ALLEN & OVERY

DAC6 – Mandatory disclosure tax reporting
what does it mean for you?

A new EU Directive (DAC6) requires EU intermediaries (including banks, accounting firms, law firms, corporate service providers and certain other persons) involved in cross-border arrangements to make a disclosure to their tax authority if certain requirements are met. Where no intermediary is required to make a filing the taxpayer may need to disclose instead. Failure to comply can result in penalties. The first reports are not due until August 2020 but all reportable transactions from 25 June 2018 must be disclosed. It is therefore crucial to consider the effects of this new regime and what information, if any, you should be collecting, now.

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1. How does the regime work?

Under the new mandatory disclosure regime Member States must implement measures requiring intermediaries, or in certain cases tax payers (see section 3 below) to file information (section 5 below) that is within their knowledge, possession or control on reportable cross-border arrangements (section 4 below) within a set time period (section 6 below).

The regime is mandatory; failure to comply will result in penalties and possibly other consequences (section 7 below). Information reported will be exchanged between EU Member States (section 8 below).

The Directive is applicable from 1 July 2020 (section 9 below). However, there is a sting in the tail: disclosure is required in respect of reportable arrangements where the first step is implemented on or after 25 June 2018. The Directive therefore has a retrospective element which means it is already necessary to consider its effect.

This is the case even though none of the Member States has yet published the legislation under which they will implement the Directive. The rules could differ in important respects between Member States, and so this uncertainty is unwelcome.

2. Why are these rules being brought in?

This mandatory disclosure regime will be the newest tool for EU tax authorities in the continuing global crackdown on perceived tax avoidance and evasion. This process has forced tax payers and advisers to grapple with a raft of recent changes to tax treaties and domestic tax rules and the introduction of new information reporting regimes (including the common reporting standard, FATCA and country by country reporting).

The purpose of these new provisions is to ensure EU tax authorities have early access to information about tax planning. The Commission hopes that this will help protect the tax base of Member States as they will be better placed to challenge the tax planning and/or change the law to prevent similar future transactions, at an early stage. In addition, the provisions are meant to deter taxpayers from implementing abusive tax schemes.

The rules are inspired by BEPS Action 12 which recommends that jurisdictions introduce a regime for the mandatory disclosure of aggressive tax planning arrangements.

The structure of the regime draws heavily on the UK's disclosure of tax avoidance scheme (DOTAS) rules. However, those familiar with the UK rules should note that the EU mandatory disclosure regime is considerably wider in scope.

3. Who has the obligation to report?

The reporting obligation primarily applies to intermediaries. However, a secondary reporting obligation applies to taxpayers, in certain circumstances.

Who is an intermediary?

An intermediary is any person:

(a) that:

  (i) designs, markets, organises or makes available for implementation or manages the implementation of a reportable cross-border arrangement; or

  (ii) provides (either themselves or through others) aid, assistance or advice for any of the matters in (i) above, and knows or could reasonably be expected to know (having regard to the relevant facts and circumstances) that it relates to a reportable cross-border arrangement; and

(b) that has an EU connection.

This is a very broad definition. It will include lawyers, tax advisers, accountants and other professionals that advise taxpayers on cross-border transactions. It can also catch lawyers, banks and service providers involved in the implementation of these transactions.

What is the EU connection?

To be an intermediary a person must have a link to an EU Member State: The intermediary must be tax resident in a Member State; have a permanent establishment in a Member State through which the services with respect to the arrangement are provided; be incorporated in or governed by the laws of a Member State; or be registered with a professional association related to legal, taxation or consultancy services in a Member State.

What about legal privilege?

The availability of a privilege 'defence' in the UK DOTAS regime has meant that the direct impact of the UK DOTAS regime for lawyers and in-house advisers in the UK has been relatively limited.

The Directive permits Member States to give intermediaries an exemption from the requirement to disclose on a reportable cross-border arrangement where the reporting obligation would breach the legal professional privilege under the national law of that Member State. However, there is no requirement that Member States implement this 'defence'; it is at their discretion. In addition, not all Member States have a principle of legal professional privilege that covers advisory rather than litigation matters.

In cases where legal privilege applies, the relevant lawyer must inform the other intermediaries (or where there are none, the taxpayer) of their disclosure obligations.

What if there are several intermediaries?

All intermediaries involved in a transaction individually have an obligation to file. However, an intermediary is exempt from disclosing if it has proof, in accordance with national law, that the same information has been filed in another Member State.

It will be important to ascertain this information in respect of a transaction at an early stage. In the case of doubt it may be safer for all intermediaries to make a disclosure.

When does the taxpayer have to report?

The disclosure obligation rests with the taxpayer if

(a) no intermediary is involved;

(b) the intermediary does not have an EU connection; or

(c) the legal professional privilege defence applies to the intermediary.

4. What is a reportable cross-border arrangement?

A cross-border arrangement is an arrangement that concerns more than one Member State, or that concerns a Member State and a third country. Therefore purely domestic arrangements and arrangements having no link to any EU Member State should not fall within the Directive (although Member States may decide to extend their national legislation to purely domestic legislation). However, once arrangements have a sufficient EU connection, it appears not to matter that any tax benefits arising from it solely relate to the tax of a third country.

A cross-border arrangement is reportable only if it has certain characteristics or features, known as "hallmarks". These hallmarks are intended to limit the application of the regime to only those transactions for which there is a potential risk of tax avoidance. However, unlike the UK DOTAS regime, not all of the hallmarks feature a main tax benefit threshold test.

The hallmarks are divided into generic and specific hallmarks. Examples of generic hallmarks are confidentiality conditions, success fees and standardised documentation. The generic hallmarks and certain of the specific hallmarks only apply if the main benefit or one of the main benefits which, taking into account all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage. Tax advantage is not defined in the Directive but will not cover advantages relating to VAT, customs/excise duties or social security contributions. Examples of the specific hallmarks are certain uses and transfers of losses, converting income into capital, gifts or low taxed/exempt income, circular transactions, transactions between related parties that include exempt tax payers, exempt or preferentially treated receipts and tax payers in non-cooperative jurisdictions.

All other specific hallmarks apply irrespective of whether this main benefit test is met. Examples of the latter are arrangements in which a recipient without tax residency in any jurisdiction is involved or that lead to double deductions, double tax relief, circumvention of reporting requirements such as the Common Reporting Standard and Ultimate Beneficial Owner reporting, use of unilateral safe harbour transfer pricing rules, transfer of hard to value intangibles and certain intra-group cross-border transfers.

We have included the full list of hallmarks in Annex 1 to this alert.

5. What information must be disclosed?

The Directive does not prescribe the information to be disclosed by an intermediary or taxpayer. The fact that disclosures must be made in respect of relevant arrangements from 25 June 2018 puts these persons in a difficult position until the details are published.

The Directive requires that the following information is automatically exchanged by Member States:

(a) identification of intermediaries and relevant taxpayers (including name, date and place of birth, tax residence, tax information number and associated enterprises);

(b) details of the relevant hallmarks that make the cross-border arrangement reportable;

(c) a summary of the content of the reportable cross-border arrangement;

(d) the date of first step of implementation;

(e) details of the national provisions forming the basis of the reportable cross-border arrangement;

(f) the value of the reportable cross-border arrangement;

(g) Member States which are likely to be concerned by the reportable cross-border arrangement; and/or

(h) identification of any other person in a Member State likely to be affected by the reportable cross-border arrangement.

The information required to be disclosed by the intermediary or taxpayer therefore must facilitate the exchange of this information by the Member State. We therefore expect the required disclosure to cover at least the names of other intermediaries, known relevant taxpayers and items (b) to (g) above.

6. When does the information have to be disclosed?

Information must be filed with the relevant tax administration within thirty days from the first to occur of:

(a) the day after the reportable cross-border arrangement is made available for implementation;

(b) the day after the reportable cross-border arrangement is ready for implementation; or

(c) the day when the first step in the implementation of the reportable cross-border arrangement has been made.

Intermediaries providing aid, assistance or advice must file information within thirty days beginning on the day after they provided aid, assistance or advice.

A special rule applies to reportable arrangements where the first step is implemented between 25 June 2018 and 1 July 2020; these transactions must be disclosed by 31 August 2020.

7. What will happen with the information that is reported?

Tax administrations of the EU Member States will exchange the reported information automatically with other Member States through a centralised database.

A similar process already applies to country by country reporting and financial account information.

8. What happens if I fail to comply with the new regime?

The penalties for failing to comply will be set by each Member State. The Directive requires the penalties to be effective, proportionate and dissuasive.

However, there is nothing to stop Member States employing additional deterrence measures. For example in the UK an intermediary who does not comply with the DOTAS rules can, in certain circumstances, be "named and shamed" by HMRC and/or required to pay tax up front in respect of a reported transaction which it challenges.

9. When will the rules in the Directive be implemented?

Member States must implement the Directive into national law by no later than 31 December 2019. The relevant law must apply from 1 July 2020 onwards.

At present, there is very little information available about how each Member State will adopt these measures, including those areas where they have some implementation discretion (such as the availability of a legal privilege 'defence' and the penalty regime).

It will be important to monitor these developments closely.

10. What should I be doing now?

This is a difficult question and the answer will develop as more information becomes available as to how the Directive will be adopted in each Member State.

Obligations on intermediaries

Our view is that persons who could be classed as an intermediary and have entered into cross-border arrangements since 25 June 2018 which have at least one of the hallmarks should keep adequate records of these transactions in case they are required to make a report in August 2020.

Going forwards, such transactions should be monitored and logged by potential intermediaries in preparation for the first reporting date.

Finally, intermediaries may wish to review their contracts in order to ensure that they are permitted to report the information required by the Directive where that information relates to the counterparty.

Obligations on taxpayers

Taxpayers that carry on any activity in the EU or derive any income or profits in the EU are potentially subject to these rules, even if they are not resident, and do not have a permanent establishment, in the EU. They may therefore have to make a disclosure. They should consider whether any of their transactions or structures are potentially affected by the hallmarks, and, where they wish to rely on disclosure by an intermediary, they will need to obtain proof from the intermediary that the disclosure has been made at the appropriate time.

11. Where can I find the rules and who can I discuss them with in more detail to determine the impact on my organisation?

The Council Directive introducing mandatory disclosure rules for reportable cross-border arrangements can be found here. It amends the directive on administrative cooperation (DAC) Directive 2011/16/EU.

Contact information

Global Tax practice

Annex

HALLMARKS

1. **Generic hallmarks (all subject to a main benefit test):**

   (a) one of the parties in the arrangement agrees to comply with confidentiality provisions which prevent disclosure to other intermediaries or to the tax authorities how the arrangement could secure a tax advantage;

   (b) the intermediary is entitled to receive a fee for the arrangement and this is linked to the amount of the tax advantage derived from the arrangement; or

   (c) the arrangement has substantially standardised documentation and/or structure and is available to more than one relevant taxpayer without a need to be substantially customised for implementation.

2. **Specific hallmarks that are subject to the main benefit test:**

   (a) taking contrived steps which consist in acquiring a loss-making company, discontinuing the main activity of such company and using its losses to reduce its tax liability, including through a transfer of losses or by the acceleration of the use of the losses;

   (b) the conversion of income into gifts, capital or other categories of revenue which are taxed at a lower level or exempt from tax; or

   (c) an arrangement which includes circular transactions resulting in the round tripping of funds.

3. **Specific hallmarks relating to certain cross-border transactions. These hallmarks do not have a main benefit test (except where they feature a *). They relate to:**

   (a) an arrangement that involves deductible cross-border payments between associated enterprises and at least one of the following conditions is met:

      (i) the recipient of the payment is not tax resident in any tax jurisdiction;

      (ii) the recipient of the payment is tax resident in:

         (A) a jurisdiction that imposes a zero or almost zero corporate tax rate*; or

         (B) the jurisdiction is included in a list of non-cooperative jurisdictions of the EU or the OECD;

      (iii) the payment benefits from a full exemption from tax in recipient's tax jurisdiction*; or

      (iv) the payment benefits from a preferential tax regime in recipient's tax jurisdiction*.

   (b) deducting amounts for depreciation on the same asset in more than one jurisdiction;

   (c) claiming relief for double taxation for the same income in more than one jurisdiction; or

   (d) transferring assets whereby there is a material difference in the amount that is considered to be the consideration for the assets transferred in the various jurisdictions involved.

4. **Specific hallmarks relating to the automatic exchange of financial information under the CRS as implemented in the Member States and the determination of the ultimate beneficial ownership. These are not subject to a main benefit test. The hallmarks include:**

   (a) arrangements which may have the effect of undermining the reporting obligation under CRS. These arrangements include at least the following:

(i) the use of a product that is not a financial account as defined under CRS but has features that are substantially similar to those of a financial account; or

(ii) transferring financial accounts or assets to or using jurisdictions that do not have to exchange information with the jurisdiction where the relevant taxpayer is resident; or

(iii) the reclassification of income and capital into products that are not subject to CRS; or

(iv) the transfer or conversion of a financial institution or a financial account that is not defined under CRS; or

(v) the use of legal entities or arrangements that eliminate reporting obligations in respect of an account holder or a controlling person; or

(vi) the use of arrangements that undermine or use weaknesses in due diligence procedures.

(b) arrangements trying to hide beneficial owners. Such arrangements involve a non-transparent legal or beneficial ownership chain with the use of persons, legal arrangements or structures:

(i) that do not carry on a substantive economic activity supported by adequate staff, equipment, assets and premises; and

(ii) that are incorporated, managed or resident in a jurisdiction other than the jurisdiction of residence of one or more of the beneficial owners of the assets held by such persons, legal arrangements or structures; and

(iii) where the beneficial owners of such persons, legal arrangements or structures are made unidentifiable.

5. Hallmarks related to transfer pricing. These are not subject to a main benefit test. These hallmarks include:

(a) arrangements involving the use of unilateral safe harbour rules;

(b) arrangements involving the transfer of hard to value intangibles; and

(c) arrangements involving an intra-group cross-border transfer of functions and/or risks and/or assets if the projected 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.