Library Briefing
Library of the European Parliament
27/05/2013

A FATCA for the EU?

Data protection aspects of automatic exchange of bank information

SUMMARY *The revelation of scandals involving offshore accounts, as well as the economic crisis, has created a new momentum in the fight against tax evasion. The EU has already put in place instruments for the exchange of bank information such as the Savings Directive, albeit with Luxembourg and Austria opting instead for an anonymous withholding tax on interest incomes.*

Bilateral agreements between some EU Member States (MS) and the United States (US) on the automatic exchange of bank information have led to five MS concluding a similar agreement using models drawn up under the US Foreign Account Tax Compliance Act (FATCA). While many have welcomed such initiatives, arguing that they are the only effective instrument in the combat against tax evasion and fraud, others claim that data protection rights are being violated.

The Article 29 Working Party evaluated the obligations under the US FATCA for their compatibility with EU data protection law. It pointed to the need for these types of measures to be built on a proper legal basis, to observe the principle of proportionality regarding the amount and nature of the data exchanged, as well as to respect all requirements to notify national data protection authorities.

In this briefing:

Background

Tax evasion under the spotlight

The holes in the public accounts of many EU Member States (MS) have led to the adoption of measures to achieve sound budgets. While many argue that austerity measures hit 'ordinary citizens' most heavily, the revenue lost as a consequence of tax evasion has attracted the attention of political actors both in Europe and the Unites States (US).

Most recently, the crisis in the Cyprus bank sector, revelations of offshore accounts by the International Consortium of Investigative Journalism, as well as some prominent cases of alleged tax evasion, such as that of the former French budget minister, Jérôme Cahuzac have brought tax evasion into the spotlight. As a result, discussions on automatic exchange of bank information between EU MS, as well as with Switzerland, Liechtenstein and other third countries, are back on the political agenda.

Recent developments

In 2012, the Commission revisited its efforts in the fight against tax fraud and evasion by adopting an Action Plan calling for better use of existing EU instruments and for more effective exchange of bank information.

Several EU MS, as well as Switzerland, have signed bilateral intergovernmental agree-

Author: Eva-Maria Poptcheva
Contact: evamaria.poptcheva@ep.europa.eu

ments with the US under its Foreign Account Tax Compliance Act (FATCA) to provide information on the bank accounts of US taxpayers. In consequence, calls have emerged to establish a similar instrument for information exchange among EU MS and later also with third countries.

Finance ministers from France, Germany, Italy, Spain and the UK agreed on 9 April 2013 to develop a pilot information exchange facility, modelled on the agreements with the US under FATCA, to crack down on tax evasion, and invited the other MS to join them in this undertaking. The French and German finance ministers stated that they intend to ask the European Commission to present a proposal on the matter soon.

While Luxembourg was one of the last MS to commit to loosening its bank secrecy rules and to signing up to FATCA-like automatic exchange of information between MS, some other MS (Austria in particular) along with several experts point to data protection issues posed by FATCA, and call for FATCA-like EU rules to comply with privacy rules.

A long road to tax evasion rules

EU instruments

Differences in tax burdens across the EU lead to some taxpayers shifting their interest income across borders, searching for the most favourable tax jurisdictions in the EU.

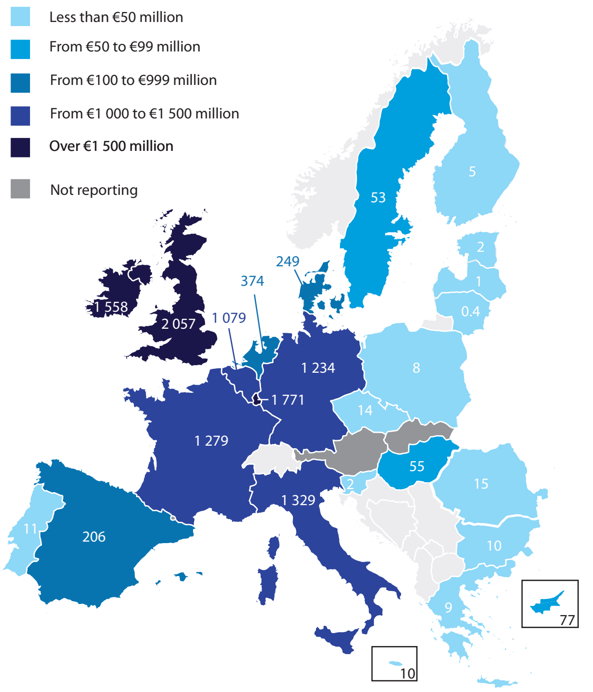
> The tax burden in the highest taxing MS is 83% higher than in the lowest. The tax ratio ranges from 26.0% of GDP in Lithuania to 47.7% in Denmark. [1]

EU Savings Directive

In order to ensure the proper operation of the internal market and tackle the problem of tax evasion, the Directive on taxation of savings income in the form of interest payments (EUSD) was adopted in 2003 (and has been in force since 2005). The Directive applies to interest paid to individuals resident in a MS other than the one in which the interest is paid. Otherwise, national rules apply.

In 2010, interest payments totalling €11.4 billion were subject to exchange of information (EoI) between national tax authorities in the EU. A further €504.8 million in withholding tax was paid to the MS of residence of beneficial owners by certain MS and third countries which levy a withholding tax rather than exchanging information.

Figure 1 - Interest payments and sales proceeds reported by countries using EoI under Art. 9 EUSD (2010, € million)



Data source: European Commission Taxation and Customs Union Directorate-General, 2013.

The European Commission adopted a proposal to amend the EUSD in 2008, which would close existing loopholes by extending information sharing to trusts, pensions, investment funds and "other innovative financial instruments". The proposal has been blocked since then in the Council due to lack of unanimity among the MS. Some of them, like Austria, have opposed the automatic exchange of bank information for years. Among their reasons is that neighbouring countries as Switzerland and Andorra would enjoy a competitive advantage as they do not exchange information.

Currently, all MS apply automatic EoI except for Austria and Luxembourg which negotiated a transitional period. Instead, they apply a withholding tax, imposing taxes on savings interest of between 15 and 35%, retaining 25% and transferring 75% to the country of residence of the account holder. The transitional period will end when Switzerland, Andorra, San Marino, Monaco and Liechtenstein meet international information exchange practices. However, Luxembourg announced recently that it will introduce automatic EoI in 2015. Moreover, the European Council, including the leaders of Luxembourg and Austria, called on 22 May for the adoption in 2013 of the modified EUSD, however in the light of new agreements with the five neighbours.

The 2011 Administrative Cooperation Directive

Directive 2011/16/EU on administrative cooperation in the field of taxation requires, as of January 2015, each MS's competent authority to automatically report to other MS information available regarding income from employment, director's fees, pension income, life insurance products as well as income from immovable property.[2] The Directive however does not concern the existence of bank accounts as such. MS not wishing to receive information can opt out of both reporting and receiving information.

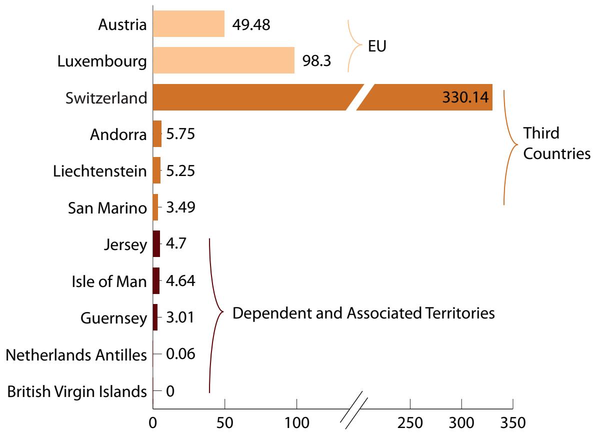
The Administrative Cooperation Directive also provides that limitations on the application of Directive 95/46/EC (Data Protection Directive) are necessary and proportionate in case of tax information exchange and cooperation, in light of the potential revenue loss for MS and of the effective fight against fraud. Thus, the rights of the data subjects to information about the use of their personal data, access to it and judicial remedy for breach of their rights under the Data Protection Directive are restricted for purposes of EoI between MS.[3]

Tax agreements with third countries

Agreements with European countries and associated territories

Under EU agreements signed in 2004, Switzerland, Liechtenstein, Monaco, Andorra and San Marino impose a 35% withholding tax on interest paid to savers resident in the EU instead of exchanging bank data.[4] Moreover, Guernsey, Jersey, the Isle of Man and seven Caribbean territories apply a withholding tax under bilateral agreements concluded with each MS. A proportion of the revenue obtained from the withholding tax is transferred to the country of the saver's tax residence.

Figure 2 - Tax revenue shared by countries with withholding tax regime (2010, € million)



Data source: European Commission Taxation and Customs Union Directorate-General, 2013.

EU finance ministers agreed in May to give the Commission a mandate to negotiate new agreements with Switzerland, Liechtenstein, Andorra, Monaco and San Marino, adapting to the proposed changes to the EUSD and ensuring transparency measures as required by it. If the five agree to hand over data, Austria and Luxembourg's exemption from automatic EoI will lapse.

US FATCA

The governments of France, Germany, Italy, Spain, the United Kingdom (UK) and the United States of America (US) issued a Joint Statement in July 2012, announcing an agreement to improve tax compliance and to implement the US Foreign Account Tax Compliance Act (FATCA).

Author: Eva-Maria Poptcheva
Contact: evamaria.poptcheva@ep.europa.eu

FATCA was adopted in 2010 and envisages as from 2014 that foreign financial institutions (FFI) will be required to report information regarding the accounts of US taxpayers (US citizens and green card holders living in the USA or abroad) to the US Internal Revenue Service.

So far Germany, the UK, Denmark, Ireland, Italy and Spain have concluded or initiated intergovernmental agreements (IGAs) with the US on the reciprocal exchange of bank account information.[5] The information shall be provided by financial institutions to the home country government, which then shares it with the US authorities.[6] While for some commentators the collaboration of the 'partner' countries is sought to reduce administrative burdens for financial institutions, the American Citizens Abroad (ACA) association points to the stated goal of the IGAs to remove "legal obstacles" to the reporting duties of FFIs, and argues that the IGAs help circumvent data protection issues in the 'partner' countries.

> The EP has called several times for an effective fight against fraud and evasion. An initiative report by Mojca Kleva Kekuš (S&D, Slovenia) on the fight against tax fraud, tax evasion and tax havens was adopted in plenary on 21 May. It calls, inter alia, on MS to remove obstacles in national law that hinder cooperation and exchange of tax information with the EU institutions and between MS, while ensuring effective protection of taxpayers' data.

Towards a European FATCA?

Intergovernmental agreement between MS

In the wake of their 9 April agreement to pilot automatic exchange, the five finance ministers of France, Germany, Italy, Spain and the UK informed EU tax Commissioner Šemeta in a letter that the pilot agreement would help prevent and detect tax evaders and that they expect it to be used as a template for a wider multilateral agreement. At the ECOFIN Council on 14 May, several other MS joined the undertaking and called for the creation of a new global standard for automatic EoI.

The agreement envisages that banks in participating MS disclose financial details of foreign clients, which will then be handed over to the tax domicile to be checked for evasion. It is unclear however whether this FATCA-like agreement will lead to exchange of information based only on residence, as with the EUSD and the Administrative Cooperation Directive, or also on nationality, as with the US FATCA.

Positions on a "European FATCA"

Some political actors and stakeholders welcome the initiative, and praise FATCA and any automatic exchange of bank information as efficient means for the fight against tax fraud and evasion. Some scholars argue that automatic EoI is superior to anonymous withholding taxes since it also addresses the untaxed principal (and not just interest and dividends) in foreign bank accounts and helps maintain taxpayer's trust in fairness and social justice. The fact that Switzerland has already signed an IGA for the implementation of the US FATCA leads many to assume that it and other alleged tax havens can be persuaded to agree on a similar EU agreement.

Conversely, some EU and US politicians, as well as representatives of civil society, allege FATCA-like agreements violate privacy by disclosing an excessive amount of personal data. Some experts also note that the EUSD's main aim is to bring associated territories and third countries into scope, as that is where the great majority of tax avoidance occurs. But an EU-only FATCA, they warn, would provide no added value, as it is unlikely that third countries (Switzerland, Liechtenstein, Monaco, Andorra and San Marino) would join an EU FATCA.

Author: Eva-Maria Poptcheva
Contact: evamaria.poptcheva@ep.europa.eu

OECD standards on EoI

The OECD has established information technology standards for EoI for taxation purposes, including capturing and processing of data, and transfer between governments to support residence-based taxation. They include data protection clauses.

The 1988 joint Council of Europe and OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters addresses 'EoI on request'.[7] It was amended in 2010 to remove obstacles to effective cooperation and exchange of information, especially those related to bank secrecy legislation, while committing to the respect of taxpayer's rights. It contains a provision (Article 20) on the disclosure of the data exchanged and requires the requesting state to comply with the national data protection requirements of the supplying state.

The "Article 29 Working Party" is established by Article 29 of Directive 95/46/EC. It provides the Commission with independent advice on data protection matters and helps in the development of harmonised policies for data protection in the MS.

Moreover, the OECD Model Tax Convention for the avoidance of double taxation was amended in 2012 to ensure that group requests refer only to 'foreseeably relevant' information for tax administration, to prevent 'fishing expeditions' (Article 26).

In addition, in 2006, the Committee on Fiscal Affairs approved a Manual on Information Exchange. The manual provides practical assistance to officials dealing with exchange of information for tax purposes.

Data protection framework for EoI

EU data protection rules

The protection of personal data is enshrined in the TFEU (Article 16) as well as in the EU Charter of Fundamental Rights (Article 8) and the European Convention on Human Rights (Article 8). The central piece of legislation on the protection of personal data in the EU is Directive 95/46/EC. The Directive sets out general rules on the lawfulness of personal data processing and the rights of the data subjects, such as access to data, rectification, judicial remedy, etc. In 2012, the Commission proposed a major reform of the EU legal framework on the protection of personal data.

Article 29 Working group on FATCA

The Article 29 Working Party (WP) has evaluated the compatibility of the obligations under the US FATCA with the EU Data Protection Directive, setting the legal standard for FATCA-like agreements.

Legal basis

An EU or national law establishing a legal obligation for financial institutions to disclose information on their clients would be needed for the processing of personal data. The WP points out that a waiver from data protection rules by means of consent from the data subjects (bank account holders) would not be possible since consent would not be "freely given" in view of the possible economic and other consequences.

Proportionality of bulk data screening and transfers

The WP points to the need for more selective, less broad measures than 'fishing expeditions' which would involve trawling through the data of law-abiding citizens, in order to guarantee their fundamental right to private life enshrined in Article 8 of the EU Charter.

Proportionality of the data processing

The WP highlighted that according to Article 6(1)b of the Data Protection Directive, the data processed need to be adequate, relevant and not excessive. In this context it points to the significant amount of personal data required under FATCA and thus to the need to examine whether the personal data processed are limited to the amount necessary to achieve the objectives, whether processing is limited to the purposes for which the data have been collected, and to explore other less-intrusive measures, such as data aggregation, anonymisation, etc.

Sensitive data
The WP stresses that since tax evasion is punished as a criminal offence in some MS, personal data linked to it may be regarded as sensitive data so that higher data protection standards would apply.

National data protection authorities
Under the Data Protection Directive (Article 18) national data protection authorities must be notified prior to automatic processing operations. Compliance with these provisions must be ensured by a FATCA-like agreement.

National bank secrecy rules: the case of Austria
Austria does not share data on EU citizens' wealth, but imposes a 35% withholding tax on their interest income and returns most of those funds anonymously to the countries of residence.

In Austria bank secrecy is regarded by many to be a privacy matter. Bank secrecy is enshrined in the Banking Sector Act (*Bankwesengesetz*, Article 38), which is accompanied by a constitutional provision establishing that the bank secrecy rule can be modified only by a two-thirds majority in parliament.

The Austrian government has however signalled its intention to agree to the reporting of information on non-resident bank account holders but not on resident taxpayers. However, some argue that having different rules for foreign depositors and for domestic account holders, respectively for non-resident and resident Austrian nationals, would contravene either Austrian constitutional rules against discrimination or EU rules on free movement of capital.

Main references

The Battle Over Taxing Offshore Accounts / I Grinberg, UCLA Law Review December, 2012, p. 304.

Compatibility of FATCA with Directive 95/46/EC / Article 29 Data Protection working Party, 21/06/2012, Ref. (2012)746461.

Disclaimer and Copyright

http://www.library.ep.ec
http://libraryeuroparl.wordpress.com

Endnotes

1. Taxation trends in the European Union / Eurostat 2013, p. 23.

2. European Commission President José Manuel Barroso announced on 22 May that a legislative proposal will be presented to extend the scope of automatic EoI under the Administrative Cooperation Directive to all relevant types of income across all MS.

3. The battle over taxing offshore accounts / I Grinberg, UCLA Law Review December, 2012, pp. 330, 331.

4. Equivalent measures in the current agreements involve either automatic exchange of information or a withholding tax on interest paid to savers resident in the EU.

5. Moreover, IGAs on the implementation of FATCA have been concluded with Switzerland, Norway and Mexico.

6. There are two types of IGAs. The first, the Model 1 IGA, requires an FFI to report all information directly to its home government, which will then share the information with the United States.

7. The "on-request" instead of automatic approach of the 1988 Convention is said by many commentators and stakeholders to be of limited applicability and no practical importance.

Author: Eva-Maria Poptcheva
Contact: evamaria.poptcheva@ep.europa.eu