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Global Tax Alert

Germany publishes draft Mandatory Disclosure Rules

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Executive summary

On 30 January 2019, the German Federal Ministry of Finance (BMF) sent a draft bill to all other federal ministries to introduce a "law on the introduction of a mandatory disclosure regime for tax arrangements" (the bill). The bill is intended to transpose the European Union (EU) Directive 2018/822/EU of 25 May 2018 into German national law and to create a reporting obligation for certain cross-border tax arrangements. The bill goes beyond the requirements of the EU Directive since it also includes a regime for the mandatory disclosure of certain domestic tax arrangements. The proposed rules have been presented in one joint legislation proposal. However, it is possible that the national disclosure rules will be separated into an independent legislative process.

The bill proposes a two-stage disclosure procedure for cross-border tax arrangements and extends the reporting obligation to domestic arrangements.

In most other respects, the bill remains largely in line with the EU Directive.

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Detailed discussion

Background

The Council of the European Union Directive 2018/822 of 25 May 2018 amending Directive 2011/16/EU regarding the mandatory automatic exchange of information in the field of taxation (the Directive or DAC6), entered into force on 25 June 2018.

The Directive requires intermediaries (including EU-based tax consultants, banks and lawyers) and, in some situations, taxpayers, to report certain cross-border arrangements (reportable arrangements) to the relevant EU tax authority. This disclosure regime applies to all taxes except value added tax (VAT), customs duties, excise duties and compulsory social security contributions. Cross-border arrangements will be reportable if they contain certain features (known as hallmarks). The hallmarks cover a broad range of structures and transactions. For more background, please refer to EY Global Tax Alert, *Council of the EU reaches an agreement on new mandatory transparency rules for intermediaries and taxpayers*, dated 14 March 2018.

EU Member States are to adopt and publish national laws required to comply with the Directive by 31 December 2019. National laws need to take full effect from 1 July 2020 following an interim period expected to last from 25 June 2018 to 30 June 2020.

A comparison between the proposed German legislation and the Directive is set out below.

Scope of Taxes Covered

The scope of taxes covered under the German draft bill appears to be fully aligned with the Directive and applies to all taxes except VAT, customs duties, excise duties and compulsory social security contributions.

Reportable arrangements

Under the Directive, an arrangement concerning a covered tax is reportable if the following two conditions are met:

- The arrangement meets the definition of a cross-border arrangement
- The arrangement meets at least one of the hallmarks A-E specified in Annex IV of the Directive

Under DAC6, cross-border arrangements are defined as arrangements concerning more than one Member State or a Member State and a third country. The hallmarks can be distinguished between those which are subject to the main benefit test (MBT), and those which by themselves trigger a reporting obligation without being subject to the MBT.

The German bill defines a reportable cross-border arrangement largely in line with the Directive. According to the explanatory memorandum attached to the bill, the concept of an arrangement must be interpreted very broadly. Examples include the creation, allocation, acquisition or transfer of income or its sources to an existing entity, as well as the creation or acquisition of a legal entity generating the income.

However, the German bill goes beyond the requirements of the Directive and includes a mandatory disclosure regime for domestic tax arrangements with domestic hallmarks (see below).

Hallmarks A-E

The German hallmarks largely follow the Directive's template. At the same time, the hallmark section is not phrased as an exact translation of the Directive. It is possible that, at least in some cases, the different wording will affect the scope of the reporting obligation.

The detailed explanatory memorandum of the bill contains additional information on most of the hallmarks, in some cases with examples. For instance, a corporate tax rate of almost zero (hallmark C.1) is defined as one that is 4% or less.

Main benefit test

The MBT rules are basically set out in accordance with DAC6. The MBT will be satisfied if it can be established that the main benefit or one of the main benefits which, considering all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement, is to obtain a tax advantage.

The bill contains a definition of a tax advantage, which includes, inter alia, the reduction or avoidance of tax liabilities, the increase of tax refunds and even the deferral of tax liabilities to other tax periods. The tax advantage may relate to German or foreign taxes.

However, there is one noteworthy difference to the Directive: if the cross-border arrangement only results in a mere German tax advantage and if, taking into consideration all relevant circumstances, this effect is intended by law, it is not to be regarded as a tax advantage for the purposes of the MBT.

Intermediaries

Under the Directive, intermediaries with EU nexus have the primary obligation to report arrangements to the tax authority. The draft German legislation also imposes the primary reporting obligation on intermediaries, whereby a two-stage notification procedure is to be applied.

Under the German proposal, an intermediary will have a reporting obligation in Germany if it is tax resident in Germany or exercises certain placeholder activities there.

If a taxpayer designs an arrangement on its own, i.e. without any involvement of an intermediary (in-house arrangement), the bill orders an application of the intermediary rules.

Whereas the Directive distinguishes between promoters and service providers giving aid, assistance or advice, the German draft bill makes no reference to the service provider.

Reporting procedure

For cross-border arrangements, the German bill provides for a two-stage notification procedure:

- In a first notification to the Federal Central Tax Office ("Bundeszentralamt für Steuern" – "BZSt"), the intermediary (or the taxpayer) is required to summarize the tax arrangement in abstract form on a no-name basis. The notification also includes the identification of the hallmarks that are met and the legal provisions concerned. The BZSt then assigns a registration number to the report and communicates it back to the intermediary (or taxpayer).
- The second-stage disclosure must then mention the registration number and identify the relevant taxpayer using the arrangement. If the intermediary is subject to a legal professional privilege (as is the case with German lawyers, tax advisors, certified public accountants, but not with banks, etc.), the obligation to make the second report passes to the relevant taxpayer, unless he releases the intermediary from the obligation to maintain confidentiality.

If the relevant taxpayer engages an intermediary without a German nexus, the relevant taxpayer is responsible for communicating both, the abstract and the personal data unless it can prove that the intermediary has already communicated the same cross-border arrangement in another EU Member State in accordance with the regulations applicable there. In addition, the relevant taxpayer of a cross-border tax arrangement needs to report the arrangement itself in case of an in-house arrangement.

The registration number of the reportable arrangement needs to be disclosed in the tax return for the first year in which the arrangement has an effect.

Reporting deadlines

Under DAC 6, for intermediaries (and relevant taxpayers) the trigger events for reporting under the Directive (from 1 July 2020) are when the reportable arrangement is "made available for implementation," or when the reportable arrangement is "ready for implementation" or when "the first step of implementation" has been made.

For intermediaries, the bill mirrors the events triggering the deadline and the timeline used in the Directive (30 days following the same triggering events). This also applies to the quarterly update for marketable arrangements, with a 10-day deadline after the quarter-end. For taxpayers, the deadline is only triggered once the intermediary has provided all the necessary data to make the second-stage disclosure.

The reporting regime for arrangements where the first step is implemented during the interim period between 25 June 2018 and 30 June 2020 is identical to the Directive, i.e. requires submission by 31 August 2020.

Penalties

Non-compliance with the obligation to report all available data in connection with the arrangement in due time constitutes an administrative offense (Ordnungswidrigkeit) and is subject to a fine of up to €25,000 per breach.

Penalties apply to both intermediaries and relevant taxpayers. Germany will not impose penalties for non-compliance in respect of arrangements where the first step is made during the interim period.

Disclosure of domestic arrangements

As stated above, the German bill goes beyond the requirements of the Directive and includes a mandatory disclosure regime for domestic tax arrangements with domestic hallmarks. Other than initially expected, the obligation to report domestic arrangements is to a large extent based on the rules set out for cross-border tax arrangements and does not create a distinct second disclosure regime. Disclosure rules only apply for specific covered taxes.

Unlike the cross-border arrangement rules, the domestic disclosure rules provide for a de-minimis rule. For individuals, the disclosure obligation applies only if at least one of them has a positive income of more than €500,000 in the calendar year preceding the arrangement. For companies, the disclosure obligation applies if they are part of a group, foreign-controlled, or if they are subject to continuous tax audits.

Six of the seven domestic hallmarks are taken verbatim from the hallmarks applicable to cross-border arrangements and one has been adapted to address domestic scenarios; it refers to arrangements aiming to achieve a tax benefit in respect of the same tax-relevant fact more than once (e.g., a tax deduction in respect of the same expense is taken into account multiple times by the same or by different taxpayers).

All domestic hallmarks are linked to the MBT.

In contrast to cross-border arrangements, for domestic arrangements the disclosure is limited to anonymous information. Therefore, the professional obligation of confidentiality is not affected. Accordingly, the intermediary is required to file the entire report. However, the relevant taxpayer is still obliged to file the report if it has designed the tax arrangement on its own.

The notification period and the events triggering the 30-day deadline are the same as for cross-border arrangements.

Implications

Due to the broad scope of the reporting obligations for cross-border arrangements, the Federal Ministry of Finance expects the number of reports to be at least in the middle five-digit range, i.e., at least 50,000 reports. The broad scope of the reporting obligation poses a major challenge not only for intermediaries, but also for taxpayers themselves, the latter being responsible for the reporting on their own in certain cases. It should also be noted that in practice, often several intermediaries participate in one arrangement, thus potentially creating multiple reporting obligations. Therefore, it will be necessary to establish a coordinated process and to ensure a consistent approach. Furthermore, group tax departments will be faced with the challenge of dealing with deviating reporting obligations in 28 EU Member States.

Therefore, it will often be in the taxpayer's best interest to directly manage and monitor the reporting process. Information technology (IT) solutions can facilitate this compliance exercise by empowering the taxpayer to swiftly gain an overview of potentially reportable arrangements as well as to document the reports transmitted to various tax authorities. IT solutions also help to reduce the risk of fines or even reputational damage and ensure timely information for stakeholders, such as executive management or shareholders.

Next steps

According to the current timetable, the legislative process in Germany will not be completed before the third quarter of 2019. As soon as ministries have completed their internal coordination process and federal states, professional circles and associations have been given the opportunity to comment on the draft bill, the Cabinet is expected to address the draft bill.

With the legislative process still ongoing and the bill not yet final, taxpayers with operations in Germany should closely monitor further developments and assess the need to take actions now so that any upcoming reporting obligations can be met on time.

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