis of pooled information, it may want to maintain the ability to confirm that benefits that have been provided were in fact appropriate. For that reason, and in order to encourage compliance in the residence State, the ICG also recommends that those financial institutions that wish to make use of the "pooled" treaty claim system be required to report*

directly to source countries (i.e. not through the chain of intermediaries) investor-specific information regarding the beneficial owners of the income."(304)

In other words, the SC should receive sufficiently detailed information to verify that, on a given interest or dividend payment, the WHT rate applied to a given investor was indeed appropriate. Therefore, the SC needs the gross amount, the WHT amount (and thus the applied WHT rate) and net amount per payment, per investor.

Of course, removing the second objective of the reporting (i.e. improving compliance in the RC via an exchange of information from the SC to the RC) does not alter the first one (i.e. ensuring the appropriateness of the DTT benefits granted).

672. **Receiving or Having Access to Detailed Information (Postponing Detailed Reporting?).** The needs of the SC have been further described as follows in the ICG Report (our underlining): *"To do so, the country may wish to receive, <u>or at least to have access to</u>, information regarding the names, addresses and treaty residence status of the beneficial owners of income for which treaty benefits have been claimed. Such information would allow the source country to make further inquiries regarding additional eligibility criteria that might be relevant ..."*

In the Implementation Package, the SC is expected to actually receive investor-specific information (otherwise, it would not in any case be able to exchange relevant information with the RC). Assuming the provision of information to the RC is no longer necessary, then ensuring that the SC *"has access to"* detailed information about the beneficiary of the DTT benefits could actually be achieved without its receiving the detailed information currently expected to be automatically provided by the AI.

Of course, whether an SC wants "to receive" information enabling it to directly carry out spot checks (and further enquiries) or whether it only wants "to be able to" access such information (without actually receiving it in first instance) is another question. We assume below that "being able to receive" the detailed information would be sufficient from the SC's point of view, so that the questions around simplification of the relief at source system make sense.

673. **Pooled Information: Year-End Summary.** In this paragraph, we address the question of whether the provision of pooled information is sufficient to enable the SC, in a second stage, to receive more-detailed information and thus make subsequent enquiries as the case may be.

In the framework of the Implementation Package, we therefore assume that only the Year-End Summary (or the like) would be submitted to the SC, to the exclusion of the Annual Information Report (the content of each of these two reports has been summarised in para. 59 and 60 of the feasibility study).

304 ICG Report, p. 3.

Thanks to the Year-End Summary, the SC would receive, for each AI, the aggregate amount of movable income (dividends and interest together) collected by non-resident investors (its Account Holders) that had benefited from the DTTs concluded by the SC.

- **Direct Request to the AI.** First of all, it would be necessary to ensure that the contractual arrangement (305) enables the SC to request such information directly from the AI, without having to take recourse to formal requests for information (within the meaning of the Directive on Administrative Cooperation) addressed to its country of establishment (AIC).

  However, the Implementation Package provides that the Annual Information Report must be provided by the AI on a yearly basis; the possibility of only providing it upon a specific request by the SC is not formally provided for. Should the SC want only "to be able to" receive the detailed information from the AI, it should then tailor the AI contractual arrangements accordingly.

- **Group Requests.** Furthermore, and maybe more importantly for legal-certainty reasons, it should be checked whether the SC could submit requests for information to the AIC based on the pooled information received pursuant to Art. 26 of the OECD Model Tax Convention (or Art. 5 of the DAC) (306). If the Year-End Summary were not sufficient in this respect, then it would be necessary to check whether, and to what extent, it should be amended to that end.

  This could be of particular importance in the following two cases:

  – if the internal legislation of a given AIC does not enable direct contact between an AI and foreign tax administrations;

  – if the Source MS implements the system by incorporating the procedures into its domestic law or regulations (instead of applying the Implementation Package based on mere contractual arrangements) the Directive on Administrative Cooperation might necessarily have to be taken into account (307).

305 To recall, the Implementation Package sets out two main approaches for implementation of the relief at source system in an SC: the contractual arrangement (preferred approach) and incorporation of the procedures into the domestic law or regulations of the SC. See Implementation Package, p. 8.

306 The text of the Directive on Administrative Cooperation presents a clear link with the OECD Model Tax Convention. However, the question arises whether the new interpretation of Art. 26 of the OECD Model Tax Convention is directly applicable to the provisions of the Directive on Administrative Cooperation as well (see also footnote 309).

307 According to the Implementation Package, some countries have indeed "*indicated that they would implement the system by incorporating the procedures into their domestic law or regulations. In that case, there would not be a contract between the source country and the financial intermediary but financial intermediaries would apply to the source country and would be approved to act as authorised intermediaries.*" In such a case, the interactions between the AI and the Source MS would not be governed by a purely contractual agreement (relationship between two contracting parties) but instead by the tax framework of the source MS, to which the AI would adhere (relationship between a taxpayer and a tax administration). The DAC could therefore possibly preclude direct contacts between the "taxpayer" (the AI) and the "taxing" administration (the SC).

674. **Group Requests: Update to Art. 26 OECD Model Tax Convention and Its Commentary.** In this paragraph, we focus on the update of the Commentary to Art. 26 of the OECD Model Tax Convention with respect to so-called "group requests" (the 2012 changes to the text of Art. 26 not actually being relevant with respect to group requests) (308) (309).

To recall, *"The OECD has updated Article 26 of the OECD Model Tax Convention, which sets out the international standard on exchange of information. The standard provides for information exchange on request, where the information is "foreseeably relevant" for the administration of the taxes of the requesting party, regardless of bank secrecy and a domestic tax interest. The update explicitly allows for group requests. This means that tax authorities are able to ask for information on a group of taxpayers, without naming them individually, as long as the request is not a 'fishing expedition.' ... All OECD countries have endorsed this latest update."* (310) (311)

In particular, the Commentary was expanded to develop the interpretation of the standard of "foreseeable relevance" and the term "fishing expedition" through the addition of general clarifications (312), language in respect of the identification of the taxpayer under examination or investigation (313), language in respect of requests in relation to a group of taxpayers(314) and new examples (315).

Although the new commentary to Art. 26 has only recently been issued, there is already an important example of an agreement based on that interpretation: the Model 2 IGA. Indeed, as mentioned in Appendix 31, the Model 2 IGA requires partner country FFIs to inform US holders of pre-existing accounts that aggregate information about these accounts will be reported to the IRS, which would then be considered sufficient for group requests to take place.

308 *"4.3 ... Paragraph 2 of the Article was amended to allow the competent authorities to use information received for other purposes provided such use is allowed under the laws of both States and the competent authority of the supplying State authorises such use. This was previously included as an optional provision in paragraph 12.3 of the Commentary."*

309 The wording of Art. 26 has not thus been amended, but the commentaries have been. This may raise concerns of interpretation. Indeed, one might ask whether an "evolving" interpretation of DTTs is permissible (more precisely, is it permissible to rely on an extended commentary of Art. 26 while a given DTT was actually signed before that extended commentary was issued?) and what method should be used to formally endorse such an interpretation. This is a question of interpretation to be addressed on an individual country basis.

310 Press Release of 18 July 2012, Tax: OECD updates OECD Model Tax Convention to extend information requests to groups.

311 Update to Article 26 of the OECD Model Tax Convention and Its Commentary, Approved by the OECD Council on 17 July 2012, 18 July 2012, OECD, http://www.oecd.org/ctp/exchangeofinformation/120718_Article%2026-ENG_no%20cover%20(2).pdf.

312 Para. 5 of the Commentary.

313 Para. 5.1 of the Commentary.

314 Para. 5.2 of the Commentary.

315 Paras. 8(e) – 8(h) and 8.1 of the Commentary.

On the other hand, the Commentary tones down the possibilities offered by the new interpretation by providing an example where a requested country would not be obliged to heed a request for information: *"Bank B is a bank established in State B. State A taxes its residents on the basis of their worldwide income. The competent authority of State A requests that the competent authority of State B provide the names, date and place of birth, and account balances (including information on any financial assets held in such accounts) of residents of State A that have an account with, hold signatory authority over, or a beneficial interest in an account with Bank B in State B. The request states that Bank B is known to have a large group of foreign account holders but does not contain any additional information."*

Nevertheless, the Commentary also states that the examples provided "*are for illustrative purposes only", "seek to clarify the principles"* and *"should be read in the light of the overarching purpose of Article 26 not to restrict the scope of exchange of information but to allow information exchange "to the widest possible extent"*. There is thus some room for interpretation.

As mentioned above, in the relief at source system, the SC would receive, for each AI, the Year-End Summary comprising in particular the aggregate amount of movable income (dividends and interest together) collected by non-resident investors (its Account Holders) and that had benefited from the DTTs concluded by the SC.

For the sake of the example, we assume that a group request aims to collect the detailed information that is provided for in the Annual Information Report.

To assess the validity of group requests in such a case, the following questions arise:

- **Is the information requested foreseeably relevant at the time the request is made?** In our view, the answer is likely to be positive as the SC would need the information to ensure correct application of the provisions of the DTT (including correct application of the AI agreement, residence status of the investors, etc.);

- **Does the request comprise sufficient information to identify the (group of) taxpayers?** Of course, in this case, the SC does not provide the name or address (or both) of the taxpayers under examination or investigation, and so the request must include other information sufficient to identify the taxpayer.

  In our view, it could possibly be argued that there are sufficient particulars to answer this question in the positive. Indeed, in that case, the AI has signed an agreement with the SC according to which it has provided aggregate information to the SC (the Year-End Summary). The Year-End Summary identifies a group of Account Holders that have benefited from the DTT relief.

  This position could be open to discussion, however, and, if that route had to be followed, it would in our view be necessary to insert such an interpretation, in one way or another, into the public guidelines. If the relief at source system had to be agreed on a multilateral

basis, this interpretation could be inserted directly into the legal instrument laying down the system (as is the case in the Model 2 IGA).

- **Does the information requested assist the SC in determining compliance by taxpayers?** In our view, the answer should again be in the positive as the SC needs information about Account Holders should it want to check their residence status (in collaboration with the respective RCs, if need be).

675. **Opportunity to Postpone the Detailed Reporting?** To answer that question, it is important to dig further into the understanding of the SC's needs. As mentioned above, the SC wants to retain the "*ability to confirm that benefits that have been provided were in fact appropriate."*

In practice, this means that the SC should be in the position to carry out spot checks. In that respect, the Procedures Regarding the Operation of a Financial Intermediary as an Authorised Intermediary laid down in the Implementation Package provide *inter alia* that the SC may *"review the AI's compliance with the Agreement. Such a review may take the form of spot checks, pursuant to which the Competent Authority would request from the AI information regarding a certain percentage or number of Account Holders receiving a specific Covered Payment, in order to determine whether the amount of withholding tax collected, and any information required to be reported, was correct. In connection with such a spot check, the Competent Authority might also examine other information held by the AI with respect to the relevant Account Holders, such as information collected in the course of complying with Know Your Customer Rules, or information on the underlying transaction on the basis of which the Account Holder has acquired the relevant securities. The Competent Authority may also decide to confirm the claims for benefits, with respect to specific Account Holders or a random sample of Account Holders, by requesting that the country listed on the Investor Self-Declaration as the Account Holder's country of residence confirm that the Account Holder is in fact a resident of that country ... In addition to such spot checks, the Competent Authority may also pursue a more expansive examination of the AI's operations and procedures ... The AI agrees that, upon request of the Competent Authority, the review by the Competent Authority may take place at the offices of the AI, subject to any required consents obtained by the Competent Authority from the competent authority of the country in which the AI is established and in accordance with applicable laws, including any bilateral or other agreements between the two countries."*

As mentioned above, the possibility to carry out spot checks is currently recognised as a right of the SC.

For it to be able to do so, best practice shows that the SC should be in a position to select itself the specific cases it would like to investigate. Therefore, the content of the Annual Information Report should in any case be provided to the SC.

So, the remaining question is not whether the reporting could be simplified (as we have seen, not providing the Annual Information Report to the SC would not be sufficient to enable the

SC to carry out its spot checks) but whether it could be made optional (in the sense that it would only be provided by the AI upon a specific request by the SC as opposed to systematic compulsory reporting).

In our view, creating such an option would simply result in postponing the reporting, which would not bring much in the way of added value, especially considering the Annual Information Report would have to be provided on a yearly basis to source third countries in any case (cf. section 18.7 below).

676. **QI Experience.** If one considered that the SC's ability to perform spot checks were not necessary – which does not reflect the content of the Implementation Package – taking into account the fact that other measures are foreseen to ensure compliance by the AI (such as audit requirements including external auditors' responsibilities, the risk of being excluded from the system, the liability of the AI towards the SC), then the content of the reporting could of course be simplified.

In that respect, the QI system is actually a good example as it does not generally require investor-specific information when DTT benefits are granted. Experience shows that the QI system works efficiently from the perspective of the SC without the provision of detailed information in the first instance (thanks to the processes put in place by the IRS, such as audits by external auditors, "QI audits" carried out by the IRS (316), etc.), but this would entail a complete change in the founding principles on which the Implementation Package is built, however.

18.3 SIMPLIFIED RC REPORTING UNDER THE RELIEF AT SOURCE SYSTEM

677. **RC Reporting Not Strictly Necessary.** As mentioned above, the added value to Residence and Source MSs of an automatic exchange of information between SC and RC under the Implementation Package is relatively limited (see paras. 657 and 658 above), so that the provision of investor-specific information by SCs to RCs (and systematic feedback from RCs to SCs) is no longer strictly necessary.

678. **Annual Information Report as Defined Level of Information under the Implementation Package**. The Implementation Package provides that *"once [investor-specific information] is received by the SC government, it is expected that the SC will provide it to the government of the investor's RC through automatic exchange of information programmes. Ideally, the latter country ... will inform the SC soon thereafter if the investor who purports to be a resident thereof in fact is not."*(317)

316 In practice, the IRS enters into direct contact with Qualified Intermediaries in order to do its QI audits. Practice shows, in some ways, that contractual arrangements between an FI established in a country (the Qualified Intermediaries) and a tax administration established in another country (the IRS) is workable. It also shows that tax audits are actually carried out without the intervention of the country of establishment of the Qualified Intermediary.

317 See Implementation Package, p. 5.

- When the Implementation Package is applied, the level of information comprised in the Annual Information Report would most probably be sufficient to "encourage" compliance by investors in their respective RCs (318).

- If the SC were to be informed systematically that investors who purport to be resident there in fact are not, the SC's needs would also be met.

679. **Question.** Irrespective of the added value of the systematic exchange of information between SCs and RCs, another question is whether the information comprised in the Annual Information Report is the minimum level of information to be exchanged with the RCs in order to ensure proper application of both relief at source and the RC's income taxation rules.

680. **Assessment of the Minimum Level of Information Required.** Various possibilities could be envisaged:

- **Pooled Information provided to the RC.** In that case, the question is whether a Residence MS that has received pooled information (the Year-End Summary) could directly encourage compliance by its resident investors. In the absence of investor-specific information, this would not be the case. Besides, the SC also would not receive any confirmation about the residence status of the investors concerned.

- **Only Investor-Specific Information provided to the SC.** In that case, the SC would only provide the RC with a list of investors that had benefited from the DTT between the SC and the RC without providing any details as regards the income involved. On that basis, the RC could confirm to the SC whether the investors who purport to be a resident there are in fact not.

  However, the information provided to the RC would most probably not be sufficient to ensure proper application of the RC's taxation rules. The investor could for instance decide to only report part of the income derived from an SC without the RC being able to directly check that the amount reported is indeed complete.

- **Investor-Specific Information together with Gross Amounts.** In this case, besides a list of investors, the SC would provide the RC with the gross amounts of the income in question. In so far as the taxation rules in the RC were based on the gross amount of income, then such information should most probably be sufficient.

681. **Simplification of RC Reporting Possible but Not Opportune.** As already stressed, RC reporting is not strictly necessary within the EU (see para. 677). That said, providing for simplified RC reporting (i.e. only providing investor-specific information together with gross amounts) is nevertheless possible.

---

318 We refer to para. 648 above regarding the discussion around "encouraging compliance" and "collecting sufficiently detailed particulars so as to automatically fill in the tax returns of the investors." Our comments in the framework of the MFN Clause are applicable *mutatis mutandis* vis-à-vis the information to be provided to the RC under the relief at source. *"Ensuring proper application of the RC's taxation rules"* should be understood as *"encouraging compliance."*

However, as already mentioned in the feasibility study (section 8.2) and above (section 17.1), the information necessary to encourage tax compliance in the RC is highly dependent on the RC's income tax system, so that this conclusion cannot be generalised for all situations. For instance, providing gross amounts per category of income might not be necessary where the tax regime applies equally irrespective of the nature of the income, dividends or interest. In other cases, gross amounts may not be necessary to assess the tax due in the RC.

Moreover, if the RC reporting to be carried out by the SC had to be tailored according to the specifics of the RC's tax regime, this would create an unnecessary additional burden on the SC. This is especially so because detailed reporting from SC to RC would in any case be needed where third countries are involved (see section 18.7 below).

Therefore, simplifying the RC reporting is possible but does not appear to be opportune (319).

18.4 FEEDBACK FROM RC TO SC

682. **Systematic Feedback Not Necessary.** As mentioned under section 17.3 above, the added value of systematic confirmation of the residence status of the investor to the SC (systematic feedback from RC to SC) should be fairly limited considering the quality of the information provided by the AIs (indeed, the measures in place to ensure compliance by AIs have been laid down in order to avoid the need to interact with RCs on an automatic basis, even though spot checks can be performed).

683. **Changes to the Models Defined for the Sake of the Comparison in the Feasibility Study.** In the framework of the feasibility study, we had initially added a functionality to the relief at source system (regardless of the routing used: direct reporting by the AI to the SC or via the AIC) consisting of systematic provision of feedback from the SC to the RC (cf. subsection 4.3.2 "Return Flows: feedback loop" of the feasibility study). Irrespective of the content of the "final" Implementation Package, it follows from the above that this additional system functionality is not required.

684. **Feedback is Good Practice.** That said, when the RC receives information from the SC and notes that it contains erroneous elements, it would be good practice for the RC then to provide feedback to the SC (320) Indeed, if the Annual Information Report is incorrect, then it is possible that the SC may not have identified the errors in the meantime (321).

319 It should be noted that this conclusion does not take into account data protection aspects.

320 Just as the SC should also provide an updated Year-End Summary to the RC in the event that errors are identified after it has been exchanged to the RC.

321 The provision of *ad hoc* feedback (as opposed to systematic) is moreover favoured by the DAC under its Art. 14.

18.5 DUPLICATE REPORTING

685. **Duplicate Reporting.** Assuming RC reporting would be catered for by the MFN Clause (322), then any information exchange by the SC to the RC in the framework of the relief at source system would be a duplication or would involve information that is not strictly necessary to ensure RCs' needs.

However, if the duplication is avoided by not exchanging information, this could result in preclusion of the opportunity to cross-check information amongst providers of information (323).

Of course, when the provider of the information is the same (i.e. the same FI reports about the same investor under the MFN Clause and under the Implementation Package), then a cross-check is useless as the sources of the information are, by definition, one and the same.

However, if the sources of information are different (i.e. different FIs report about a given investor under the MFN Clause and under the Implementation Package) then proceeding by simply deleting one of the reports would be a too radical way to go.

When the two reporting agents are established in the same MS, then the AIC could take on the role of centralised data processor whose purpose would be to receive/filter/regroup the information before sending it out to the interested parties (SC, RC, even FIs in some cases), which would reduce duplication.

However, if the two reporting institutions are not established in the same MS, that role of centralised data processor would have to be assigned at a higher level (EU level), though it is likely that setting up a centralised hub, albeit the only way to avoid duplicate reporting, would be very difficult to achieve and, to the best of our knowledge, baulk against the current trend within the EU.

18.6 ENTRY INTO FORCE

686. **Entry into Force.** Would it be necessary to link the entry into force of the relief at source system with generalised application of the enhanced RC reporting system brought about by FATCA?

687. **Compared Tax Compliance Matrix.** To answer to that question, we suggest having a pragmatic look to the potential achievements in terms of compliance by both the relief at source system (Implementation Package) and the MFN Clause (as a consequence of FATCA IGAs):

322 Cf. section 17.2 for more detail in this respect.

323 Although this might be expensive, depending on the solution to be implemented (from spot checks to fully automated cross-checking systems).

	COMPLIANCE IN SC	COMPLIANCE IN RC
RELIEF AT SOURCE SYSTEM	Compliance OK ⟺ (compliance measures foreseen) *Cf. final report to the feasibility study*	Compliance Not OK (if no DTT benefits, no information) *Cf. final report to the feasibility study*
MFN CLAUSE (FATCA)	Compliance Not OK ⟺ (not the purpose of FATCA)	Compliance OK (main objective of FATCA) *Cf. Chapter 16*

Table 61: Compared Tax Compliance Matrix

The table above summarises our conclusions in terms of compliance in SC and in RC according to the reporting system at stake; relief at source and MFN Clause:

- **Relief at Source System:** It should enable the application of DTT benefits more efficiently than in the current situation. However, compliance in the RC is not achieved sufficiently by that system;
- **MFN Clause:** Compliance in the RC should improve significantly thanks to application of the MFN Clause. But, it is not expected to play a role as regards DTT relief as that is not the purpose of FATCA or of any RC reporting system.

688. **Timing Consideration.** It results from the above that, should MSs wish to achieve compliance in SC and RC at the same time, then both reporting systems (relief at source and MFN Clause) should be implemented simultaneously.

Should MSs decide to apply the MFN clause first, this should be followed, within a reasonable timeline, by the application of an efficient and effective relief at source system so as to grant to the investors (whose income is subjected to reporting) a right to which they are entitled under DTTs. Besides, there could be side effects in terms of burden for the tax administrations, as one may expect an important increase in DTT refund applications.

That said, MSs could decide to apply the relief at source system before the MFN Clause, without creating any new issues in RC MSs (at least as long as the exchange of information from SC to RC is carried out as currently provided for in the Implementation Package). That is also one of the reasons why it would be necessary, at least in first instance, to maintain the automatic exchange of information from SC to RC under the Implementation Package, even if it might sometimes create a duplication of work.

In addition, there is the practical consideration that, unless the timing for implementation is aligned, this landscape of increased information exchange is only going to increase over time. On an on-going basis, FIs would thus need to keep amending and changing processes to deal with new RCs (MFN Clause) and new SCs (relief at source) to search for and provide

information on behalf of (through to their tax administration or directly, as the case may be), which again emphasises the need for a coordinated solution.

18.7 INTERACTION WITH THIRD COUNTRIES

689. **Detailed Reporting Required.** In this section, we consider the interaction with third countries in terms of SC reporting.

Considering that AIs and/or the SC MSs' tax administrations would nevertheless in principle have to keep appropriate resources and IT systems in place to ensure reporting in cases involving third countries acting as RC (cf. para. 664 above), our comments in sections 18.2 to 18.5 above aimed at simplifying reporting under the Implementation Package cease to be of relevance, as detailed reporting (including investor-specific information) from SC to RC is needed in cases where third countries are involved.

18.8 CONCLUSION

690. **Simplification of SC Reporting Not Opportune.** It is not really opportune to simplify the SC reporting provided for in the Implementation Package by not sending Annual Information Reports to the SC. The SC would in any case require such reports from time to time in order to carry out spot checks. Besides, it is likely that third countries that are wanting to implement a standardised relief at source system will do so by adopting the Implementation Package (presumably), so that consistency pushes again in favour of a similar reporting within the European Union.

While a QI-like system, such as they have in the US – which is a simplification of the SC reporting system – could be an option, it does not seem very much in line with the latest developments on WHT relief systems at OECD level (and resulting in the Implementation Package), so that we doubt whether there would be political agreement in this respect. Our perception is that, nowadays, countries are very reluctant to grant any kind of tax advantages, like relief based on a DTT, without receiving all relevant information to be in a position to verify that the advantage is granted appropriately.

691. **Simplification of RC Reporting Under the Relief at Source System Possible but Not Opportune.** RC reporting under the Relief at Source System is not strictly necessary within the EU. That said, providing for simplified RC reporting (i.e. only providing investor-specific information together with gross amounts) is nevertheless possible, though the information necessary to encourage tax compliance in the RC is greatly dependent on the RC's income tax system, so that this conclusion cannot be generalised for all situations.

Moreover, if the RC reporting to be carried out by the SC had to be tailored according to the specifics of the RC's tax regime, this would create an unnecessary additional burden on the SC. This is especially so because detailed reporting from SC to RC would be needed in any case where third countries are involved. So, simplifying RC reporting is, in principle, possible but not opportune.

692. **Feedback.** Systematic feedback from RC to SC is not strictly necessary, either, given that the SC can always carry out spot checks. Nonetheless, if the RC receives information from the SC and notices that it contains erroneous elements, it would be good practice for the RC then to provide feedback to the SC.

693. **Duplicate Reporting.** Duplication between RC (MFN Clause) and SC (Implementation Package) reporting will be fairly limited given the differing purposes between the two systems. Some duplication may nevertheless arise at the level of the RC, upon receipt of information about the same investors under both the MFN Clause and the Implementation Package. If it were desired to apply both systems fully (i.e. by keeping the RC reporting provided for in the Implementation Package), then duplication could hardly be avoided in the absence of a centralised hub.

694. **Entry into Force.** Should MSs wish to achieve compliance in SC and RC at the same time, then both reporting systems (relief at source and MFN Clause) should be implemented simultaneously. Besides, if MSs decided to apply the MFN Clause first, then it would be fairly difficult for Investors (and FIs) to accept as, in practice, they would continue to be denied a right which has been formally conferred on them via DTTs.

Unless the timing for implementation of the MFN Clause reporting and the Implementation Package reporting is aligned, the landscape of increased information exchange will only increase over time. So, it would be necessary, at least in first instance, to maintain the automatic exchange of information from SC to RC under the Implementation Package, even if it might sometimes create a duplication of work.

* *

*

CHAPTER 19 SC REPORTING USING THE AIC ROUTING

This chapter is made up of two sections. The first section analyses the advantages of adopting an AIC routing for the purpose of SC reporting within the EU, from the perspectives of AICs and FIs. The second section deals with possible alignment of the various RC and SC reporting systems.

* * *

19.1 AIC ROUTING FOR SC REPORTING

695. **Question.** In this chapter, we first address the question of whether potentially generalised adoption of an AIC routing for the purpose of RC reporting within the EU could justify also using AIC routing for the purpose of SC reporting, under the relief at source system provided for in the Implementation Package. In particular:

a. **Data Flows and Type of Reporting.** How do the data flows and types of reporting required for compliance in the RC under FATCA compare with the data flows and type of reporting required for WHT relief in the SC under the relief at source system provided for in the Implementation Package?

b. **Efficiency for Financial Institutions.** Would such a solution be the most efficient from the perspective of financial institutions, considering the various reporting obligations they have under domestic and EU law and corresponding IT systems?

c. **Efficiency for AICs.** Would such a solution be the most efficient from the perspective of the tax authorities of AICs, considering that they would have to extract the data received and send it to different countries at different times for different purposes? What role do IT considerations play in this respect?

d. **Duplicate Reporting.** Would such a solution reduce or increase duplication of reporting?

19.1.1 HIGH-LEVEL COMPARISON BETWEEN REPORTING UNDER THE IMPLEMENTATION PACKAGE AND UNDER THE MFN CLAUSE (FATCA)

696. **Various perspectives.** In a high-level manner, we summarise below the data flows and types of reporting under FATCA and the relief at source system (324). Besides the stated objectives of each reporting system, the summary comprises four different perspectives, based on which we enquire into what is reported, by whom, on whom and according to what timing. On that basis, we draw some comparative conclusions.

697. **Reporting under the Implementation Package**

- **Purpose? WHT Relief at Source and Interrelated RC Tax Compliance.** The system produced by adopting the Implementation Package would allow AIs to claim exemptions or reduced rates of WHT pursuant to DTTs (or domestic law) on a pooled basis on behalf of their customers that are portfolio investors. In addition, it is expected that the SC will provide information to the RC through automatic exchange of information programmes so as to improve compliance in the RC (325).

324 We refer to subsection 19.2.1 for a broader comparison including the Savings Directive.
325 See Implementation Package, p.6. We also refer to section 2.1 of the final report.

- **What? Limited to Dividends and Interest.** A Reportable Payment under the relief at source system is defined in the Implementation Package as follows (326): *"any payment of dividends or interest* (327) *arising in the Source Country received by the AI with respect to an account that has been designated by the AI as one for which it is acting in its capacity as an Authorised Intermediary* [i.e. Covered Payments], *but only to the extent that it,*

  – *is paid directly, or indirectly through one or more Contractual Intermediaries, to another Authorised Intermediary acting in its capacity as an Authorised Intermediary, or*

  – *if not so paid, is a payment that qualifies for a reduction or exemption from withholding tax."*(328)

  This information is reported in the annual information report (i.e. the most detailed report foreseen in the Implementation Package). The annual information report, besides identifying the reporting AI, identifies each reportable payment with the following particulars: type of payment, date of payment, issuer of security, security number, SC currency, gross amount of payment (in SC currency), tax rate applied to payment, amount of tax withheld by AI, amount of tax withheld by WA (if different), proportion of payment qualifying for a reduced rate (if applicable for CIVs, trusts, partnerships etc.), method applied to calculate this proportion (for widely held CIVs).

- **How? Reporting per Payment.** Although the annual information reports are produced once a year by each AI, they comprise detailed information per payment (i.e. not a total amount for a given period, but details of all the payments during the period) and per investor (see below).

- **On whom? Reporting per Account Holder (i.e. for Investors that have opted for DTT relief).** This reporting is (ultimately) (329) done per Account Holder, i.e. per person that is a DAH (330) or an IAH (331) *and* with respect to which the FI acts as AI (requesting its FI to apply DTT relief is optional for any investor).

  The Account Holder is identified with the following particulars: name of investor, investor type (in RC), full address, RC TIN (if any), place and date of birth for

326 Payments that were considered in the draft Implementation Package as Reportable Payments due the fact that SC = RC are henceforth disregarded. This is due to the change in the definition of Reportable Payments agreed at OECD level as implemented in the final Implementation Package.

327 Except to the extent modified on a case-by-case basis in the relevant AI agreement.

328 Implementation Package: Appendix B: Procedures Regarding the Operation of a Financial Intermediary as Authorised Intermediary: Section III: Definitions (pp. 27-28).

329 The chain of AIs can indeed be disregarded here, as, in the end, detailed investor information is only reported for payments to which a relief has been applied.

330 Any person (including another Intermediary) who has an account directly with an FI.

331 Any person who receives amounts that have been paid through an FI but who does not have a direct account relationship with the FI (in practice, detailed investor information will only be reported when the FI has received such information from a CI; otherwise, the FI will not be in the position to act as AI for that IAH).

individuals, place and date of incorporation/organisation for investors other than individuals.

In other words, when a dividend or interest payment is made, the SC expects to receive details about the investors that have benefited from a relief and details of their share in the payment (gross amount, WHT amount, net amount).

- **By whom? Reporting by the FI acting as AI.** The entity responsible for the reporting is the AI, i.e. an FI that is authorised to apply for treaty relief at source (or a refund) on behalf of its clients and on a pooled basis.

  More precisely, generally speaking, in order to be able to become an AI, the FI should be:

  - a person that acts on behalf of another person, such as a custodian, broker, nominee or other agent (332) (333);
  - subject to know-your-customer rules that are consistent with specified anti-money-laundering principles (though not necessarily identical to those principles) (334);
  - located in a country that has been approved by the source country (i.e. Eligible Country) (335);

332 Implementation Package: Application by [financial intermediary] to [the competent authority of the source country] for authorisation to act as an authorised intermediary with respect to income arising in [the source country]: Instructions (p. 16).

333 Including a Fiscally Transparent Entity i.e. "*an entity or arrangement with respect to which, under applicable tax treaties or the domestic law of the Source Country, the partners, beneficiaries or similar persons are treated for tax purposes as the owners of the income received by the entity or arrangement [provided it is regulated as a financial institution or collective investment vehicle]"* (ibid.).

334 Know Your Customer Rules means "*customer due diligence and record-keeping requirements relating to the opening and maintenance of accounts with financial services firms that are consistent with the relevant principles established by the Financial Action Task Force, including in particular Recommendations 4-11 of the 40 Recommendations relating to measures to prevent money laundering and terrorist financing and the 9 Special Recommendations relating to terrorist financing as they relate to financial institutions (found at www.fatf-gafi.org)*" (ibid.).
This requirement does not apply to "*to the extent that the Applicant or an Affiliate is an Intermediary only by reason of being a Fiscally Transparent Entity.*" Implementation Package: Application by [financial intermediary] to [the competent authority of the source country] for authorisation to act as an authorised intermediary with respect to income arising in [the source country] (p. 13).

335 Eligible Countries means "*[list of countries and jurisdictions identified by the Source Country, taking into account factors including whether the Source Country has with that country or jurisdiction an effective exchange of information relationship, whether that country or jurisdiction has in effect adequate Know Your Customer Rules, whether the country or jurisdiction is a member of a multilateral organisation or community or grouping of countries that adopt common standards and approaches to issues of tax compliance, including mutual assistance (such as the Member States of the European Union or Organisation for Economic Co-Operation and Development)].*" Implementation Package: Application by [financial intermediary] to [the competent authority of the source country] for authorisation to act as an authorised intermediary with respect to income arising in [the source country]: Instructions (p. 16).

Additionally, it is important to remember that becoming an AI is optional for an FI. The FI could also choose to act as a CI (where the FI passes the detailed Investor information over to an FI acting as AI), or even not to participate in the relief at source system.

- **When? Information provided to the SC by 30 April of the following Calendar Year.** The Implementation Package specifies that the AI must send its report to the tax administration of the SC (no exchange of information between tax administrations at this stage) on or before 30 April for all Reportable Payments received by the AI acting as an AI during the previous calendar year.

698. **Reporting under the MFN Clause (FATCA).** Based on information collected so far, it seems that most MSs, if not all, will opt for an IGA based on Model 1. As a result, the reporting summarised here only deals with the Model 1 IGA.

- **Purpose? RC Tax Compliance.** As already mentioned in Appendix 1 to the feasibility study, FATCA is aimed at enforcing disclosure by US citizens and residents that may be evading US federal income tax by holding certain investments through a Foreign Financial Institution (FFI). It includes certain provisions on WHTs and on the reporting of information by FFIs for US tax compliance purposes (336).

- **What? Includes Dividends and Interest.** The information to be reported under FATCA is basically as follows: besides identification of the Reporting FI, it comprises the account number, account balance or value as of the end of the relevant calendar year, total gross amount of interest paid or credited (Depository account), total gross amount of interest, total gross amount of dividends, total gross amount of other income generated and total gross proceeds from the sale or redemption of property (Custodial account), total gross amount paid or credited including aggregate amount of any redemption payment (other account such as some insurance operations).

- **How? Reporting per Category.** Details of individual payments during the reporting period are not provided: there is only reporting per category of payment; the various payments forming a category are not detailed.

- **On whom? Reporting per Specified U.S. Person.** This reporting is done with respect to Financial Accounts held by one or more Specified U.S. Person(s) or by Non-U.S. entity/ies with one or more controlling persons qualifying as Specified U.S. Person. The reporting is thus potentially done at two levels: at the level of the direct holder of the account and, applying a look-through approach, at the level of any indirect holder of that account.

336 See also the Background section in the final regulations (p. 4), where it is stated that *"Like U.S. financial institutions, FFIs are generally in the best position to identify and report with respect to their U.S. customers. Absent such reporting by FFIs, some U.S. taxpayers may attempt to evade U.S. tax by hiding money in offshore accounts. To prevent this abuse of the U.S. voluntary tax compliance system and address the use of offshore accounts to facilitate tax evasion, it is essential in today's global investment climate that reporting be available with respect to both the onshore and offshore accounts of U.S. taxpayers."*

U.S. Persons are identified using the following particulars: name, address, U.S. TIN and place of birth where applicable. Since U.S. Person is defined broadly (i.e. U.S. citizen, resident individual, partnership, corporation, some trusts), it therefore not only concerns individuals but also entities (Specified U.S. Persons being a subset of U.S. Persons).

It follows from this that, applied multilaterally pursuant to the MFN Clause, reporting would have to be done at two levels. For example, a financial account held with a financial institution of MS "X" by a company of MS, "Y", which has substantial shareholders in MSs "Z and U" would be subject to three different reportings, depending on the MS of establishment of the EU account holder: one to MS "Y", where the direct account holder is established, and two others to MSs "Z and U", where substantial shareholders are resident.

As a recommendation, to clearly distinguish these two levels of reporting, we suggest creating two different reports: one, the direct account holder report, and the other, the indirect (i.e. look-through) report.

- **By whom? Reporting by the FI.** Under FATCA, reporting is done by a Financial Institution, i.e. a Custodial Institution (any entity that, as a substantial portion of its business, holds financial assets for the account of others), a Depository Institution (any entity that accepts deposits in the ordinary course of a banking or similar business), an Investment Entity (any entity that conducts as a business trading activities, portfolio management or otherwise investing, administering or managing funds or money on behalf of other persons), or a Specified Insurance Company (any entity that is an insurance company (or the holding company of an insurance company) that issues, or is obliged to make payments with respect to, a Cash Value Insurance Contract or an Annuity Contract).

  Considering the bilateral character of an IGA Agreement and the territorial reach of such Agreements, a reporting FI is any FI established in the country that has signed an IGA (i.e. any FI resident in that country but excluding any branches of that FI that are located outside the country, and any local branch of a foreign FI) when the FI maintains Financial Accounts held by one or more Specified U.S. Person or by a Non-U.S. entity with one or more controlling persons qualifying as Specified U.S. Persons. Reporting is thus mandatory.

  Under the MFN Clause, a reporting FI would be any FI established in an MS (i.e. any FI resident in that MS but excluding any branches of that FI that are located outside that MS, and any local branch of a foreign FI) where the FI maintains Financial Accounts held by one or more EU account holder(s).

- **When? Information provided to the IRS by 30 September of the following Calendar Year.** Normally (except during a transitional period), the information is due to be exchanged between the MS's tax administration and the IRS within nine months after the end of the calendar year to which the information relates (this timing is a permanent feature across all the IGAs signed so far). The FIs will therefore be due to report to their

own tax administration before that date, according to the timing that will be set down by the internal legislation of the MS in question (the exact timing for reporting by the FI to its tax administration is not laid down in the Model 1 IGA).

699. **Comparison.**

	SC MODEL (Implementation Package)	**MFN CLAUSE** (≈ FATCA)
PURPOSE? (SC v. RC Reporting)	SC Reporting (WHT Compliance)	RC Reporting (RC Compliance)
WHAT? (Reporting Content)	Limited to dividends and interest	Includes dividends and interest
HOW? (Level of Details)	Details per individual Payment	Details per category
ON WHOM? (Reporting Subject)	DAH and IAH with DTT Relief	Reporting per direct and indirect EU Account holder
BY WHOM? (Reporting Agent)	Authorised Intermediary	Foreign Financial Institution
WHEN? (Timing)	30 April	30 September

Table 62: High-Level Comparison between SC Model (Implementation Package) and MFN Clause (FATCA)

700. **Comparison.** In general, a financial institution acting as an AI for one of its direct account holders will also be a reporting agent under the MFN Clause for that investor (337).

That said, and besides that common aspect, the analysis reveals differences across the various systems:

- **Reporting Content**. Under the SC Model, the reporting comprises detailed information per payment, while, under the MFN Clause, reporting is done per category of payment. Additionally, under the SC Model, reporting is done with respect to dividends and interest payments only (as defined, in general, under the OECD Model Tax Convention, i.e. payments which could potentially give rise to DTT relief based on its Arts. 10 and 11)

337 Except for the cross-border scenario, where the MFN Clause is not applicable (see section 17.4).

(338), while, under the MFN Clause, the scope of the reporting is different (gross proceeds, account numbers, insurance products, etc.).

- **Reporting Subject.** A reporting agent under the MFN Clause also has to report with respect to financial accounts "indirectly" held (i.e. applying a look-through approach to entities in which the persons to be reported on can be regarded as controlling persons), which is not the case under the Implementation Package, where only investors entitled to DTT benefits (in principle, direct investors) (339) are subject to reporting.
- **Reporting Agent.** Although a reporting agent in the context of the Implementation Package (an AI) will also be a reporting agent under the MFN Clause, there are also cases where the reporting agents under the two systems are not the same. We particularly have in mind contractual intermediaries who will not report under the SC Model (but will ask an AI to do so) and financial institutions not taking part in the relief at source system, but would nevertheless have to report under the MFN Clause. Furthermore, in the cross-border scenario, the FI can act as an AI but will not, as such, have to comply with the MFN reporting as the MFN Clause is not applicable in such a case (340).

701. **Limited role for AIC in terms of Information Matching.** This high-level comparison shows that reporting under the Implementation Package and reporting that would be expected from applying the MFN Clause are very different.

That said, it appears that there are cases where a single FI acts as reporting agent for a given reporting subject under both systems. Typically, this would be the case within the EU, when an investor requests its foreign FI acting as AI to apply a DTT.

In such a case, besides the FI identification, the account holder should be reconcilable, but this does not seem to offer much of an added value as regards the "outward flows" as the information is actually provided by the same institution (the information should thus theoretically be the same) (341).

19.1.2 EFFICIENCY FOR AICS

702. **Introduction.** In this section, we address the question of whether generalising an AIC Model for the purpose of RC reporting could justify also using the AIC Model for the purpose

338 Although the option exists for SCs to allow AIs to also claim relief for other forms of taxes on securities income e.g. capital gains tax.

339 But it will also cover investments made via other financial intermediaries or CIVs.

340 To recall, in the cross-border scenario, compliance in the RC does not depend on information received from the SC as the RC should have sufficient investigative powers with respect to FIs established in its territory to collect the relevant investor-specific information.

341 Moreover, as no feedback is currently provided for in the MFN Clause, the AIC will probably not receive any systematic feedback from the various RCs. As a result, this is an additional argument that the AIC cannot assign a centralisation role where it has used the feedback received from RCs further to the MFN Clause to complement (and, where necessary, amend) the SC reporting under the relief at source system.

of the SC reporting from an efficiency point of view. We look at the consequences for FIs and AICs.

703. **Question**. Would an AIC Model used for the purpose of SC reporting be the most efficient solution from the perspective of the tax administrations of AICs, considering that they would have to extract the data received and send it to different countries at different times for different purposes? The question should also be looked at from an IT point of view, where appropriate.

704. **Main Role of the AIC under the AIC Model.** As already mentioned in Appendix 3 to the feasibility study (cf. Appendices 3.5.2 and 3.5.6), under the AIC Model (as explicitly defined for the purpose of the first part of the feasibility study), the AIC role in the first instance consisted of assessing the completeness of the information received, checking the validity of the information format and dispatching that information to the different MSs and, in the second instance, processing requests in the context of the systematic feedback loop.

As mentioned in the previous subsection, this second role is no longer a role that the AIC could take on (see subsection 18.4 together with para. 701 above), while the first is still a role which could be carried out by the AIC. The checks and processing that would still need to be performed by the AIC upon reporting by the AIs (completeness and validity checks, forwarding of the reports to the appropriate foreign tax administrations, etc.) could be automated to a large extent (irrespective of the number of reports produced by a given AI (342). the addressees of such reports, and the timing within which such reports would be produced), hence avoiding unnecessary manual processing. As a result, the role of the AIC, and therefore the workload associated with it, is very much reduced at that level compared to the role initially expected to be endorsed by the AIC in the feasibility study.

705. **AIC routing more efficient.** From a pure efficiency standpoint, as detailed in the final report on the feasibility study, it appears that passing information through the AIC for SC reporting purposes is more efficient (343). Indeed, besides the various reasons highlighted in the next few paragraphs, the Savings Directive, and now FATCA and the MFN Clause, already use the AIC as a routing channel so that it seems obvious to use the existing conduit (FIs communicate with their tax administrations, cross-border exchange of information is carried out between tax administrations).

706. **Benefit of the AIC routing.** Some MSs had clearly highlighted reasons why they thought it a good idea, as an AIC, to take on these responsibilities.

342 And irrespective of other reports which would be produced by the same FI for other purposes such as the Savings Directive, FATCA or the reporting that would be carried out pursuant to the application of the MFN Clause, or other local reporting requirements.

343 Any actor in the system would obviously prefer having to endorse the least possible roles and responsibilities in order to avoid additional workload. That would be considered the most efficient in their views but one should consider the efficiency of the whole system and not consider individual perspectives only. This point has already been addressed in the feasibility study (section 8.1.1).

- **Close Relationship.** The AIC generally has a closer relationship with the AI than the SC as the AI already often acts as a tax intermediary for other purposes (e.g. internal WHT, reporting of local client's income to the tax administration, reporting in the framework of the Savings Directive, stamp duty, etc.). This relationship will further increase with the application of FATCA with the US (IGA signed with the US) and application of the MFN Clause. The AIC has therefore a good knowledge of the national legal framework and the specificities of its financial sector. This (technical, legal and cultural) understanding could facilitate communication in the framework of the relief at source.

- **Audit.** The AI is already subject to auditing by the AIC (including in the framework of the Savings Directive). Auditing is likely to become more frequent thanks to application of FATCA with the US (IGA signed with the US) and consequential application of the MFN Clause. This should enhance effectiveness as the AIC already has to audit the AI for other purposes in any case. Besides, questions raised in the framework of several audits can often overlap. Note that, even if it is decided not to go the AIC route for reporting purposes, it could still be interesting to invite the AIC to take part into the audit process (see below).

- **Statistics.** Other factors increase the effectiveness of the AIC routing. On the one hand, should feedback be given by SCs (Implementation Package) or RCs (MFN), the AIC could play a role in centralising the feedback received and enforcing the necessary corrective action by FIs (whether acting as AI or not).

  As an example and as illustrated in the feasibility study, some countries intend to keep statistics of the feedback to identify recurring errors that might indicate a shortcoming in the procedures of some AIs. This practice is currently applied by some MSs in the exchange of information system under the Savings Directive and allows the State of Establishment of the paying agent to help identify weaknesses and apply sanctions when appropriate. When considering statistical records as a tool to ensure compliance by the AI, the AIC routing is more appropriate because a single tax administration (i.e. the AIC) has a full view of all the AI's operations and not only with respect to one country, as in the case of direct reporting by FIs to foreign tax administrations.

  On the other hand, in the case of direct reporting by AIs to the SC, the SC has direct contact with the various AIs. Some tax administrations have confirmed that they believe that a direct relationship between SC and AI could be more efficient than indirect communication via the AIC. Some tax administrations (as SCs) are concerned about the lack of responsiveness of the AI when using the AIC routing or the fact that they might not be able to directly contact or chase the AI if it failed to reply in time (in this respect,

see also para. 673 above). They find it important that the SC, which is able to remove the Financial Intermediary's AI status, and the AI should be in a direct relationship (344).

- **Data Protection.** We refer to Chapter 7 of the feasibility study, highlighting the advantages of the AIC routing for data protection-related matters. In essence, an AIC Model is preferable as information exchanged between tax administrations under DTTs or other administrative-cooperation tools is normally better protected than information sent by FIs directly to foreign tax administrations.

- **IT Aspects – Main Elements.** As mentioned above, the role of the AIC has changed since the feasibility study as far as the management of feedback loops is concerned (cf. para. 704 above). From an IT perspective, the main role of the AIC is henceforth limited to supporting the reporting process by assessing the completeness of the information received, checking the validity of the information format and dispatching that information to the different MSs of residence.

  From an IT architecture point of view, the AIC routing still appears to be the most cost-efficient for the MSs' tax administrations:

  - The AIC routing still requires less effort for tax administrations in terms of implementation and operation as the required IT solution bears greater similarity to the IT systems used by the current Savings Directive (see following paragraph).

  - Tax administrations would not need to communicate with non-resident AIs (required under the SC routing).

  - The SC routing would force tax administrations to deal with the different national data-transfer and encryption standards of other MSs as there is no pan-European standard for the exchange of data between AIs and tax administrations.

  - Finally, these cross-border data exchanges would significantly increase the total number of connections needed as each tax administration would have to be able to exchange data with all AIs of all participating MSs.

  The OECD is currently working on an RC reporting model based on the Model 1 IGA. So, in the fairly near future, we can expect an increase in the interoperability of information systems used to exchange data between TAs on a global scale. The European Commission's work in this field could be leveraged on.

707. **Smaller Functional IT Gap for the AIC Routing.** We reviewed the functional IT gap for the AIC and SC routing in light of the changes in terms of the AIC's roles and responsibilities (cf. para. 704 above). As already demonstrated in the feasibility study, the

344 However, as far as direct reporting is concerned, one should bear in mind that the only way to "force" an FI to take corrective action upon feedback being received from a RC (under the MFN Clause) is via that FI's tax administration in its country of establishment.

AIC routing entails a smaller functional IT gap than the SC routing. This stems from the required cross-border communication between AIs and TAs.

The colours used in the table below (which is a review of Table 23 of the feasibility study) indicate the degree of availability of the IT functionality per logical application component. The table uses the following colour codes:

- **Green:** Component is available; no or only minor configuration changes need to be made to support the Model.
- **Yellow:** Component is available; minor functionality changes need to be made to support the Model.
- **Orange:** Component is available; major functionality changes need to be made to support the Model.
- **Red:** Component is not available; component needs to be implemented to support the Model.
- **Grey:** No information is available.

BLOCK OF IT FUNCTIONALITY	AIC ROUTING	SC ROUTING
AI Client administration	Current functionality is expected to be sufficient	Current functionality is expected to be sufficient
AI Account administration	Current functionality is expected to be sufficient	Current functionality is expected to be sufficient
AI Transaction administration	Current functionality needs to be extended to provide the right source data for reports	Current functionality needs to be extended to provide the right source data for reports
AI Reporting	Current functionality needs to be adapted to generate the required reports	Current functionality needs to be adapted to generate the required reports
TA Reporting	Current functionality needs to be adapted to generate the required reports	Current functionality needs to be adapted to generate the required reports + Handling of reports from non-resident AIs needs to be supported
AI Validation	Current functionality is expected to be sufficient	Current functionality is expected to be sufficient
TA Validation	Current functionality is expected to be sufficient	Current functionality is expected to be sufficient

BLOCK OF IT FUNCTIONALITY	AIC ROUTING	SC ROUTING
Encryption and signature	Current functionality might have to be adapted	Current functionality might have to be adapted + Enable encryption and e-signatures with non-resident AIs or TAs
Transfer	Current functionality needs to be adapted to handle the exchange of RFIs and requests for clarification	Current functionality needs to be adapted to handle the exchange of RFIs and requests for clarification + Data transfer with non-resident AIs needs to be implemented
Contact administration	Component is usually missing	Component is usually missing

Table 63: Reviewed Functional IT gap analysis between the IT functionality available on average and both Routings

708. **Efficiency of the AIC routing in the light of MFN residence reporting.** Though the AIC routing still seems to be more efficient, at least within the EU, there are some arguments in favour of the AIC routing in the final report on the feasibility study that are not as relevant as before:

- To recall, one of the main advantages of the AIC routing was the fact that the RC would receive the information "at the same time" as the SC. Given application of the MFN Clause, this provision of information to the RC is no longer *per se* an added value of the AIC routing under the Relief at source. This reporting from SC to RC in the framework of the relief at source system does not appear to be as necessary as it appeared to be before. The decision by an MS to apply a Relief at Source system can now, in principle, be independent from RC reporting purposes.

- We mentioned in the final report on the feasibility study that certain side effects could arise if MSs were to remain outside the relief at source system as provided for in the Implementation Package (with direct reporting from the AI to the SC). Indeed, if an MS decided not to join the system as an "SC" (i.e. it did not enter into agreements with FIs to enable them to act as AIs as provided in the SC Model), which is a unilateral decision, it would not be in a position to automatically exchange information to RCs (345) while they could still benefit from the work performed by such countries acting as "SCs" (i.e. it might receive data from those countries) in the framework of the Relief at Source system (cf. subsection 8.1.5 of the final report on the feasibility study).

345 It could only at best provide information spontaneously to RCs when it received claims for "refunds" of WHT from residents of those countries.

RC reporting is now distinct from the SC reporting obligations: wherever the investor and the AI are within the EU (i.e. the MFN Clause is applicable), the RC's needs are met. As a result, the side effect previously identified in the feasibility study is no longer a disadvantage of the Implementation Package (with direct reporting from the AI to the SC).

- The elements of the AIC Model, as detailed in the feasibility study, are still roughly valid, but are not specific to just SC reporting (i.e. they also apply to RC reporting thanks to application of the MFN Clause). As an example, the AIC routing was privileged because of the use of information collected for other purposes than just exchanges of information: information collected from the AIs if the relief at source system had to be implemented under the AIC Model (routing via the AIC) could be used for purposes other than just exchanging information (e.g. fight against fraud, statistics). However, the increasing role of AIC in the routing of information to RCs will already provide a lot of new data and useful particulars: the tax administrations will indeed collect information about Specified US Persons under FATCA and might be required to collect information about foreign EU investors (via the MFN Clause). One might thus wonder whether there is still an important added value for an AIC to act as an intermediary for SC reporting purposes.

19.1.3 EFFICIENCY FOR FINANCIAL INSTITUTIONS

709. **Question**. Would an AIC Model used for the purpose of SC reporting be the most efficient solution from the perspective of financial institutions, considering the various reporting obligations under domestic and EU law, and the relevant IT systems?

710. **Preference of the AIC routing.** In the various interviews carried out for the first phase of the feasibility study, the representatives of the financial services sector all highlighted the importance of having only one Model and of avoiding the proliferation of reporting channels and mechanisms. Considering the current Savings Directive, recent FATCA developments, many FIs expressed a preference for the AIC approach, which would facilitate the technical interoperability of systems. From a business perspective, implementing an AIC routing, AIs will only have to deal with one tax administration, being their own tax administration (AIC), which should promote the overall effectiveness of the system in many respects (e.g. same language, existing relationships, procedures already known, compatibility of IT systems possibly already in place, etc.) (346). Besides that and in the context of a generalisation of an AIC routing for the purpose of SC reporting, one might expect that FIs would prefer the AIC Model, at least within the EU.

However, we should remember that a limited number of FIs still indicated a preference for the SC approach (in the feasibility study), given that the SC Model is more suitable to build a global system.

346 In this sense, the ICG Report recognises that the AIC Model "*would probably involve the smallest transition costs for the financial institutions. In particular, this system likely would require the least in terms of changing computer systems, since in many cases intermediaries will already have some reporting obligations with their local tax authorities, which likely take place in electronic form.*"

711. **Review of number of information flows**. We have reviewed the equation used in section 8.1.2 of the feasibility study to reflect the absence of reporting between SC and RC. The first factor influencing the total amount of flows for SC routing is the number of AIs within the MSs *(#AIs*). This number should be multiplied by the number of SCs (second factor). Adding third countries will increase the number of information flows but will not have an impact as such, as the number of participating countries remains the same in both Models, the variable being the number of AIs. Therefore, for this calculation, the figure will be limited to the 27 MSs *(27MSs*) of the EU.

- SC Routing (direct reporting by AIs to SCs)
  - The total number of information flows is: #AIs*27MSs
- AIC Model (indirect reporting through the AIC)
  - In the context of the AIC Model, there is one report per AI (*#AIs*) that is sent to the tax administration of the AIC. Each AIC will then transmit the information to each SC (*27MSs*).
  - The total number of information flows is therefore: *#AIs+27MSs*27MSs.*
- Comparing the two Models from this angle leads to the following mathematical equation:
  - SC Routing = AIC Routing
  - x*27 = x+27 *27
  - 27x-x = 729
  - 26x = 729
  - x = 28,03

    where "x" is the number of AIs participating in the system (#AIs) and assuming that the 27 MSs participate in the system.

Accordingly, it appears that summing up all the information flows leads to the same conclusion as before, being that, where 29 AIs participate in the system, the total number of flows in the SC Model becomes larger than in the AIC Model. Assuming (and it seems quite likely) that more than 29 AIs will participate in the Model, it is reasonable to posit that the SC Model entails more information flows for the same result than the AIC Model (347). In that respect, it should be recalled that, in the contacts made when working on the feasibility study, many FIs expressed a preference for maintaining contact with their own tax administrations,

347 One could object that not all AIs will effectively receive income from the 27 MSs or have investors resident in the 27 MSs. Nevertheless, the key element to be taken into account in comparing the two Models from a flow-number perspective is the "multiplication factor", which is always "1" in the AIC Model (cf. "x") but much higher than 1 in the SC Model (cf. in our example "27x").

rather than having contact with the tax administrations of all SCs. In addition to the cultural, linguistic and legal difficulties, they point to the workload that would result from such communication channels.

712. **Feedback from SCs.** As mentioned above, should a feedback loop be instituted, the AIC could play a role in centralisation of the requests. In that respect, note that, in the context of the MFN Clause, no feedback loop is provided for. Hence, we are mainly referring to feedback from the SC in the context of the relief at source.

The consequences are that the AIC would have to handle many queries in which it often (but not always) has no direct interest, but the total number of queries for the system would decrease, which is certainly of importance to FIs. In addition, from a business perspective, it would be more efficient for an AI to build up a relationship with just its own tax administration than with the tax administrations of all MSs. For example an AIC could easily implement a query-identification system, including a query number for each request, that would allow the AIC and the AI to ensure proper follow-up of the various queries. However, such a system would be difficult to use if AIs were contacted by all the SCs and had to work with 27 different systems. Note that, even if it were decided not to pass by the AIC for the initial routing of information, it could still be worth involving the AIC in handling queries.

713. **Administrative Burden.** Using the SC approach, one can expect an increase in administrative burden. This may involve following up on several hundreds of requests. For example, if an Investor indicated a wrong RC, it involves one AIC but, potentially, 27 MSs (if the Investor benefited from a reduced tax rate in the 27 MSs). Thus, it could entail one request being handled by one AIC instead of 27 requests being handled by 27 countries. Considering the total number of requests handled by the MSs, there is a clear lack of effectiveness, due to the fact that it is not possible to consolidate the various requests at Investor level. This aspect will be particularly important for AIs that are faced with a multiplicity of requests for one and the same issue.

714. **Audit.** The AI is already subject to auditing by the AIC (including in the framework of the Savings Directive). Auditing will be more frequent thanks to the application of FATCA with the US (IGA signed with the US) and applying the MFN Clause. This should enhance effectiveness as the AIC already has to audit the AI for other purposes in any case. Besides, questions raised in the framework of several audits can often overlap. Note that, even if it is decided not to pass by the AIC for reporting, it could still be more efficient for FIs to invite the AIC to take part in the audit process so as to coordinate their audit involvement as much as possible.

715. **IT Aspects.** From an IT-architecture point of view, the AIC routing still appears to be the most cost-efficient for FIs:

- The AIC routing still requires less effort in terms of implementation and operation for AIs as the required IT solution bears greater similarity to the IT systems used by the current Savings Directive (see para. 707 above for the summary table).

- AIs would not have to communicate with foreign tax administrations (required under the SC routing).
- The implementation and operation efforts related to these cross-border transfers would be avoided.
- The SC routing would force AIs to deal with the different national data-transfer and encryption standards of other MSs as there is no pan-European standard for the exchange of data between AIs and tax administrations.
- Finally, these cross-border data exchanges would significantly increase the total number of connections needed, as each AI would have to be able to exchange data with the tax administrations of the participating source MSs.

19.1.4 COORDINATED APPLICATION OF THE RELIEF AT SOURCE SYSTEM

716. **Overall Efficiency.** For the various reasons highlighted in the two previous subsections, the AIC routing remains a preferred option, at least within the EU.

However, a flexible approach in terms of implementing a coordinated solution within the EU in terms of channels of information could be that each MS acting as AIC could be given the opportunity to opt out of an "AIC routing system" if it was considered (348) that the increased administrative burden on the AIC outweighed the advantage in the hands of FIs established in that MS, so that these FIs would report directly to SCs.

717. **Coordinated Application of the AI Agreements under the Implementation Package.** In the feasibility study, two different elements were examined:

- on the one hand, the routing of information (direct report from AI to SC under the Implementation Package v. indirect reporting via the AIC under the suggested AIC Model); and,
- on the other hand, as already mentioned in the final report to the feasibility study, a number of additional principles had been defined for the purpose of conducting the study. Other structuring principles were modified because this was justified by use of the EU context (Audit, Recognition of the AI, bilateral v. multilateral approach).

If agreement cannot be achieved regarding the communication channel, whatever the reason may be (lack of interest on the part of the AIC (349), etc.), we nevertheless strongly

348 Although the role of the AIC, and therefore the workload associated with it, is much reduced compared to the role initially expected to be endorsed by the AIC in the feasibility study (see para. 704).

349 As mentioned in Chapter 8 of the final report (section 8.1.1 Interest of the Various Stakeholders), the AIC would be a key actor in a relief at source system, where the information would flow through the AIC although it might not have a direct financial interest in that case (i.e. in a pure triangular scenario where a given MS acts as AIC without being either the SC or the RC). However, the AIC is also an SC and an RC for other AICs in other cases (i.e. triangular situations where a given MS acts as SC or RC). Moreover, in

recommend that it be considered revisiting application of the Implementation Package with some of the elements that were initially defined for the AIC *Model* in the context of the feasibility study, in so far as these elements would enable better coordination between MSs and therefore improve the efficiency of the overall system. For instance:

- **AI Recognition Process.** The criteria to become an AI could be shared across the EU, which would ensure a level playing field among financial institution. The criteria for an FI to be considered as an Excluded Intermediary could also be shared, for the same reasons.
- **Independent Reviewer Recognition Process.** The criteria for designating an independent reviewer could be common across the EU and it would make sense for a single independent reviewer to be designated for a given AI, irrespective of the Source MSs concerned.
- **Joint Audits by Tax Administrations (Use of the Directive on Administrative Cooperation).** Simultaneous controls, presence in administrative offices, participation in administrative enquiries by foreign agents (e.g. officials of the SC and the RC) and, more generally, use of all the administrative cooperation tools offered by the Directive on Administrative Cooperation could be favoured in order to avoid, especially, duplicate audits for the same AI;
- **Liability of the AI (use of the Recovery Directive).** The type of liability the AI has to bear may have consequences on the type of legal instruments available within the EU that could be called upon to ensure proper application of the relief at source system. For instance, the Recovery Directive does not apply to dues of a contractual nature, so that the liability of the AI should be thought out and defined accordingly. There is clearly a need to harmonise the definition of AI liability within the EU so as to ensure consistent application of the available legal instruments.

As already mentioned above, the AIC routing should not in the first instance create too much additional workload for the AIC (see para. 704). However, deciding to involve the AIC for other purposes than exclusively the routing (or irrespective of that) (for instance, for the audit and handling of queries from various source countries, etc.) could increase the burden on it. Therefore, each MS should assess whether the increased administrative burden in its hands when taking on such additional roles would outweigh the advantages to FIs established in that MS, so that the AIC would prefer not to intervene.

19.1.5 DUPLICATE REPORTING

718. **Duplicate Reporting.** Duplicate reporting should be read as sending/receiving the *same* information *twice*.

other cases, an MS would simultaneously act as AIC and RC or SC (i.e. cross-border scenario and reversed cross-border scenario, respectively). Thus, the lack of interest on the part of the AIC is fairly relative.

719. **Reporting subject and Reporting content.** It may well be that information is reported several times on one and the same reporting subject (i.e. under the MFN Clause, under the Implementation Package), but the reporting content (cf. section 19.1.1 above) is normally different (350). Accordingly, in that situation, one can hardly speak of duplicate reporting.

19.2 Alignment of Content and Timing of the Various Reporting Systems

720. **Question.** In this section, we assess whether it would be possible and desirable to align the information to be reported and timelines under the relief at source system with those under FATCA and the Savings Directive. In particular:

a. **Aggregate Amounts.** Would it be reasonable under the relief at source system to require AIs to only report aggregate amounts of dividends and interest rather than individual dividends and interest payments (on the basis that, in cases of doubt, the SC could request detailed information from the AIs or the AICs)?

b. **Other Particulars.** Are there other types of information that could be aligned?

c. **Timeline.** Should the timeline for reporting under FATCA, the Savings Directive and the relief at source system be aligned?

19.2.1 High-Level Comparison among Reporting under the Implementation Package, FATCA (MFN Clause) and the Savings Directive (and its Amending Proposal)

721. **Information Reported under the Savings Directive (and its Amending Proposal).** As the questions here also address the Savings Directive, it is first necessary to briefly compare the Savings Directive with reporting under the Implementation Package and FATCA. To that end, we use the same perspectives as used in the previous section (cf. 19.1.1 above).

- **Purpose? Compliance in the RC.** The ultimate aim of the Savings Directive is to enable savings income in the form of interest payments made in one MS to beneficial owners who are individual residents for tax purposes in another MS to be made subject to an effective tax charge in accordance with the laws of the second MS (351).
- **What? Interest (and Interest Component).** Currently, reporting under the Savings Directive only concerns interest payments. As already mentioned in Appendix 11 to the feasibility study, the term "interest payment" has a broader meaning than in the OECD Model Tax Convention. It concerns the following categories of income: (1) interest paid or credited to an account, but also (2) interest accrued or capitalised upon the sale, refund

350 Apart from in the exceptional case where an investor with a foreign account only has investments in foreign countries, the income from which is all subject to DTT benefits granted by its foreign financial institutions acting as AI.

351 We refer to Appendix 11 to the final report for a more detailed summary of the Savings Directive.

or redemption of debt claims and some income attributed by funds and deriving from interest payments ((3) upon distribution and (4) upon redemption, sale or liquidation).

The main changes introduced by the Amending Proposal in terms of products deemed to produce interest income are (1) a new category constituted by some life insurance contracts, (2) an enlarged definition of the investment funds category, and (3) a new category constituted by derivatives. Nevertheless, at this stage, the ultimate aim of the Savings Directive remains unchanged, so that a direct or indirect return on equity (in particular mere dividend payments) is not in scope.

Besides identification of the Paying Agent, the information to be reported is basically as follows: account number or identification of the debt claim giving rise to the interest (or of the life assurance contract under the Amending Proposal), information concerning the interest payment i.e. at least the total amount of interest or income, the total amount of the proceeds from sale, redemption or refund (and the total amount paid out under life assurance contracts in the Amending Proposal) (352).

- **How? Reporting per Category**. Reporting is in principle per defined category of interest payment.
- **On whom? Reporting per Beneficial Owner.** Reporting is only applicable with respect to Beneficial Owners, i.e. individuals resident in the EU.

  Beneficial Owners are identified by the following particulars: name, address, TIN and/or date and place of birth.
- **By whom? Reporting by the Paying Agent.** Reporting is done by the Paying Agent. The definition of paying agent is twofold. An economic operator can be either a paying agent upon payment of interest to another party or a paying agent upon receipt of such a payment (only one economic operator being the paying agent in a given chain of payments). In a nutshell, without considering the details (especially those introduced by the Amending Proposal),
  - **Paying Agent upon Payment**. Any economic operator that pays interest to or secures the payment of interest for the immediate benefit of the beneficial owner, whether the economic operator is the debtor (or issuer) of the claim (or security) producing the income or the operator charged by the debtor (or issuer) or the beneficial owner with paying income or securing the payment of the income;
  - **Paying Agent upon Receipt.** Any EU entity (or legal arrangement) established in an MS that is not subject to effective direct taxation is in principle considered to be a paying agent upon receipt of an interest payment or upon securing such payment.

352 The Amending Proposal, as does the Savings Directive, provides for numerous options in terms of reporting. We refer to our comments in the final report with respect to the relevance of these options (see para. 128 under Chapter 6 of the feasibility study).

Reporting is compulsory.

- **When? Information provided to the RC MS within six Months after the End of the Tax Year.** The exchange of information between tax administrations takes place at least once a year, within six months following the end of the tax year of the MS of the paying agent (usually 30 June) (353), for all interest payments made during that year. The paying agent must report to its own tax administration before that date, according to the timing laid down in the internal legislation of the MS in question.

722. **Comparison.** The table below summarises the comparison between reporting under the Savings Directive (and Amending Proposal), reporting under the FATCA as it could be applied within the EU pursuant to application of the MFN Clause and reporting under the SC Model (Implementation Package).

	SC MODEL (Implementation Package)	**MFN CLAUSE** (≈ FATCA)	**SAVINGS DIRECTIVE** (& Amending Proposal)
PURPOSE? (SC v. RC Reporting)	SC Reporting (WHT Compliance)	RC Reporting (RC Compliance)	RC Reporting (RC Compliance)
WHAT? (Reporting Content)	Limited to dividends and interest	Includes dividends and interest	Interest (and interest component)
HOW? (Level of Detail)	Details per individual Payment	Details per category	Details per category
ON WHOM? (Reporting Subject)	DAH and IAH with DTT Relief	Reporting per direct and indirect EU Account holder	Reporting per Beneficial Owner (limited to individuals)
BY WHOM? (Reporting Agent)	Authorised Intermediary	Foreign Financial Institution	Paying Agent (upon payment v. receipt)
WHEN? (Timing)	30 April	30 September	30 June (usually)

Table 64: High-Level Comparison Among SC Model (Implementation Package), MFN Clause (FATCA) and Savings Directive (and Amending Proposal)

353 For all MSs except the UK (6 October).

19.2.2 ALIGNING REPORTING SYSTEMS (CONTENT, TIMING AND OTHER ELEMENTS)

723. **Introduction.** The questions raised in this chapter all deal with the possible alignment of (part of) the reporting and exchange of information systems. The first question addresses the possibility of only reporting aggregate amounts under the SC reporting as in FATCA or the Savings Directive; the third question asks whether it would be appropriate to align the timelines for reporting under the three systems; while the second question is more general and basically asks whether there could be other elements to be aligned.

In order to answer to these questions, and more generally to meet their underlying purpose, we consider it worth taking a two-step approach starting from the high-level summary provided in the preceding table. This two-step approach is driven by the main purpose of each reporting system:

- Should the reporting provided for in the Implementation Package, whose purpose is to answer the SC's needs when applying the relief at source, be aligned with the MFN Clause and the Savings Directive reporting systems, which are aimed at answering the RC's needs?
- Should the MFN Clause and Savings Directive reporting systems, whose objectives are basically the same (i.e. answering RC needs), be aligned with each other?

19.2.2.1 ALIGNING THE IMPLEMENTATION PACKAGE WITH THE MFN CLAUSE AND/OR THE SAVINGS DIRECTIVE?

724. **Alignment?** Referring to Table 64 above, we will, in turn, look at the various perspectives being: the reporting content, the reporting subject, the reporting agent and timing.

- **Reporting Content.** As already mentioned in section 18.2 above, aligning the content of the SC reporting provided for under the Implementation Package (details per payment) to the content of the other two reporting systems (details per category) is not advisable in our view: should the SC want to be in a position to carry out spot checks where it matters most, i.e. at the level of the WHT rate applied per payment and per investor, it will in any case first have to receive the detailed information (gross amount, WHT and net amount per payment per investor).
- **Reporting Subject.** As mentioned in section 19.1.1 above, reporting under the Implementation Package is only done with respect to direct account holders (the only ones who are in principle entitled to DTT benefits) while, under the MFN Clause and the Savings Directive (especially further to its Amending Proposal), it would also affect persons considered as account holders under a look-through approach (which is independent from any entitlement to DTT benefits). The possibility of aligning the three reporting systems at that level would therefore be limited to direct account holders.

It could nevertheless be envisaged harmonising the identification procedures for direct account holders. Besides, and in any case, it would be necessary for an AI applying DTT benefits for an investor to ensure consistency in terms of the residence status of the investor in relation to MFN Clause reporting.

- **Reporting Agent.** Becoming an AI is optional for an FI. The FI could also choose to act as CI (where the FI passes the detailed Investor information to an FI acting as AI), or even not to participate in the relief at source system. On the other hand, under the MFN Clause and the Savings Directive, becoming a reporting agent is not an option, thus limiting any alignment opportunities.

- **Timing.** First of all, the timing under the Implementation Package is that for reporting by the AI while, under the MFN Clause and the Savings Directive, is the timing for information exchange (the timing for reporting being laid down by the internal legislation of the MS in question).

  Then, considering the limited options for alignment at the level of the reporting agent and reporting subject (besides content), we hardly see any added value in aligning the timings.

  Because the Implementation Package is silent on the timing for exchanges of information from SC to RC (governments are only *"encouraged to agree on the timing and modalities of such exchange of information by entering into a Memorandum of Understanding"*) (354), alignment is nevertheless possible. The added value should be balanced with the workload and joint-working planning associated with the alignment.

19.2.2.2 ALIGNING THE SAVINGS DIRECTIVE AND THE MFN CLAUSE REPORTING?

725. **The MFN Clause sets the scene for a coordinated RC reporting system.** Referring to Table 64 above, it can clearly be seen that the MFN Clause and Savings Directive aim at answering RCs' needs (albeit they are defined differently). In essence, it would make sense to align these forms of reporting, at least within the EU. As mentioned in Chapter 16, the MFN Clause, applied in a multilateral manner, sets the scene for a minimum scope of a coordinated RC reporting system within the EU (if such coordinated reporting system did not release the full potential created by the MFN Clause, then any MS could continue to bilaterally require the potential gap).

726. **Amending the Savings Directive.** Alignment between the Savings Directive and the MFN Clause reporting could be achieved in different ways:

- by identifying the elements of the MFN Clause that are already fulfilled by the Savings Directive (as the MFN Clause is not applicable to these elements) so as to apply the MFN Clause to whatever is not already covered by the Savings Directive;

354 Implementation Package pp. 4-5.

- by amending the Savings Directive with a view to incorporating the principles of the MFN Clause;
- by adopting a brand new legal instrument (and repealing the Savings Directive).

Whatever method is chosen, the objective should ultimately be to achieve a single, fully coordinated RC reporting system within the EU.

727. **Alignment?** Referring to Table 64 above, we again take a look at the various perspectives considered in the high-level comparison: reporting content, the reporting subject, the reporting agent and timing.

- **Reporting Content**. First of all, it is important to mention that reporting under the Savings Directive currently only concerns interest payments whereas it is much broader under the MFN Clause (cf. subsections 17.4 above and 19.1.1 above). Thus, it is recommended broadening the scope of the Savings Directive.
- **Reporting Subject.** The MFN reporting would also cope with entities (companies in particular), which at present are not covered by the Savings Directive. The Savings Directive could therefore be amended on that aspect. This need for a change in scope is reinforced by the fact that, in the case of indirect account holders, it might well be necessary for the reporting to be carried out at two levels: both direct and indirect (cf. subsection 17.4 above).
- **Reporting Agent.** As mentioned above, there are differences with respect to the definition of the paying agent (in particular the notion of paying agent upon receipt under the Savings Directive). It should be considered harmonising these definitions, provided that that does not impair alignment on the most important elements, being reporting content and the reporting subject.
- **Timing of reporting.** Once all the above elements have been aligned, the timing can of course also be aligned as it would not make sense to have two reporting timings for similar objectives.

728. **Duplicate RC reporting.** The following example further illustrates the need for the coordination and alignment of RC reporting systems.

Under FATCA, no feedback by the IRS to FFIs is provided for, except where the IRS has problems with information reported by FFIs (on a case-by-case basis). As a result, when a client is reported to the IRS but is not ultimately considered by the IRS as a Specified U.S. Person, the FFI would not be aware of the mismatch between its database and the IRS's stance.

Under the MFN Clause, this could lead to duplicate reporting:

- MS "X" has a (bilateral) MFN agreement with MS "Y", according to which FIs established in MS "X" should report information on account holders with "MS Y residence indicia;"
- MS "X" has another (bilateral) MFN agreement with MS "Z", according to which FIs established in MS "X" should report information on account holders with "MS Z residence indicia;"
- In this case, the FIs established in MS "X" would have to duplicate their reporting with respect to account holders having "MS X and MS Z residency indicia."

If they want to avoid such a situation, then the MSs should coordinate their actions. One possibility is to have a look at how this issue is dealt with in the Savings Directive.

Irrespective of this, an MS that has received information considered incorrect after having carried out the necessary checks should provide for feedback to the FIs (via the AIC) that provided the information. Such feedback would enable the FI to be aware of the mismatch, incline it to further investigate its customer information and, as the case may be, provide *ad hoc* reporting to another MS.

19.3 INTERACTION WITH THIRD COUNTRIES

729. **Benefit of the AIC Routing.** From the above and as detailed in the feasibility study (Chapter 8), it appears that passing the information through the AIC for SC reporting purposes could be more efficient. Indeed, the Savings directive, and now FATCA and the MFN Clause, already use the AIC as a routing channel.

730. **One Model.** To recall, all the stakeholders and especially the FIs emphasised the importance of limiting the number of systems, reporting obligations and frameworks.

731. **Implementation of the Implementation Package by Third Countries.** Assuming the Implementation Package is applied by third countries (acting as SC, of course), then European AIs will in any case have to send information directly to these SCs (apart from the fact that detailed reporting would be due: cf. section 18.7).

732. **Interaction with Third Countries May Lead to the Implementation of Two Systems Within EU, Pursuing One Specific Objective.** In that situation, European AIs will have to put systems in place not only to communicate with their own tax countries but also potentially to report directly to many other source third countries. As a result, a European FI would have to "apply" two systems for the same purpose, which is clearly not ideal, as already mentioned several times in the feasibility study.

733. **IT Aspects: Coexistence of AIC and SC routing.** In other words, as explained in the previous chapters, both the AIC and SC routings will most probably need to coexist, especially in the context of interaction with third countries:

- **RC Reporting under the MFN Clause.** Due to the MFN Clause, IT needs to support routing via the country of establishment of FIs for RC reporting purposes.
- **SC Reporting (and RC Reporting) under the Implementation Package.** To apply the relief at source system, IT needs to support both direct reporting from AIs to SCs (and RCs) and indirect reporting from AIs via the AIC to SCs (and RCs).

As already mentioned in the final report on the feasibility study, even from a purely internal EU perspective, the more coordinated the approach is, the more efficient it is from a cost and synergy perspective. Considering the additional layer of complexity resulting from the interaction with third countries and the co-existence of AIC (indirect) reporting and SC (direct) reporting, the coordination aspect is all the more important. As under the FATCA Model 1 IGA, AICs could also contemplate opening up their IT systems to FIs located in their territory for relief at source purposes, which would lead to IT cost savings for AIs (provided this can be agreed with sufficient tax administrations acting as SCs).

734. **Enhanced EU-Coordinated Solution for RC Reporting.** Third countries should not have any impact on the application of an EU-coordinated solution taking into account the consequences of the MFN Clause. The MFN Clause is strictly independent from whatever might be required in terms of information exchanges that might be required by third countries to MSs (see Chapter 16). Of course, this does not mean that the EU should not also ask third countries to provide the same level of information as is exchanged amongst MSs. There may be a role for the European Commission in that respect, as was previously the case in the framework of the discussions around applying the Savings Directive with third countries.

735. **Towards a Global Standard of Automatic Exchange of Information?** To recall, FIs and tax administrations are keen, as far as possible, to apply harmonised reporting and exchange of information systems.

That said, the analysis shows that a relief at source system is independent from an RC reporting system, so that it is likely that at least two reporting systems will have to be applied.

To avoid further complexity, it should be borne in mind that an EU-specific RC-reporting system (cf. subsection 19.2.2.2 above) could face the same issues as where an EU-specific relief at source systems is implemented, being that two reporting systems might have to be applied to meet the same objectives, depending on the countries involved (MSs v. third countries).

As a result, it should be ensured as far as possible that any RC reporting system implemented in the EU is compatible with any RC reporting system that might be developed at a global

level, assuming that the latter has regard to data protection laws and existing information exchange laws in regional groups of countries such as the EU (355).

19.4 LEGAL TOOLS TO IMPLEMENT THE RELIEF AT SOURCE SYSTEM

736. **Question.** Another question raised concerns the legal tools that would be necessary to implement SC reporting (the relief at source system). Should contractual arrangements or local/EU tax legislation be the legal basis for implementing the system?

737. **SC Reporting (Relief at Source System).** For the implementation of SC reporting under a relief at source system, interaction with third countries could lead to application of the Implementation Package

- **Options.** The Implementation Package does not provide for a single legal means of implementation. It makes it possible to go down the contractual arrangement route or any other route that might be suitable: *"While the documents in the Implementation Package are self-contained, in many circumstances the source country will need to modify its domestic law in order to adopt the system. Some countries have indicated that they would have to change their domestic law in order to allow the contractual agreements contemplated by the Implementation Package. Others have indicated that they would implement the system by incorporating the procedures into their domestic law or regulations."*

  It cannot therefore be argued that third countries will necessarily opt for one option rather than the other.

- **EU Framework.** That said, the EU legal framework created by the Directive on Administrative Cooperation and the Recovery Directive should be considered as it could render application of a relief at source system by (some) MSs more efficient. As already mentioned in the feasibility study:

  - the Directive on Administrative Cooperation enables coordination between MSs at various levels (in particular, presence in administrative offices and participation in administrative enquiries; simultaneous controls; administrative notification; feedback; sharing of best practices and experience) and

355 In that respect, it will be interesting to follow up on the developments in terms of future reporting that would have to be gone through by US FIs to fulfil the reciprocal character of the exchange of information provided by the FATCA Partner. In that respect see, *inter alia*: http://www.reuters.com/article/2013/02/04/us-usa-tax-fatca-idUSBRE91312W20130204.

- the Recovery Directive could be used to ensure proper recovery of tax claims when needed. In that case, however, the AI's liability should be defined accordingly and certain limits on the Requested Authority's obligations (356), in particular the EUR 1.500 threshold, should be disregarded in practice.

Therefore, depending on the level of cooperation that MSs would like to achieve from each other, but also depending on their local legislation, both the contractual arrangement and the incorporation of procedures into the domestic law or regulations are possible.

- **Coordination.** Should the MSs want to coordinate their action in this area, then it would of course be best to adopt a directive. This would aim at harmonising *application of* the Implementation Package within the EU (357).

19.5 CONCLUSION

738. **AIC Routing for SC reporting.** We first addressed the question whether the potentially generalised adoption of AIC routing for the purpose of RC reporting within the EU (under the MFN Clause) could justify using the AIC routing for the purpose of SC reporting (under the relief at source system). In that respect, the AIC routing could be envisaged from a purely internal EU perspective, but interaction with third countries would make it more difficult (in particular with regard to the IT for transferring information to third countries).

739. **Coordinated application of the Implementation Package.** If agreement cannot be achieved regarding the communication channel, whatever the reason may be (lack of interest on the part of the AIC, etc.), we nevertheless strongly recommend that it be considered revisiting application of the Implementation Package with some of the elements that were initially defined for the AIC *Model* in the context of the feasibility study, in so far as these elements would enable better coordination between MSs and therefore improve the efficiency of the overall system.

740. **Alignment of SC Reporting.** With regard to the question of possible, desirable alignment of the various reporting systems (under the Implementation Package, the MFN Clause and the Savings Directive), reporting under the relief at source system as provided for in the Implementation Package is relatively independent from that under the other reporting systems. This is due to the different objectives pursued by these systems (SCs' needs for the Implementation Package and RCs' needs for the MFN Clause and the Savings Directive).

356 This could, however, impinge on the possibility of acting via contractual arrangements: to recall, Art. 2.3(c) and (d) of the Recovery Directive state that it may not apply to *"dues of a contractual nature (and) criminal penalties imposed on the basis of a public prosecution or other criminal penalties not covered by paragraph 2(a)"* (cf. section 5.2.2 of the final report).

357 We refer to chapter 6 of the feasibility study for the pros and cons in that respect. Enhanced cooperation could possibly be used to that end amongst MSs wishing to apply a relief at source system (no exchange of information would be necessary within the EU, given application of the MFN Clause, so that it might be argued that no other EU instrument is currently dealing with this question). An alternative could be a Commission Recommendation, allowing those countries that so wish to go ahead, following by a directive once there is a critical mass of MSs.

741. **Alignment of RC Reporting.** At the level of the RC reporting systems, they should be aligned (at least within the EU).

* *

*

CHAPTER 20 CONCLUSION

742. This chapter sets out the main conclusions of the analysis done in the framework of the Addendum and explains, where appropriate, to what extent and how it deviates from the conclusions in the feasibility study.

Chapter 16 analyses the MFN Clause in the light of the bilateral agreements under negotiation under FATCA (Models 1 and 2 IGA).

- **Application of the MFN Clause.** When an MS enters into an IGA with the US, this should trigger application of the MFN Clause set out in Art. 19 of the DAC. From a legal point of view, the MFN Clause creates a right for each MS to request an equivalent level of cooperation from an MS that has signed an IGA with the US, according to whatever Model, and even without an IGA in the case of unilateral cooperation with the US.

  Although there could be differences in terms of the cooperation that MSs could require from each other depending on how the cooperation with the US is actually given, potential application of the MFN Clause should at least be understood as a clear political agreement to move towards wider cooperation in terms of RC reporting.

- **Bilateral Negotiations.** MSs will soon be in a position to ask other MSs with which they consider having more dealings to exchange information, and therefore to enter into bilateral negotiations to that end. It is likely that all these agreements will be made available to other MSs, creating a level playing field among MSs as a result of peer pressure.

  Potentially, in order to address the RC reporting needs of each and every RC MS within the EU (currently 27), and assuming every MS signs an IGA with the US, up to 702 bilateral agreements could be negotiated (27 * 26). Of course, in the short run, the MSs would probably decide to enter into wider cooperation with key other MSs, but the system would not be really efficient until a sufficient number of agreements were signed.

- **Need for Coordination.** Accordingly, the MFN Clause will be very difficult to apply on a large scale if no EU-coordinated approach is taken.

  Indeed, in practice, actual implementation of the MFN Clause may encounter numerous issues. In particular, the MFN Clause is essentially bilateral in character and has not been designed to implement a fully new exchange of information system and cope with in-depth cooperation such as provided for in the IGAs (covering various aspects from due diligence procedure to sanctions in cases of non-compliance). Moreover, the bilateral character of the MFN Clause will ultimately, at best, lead to an uncoordinated framework.

  In other words, although applicable, we do not see the MFN Clause as a tool for fully harmonising administrative cooperation in tax matters within the EU but more as a strong incentive for MSs to initiate discussions on how best to achieve such harmonisation.

- **New Rules of Engagement.** Thanks to the MFN Clause, the focus in the EU should move from mere "conceptual" questions (Do the MSs want to improve RC reporting, in particular for dividends, for instance? etc.) to "practical" questions (How do you further extend RC reporting at EU level? Are the existing channels of information still suitable? How do you leverage on and align with existing exchange of information systems? Etc.).

Chapter 17 analyses the relevance of RC reporting under a relief at source system.

- **Scope of the Feasibility Study.** It had initially been decided to compare two main routing systems, referred to as the "SC Model" and the "AIC Model" (see section 15.1.2 for more detail), both pursuing a *twofold* purpose: (i) to grant WHT relief in the Source MS (including checking the residence status with the relevant Residence MSs, if need be) and (ii) to ensure compliance in the Residence MS.

- **SC to RC Exchanges of Information under a Relief at Source System not strictly necessary within the EU.** The particulars provided for under the MFN Clause are in our view likely to be sufficient to meet the objective of ensuring compliance in the RC. As a result, reporting from SC to RC in the framework of the relief at source system does not appear to be necessary within the EU.

  The context is therefore different from that of the feasibility study, where compliance in the RC ideally had to be ensured by the relief at source system, which is no longer a strict requirement, at least within the EU.

  More importantly, the absence of RC reporting when DTT benefits were not claimed by a taxpayer was the major issue previously identified in the feasibility study with respect to tax compliance in the RC (cf. section 8.2 of the final report on the feasibility study). This issue has now been resolved since the RC's compliance needs should be met in any case, regardless of whether DTT benefits have been claimed.

  Even in the limited cases where there might not be any RC reporting under the MFN Clause, our conclusion remains the same, essentially because we believe that RC and SC reporting systems are very different, so that it is preferable to have two different systems for two different purposes. Any RC reporting that might be adopted (or coordinated) within the EU could accommodate this by laying down stricter regulations than under FATCA (in particular by not using thresholds or by using lower one than provided for by FATCA), as long as the rest of the reporting system applied within the EU continued to be aligned to and consistent with international developments.

- **Reporting to RC nevertheless required from/to third countries.** In considering interaction with third countries, RC reporting under the relief at source system proposed in the Implementation Package nevertheless continues to be a requirement in the absence of a generalised RC reporting system *per se* (MFN Clause not applicable), both where the RC is an EU MS and where it is not.

- **Global perspective.** Given that AIs and/or the SC MS's tax administrations would even so, in principle, have to maintain appropriate resources and IT systems to ensure reporting in cases involving third countries, one might consider keeping RC reporting in the relief at source system proposed in the Implementation Package, even within the EU, to avoid drawing a distinction dependent on the precise case, which might be difficult to implement.

Chapter 18 analyses the possibilities of simplifying SC reporting under a relief at Source System and related aspects.

- **Simplification of SC Reporting Not Opportune.** It is not really worth simplifying the SC reporting provided for in the Implementation Package by not sending the Annual Information Report to the SC. The SC would require this report from time to time anyway in order to carry out spot checks. Besides, it is likely that third countries that are wanting to implement a standardised relief at source system will do so by adopting the Implementation Package (presumably), so that consistency again presses in favour of similar reporting within the European Union.

  While a QI-like system such as they have in the US – which is a simplification of the SC reporting system – could be an option, it does not seem to be very much in line with the latest developments on WHT relief systems at OECD level (and resulting in the Implementation Package), so that we doubt whether there would be political agreement in this respect. Our perception is that, nowadays, countries will be very reluctant to grant any kind of tax advantage, like a relief based on a DTT, without receiving all the information they need to verify that the advantage has been granted appropriately.

- **Simplification of RC Reporting Under the Relief at Source System Possible but Not Opportune.** Chapter 17 concluded that RC reporting is not strictly necessary within the EU. However, should it be introduced, Chapter 18 also looked at whether such RC reporting could be simplified. It appears that it can. For instance, only providing investor-specific information together with gross amounts could be an option.

  However, the information necessary to encourage tax compliance in the RC is greatly dependent on the RC's income tax system, so that this conclusion cannot be generalised for all situations. Moreover, if the RC reporting to be done by the SC had to be tailored according to the specific features of the RC tax regime, this would create an unnecessary additional burden on the SC. This especially so since detailed reporting from SC to RC would be needed in any case where third countries are involved. So, simplifying RC reporting is possible in our view, but not appropriate.

- **Systematic Feedback.** Systematic feedback from RC to SC is not strictly necessary, either, given how the SC can always carry out spot checks. That said, when the RC receives information from the SC and notices that it contains erroneous elements, it would be good practice for the RC to then provide feedback to the SC.

- **Duplicate Reporting.** Duplicate reporting between RC (under the MFN Clause) and SC reporting (under the Implementation Package) will be comparatively limited given the different purposes of the two systems. Some duplication may nonetheless arise at the level of the RC, upon receipt of information about the same investors both under the MFN Clause and the Implementation Package. If it were desired to apply both systems fully (i.e. by keeping the RC reporting provided for in the Implementation Package), then duplication would hardly be avoidable in the absence of a centralised hub.

- **Entry into Force.** If MSs wish to achieve compliance in the SC and in the RC at the same time, then both reporting systems (relief at source and MFN Clause) should be implemented simultaneously.

  Unless the timing for implementation of the MFN Clause reporting and the Implementation Package reporting is aligned, the ambit over which information exchange increases is only going to broaden over time. Hence, it would be necessary, at least in first instance, to maintain automatic exchanges of information from SCs to RCs under the Implementation Package, even if that might occasionally create a duplication of work.

Chapter 19 analyses whether generalised adoption of an AIC routing for the purpose of SC reporting would be efficient for AICs and FIs. It also addresses potential alignment of the information to be reported and timelines under the relief at source system proposed in the Implementation Package with those under FATCA and the Savings Directive.

- **Role of the AIC: More Limited than in the AIC *Model* Defined in the Feasibility Study.** Under the AIC Model (as explicitly defined for the purpose of the first part of the feasibility study), the AIC's role in first instance was to assess the completeness of the information received, check the validity of the information format and dispatch that information to the different MSs and, in the second instance, to deal with the requests in the context of the systematic feedback loop. This second role is no longer a role that the AIC could take on while the first is still a role which could be carried out by the AIC. As a result, the role of the AIC, and therefore the workload associated therewith, is far reduced at that level compared to the role initially expected to be taken on by the AIC in the feasibility study.

- **AIC Routing for SC reporting.** The potentially generalised adoption of an AIC routing for the purpose of RC reporting within the EU (under the MFN Clause) reinforces the arguments in favour of using the AIC routing for the purpose of SC reporting (under the relief at source system). This is because the number of information flows is lower using the AIC routing, the AIC generally has a closer relationship with the AI than the SC, it is already auditing FIs established in its jurisdiction. The AIC could play a role in centralising feedback that is received and enforcing necessary corrective action by FIs. The AIC routing presents advantages for data protection purposes, and from an IT architecture point of view, the AIC routing remains the most cost-efficient proposition.

- **Coordinated application of the Implementation Package.** If agreement cannot be achieved regarding the communication channel, whatever the reason may be (lack of interest on the part of the AIC, etc.), we nevertheless strongly recommend considering revisiting application of the Implementation Package with some of the elements that were initially defined for the AIC *Model* in the context of the feasibility study, provided these elements would enable better coordination between MSs and therefore improve the efficiency of the overall system

- **Alignment of SC Reporting.** It appears from the high-level comparison among the reporting provided for in the relief at source system, the MFN Clause and the Savings Directive that the reporting under the relief at source system is relatively independent from the two others. This is due to the different objectives pursued by the systems (SCs' needs for the Implementation Package and RCs' needs for the MFN Clause and Savings Directive). Hence the limited opportunities for alignment.

- **Alignment of the RC Reporting.** At the level of the RC reporting systems, however, they should be aligned (at least within the EU). In that respect, the principles of the MFN Clause should ideally be incorporated into a binding instrument so as to ultimately achieve a single, fully coordinated RC reporting system within the EU.

* *

*