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IMT BLOG

THE AUTOMATIC EXCHANGE OF INFORMATION IN TAX MATTERS – 10 GOLDEN RULES

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In 2016 the first laws governing the implementation of the Common Reporting Standard (CRS) on the Automatic Exchange of Information In Tax Matters (AEOI) came into force. Some of the developments associated to the application of law are alarming, especially in relation to the interpretation of the legal provisions governing the AEOI and the integration of the AEOI into data protection law. In the following blog post you will find a critical report based on our experiences and also 10 golden rules which it is imperative to observe in connection with the application of the AEOI.

We will be pleased to answer any questions you may have.

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The AEOI – Some Oberservations

More than three years ago the first jurisdictions that committed themselves to the Automatic Exchange of Information In Tax Matters enacted national laws implementing the AEOI.

The initial issues associated with the application of these rules were huge and still continue to be very challenging. The number of new rules being introduced by the various law makers is overwhelming. The OECD's Common Reporting Standard (CRS), including the commentary thereto, currently comes to a total of 321 pages. With 170 pages, the OECD's CRS Implementation Handbook is almost equally exhaustive. Moreover, the individual Participating Jurisdictions have enacted their own laws on implementation as well as directives and guidelines. In Liechtenstein alone, the jurisdiction's AEOI law covers 42 pages at present, the AEOI directive is 26 pages long and the explanatory information document of the Liechtenstein Tax Authority runs to 159 pages. The Liechtenstein Financial Market Authority's FMA Communication 2015/7, which pertains to the aforementioned AEOI information document, is 28 pages long. That makes a total of 776 pages of reading material just with regard to Liechtenstein! Anyone taking a distant look at the various national provisions and supporting materials on the AEOI will soon realize that the international rules of the AEOI are quite differently interpreted and implemented by law makers and governments. This is hardly what the international harmonization of law is supposed to look like.

As a consequence, the differing interpretations of the AEOI and the CRS are sometimes scary and astonishing. It happens repeatedly that legal AEOI concepts are equated with, or confused with, concepts of other, allegedly similar, legal areas (in particular Compliance focusing on Anti-Money Laundering and Know Your Customer rules).

Furthermore, there are some highly esteemed and respected practitioners who wish to transfer the legal provisions of the AEOI to other areas of law (e.g. regarding the register of beneficial owners of legal entities). ***Regulations that intervene so massively in fundamental rights (even more so than the AEOI) require an explicit legal basis and must be sufficiently defined in terms of content.*** The AEOI does not provide a suitable legal basis for this. A conclusion by analogy is legally inadmissible, but unfortunately it is made much too often.

Another cause for great concern is the fact that a considerable number of financial intermediaries request information which they actually do not need for AEOI purposes (e.g. tax identification numbers of persons who do not actually need to be reported under AEOI rules). This conduct seems plausible and comprehensible under AEOI law, but in reality is highly questionable under data protection law. ***Personal data must be adequate in purpose, substantial and limited to what is necessary for the purposes of processing*** (principle of data minimization).

The penalties in the event of breach of data protection regulations are horrendous. Fines can be as high as CHF 22 million or, in the case of a company, up to 4% of the previous year's turnover achieved worldwide, depending on which amount is higher. The penalties in the AEOI area are also immense. Violations of AEOI obligations are punishable by fines of up to CHF 250,000.00 and might also result into criminal prosecution.

But, the AEOI is above all one thing: a legally extremely complex administrative nuisance.

Formalism is terrible! However, there is only one thing at stake: the prevention of cross-border tax evasion! – *That's it!*

The precise purpose of the AEOI is to ensure that national tax authorities can exchange information with their counterparts in other jurisdictions on matters which affect them. The information is exchanged electronically at recurrent intervals and using a prescribed data format.

To survive in the jungle of the numerous provisions that make up the AEOI, we recommend to heed the following rules:

Rule 1 – Keep calm

The fact that a person is reported under the AEOI is in principle not worrying and does not automatically constitute evidence of cross-border tax evasion. All persons who have a specific reference to a reportable financial account or to a financial institution or to a NFE (so-called non-financial entity) are reported under the AEOI, including those who have duly paid all taxes for which they are liable. Therefore, first of all: keep calm!

Rule 2 – Do not underestimate the AEOI

The possibilities available to the AEOI are more far-reaching than you might think. So what could be more obvious than asset structuring in a Nonparticipating Jurisdiction? Not (really) a good idea. In this age of international tax cooperation there is no way of preventing tax authorities from exchanging information. An AEOI-relevant or reportable financial account is held in most cases. And then an AEOI report is always triggered, from which the asset structuring in a Nonparticipating Jurisdiction can be derived. Very suspicious! This will be of great interest of the national tax authorities.

Rule 3 – Call in tax experts

The tax assessment of an AEOI reporting depends on the tax law of the recipient jurisdiction . Examine the tax implications of asset structuring from the perspective of the jurisdictions in question and consult legal experts. Without an international network of expert consultants, the AEOI simply cannot be managed alone due to its complexity.

Rule 4 – Respect the legislative environment

In AEOI matters, always observe the applicable legal requirements and do not simply ignore them. This applies in particular to the area of data protection. The disclosure of personal data to financial intermediaries requesting such information but are not legally bound to collect these is not an AEOI-compliant conduct, but an infringement of data protection regulations. Clarify each question on a case-by-case basis and do not act rashly.

Rule 5 – Examine the fiscal autonomy of a legal entity

Check whether, from the viewpoints of the jurisdictions in question, the legal entity is to be considered being a tax autonomous structure or not (autonomous legal entity vs. tax transparent legal entity). In the case of asset structures such as foundations, for example, this is done on the basis of the relevant criteria of tax autonomy, and in the case of corporations on the basis of the actual corporate substance (personnel, office space and material resources). If, for example, a reportable person is referred to as the account holder of an asset structure lacking own tax autonomy, then the assets and income of said foundation are (always also) taxable in the jurisdiction of residence of the reportable person (additional taxation).

Rule 6 – For non-transparent legal entities: check the tax residency

Each legal entity has a statutory seat. But this does not mean that the legal entity is taxable solely at that location. Most jurisdictions link the tax residency of a legal entity not only to its statutory seat but also to the location of its business management (place of effective management). When, for example, a functional representative of a legal entity is referred under the AEOI, this always provides a reason for an enquiry as to whether the place of effective management might possibly be in the jurisdiction of residence of the person referred.

Rule 7 – For non-transparent legal entities: check whether any gift tax or similar tax has been paid

If assets are transferred to a fiscally non-transparent (tax autonomous) legal entity, the question always arises of whether a gift tax or a similar tax must be paid in the jurisdiction of residence of the person transferring the assets. For this reason, a person who has set up a foundation must always be reported. Whether that person really controls the foundation or not is irrelevant.

Rule 8 – Check whether appropriate taxation is ensured in the event of a payout

Receiving a distribution from a foundation not controlled by the recipient is nice, but usually also a taxable event. It is clear that such payments usually flow into an AEOI reporting. The tax authorities know when someone has received a distribution from a foreign foundation. Always be aware of that fact.

Rule 9 – Keep records

Create logs and keep flight tickets, travel expense reports and similar documents. Just as proof that the place of effective management of a legal entity is actually located in the jurisdiction of the statutory seat. These documents do not offer proof of God. However, they are always helpful.

Rule 10 – Be prepared

The implementation of the AEOI must be reviewed at some point. Be prepared that the current legal view may change. Act now before everything collapses administratively. The AEOI still is in its beginning.

How can we support you?

IMT has a network of international tax experts at its disposal and specializes in analyzing asset structures with regard to AEOI and fiscal legislations. The author of this post, Mr. Stefan Gridling, will be pleased to answer any questions you may have in this regard.

ABOUT US

Our first group company was formed more than thirty years ago. Since then we have grown continuously into a group of wealth advisory boutiques with four divisions. Each division has its own field of competence.

We adhere to the highest ethical, professional and corporate standards. Competence, efficiency and transparency are of utmost importance to us and our clients. We advise our clients comprehensively and develop with them a mid- to long- term sustainable wealth strategy based on their family values.

Since our formation we have successfully adapted ourselves to the changing legal and economic environment always with focus on our clients' interests. We share their entrepreneurial spirit and support them developing and implementing their goals.

We care about all values – not only material assets – of our clients and help to preserve these for future generations.

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