Customer Tax Integrity:

more than an information reporting obligation and more than tackling tax evasion in the context of AML

Introduction

The global tax landscape has been undergoing significant changes in the last couple of years as there is an increased awareness of the negative consequences associated with tax evasion and aggressive tax avoidance. Governments and international organizations are therefore intensifying their efforts to combat tax evasion, aggressive tax planning, and money laundering. This can be seen in the introduction of information exchange frameworks reflecting the growing emphasis on transparency, cooperation between jurisdictions, and the exchange of financial information to ensure fair and effective tax systems, but also anti-abuse legislation targeting aggressive tax avoidance.

De Nederlandsche Bank (DNB) is committed to ensuring a safe financial sector. One of the tasks is to assess whether financial institutions comply with the law. DNB calls this “integrity supervision”. DNB also checks whether financial institutions do not take too much integrity risk, meaning that criminals could launder money through financial institutions leading to financial and reputational risks. DNB is responsible for integrity supervision of Dutch banks and Dutch branch offices of foreign banks. If banks from other EEA countries provide cross-border services into the Netherlands only (without a physical presence), supervision rests entirely with the home supervisor.

As gatekeepers of the financial system, banks play a crucial role in safeguarding the integrity of the financial system and preventing it from being used for illicit activities, including tax evasion, money laundering but also increasingly acts of aggressive tax avoidance. One of the relatively new topics related to integrity risk is Customer Tax Integrity. In 2019, DNB published the guidance document Good Practices Customer Tax Integrity Risk Management for Banks and a separate version for trust offices. This guidance document provides banks practical tools for implementing risk management as it relates to tax avoidance and tax evasion to safeguard sound and business operations.

pwc

The guidance documents mention it is possible that Dutch branches of foreign banks in the Netherlands do not follow these good practices as part of the entire group's integrity policy. However, branches can use the good practices to achieve compliance with Dutch legislation and regulations, depending on the tax integrity risks of its Dutch customer portfolio.

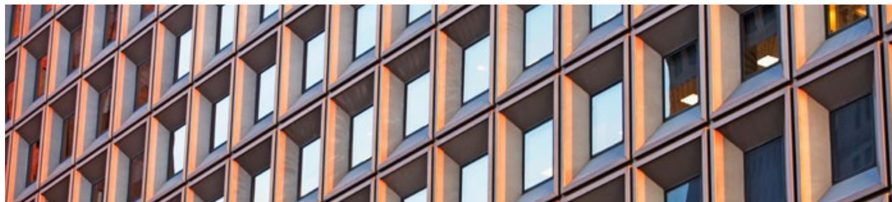
According to this guidance DNB requires banks not to view tax integrity risks as a separate category of risk, but rather as part of prevailing requirements for conducting due diligence on customer-related integrity risks and for monitoring such risks. Although there is no explicit legal definition for the concept of customer tax integrity, it is important for banks to consider this concept when implementing risk management processes to manage integrity risks. As the DNB guidance was already published several years ago, it is likely that supervision and enforcement will follow in the near future.

This document aims to provide a comprehensive understanding of Customer Tax Integrity within the broader integrity risk framework, focusing on the role of banks as gatekeepers. It explores the legal frameworks that define and shape Customer Tax Integrity, including concepts such as tax evasion and tax avoidance. By examining these concepts, valuable insights can be gained into the obligations and responsibilities that banks face as they navigate the complex landscape of Customer Tax Integrity.

Information exchange frameworks - Tackling tax evasion

The evolving landscape of information exchange frameworks, such as FATCA and CRS, has amplified the gatekeeper role of banks. Already in 2010, the US enacted the Foreign Account Tax Compliance Act (FATCA) to combat tax evasion by US citizens and residents with undeclared offshore financial accounts. FATCA aims to enhance information exchange between tax authorities, with banks and other financial entities required to report information about their US account holders to the US Internal Revenue Service (IRS) via the local tax authorities. FATCA's implementation also led to the development of the Common Reporting Standard (CRS) by the OECD in 2014. CRS mandates the automatic exchange of financial account information between tax authorities in participating jurisdictions. Banks play a crucial role in implementing FATCA and CRS requirements, acting as intermediaries in reporting relevant financial information and facilitating global efforts to combat tax evasion and promote tax transparency.

Under FATCA/CRS legislation, tax evasion is defined as the willful attempt to evade or defeat the assessment of taxes or the payment of taxes, including any activity that is intended to conceal assets or income from tax authorities.



Information exchange frameworks - Tackling tax avoidance

The DAC6 directive (Directive on Administrative Cooperation) was presented by the European Commission in 2018 and subsequently adopted by the Council of the European Union in the same year. The directive's introduction in 2018 reflects the recognition of the need to address aggressive tax avoidance practices and strengthen cooperation among EU member states to tackle harmful tax planning schemes. By establishing reporting obligations for intermediaries, including banks, DAC6 aims to enhance transparency, deter abusive tax practices, and promote fair and effective tax systems across the European Union.

The distinction between acceptable tax planning and aggressive tax avoidance can be subjective and context specific. Instead of defining the concept of aggressive tax planning, the DAC6 directive therefore provides for a list of the features and elements of transactions representing a strong indication of tax avoidance or abuse. These indications are referred to as "hallmarks", meaning a characteristic or feature of a cross-border arrangement that presents an indication of a potential risk of tax avoidance.

AML - Tackling tax evasion

Recital 11 of the 4th Anti-Money Laundering Directive (AMLD4) explicitly notes that: *'It is important expressly to highlight that* ***'tax crimes'*** *relating to direct and indirect taxes are included in the broad definition of 'criminal activity' in this Directive, in line with the revised FATF Recommendations.'* This directive also makes clear that criminal activity must be punishable by means of sanctions, but that national law definitions of tax crimes may diverge. The reason for this is that the definition of 'tax crimes' is not harmonized in the EU. Member states are free to determine what would fall within its scope. It is commonly agreed that tax evasion, which is illegal, is covered by the Anti-Money Laundering Directive. The requirement of due diligence regarding tax avoidance is not explicitly mentioned in AMLD4. However, the position of the European Commission in the current trilogue on the new proposed European AML package suggests that the use and access of beneficial ownership registers to fight tax avoidance is not entirely ruled out yet. This might indicate that specific elements of future EU AML regulations could cover more than just tax evasion.

While FATCA, CRS, and DAC6 are rule-based and compliance-driven, tackling tax evasion in the context of AML is not only rule-based, but also risk based. Customer Tax Integrity goes even beyond these two concepts.

Customer Tax Integrity: more than an information reporting obligation and more than tackling tax evasion in the context of AML

DNB Good Practices Customer Tax Integrity Risk Management for Banks
This guidance document is based both on the Dutch Financial Supervision Act (Wft) and the Dutch Anti-Money Laundering and Anti-Terrorist Financing Act (Wwft). The Wwft reflects the implementation of the EU Anti-Money Laundering Directive. Although DNB has made clear that the guidance document is not legally binding and has no legal effect, the legal basis of the guidance document has been subject of discussion.

It is clear that banks have a statutory obligation to take measures to ensure sound, controlled business operations and to prevent involvement in financial and economic crime, including money laundering in conjunction with tax evasion as DNB mentions. However, as noted before, the guidance document provides banks practical tools for implementing risk management as it relates to tax evasion *and tax avoidance* in order to safeguard sound and business operations. According to DNB, a bank will have to first assess a customer's tax-driven motives to avoid its involvement in tax evasion, but also have to assess whether or not a customer's tax integrity risks are acceptable if motives of tax avoidance are present. *'A bank must understand which areas of its customer portfolio run an increased risk of tax evasion in order to ensure ongoing, risk-based monitoring of such practices. In practice, it may not be immediately clear to a bank whether its customers are engaging in tax avoidance or tax evasion. The bank will have to conduct ongoing due diligence to make this distinction among its customers and customer categories'*.

In that regard, it is important to note that Dutch financial supervisory legislation leaves it up to the banks' discretion whether or not tax avoidance of a certain client is permissible. The Wft requires banks to have and apply an adequate policy that ensures integrity in the conduct of its business operations. That includes preventing trust in the bank itself or in the financial markets from being damaged because of (conduct by) the bank's clients. Tax evasion has been a common reason for banks to determine that unacceptable integrity and reputational risks exist. Analogously, there is a legally viable argument to be made that tax avoidance might in some cases and to a certain extent damage trust in the bank and/or the financial markets as well.

Administrative Fines

DNB seems to take it a step further in its guidance documentation. In it, it asserts that societal tolerance for tax avoidance is decreasing and has already led to “the introduction of stricter regulations to curb such practices”. Concerns have been raised that, by treating tax avoidance the same as tax evasion without a statutory basis, the scope of tax crimes might be wrongly broadened. However, in practice, even though DNB’s CIT guidance document is not legally binding, banks generally take it into account and apply the good practices as they see fit.

Customer Tax Integrity encompasses a broader framework that requires Dutch banks to have robust processes in place to assess the tax integrity of their customers. This involves conducting due diligence, risk assessments, and investigations to ensure that their customers are complying with tax laws and regulations. Customer Tax Integrity emphasizes the responsibility of banks to proactively identify and address potential risks of tax evasion and aggressive tax avoidance. Given this risk-based outlook, banks should therefore set their tax integrity risk appetite, taking into account their business operations and relevant stakeholders.

Customer Tax Integrity is a topic that should not be easily disregarded. For one thing, that could lead to administrative sanctions and even criminal prosecution.

The Decree on administrative fines in the financial sector (Besluit bestuurlijke boetes financiële sector) contains general rules for determining the amount of an administrative fine imposed under the Financial Supervision Act or other financial supervision law. Depending on the gravity on non-compliance, categories 1-3 will be used to determine the amount of the fine. Irrespective of the category, repetition, ability to pay and proportionality are always taken into account. These sanctions are not to be underestimated. Depending on the violation, Wft and Wwft non-compliance can fall in the third and highest category. For banks, the base amount is €2.500.000 per Wwft violation, with a maximum amount of €5.000.000 or 20% of its yearly net revenue. In case of a Wft violation, the supervisor may even impose an administrative fine of up to three times the amount of the benefit that the offender obtained as a result of the violation.

In addition, Customer Tax Integrity non-compliance could on some occasions be considered culpable money laundering by the respective bank as well. As tax evasion, i.e. a tax crime, would fall within the definition of money laundering, negligence with regard to it could lead to criminal prosecution.

What we see in the market

Over the last couple of years, Compliance departments of banks have been busy with customer due diligence and transaction monitoring processes, both in terms of AML as well as sanction legislation. Even though Customer Tax Integrity has not been a top priority for many, there is ample reason to argue that it should be. CTI can and should be a key element for banks to take into account when conducting their CDD and TM processes.
Several banks are currently in the process of engaging in customer portfolio remediation and enhancing their policies, risk appetite, processes & controls for CTI. Banks that are not yet, should, as CTI is a topic that cannot be disregarded.

Contact

Keetie van der Torren-Jakma
Director Tax
T: +31 6 1856 5973
E: keetie.van.der.torren-jakma@pwc.com

Robert Jan Meindersma
Senior Director
T:+31 68 360 84 41
E: robert.jan.meindersma@pwc.com

© 2023 PricewaterhouseCoopers B.V. (KvK 34180289). All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.