Germany – September 2019

Release of the draft law on the introduction of a reporting obligation for cross-border tax arrangements

In brief

On 26 September, the German Federal Ministry of Finance (BMF) forwarded the draft law on the introduction of a reporting obligation for cross-border tax arrangements to various market associations for their comments until 30 September.

The foundation for this law is the Council Directive amending EU Directive 2011/16/EU (6th Amending Directive 2018/822/EU to the Directive on Administrative Cooperation - hereinafter 'DAC 6'), which entered into force on 25 June 2018, and which provides for the mandatory automatic exchange of information in the field of taxation on reportable cross-border arrangements. DAC 6 requires Member States to transpose the Directive into national law by 31 December 2019. The regulations are applicable from 1 July 2020.

When is a cross-border arrangement subject to reporting requirements?

An arrangement is reportable if it is cross-border, fulfils at least one of the so-called "hallmarks", and the arrangement concerns a tax to which the EU Directive on Administrative Cooperation applies. These are all taxes levied by EU Member States with the exception of value added tax, customs duties, and certain excise duties.

With regard to the selection of the hallmarks as well as to a large extent, their wording, the draft law adheres to the relevant list of hallmarks in the Directive. The introduction of additional hallmarks is not planned.

According to the Directive, certain hallmarks only lead to a reporting obligation if the arrangement fulfils the so-called "main benefit test." This is the case if it can be expected that the main benefit or one of the main benefits of the arrangement is to obtain a tax benefit.

This concerns:

- the general hallmarks relating to the relationship between the intermediary (eg, lawyer, tax adviser, investment adviser) and the taxpayer (confidentiality clause, performance fee) or characteristics of the intermediary's service (standardised documentation or structure);
- the specific hallmarks, such as the acquisition of loss-making companies for the purpose of using those losses; the conversion of income into capital, gifts, or lower taxed income; and circular transactions; and
- payments between associated enterprises that are tax-exempt for the recipient, that benefit from a preferential tax regime, or for which the recipient is (almost) not taxed because the recipient's state of residence does not levy corporate taxes or only does so at a (near) zero rate.

According to the draft law, the concept of tax benefit is broad. For example, tax refunds, the reduction or avoidance of tax claims, or the postponement to other taxation periods or to other taxation dates should lead to a tax benefit. In addition, when assessing the existence of a tax benefit, benefits obtained abroad must also be considered. However, if the tax benefit of a cross-border tax arrangement only affects Germany and is foreseen by the legislator, it should not be considered a tax benefit.

Those hallmarks whose application are not subject to the "main benefit test" are:

- payments between associated enterprises where the recipient is not resident in any tax jurisdiction or in a tax jurisdiction classified as uncooperative by the EU or OECD;

- arrangements in which the same asset is depreciated in more than one tax jurisdiction or relief from double taxation for the same income/assets is claimed in more than one jurisdiction;
- the transfer of property where there is a material difference in the value being treated as payable for that asset in the Member States;
- the hallmarks with respect to the exchange of information on financial accounts or with respect to beneficial ownership;
- transfer pricing hallmarks, such as the use of unilateral safe harbour rules, the transfer of intangible assets that are hard to value between associated enterprises, or the transfer of functions, risks or assets within associated enterprises, where the transferor's profit expectations are reduced by more than 50 % over a three-year period.

However, the wording of the draft law also contains some deviations from the Directive in the precise wording of the hallmarks.

For example, under the Directive, the hall-marks relating to payments between associated enterprises cover only those payments which are deductible by the payer. The draft bill does not provide for such a restriction.

Furthermore, the draft bill regularly focuses not only on the legal transfer (between different legal entities) of intangible assets and functions, risks or assets, but also on their internal transfer (between the company and its permanent establishments).

Conversely, the draft bill is more restrictive than the scope of the Directive in the case of the hallmark that addresses the exemption from double taxation for the same in-come/assets in several states. Corresponding arrangements should only be subject to re-porting if the income or assets remain wholly or partially untaxed as a result of the arrangement.

Who has the reporting obligation?

According to the draft bill, the intermediary is obliged to report. An intermediary is any person who markets, designs for a third party, organises or makes available for implementation or manages the implementation for a third party of a cross-border tax arrangement.

This is the case if the intermediary is domiciled in Germany (registered office, management, domicile or habitual residence) or - in the case of non-EU residents - if the service is provided via a permanent establishment in Germany. Intermediaries located in other EU countries are not subject to the reporting obligation in Germany (as they should be subject to a reporting obligation in their own EU Member State).

If an intermediary is involved in the arrangement, a certain amount of “abstract information” must always be reported by the intermediary. Following that, there is a second reporting (information on the user and on the persons involved in or affected by the arrangement), with two alternatives if the intermediary is subject to a statutory duty of confidentiality (eg, tax advisors, lawyers and auditors):

1. The user of the arrangement releases the intermediary from the obligation of secrecy. In these cases, the intermediary must also perform the second reporting.
2. If, on the other hand, the intermediary is not released from its duty of confidentiality, the user must report the matter itself.

In any case, users are subject to both reporting obligations if they have designed the reportable cross-border arrangement independently.

What information needs to be reported?

The reporting to the tax authorities consists of two parts: In the first part, abstract information shall be reported. This includes:

- information on the intermediary(-ies);
- the hallmarks leading to the reporting obligation and a summary of the content of the cross-border tax arrangement;
- the economic value of the arrangement;

- the (planned) date of the first step of the implementation; and
- details of the relevant legislation of all the Member States concerned.

The second report shall contain individual information concerning the user and the arrangement. These are, among others:

- information on the user of the arrangement;
- information on associated enterprises involved in the arrangement;
- (if known) likely impacted persons and Member States.

After the first reporting, the intermediary receives a registration number for the reported arrangement and a disclosure number for the report. He must inform the user of both numbers without delay, and such numbers must be included in the second report. In addition, if the intermediary knows of other intermediaries involved in the arrangement, it must also inform them of the registration number received.

Finally, the user must include both numbers in the tax return in which the tax benefit will be obtained for the first time.

How and by when should the report be made?

The reports must be submitted electronically to the German Federal Central Tax Office (BZSt) according to the officially prescribed data format.

It should be carried out within 30 days of the end of the day on which:

- the cross-border arrangement is made available for implementation,
- the user is able to implement the cross-border arrangement, or
- at least one user has taken the first step in the implementation of cross-border arrangement.

The decisive factor is which event occurs first.

How high are the sanctions for breaches of the reporting obligation?

According to the draft bill, violations of the reporting obligation are treated as an administrative offense and punishable with fines of up to €25,000. Violations include failure to report, late reporting, or incomplete reporting.

If the registration number and the disclosure number are not stated in the tax return in which the user obtains the tax benefit for the first time, there is also an administrative offense which can be punished with a fine of up to €25,000.

What happens to the reports?

The BZSt evaluates the received reports on cross-border arrangements. The results of the evaluation will be communicated to the BMF. As far as taxes are concerned which are wholly or partly due to the German states or municipalities, the BMF will inform the supreme financial authorities of the German states about the results of the evaluation.

The reported information will also be entered into a central register to which the authorities of all EU Member States will have access.

Outlook for the financial services / real estate industry

The definition of intermediary, which is important for the financial services industry, has not changed in the wording of the current draft bill. The idea of capturing supporting activities in the Directive is countered by a negative definition in the legal reasoning. Accordingly, an intermediary should not be anyone who has merely participated in the implementation of individual partial steps of cross-border tax arrangement without knowing this or without reasonably being expected to know it. The requirement therefore remains to look at the concrete function and activity of the individual market participants and to examine to what extent there is relevant activity in individual cases. Of particular relevance in this context will be the extent to which the individual functions have knowledge of the relevant circumstances or the extent to which knowledge is required.

In particular, for in-house tax functions, the legislator has made it clear that if a user designs a cross-border tax arrangement for him-self, the rules applicable to intermediaries must also be applied to him accordingly.

Moreover, the draft law does not define the concept of an arrangement any further on the product side. However, the explanatory reasoning makes it clear that “tax planning” is an active creation process in which the user consciously brings about a certain situation and this situation leads to a fiscal result that would not otherwise have occurred.

Regarding the hallmarks with the so-called “main benefit test,” it is not sufficient, according to the explanatory reasoning, as in the cases of §42 Paragraph 2 Sentence 2 Fiscal Code (AO), to merely prove considerable non-tax benefit. Rather, it must be demonstrated that the tax benefit is not the main benefit of the arrangement. In operational terms, this means that the financial industry will have to meet higher documentation requirements that clearly demonstrate the purpose of certain products or contracts and other arrangements. In cases of doubt, the arrangements or purpose will have to be checked, eg, within the framework of substance requirements.

With regard to reporting and in particular regarding cross-border investment structures, the present draft law also contains further requirements. The wording of the draft law suggests, inter alia, that given the expected heterogeneity of implementation of the requirements in the individual Member States, reporting in one Member State does not necessarily exempt the intermediary from reporting in another Member State. Where the scope of reporting requirements in Member States differs, multiple reports may be required. This may be avoided by reporting in the country that has the most extensive reporting requirements in cases where more than one intermediary has a reporting obligation.

As a result, it is now up to the financial industry, which is explicitly named as an intermediary industry by the bill in the form of financial service providers, to identify the situations and product groups in which they have a relevant (intermediary) market function. Over the next few months, best practice approaches will emerge. To the extent that specific reporting obligations exist, there remains room for consideration as to how the effort required to carry out the reporting in the respective market context can be efficiently implemented in compliance with the law.

When does the new law become effective?

The provisions on the obligation to report cross-border arrangements shall apply from 1 July 2020.

It should be noted, however, that cross-border reportable arrangements whose first step was or will be implemented after 24 June 2018 and by 30 June 2020 must also be reported by 31 August 2020.

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