



KPMG Japan Tax Newsletter

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EU MANDATORY DISCLOSURE RULES

On 25 May 2018, the Council of the European Union formally adopted new mandatory disclosure rules (MDRs), under which EU intermediaries or, in some cases, relevant taxpayers, will be required to disclose to their tax authorities information on reportable cross-border arrangements.

We have set out below an overview of the EU MDRs and some remarks to be considered from the perspective of Japanese enterprises.

I. Background of the Introduction of the EU MDRs

In the light of recent revelations raising concerns regarding certain tax planning practices (the so-called 'Lux Leaks' and 'Panama Papers', etc.), the European Parliament called on the European Commission to introduce tougher transparency requirements for intermediaries in July 2016. The Economic and Financial Affairs Council (ECOFIN) also invited the European Commission to consider initiatives on mandatory disclosure rules in line with those proposed by the OECD in Action 12 of the Base Erosion and Profit Shifting (BEPS) initiative.

On 21 June 2017, the European Commission published its proposal for mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements. The proposal comes in the form of an amendment to the Directive on Administrative Cooperation in the field of taxation (the Directive) and introduces an obligation on intermediaries and, in certain cases, taxpayers, to disclose potentially aggressive tax planning arrangements and also the means for tax administrations to exchange information on these structures.

On 25 May 2018, the amendments to the Directive, which introduce mandatory disclosure requirements for tax intermediaries, were formally adopted. The amended Directive entered into force on 25 June 2018.

Member States must implement the Directive into their domestic legislation by the end of 2019 and its provisions will become applicable on 1 July 2020.

II. Overview of the EU MDRs

As of 1 July 2020, EU intermediaries or, in some cases, relevant taxpayers, will be required to disclose to their tax authorities information on reportable cross-border arrangements. Despite this application date, reportable cross-border arrangements, the first step of which is implemented between 25 June 2018 and 1 July 2020, must also be reported by 31 August 2020.

The reported information will be automatically exchanged quarterly by the competent authorities of each Member State. The automatic exchange of information will take place within one month from the end of the quarter in which the information was filed, and the first information will be communicated by 31 October 2020.

1. Person with whom the Reporting Obligation Lies

(1) EU intermediary

The primary obligation to disclose information on a reportable cross-border arrangement to the tax authorities rests with the 'EU intermediary'.

'Intermediary' means any person that designs, markets, organizes or makes available for implementation or manages the implementation of a reportable cross-border arrangement.

In order to be an 'EU intermediary', a person shall meet at least one of the following additional conditions:

- (a) be resident for tax purposes in a Member State;
- (b) have a permanent establishment in a Member State through which the services with respect to the arrangement are provided;
- (c) be incorporated in, or governed by the laws of, a Member State;
- (d) be registered with a professional association related to legal, taxation or consultancy services in a Member State.

EU intermediaries will be given the right to a waiver from filing information on a reportable cross-border arrangement where the reporting obligation would breach the legal professional privilege under the national law of that Member State. EU intermediaries that benefit from a waiver for legal professional privilege must notify the relevant taxpayer, or another intermediary to which the obligation is passed on, of their disclosure responsibility.

(2) Relevant taxpayer

Where a waiver for legal professional privilege applies, where an intermediary is located outside the EU, or where an arrangement is developed in-house and no intermediary is involved, the obligation to disclose falls on the relevant taxpayer.

'Relevant taxpayer' means any person to whom a reportable cross-border arrangement is made available for implementation, or who is ready to implement a reportable cross-border arrangement or has implemented the first step of such an arrangement.

2. Reportable Cross-Border Arrangement

'Reportable cross-border arrangement' means any cross-border arrangement (discussed in (1)) that contains at least one of the hallmarks (discussed in (2)).

(Note that the scope of the Directive on Administrative Cooperation includes all taxes of any kind with the exception of VAT, customs duties, excise duties and compulsory social contributions.)

(1) Cross-border arrangement

'Cross-border arrangement' means an arrangement concerning either more than one Member State or a Member State and a third country where at least one of the following conditions is met:

- (a) not all of the participants in the arrangement are resident for tax purposes in the same jurisdiction;
- (b) one or more of the participants is a dual tax resident;
- (c) one or more of the participants carries on a business in another jurisdiction through a permanent establishment, and the arrangement is related to the business of that permanent establishment;
- (d) one or more of the participants in the arrangement carries on an activity in another jurisdiction without being resident for tax purposes or creating a permanent establishment situated in that jurisdiction;
- (e) such arrangement has a possible impact on the automatic exchange of information or the identification of beneficial ownership.

(2) Hallmarks

'Hallmark' means a characteristic or feature of a cross-border arrangement that presents an indication of a potential risk of tax avoidance. Some of the 'hallmarks' may only be taken into account where they fulfil the 'main benefit test'.

That 'main benefit test' will be satisfied if it can be established that the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage.

Please see a list of 'hallmarks' and which 'hallmarks' are subject to the 'main benefit test' in the Annex.

3. Information to be Disclosed

The Directive only provides a list of details that must be exchanged among Member States and does not address the question of what information should be filed by EU intermediaries and relevant taxpayers. It is expected that this will include, at a minimum, the information to be exchanged.

The information to be communicated by the competent authority of a Member State contains the following:

- the identification of the relevant taxpayers and EU intermediaries involved
- details of the hallmark(s) that make the cross-border arrangement reportable
- a summary of the reportable cross-border arrangement
- the date on which the first step in implementing the reportable cross-border arrangement has been made or will be made
- details of the relevant domestic tax rules
- the value of the reportable cross-border arrangement
- the identification of the Member State of the relevant taxpayers and any other Member States which are likely to be concerned by the reportable cross-border arrangement
- the identification of any other person in a Member State likely to be affected by the reportable cross-border arrangement

4. Reporting Deadline

The person with whom the reporting obligation lies is required to file the information with the relevant authorities within 30 days beginning:

- (a) on the day after the reportable cross-border arrangement is made available for implementation; or
- (b) on the day after the reportable cross-border arrangement is ready for implementation; or
- (c) when the first step in its implementation has been made,

whichever occurs first.

Despite the above, reportable cross-border arrangements, the first step of which is implemented between 25 June 2018 and 1 July 2020, must also be reported by 31 August 2020.

III. Remarks

As the EU has not issued accompanying guidance to the text of the Directive, it remains to be seen whether some Member States choose to publish guidance for local implementation of the Directive. Any additional guidelines would certainly be welcome as there are a number of areas and definitions that may lead to uncertainties when applying these rules in practice.

It is unlikely that a Japanese enterprise itself will be obliged to disclose information on a reportable cross-border arrangement to the tax authorities, but its EU subsidiaries or permanent establishments may be depending on the circumstances.

For example, where a Japanese company is involved in a reportable cross-border arrangement involving an EU intermediary, the obligation to report information about the arrangement will be imposed on that EU intermediary unless that EU intermediary is exempt from the obligation due to legal professional privilege. However, if only non-EU intermediaries are involved with that arrangement, the relevant taxpayers (e.g. EU subsidiaries or permanent establishments of the Japanese company, if any) will be required to report information about the arrangement to the competent tax authorities.

Therefore, it is recommendable to consider whether any cross-border arrangements to be implemented on or after 25 June 2018 are reportable and who bears the burden of disclosure.

[Annex] Reportable cross-border arrangement

Hallmarks		Main benefit test
A	Generic hallmarks linked to the main benefit test	
1.	An arrangement where the taxpayer undertakes to comply with a confidentiality condition (in relation to other intermediaries or the tax authorities).	Applied
2.	An arrangement where the intermediary is entitled to a fee contingent on either the amount of tax advantage derived from the arrangement or on the advantage being obtained.	
3.	An arrangement that has substantially standardized documentation and/or structure and is available to more than one relevant taxpayer without a need to be substantially customized for implementation.	
B	Specific hallmarks linked to the main benefit test	
1.	An arrangement whereby a participant in the arrangement acquires a loss-making company through contrived steps, discontinuing the main activity of such company and using its losses in order to reduce its tax liability.	Applied
2.	An arrangement that has the effect of converting income into lower-taxed categories of revenue, such as capital or gifts.	
3.	An arrangement which includes circular transactions resulting in the round-tripping of funds.	
C	Specific hallmarks related to cross-border transactions	
1.	An arrangement that involves deductible cross-border payments made between two or more associated enterprises where at least one of the following conditions occurs: (a) the recipient is not resident for tax purposes in any tax jurisdiction; (b) although the recipient is resident for tax purposes in a jurisdiction, that jurisdiction either: (i) does not impose any corporate tax or imposes corporate tax at the rate of zero or almost zero; or (ii) has been blacklisted by the EU or the OECD; (c) the payment benefits from a full exemption from tax in the jurisdiction where the recipient is resident for tax purposes; (d) the payment benefits from a preferential tax regime in the jurisdiction where the recipient is resident for tax purposes.	Applied: (b)(i), (c) and (d) Not applied: (a) and (b)(ii)
2.	Deductions for the same depreciation on the asset are claimed in more than one jurisdiction.	Not applied
3.	Relief from double taxation in respect of the same item of income or capital is claimed in more than one jurisdiction.	
4.	There is an arrangement that includes transfers of assets and where there is a material difference in the amount being treated as payable in consideration for the assets in those jurisdictions involved.	
D	Specific hallmarks concerning automatic exchange of information and beneficial ownership	
1.	An arrangement which may have the effect of undermining the reporting obligation (automatic exchange of financial account information)	Not applied
2.	An arrangement that aims to make beneficial owners unidentifiable	

E	Specific hallmarks concerning transfer pricing	
1.	An arrangement which involves the use of unilateral safe harbor rules.	Not applied
2.	An arrangement involving the transfer of hard-to-value intangibles.	
3	An arrangement involving an intragroup cross-border transfer of functions and/or risks and/or assets, where the projected annual earnings before interest and taxes (EBIT), during the three-year period after the transfer, of the transferor(s), are less than 50% of the projected annual EBIT of such transferor(s) if the transfer had not been made.	

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