

## Improved relations with tax authorities vs. criminalisation of tax law (the carrot & the stick...)

After the crisis, a new tax landscape  
CMS Annual Tax Conference - Tuesday 8 February 2011, Paris

## Improved relations with tax authorities vs. criminalisation of tax law (the carrot & the stick...)

### Chair

Stéphane Austry – CMS Bureau Francis Lefebvre (France)

### Speakers

Giuseppe Ascoli – CMS Adonnino Ascoli & Cavasola Scamoni (Italy)

Heino Büsching – CMS Hasche Sigle (Germany)

Richard Croker – CMS Cameron McKenna (UK)

Jochem de Koning – CMS Derks Star Busmann (The Netherlands)

## Programme

- Short introduction (Stéphane Austry)
- Disclosure of a financing operation (Richard Croker)
- Risk of criminal procedure rather than tax / civil (Heino Büsching)
- Complex operations and liability of directors (Jochem de Koning)

## Short introduction

### — Improved relations with tax authorities

- Interaction between the legislator and the taxpayer during the elaboration of the law or before the modification of the law
- Application of the law (administrative doctrine, rulings)
- Interaction between the tax authorities and the taxpayer in everyday life (formal or informal)

### — Criminalisation of tax law

- There is a diversity in practice in the use of criminal law / procedure
- Use is generally increasing

## **Disclosure of a financing operation**

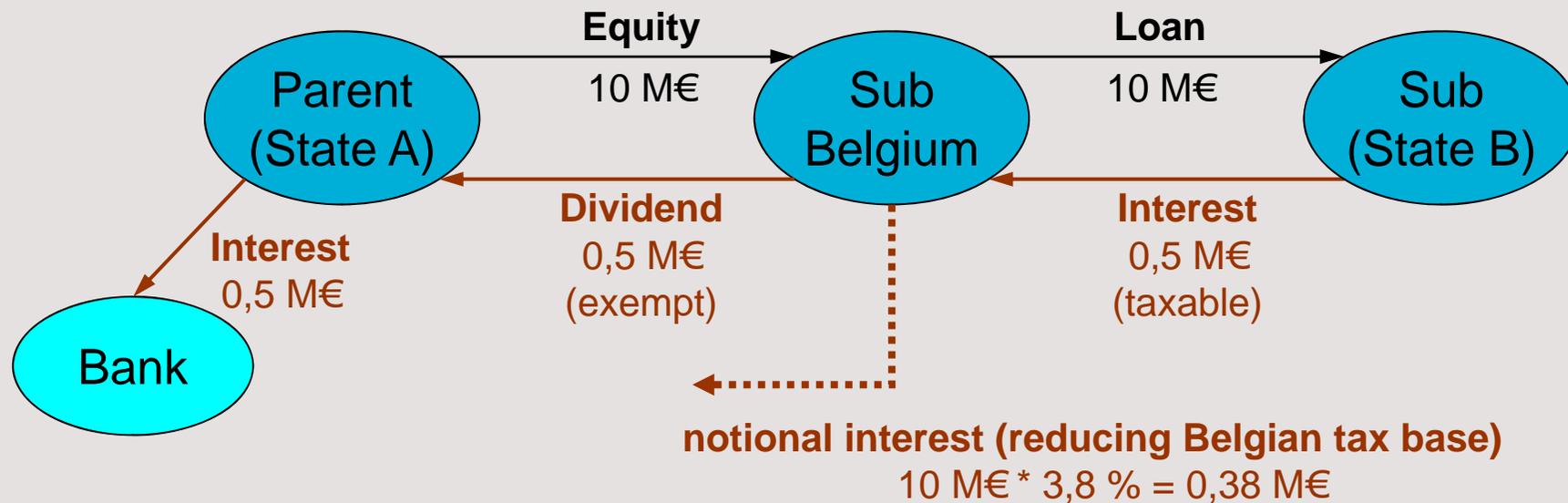
Lead speaker : Richard Croker

## Disclosure of a financing operation

- In some countries, there is an obligation to disclose arrangements/transactions (tax schemes), while in others this might be desirable to avoid recharacterisation and/or penalties.
- To disclose, there needs to be a national tax advantage for the company
- The discloser may be the company itself or the promoter of such schemes (banks, tax advisers...)
- An example: the Belgian notional interest regime

## Disclosure of a financing operation (cont'd)

### Belgian notional interest regime



## Disclosure of a financing operation (cont'd)

### — In the UK (1/2),

- A statutory regime for the disclosure of tax avoidance schemes (DOTAS) applies
- The promoter (and, in certain circumstances, the user) of a prescribed tax avoidance scheme must notify HMRC of the existence of the scheme and any subsequent use
- To be discloseable a scheme must have one or more hallmarks  
These include:
  - Confidentiality from competitors or HMRC
  - Premium fee
  - Off market terms
  - Standardised (not bespoke) product (and not grandfathered)
  - Loss/leasing/pensions schemes

## Disclosure of a financing operation (cont'd)

— In the UK (2/2),

- HMRC will appoint a “customer relationship manager” to act as a liaison point for large businesses. His or her role will be to encourage early disclosure and discussion of tax aggressive strategies
- UK banking businesses may be signatories of the so called voluntary ‘banking code of conduct’ which imposes restrictions on a bank’s ability to employ and/or promote to its customers certain tax avoidance strategies
- A non-statutory clearance procedure is available to obtain binding tax rulings on areas of genuine interpretative difficulty and commercial importance

## Disclosure of a financing operation (cont'd)

### — In France,

- Taxpayers have **no obligation to declare** their schemes: they have the opportunity to ask the DLF to agree the tax treatment (in certain prescribed circumstances, if the tax administration does not answer within 6 months, then the abuse of law procedure cannot apply)
- There have been several attempts to introduce a disclosure obligation in French law:
  - First **draft legislation** date back in 2005 (it was removed because largely rejected by the professionals)
  - Such legislation is still under consideration by tax administration and has not been ruled out by the Parliament (an October 2010 parliamentary report on tax loopholes/shelters includes it among other proposals)

## Disclosure of a financing operation (cont'd)

— In the Netherlands,

- There is no obligation to disclose a tax scheme
- On a voluntary basis, a corporate tax payer can enter into a Tax Control Framework (TCF) agreement with the tax authorities; a TCF agreement is based on and assumes trust on both sides
- Under a TCF agreement, the tax payer benefits from a 'light' supervision of the tax authorities, e.g. less stringent and frequent tax audits. In exchange, the tax payer needs to (i) have in place a tax control framework, safeguarding the correct tax application, and (ii) disclose to the tax authorities any potentially controversial tax issue
- In other words, under a TCF agreement there is an obligation to disclose a tax scheme

## Disclosure of a financing operation (cont'd)

### — In Germany (1/2),

- No rule explicitly demands disclosure of tax avoidance schemes (such legislation was planned in 2008, but not introduced)
- Tax authorities may find a tax planning scheme to be “misuse of tax planning options” in respect of the underlying economic purpose: they can then apply “appropriate” rules instead
- Misuse of tax planning options is not criminal, concealing facts which constitute a misuse may be
- Criminalisation is limited to particular instances formed by case law

## Disclosure of a financing operation (cont'd)

### — In Germany (2/2),

- The taxpayer may request a binding statement of the tax authorities on taxation of prospective schemes, unless the only purpose is to determine if a scheme will be considered criminal or not
- The issuance of a binding ruling is subject to the discretion of the tax authorities; the taxpayer does not have a legal claim and may decide whether or not to proceed with the envisaged transaction

## Disclosure of a financing operation (cont'd)

### — In Italy,

- The taxpayer may request a preliminary opinion (tax ruling) of the tax administration in order to clarify if a certain arrangement/transaction could fall within the anti-avoidance rule or could constitute an abuse of law. The tax ruling is not mandatory and in certain circumstances, if the tax administration does not answer, the applicable tax treatment will be the one proposed by the taxpayer
- If, based on the tax ruling, the transaction/operation does not fall within the anti-avoidance rule or does not constitute an abuse of law, the risk of assessment, and consequent application of penalties, can be excluded
- On the contrary, if, based on the tax ruling, the transaction/operation falls within the anti-avoidance rule or constitutes an abuse of law, the taxpayer could disregard the ruling and accept the risks of the assessment (in such case the transaction/operation will be discussed in front of the Tax Court) and, under certain conditions, of the criminal procedure

## Disclosure of a financing operation (cont'd)

- In Belgium, Hungary or Spain, there is usually no obligation to report tax schemes, but taxpayers can report on a voluntary basis (ruling request)
  - In Belgium, a ruling:
    - Can clarify the possible application of the anti-avoidance rule or recharacterisation for tax purposes in case of an abuse of law (tax authorities are bound by the ruling decision for a maximum of 5 financial years)
    - Cannot relate to the application of tax laws on transactions already implemented / carried out
    - Can only be used by the taxpayer who has requested it, but they are generally published by extract on an anonymous basis

## Disclosure of a financing operation (cont'd)

- In Hungary, a ruling:
  - Is possible if the taxpayer describes the planned transaction in detail (also giving names of the parties involved) and requests confirmation of the tax treatment from the Ministry of Finance
  - Is only used for larger transactions, as the official fee payable is around €28,500
- In Spain,
  - Although customary practice is that most (if not all) tax ruling requests are answered, the fact is that there is no provision establishing the obligation of the Spanish Tax Administration to answer a tax ruling request, nor there is a specific deadline where the STA must compulsorily deal with the request

## **Risk of criminal procedure rather than tax / civil**

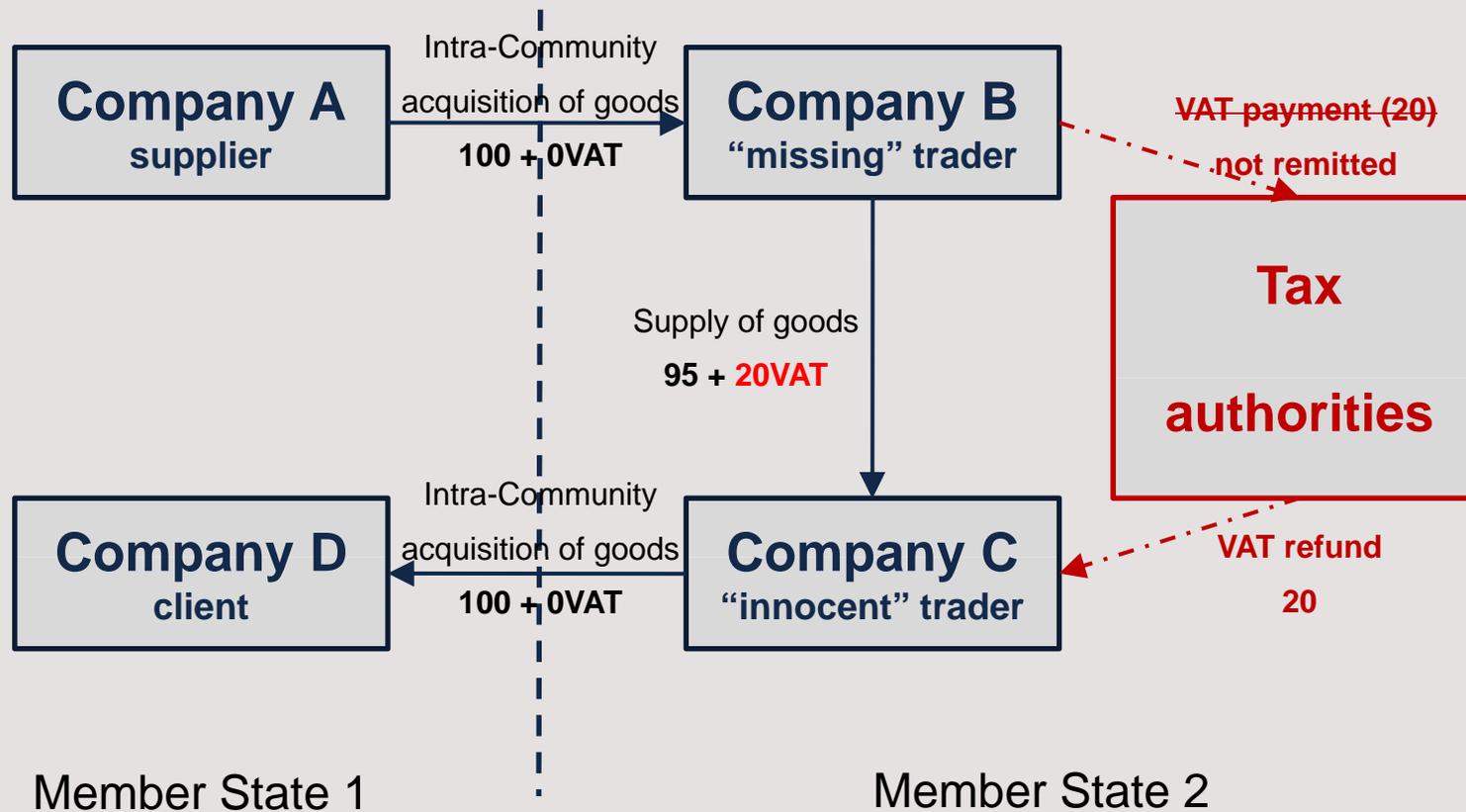
Lead speaker : Heino Buesching

## Risk of criminal procedure rather than tax / civil

- Companies might be engaged in operations that might lead to a criminal procedure
- This might happen even if the company or its directors are not themselves to be blamed for a fraud
- “Carousel fraud” is an usual case for use of criminal law

## Risk of criminal procedure rather than tax / civil (cont'd)

### “Carousel fraud”



## Risk of criminal procedure rather than tax / civil (cont'd)

- The “missing” trader is not immediately detected by the tax authorities because he doesn’t deduct any input VAT
- Risk of **tax recovery** (+ late interest payments and additional penalties):
  - For company A (**supplier**): denial of the exoneration on the Intra-Community acquisition
  - For company C (“**innocent**” **trader**): denial of the deduction of input VAT, or joint responsibility for the payment of the tax not remitted by the “missing” trader
- ... but a **criminal suit** might also follow

## Risk of criminal procedure rather than tax / civil (cont'd)

— There are various practices:

- The criminal suit may be automatic or not
- The criminal responsibility might be a personal responsibility (falling on the company's representatives) or a corporate responsibility
- Prosecution in the same procedure as the tax recovery or in a separate one.

## Risk of criminal procedure rather than tax / civil (cont'd)

### — In France,

- The tax authorities have a **legal obligation to refer** any crime or misdemeanour (such as tax fraud or swindling) to the prosecutor who then decides whether or not to refer the case to the criminal judge
  - In tax fraud cases, the tax administration needs to place a complaint (this requires the assent of a special Commission), otherwise the prosecutor cannot refer the case
- **Corporate and personal responsibility** might be engaged on criminal ground
- Tax and criminal **proceedings are parallel**. Practice shows that the criminal judge may decide that a taxpayer has not committed any criminal offence, while the tax judge, informed of this decision, may consider that the same taxpayer knew or could not ignore that he participated in a VAT fraud.

## Risk of criminal procedure rather than tax / civil (cont'd)

— In the UK,

- Suspected cases of tax fraud may be pursued under civil and/or criminal codes
- HMRC's policy is to deal with suspected tax fraud via its cost effective civil procedures although it may reserve the right to conduct a criminal investigation
- Carousel fraud will usually be dealt with via criminal procedure
- Criminal charges will be pursued by the Revenue and Customs Prosecutions Office, part of the Crown Prosecution Service
- Criminal prosecutors have extended powers of search, arrest etc.

## Risk of criminal procedure rather than tax / civil (cont'd)

### — In Germany,

- As far as tax fraud is concerned, special forces within the tax administration decide to go criminal or not. If there is initial suspicion of a tax crime, tax authorities are forced to investigate on criminal grounds
- Tax and criminal procedures are legally separated, but both will be carried out by the tax authorities in the first phase
- Financial and criminal Courts are independent and may rule differently in the same case
- Tax crimes can be committed by individuals only. Corporations can be subject to fines in administrative procedures

## Risk of criminal procedure rather than tax / civil (cont'd)

### — In Italy (1/2),

- Tax authorities have the obligation to refer any fact that could potentially constitute an infringement of the tax criminal law to the prosecutor who then decides whether or not to refer the case to the criminal judge
- For VAT purposes, the infringement of the tax criminal law occurs in case of
  - (i) utilization of invoices related to non-existent transactions
  - (ii) amounts involved higher than determined figures

## Risk of criminal procedure rather than tax / civil (cont'd)

### — In Italy (2/2),

- The responsibility of the company may be criminal only in very serious cases: in particular, when the judge considers that a crime is committed against the state (criminal procedure against a director would be more common)
- Tax and criminal procedures are parallel and independent: the different impact of the proofs admitted in the tax and in the criminal procedures might also lead to different decisions (e.g., sentence in the tax procedure and acquittal in the criminal procedure, or vice versa)

## Risk of criminal procedure rather than tax / civil (cont'd)

### — In the Netherlands,

- A taxpayer generally does not suffer from uncollectible taxes if another entity commits fraud; the tax authorities will (need to) try to collect the tax from the “missing” trader
- In case of fraud, the case may become a criminal case, depending on the amounts involved and various other criteria; in practice, criminal prosecution usually is limited to serious fraud cases or situations involving public persons (like a well known football trainer)
- A criminal case can be against the entity as well as an individual involved; usually it is only against individuals, i.e. decision makers and persons actively engaged in the fraudulent actions

## Risk of criminal procedure rather than tax / civil (cont'd)

### — In Spain,

- Tax authorities have an obligation to refer to the criminal authorities (prosecutor or criminal judge) any potential crime as soon as they become aware of that possibility
  - Due to the vague definition of tax crime, in practice, a tax infringement must amount above €120,000 of unpaid tax (per tax and per year) to be reported to the prosecutor
- Criminal liability can apply to the company itself based on new legislation that will apply on 23 December onwards
- From the moment the tax file is referred to the criminal authorities, the tax administrative procedure must stop, but if criminal authorities do not find the existence of a tax criminal offence, then the tax (administrative) procedure can be reopened
- Tax authorities are using **more and more** tax crime, referring many files to criminal courts (but most of them are rejected)

## Risk of criminal procedure rather than tax / civil (cont'd)

### — In Belgium,

- The tax authorities can refer any crime or misdemeanour (such as tax fraud or tax evasion) to the prosecutor who then decides whether or not to refer the case to the criminal judge
- Corporate and personal responsibility might be engaged on criminal grounds
- Tax/civil courts are held by the decision of the criminal courts; different procedures cannot lead to contradictory decisions

### — In Hungary,

- Criminal liability applies only to private individuals
- However companies may be subject to criminal sanctions in case they benefited from a crime committed by their director

## **Complex operations and liability of directors**

Lead speaker : Jochem de Koning

## Complex operations and liability of directors

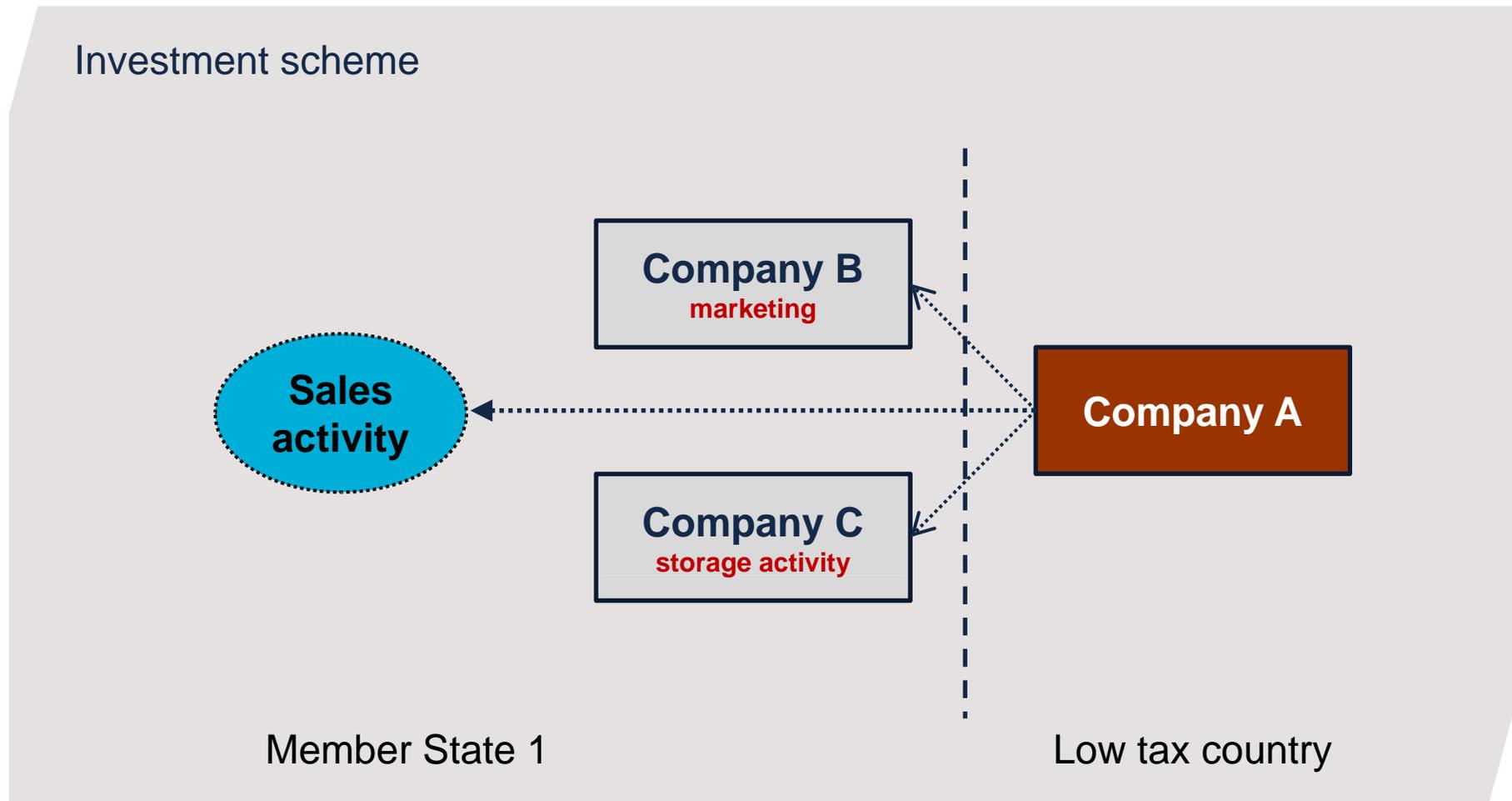
- Can liability of directors be involved when the tax authorities argue that a company resident in a low tax country has a PE locally?
- A company resident in a low tax country will try to have most of the margin generated by an operation in its own country. It therefore may resort to local agents to help with for example

- Storage and other auxiliary operations
- Sales and marketing

If such local agent is an independent agent, it does not constitute a PE of the foreign company provided the agent acts in the ordinary course of its business

Otherwise, there may be a PE

## Complex operations and liability of directors (cont'd)



## Complex operations and liability of directors (cont'd)

— Can tax liability be aimed at directors of Company A? (1/4)

— In France,

- Any person considered to be managing the company can be held liable for the payment of the tax but only in case of fraudulent acts or serious and repeated failure to fulfill tax requirements

— In Germany,

- Statutory directors of companies, foreign or domestic, are liable for taxes owed by the company, if those taxes are lost through gross negligence of the directors in respect of their fiscal reporting duties or by a committed tax fraud

## Complex operations and liability of directors (cont'd)

— Can tax liability be aimed at directors of Company A? (2/4)

— In the Netherlands,

- A statutory director is not personally liable for unpaid CIT. But he can be held liable for unpaid wage tax (and VAT); it is generally very difficult to avoid such liability, even in case he did not have any knowledge or involvement. This is also true for a PE manager

— In Italy,

- The director cannot be held liable for the payment of the tax (nor for the relative penalties)

## Complex operations and liability of directors (cont'd)

— Can tax liability be aimed at directors of Company A? (3/4)

— In the UK,

- Generally speaking an understated UK tax liability remains the liability of the taxpayer company, subject to any offence committed or civil liability imposed on the directors
  - However, the UK corporation tax liability of a non-UK incorporated company may be recovered from an officer of the company (who has a corresponding right of indemnity)
- Where a penalty is payable by a company for a deliberate inaccuracy in a return or other document relating to tax for which an officer was responsible, HMRC may pursue the officer for such portion of the penalty (up to 100%) as it determines.

## Complex operations and liability of directors (cont'd)

— Can tax liability be aimed at directors of Company A? (4/4)

— In Belgium,

- As a general rule, directors are responsible for the performance of their duties and are individually liable to the company for any shortcoming
  - In case of company bankruptcy, a special liability rule applies if it is established that a manifestly serious mistake has contributed to the company bankruptcy (director or person who had authority to manage the company)
- Any person considered to be managing the company can be held liable for the payment of VAT (and the professional withholding tax) in case of failure to pay the tax
- Under certain conditions (mainly, in case of 'cash companies'), any shareholder of a Belgian company who holds at least 33% of the shares and sells at least 75% of his shares within a period of one year could be liable for the taxes owed by the company

## Complex operations and liability of directors (cont'd)

- Can criminal liability be aimed at directors? (1/8)
- In France,
  - The tax authorities have a legal obligation to refer any crime or misdemeanour (such as tax fraud or swindling) to the prosecutor who then decides whether or not to refer the case to the criminal judge
    - In tax fraud cases, the tax administration needs to place a complaint (this requires the assent of a special Commission), otherwise the prosecutor cannot refer the case
  - Tax administration was traditionally reluctant to report tax fraud cases to the prosecutor. It usually applied to individuals having a business but filing no tax return
  - Recently, tax administration tends to threaten criminal prosecution not only on simple operations but also on operations where discussion is open, like a PE matter

## Complex operations and liability of directors (cont'd)

— Can criminal liability be aimed at directors? (2/8)

— In Italy,

- If on the basis of certain elements the Italian tax authorities argue that Company A has a PE in Italy and criminal laws were infringed, they are obliged to refer the case to the prosecutor, who then decides whether or not to refer the case to the judge
- Personal liability of directors, foreign or domestic, might be engaged on criminal ground. The criminal prosecution of the company itself is unusual (possible where fraudulent actions to the detriment of the State occur)

## Complex operations and liability of directors (cont'd)

— Can criminal liability be aimed at directors? (3/8)

— In Germany,

- Criminal liability of a director requires that he has himself knowledge of a wrong tax return being filed on behalf of the company
- PE Managers, if not statutory directors, may be subject to criminal charges, only if they file wrong or incomplete tax returns on behalf of the company

## Complex operations and liability of directors (cont'd)

— Can criminal liability be aimed at directors? (4/8)

— In the Netherlands,

- Criminal liability of a director is not really imaginable, unless he has actively been involved in seriously wrong tax reporting
- Criminal liability of a person actively involved in the Netherlands in the wrong tax reporting is possible and imaginable, but not likely in practice
- More importantly, a person involved in wrong tax reporting is liable to fines the same way as the taxpayer; for example tax advisors preparing tax returns; this stems from new legislation, which may play an important role in future

## Complex operations and liability of directors (cont'd)

— Can criminal liability be aimed at directors? (5/8)

— In the UK (1/2),

- Criminal liability can be imposed for tax fraud. There is a statutory offence of VAT evasion, with penalties of:
  - (1) A fine of the statutory maximum or three times the amount of the VAT (whichever is the greater) or imprisonment for a term not exceeding 6 months or both
  - OR (2) A fine of any amount or imprisonment for a term not exceeding 7 years or both
- Criminal liability does not apply to companies but to individuals only

## Complex operations and liability of directors (cont'd)

— Can criminal liability be aimed at directors? (6/8)

— In the UK (2/2),

- Criminal conviction would prevent a claim also to recover a penalty from a company officer
- This however does not preclude HMRC investigating with a view to bringing both civil and criminal proceedings (or indeed the Prosecutions Office running criminal proceedings concurrently) against an individual
- Directors found guilty of a criminal offence can be disqualified from acting as directors for up to 15 years (note recent cases)

## Complex operations and liability of directors (cont'd)

— Can criminal liability be aimed at directors? (7/8)

— In Belgium,

- The tax authorities can refer any crime or misdemeanour (such as tax fraud or swindling) to the prosecutor who then decides whether or not to refer the case to the criminal judge
- Only serious tax fraud cases are reported to the prosecutor
- In case of serious (tax) fraud or fraudulent organization of insolvency, the liability of the directors could be engaged on criminal grounds

## Complex operations and liability of directors (cont'd)

— Can criminal liability be aimed at directors? (8/8)

— In Hungary,

- Tax authorities have an obligation to refer any crime they become aware of ; on the other hand, tax planning schemes are generally not considered to be a crime
  - In practice usually only serious fraud cases are dealt with as a crime (false invoices, failing to declare income...)
- But definition of tax fraud is quite vague and allows for ad hoc decisions (with sometimes a political component)

— In Spain,

- Criminal liability cannot exist under €120,000 of unpaid tax. Administrative proceeding is suspended during criminal proceeding and criminal liability excludes administrative liability