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DAC 6: new EU tax disclosure rules

Mandatory reporting of cross-border transactions for taxpayers and intermediaries

Effective June 25, 2018

The tax transparency agenda

Transparency is high on the global agenda for governments looking to counter tax avoidance. Recent years have seen the introduction of a number of tax transparency and anti-avoidance measures across the EU, several in direct response to the OECD's final BEPS (Base Erosion and Profit Shifting) reports and the Panama Papers revelations. Taxpayers and their advisers are needing to devote an increasing amount of time and resource to compliance and the provision of information to tax authorities.

The adoption of the Common Reporting Standard (CRS) introduced the automatic exchange of tax and financial information on a global level. It was a game-changer, allowing for the exchange of account holder information and introducing a new level of transparency.

Now, responding to Action 12 of the OECD's BEPS project, the transparency agenda is looking at cross-border arrangements and the disclosure of actual transactions undertaken. This concerns not just transactions that are tax-motivated but also ordinary transactions that may have a "potential tax effect" but are not driven by tax planning motives.

The proposals for the amendment of Council Directive 2011/16/EU on administrative cooperation in the field of taxation (commonly referred to as DAC 6) were originally announced by the European Commission in June 2017, are now in force.

Although not yet implemented at national level, the disclosure obligations need to be treated as "live" as they provide for implementation with retrospective effect from June 25, 2018.

DAC 6: disclosure requirements for taxpayers and intermediaries

DAC 6 imposes mandatory reporting of cross-border arrangements affecting at least one EU Member State that fall within one of a number of "hallmarks": broad categories setting out particular characteristics identified as potentially indicative of aggressive tax planning. The reporting obligations fall on "intermediaries" or, in some circumstances, the taxpayer itself. The information reported will be contributed to a central directory accessible by the competent authorities of the Member States.

It might be thought that this is about aggressive tax planning, but the way the Directive has been drafted means that it potentially also applies to standard transactions with no particular tax motive. This means that ordinary transactions such as cross-border leasing; securitisation structures, certain types of reinsurance and many standard group corporate funding structures may be reportable. There is no safe harbour for arrangements having an underlying commercial purpose.

The scope of the Directive is very wide and the detail is left to local implementing law and guidance. The Directive states that it does not go beyond what is necessary to discourage the use of aggressive cross-border arrangements and does not therefore offend the basic EU principle of proportionality. Given how broadly drafted it is, this is a bold statement. The implementing jurisdictions transposing the Directive will need to determine what compliant provisions look like and exactly how far the domestic legislation needs to go to achieve the stated objectives.

Timeline

DAC6 in force (*transactions now reportable*)	Domestic implementation	Domestic regimes effective	First reports due	First exchange of information
June 25, 2018	December 25, 2019	July 1, 2020	August 31, 2020	October 31, 2020

The first notifications will be due in August 2020 but the Directive provides that notifications should be made in respect of arrangements dating back to June 25, 2018.[1] Those potentially within scope therefore need to work out how they will respond before they have any guidance or detail.

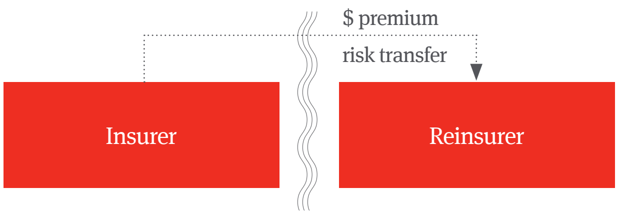
There are three key concepts underpinning the new regime

- Intermediaries
- Reportable cross-border transactions
- Hallmarks

1 Notwithstanding Brexit, it is anticipated that the UK will implement the Directive.

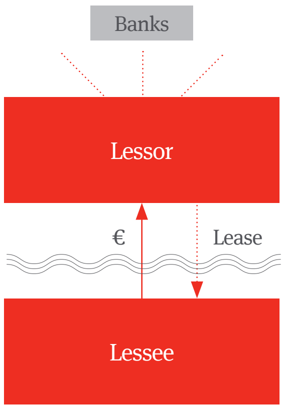
Examples of common structures that are potentially reportable

Reinsurance transactions with low tax jurisdictions



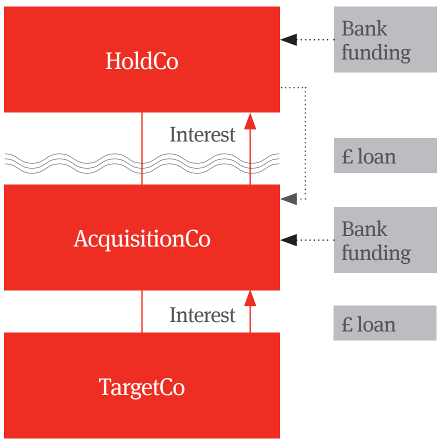
Arrangements involving cross-border payments and transfers (including to third party reinsurers) may require disclosure under Category C hallmarks.

Cross-border leasing transactions



- Arrangements under which depreciation is claimed in relation to the same asset in different jurisdictions come under the Category C hallmark, whether or not giving rise to any tax benefit.
- Cross-border payment to low tax jurisdictions would also need consideration.
- Category D hallmarks pick up arrangements involving entities without substantive economic activity or substance (whether or not tax motivated).

Acquisition finance



Arrangements involving cross-border payments and transfers may require disclosure under Category C hallmarks.

Who is an “intermediary”?

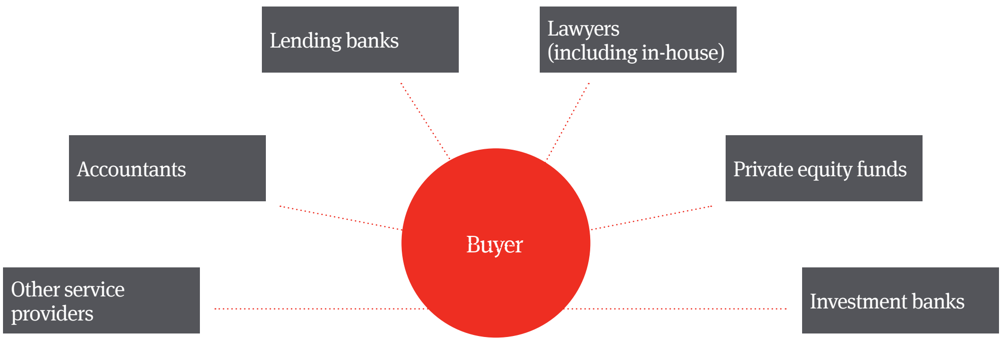
The answer is anyone who designs, markets, organises or makes available or implements a reportable arrangement or anyone who helps with reportable activities and knows or could reasonably be expected to know that they are doing so.

The broad scope of the definition means that a large number of those involved are potentially “intermediaries”. Those caught include

- Consultants, accountants, financial advisers, lawyers (including in-house counsel).
- Banks, trust companies, insurance intermediaries.
- Holding companies, group treasury functions.

A single transaction will involve many intermediaries. Take for example an M&A transaction. The intermediaries involved potentially would include investment banks, lawyers, accountants, corporate services companies, holding and group treasury companies. There is no carve-out for non-tax people.

Intermediaries on an M&A transaction: the buyer side



There is no exclusion from the reporting obligations for in-house advisers.

To fall within the disclosure rules, the intermediary must have some connection to the EU.

This is established by

- Tax residence or place of incorporation.
- The presence of a permanent establishment or branch connected with the provision of the relevant services.
- Being registered with a tax, consultancy or legal professional association in the EU.

What is reportable?

The reporting requirements apply to "reportable cross-border arrangements".

"Arrangement"

This is a broad concept picking up any common understanding as to a course of action, whether or not contractually binding.

"Cross-border"

An arrangement will be "cross-border" where it concerns either more than one Member State or a Member State and a third country where at least one of the following conditions is met.

- Not all of the participants in the arrangement are resident for tax purposes in the same jurisdiction.
  — *Dutch FinCo grants an inter-company loan to a German affiliate.*
- One or more of the participants is resident for tax purposes in more than one jurisdiction.
  — *FinCo was established as a GmbH under Austrian law. Its place of effective management is in the Netherlands.*
- One or more of the participants carries on a business in another jurisdiction through a permanent establishment situated in that jurisdiction and the arrangement forms part or all of the business of that permanent establishment.
  — *French S.A. is granted a loan by the London branch of a French bank.*
- One or more of the participants carries on an activity in another jurisdiction without being resident for tax purposes or creating a permanent establishment in that jurisdiction.
  — *Lux PropCo acquires property in Germany and earns rental income.*
- The arrangement has a possible impact on the automatic exchange of information or the identification of beneficial ownership.
  — *UK managed fund enters into securities lending with Spanish counterpart for shares in a South American corporation.*

This does not necessarily require a cross-border transaction to take place: a domestic transaction which has tax implications for another EU Member State is within scope. Purely domestic arrangements which do not impact tax in another jurisdiction are not the target of this regime.

"Reportable"

Arrangements are reportable if they fall within one of a number of "hallmarks": broad categories setting out particular characteristics identified as potentially indicative of aggressive tax planning.

The hallmarks are widely drawn and leave a lot of room for debate as to whether many "ordinary" transactions and structures will be reportable in addition to planning that indicates, in the Commission's words, "potentially aggressive tax planning".

The Directive does not contemplate any *de minimis* value for reportable arrangements: hopefully, implementing governments will see the benefit of this. It is possible that domestic implementing legislation will confine the scope of the requirements and consider introducing a *de miminis* value for reportable arrangements (commonly seen in existing disclosure regimes). Given the information exchange underpinning the regime however, attempts to do so may be challenged.

"Main benefit"

A number of the hallmarks only apply if a threshold "main benefit" test is met. This is met where one of the main benefits expected from an arrangement is a tax advantage. This terminology is used in other regimes and is notoriously difficult to apply. Until the scope is clearly defined, it makes sense to interpret it widely. Other regimes may offer indications of how this will be implemented. The UK guidance in respect of a similar test under the domestic reporting regime views this "a main benefit" as picking up any benefit that is not "incidental", a low threshold. If the tax outcome is of significance in the way you decide to structure a transaction, disclosure should be your default course of action.

The hallmarks

This table summarises the hallmarks and, importantly, distinguishes those to which the "main benefit" threshold applies.

Categories	Hallmarks	"Main benefit" test?
Category A Commercial characteristics seen in marketed tax avoidance scheme.	Taxpayer or participant under a confidentiality condition in respect of how the arrangements secure a tax advantage.	✓
	Intermediary paid by reference to the amount of tax saved or whether the scheme is effective.	✓
	Standardised documentation and/or structure.	✓
Category B Tax structured arrangements seen in avoidance planning.	Loss-buying.	✓
	Converting income into capital.	✓
	Circular transactions resulting in the round-tripping of funds with no other primary commercial function.	✓
Category C Cross-border payments, transfers broadly drafted to capture innovative planning but which may pick up many ordinary commercial transactions where there is no main tax benefit.	Deductible cross-border payment between associated persons	
	• To a recipient not resident for tax purposes in any jurisdiction.	
	• To a 0 percent or near 0 percent tax jurisdiction.	✓
	• To blacklisted countries.	
	• Which is tax exempt for the recipient.	✓
	• Which benefits from a preferential tax regime in the recipient jurisdiction.	✓
	Deductions for deprecation claimed in more than one jurisdiction.	
	Double tax relief claimed in more than one jurisdiction in respect of the same income.	
	Asset transfer where amount treated as payable is materially different between jurisdictions.	
Category D Arrangements which undermine tax reporting/transparency.	Arrangements which have the effect of undermining reporting requirements under agreements for the automatic exchange of information.	
Category E Transfer pricing: non-arm's length or highly uncertain pricing or base erosive transfers.	Arrangements involving the use of unilateral transfer pricing safe harbour rules.	
	Transfers of hard to value intangibles for which no reliable comparables exist where financial projections or assumptions used in valuation are highly uncertain.	
	Cross-border transfer of functions/risks/assets causing a more than 50 percent decrease in earnings before interest in tax during the next three years.	

The “when”, “what”, “who” and “where” of reporting

Once implemented, reports will need to filed within 30 days of the earlier of the day on which the arrangement is made available for implementation; the day it is ready for implementation; and the day the first step in implementation is made. There are ongoing quarterly reporting obligations for “marketed arrangements” – marketed tax schemes which can be implemented with minimal customisation.

Non-compliance by either intermediaries or taxpayers will attract penalties. The Directive prescribes that penalties under the local legislation in all EU Member States must be “effective, proportionate and dissuasive”.

What needs to be reported?

The information to be reported is listed in the Directive.

- Identification of all taxpayers and intermediaries involved, including
  - Tax residence.
  - Name, date and place of birth (if an individual).
  - Tax Identification Number (TIN).
  - Where appropriate, the associated persons of the relevant taxpayer.
- Details of the relevant applicable hallmark(s).
- A summary of the arrangement, including (in abstract terms) a summary of relevant business activities.
- The date on which the first step in implementation was or will be made.
- Details of the relevant local law.
- The value of the cross-border reportable arrangement.
- Identification of relevant taxpayers or any other person in any Member State likely to be affected by the arrangement.

This is a lot of detail. In many cases the requirements to identify and provide detail in respect of the other intermediaries involved will be tricky. Ascribing a value to the arrangement may also be hard.

Collating information

Whichever intermediary/taxpayer is making the report will clearly need to devote time to collating information but will also need to ensure others involved are lined up to cooperate with this process.

Who should make the report?

The “intermediaries’ net is cast very wide and as we have illustrated a transaction may involve a number of intermediaries.

An intermediary may be exempt from its reporting requirements if it can show that another intermediary has reported the arrangement.

An intermediary unable to report due to domestic legal professional privilege rules is required to inform other intermediaries of their reporting obligations. Where there is no intermediary or the intermediary is subject to legal professional privilege, the report must be made by the taxpayer.

A documented, formal agreement should set out who will make the report before the actual reporting obligations kick in. Parties involved will want to consider rights of review and comment and will need to ensure that the making of the report will not breach any contractual terms, including terms of engagement.

Where should the report be made?

Disclosure only needs to be made once in respect of arrangements: the Directive sets out a hierarchy to determine in which member state disclosure should be made.
This is determined, in descending order by

- Tax residence.
- The location of a PE connected with the provision of the relevant services.
- Place of incorporation and location of a tax, consultancy or legal professional association with which the intermediary registered.

What practical steps need to be taken?

Be prepared.

- Arrangements from June 25, 2018 need to be monitored. This means that you need to be reviewing all transactions that you are involved in (both as intermediary and as a client) in light of this disclosure obligation and you need to obtain certainty that any reportable transaction will in fact be reported by one intermediary. It is prudent to give a wide interpretation to the Directive when considering which arrangements may, at a future date, be reportable.

- Maintaining a record of potentially reportable arrangements which identifies the potentially applicable hallmark, relevant arrangement, value and the intermediaries involved will be important. Once legislation and guidance -becomes available across the different European Member States, these records can then be scrutinised to work out exactly what reports need to be made. Having a list of the type of relevant transactions undertaken in your organisation will assist in-house teams.

- Depending on the number of reportable arrangements you may need to put a suitable system in place to monitor arrangements and collect the relevant data. Ideally the system would enable the secure exchange of reportable information with the authorities in 2020.

- Due to the absence of a “main benefit” test in respect of many hallmarks, arrangements may need to be reported in situations where no tax advantage is obtained: teams need to be aware that the fact that there is no discussion of tax does not mean that the transaction is out of scope. Communications with in-house teams will be vital to encourage their input from an early stage.

- With time, disclosure may be able to be better targeted due to a combination of market experience, guidance, domestic implementation and refinements to the regime itself but reverse engineering, trying to identify relevant transactions two years on, is a very unattractive, perhaps impossible, proposition.

We can assist you with putting in place a (web-based) system to identify and monitor reportable advice, transactions or structures and if ultimately you are the reporting entity, support you with your reporting obligation.

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