CLIFFORD CHANCE

# DAC 6 – A PRACTICAL APPROACH TO THE NEW EU TAX REPORTING REGIME

EU rules - commonly known as **"DAC 6"** - under the Directive on Administrative Cooperation require intermediaries and in some cases taxpayers to report a wide range of transactions to tax authorities from July 2020 – including transactions entered into from 25 June 2018.

In many jurisdictions, although legislation is in now place, crucial guidance from the local tax authority as to how to apply and operate the rules has not yet been published. However, taxpayers and intermediaries are nonetheless required to identify historic reportable cross-border arrangements, as well as put in place systems to enable identification and reporting of relevant transactions going forwards. This briefing summarises the obligations and challenges of DAC 6 and outlines some practical approaches to managing compliance.

## What are the new reporting rules?

The Directive on Administrative Cooperation was amended in 2018 to require taxpayers and intermediaries to report details of "reportable cross-border arrangements" to their home tax authority, which will then automatically exchange the information with tax authorities in other Member States.

These rules are intended to give tax authorities greater visibility on aggressive tax planning. However, the scope of DAC 6 is intentionally much wider than that and includes a range of transactions which in many cases will have no particular tax objective.

## When do the reporting rules come into effect?

The amending directive came into force on 25 June 2018. It required Member States to bring the rules into their national law by the end of 2019 and to apply those rules from 1 July 2020. Poland got ahead of the game and enacted its rules with effect from 1 January 2019.

However, in practical terms DAC 6 has applied since 25 June 2018 as the rules require taxpayers and intermediaries to report in respect of all relevant arrangements starting after the date the Directive came into force. The first reports were due to be made by 31 July 2020 (in respect of reportable transactions entered into from 1 July 2020) and 31 August 2020 (in respect of reportable transactions entered into since 25 June 2018). However, as a result of the impact of COVID-19, many jurisdictions are now implementing up to a six month delay in these reporting dates. Importantly, Germany is one of the jurisdictions that has elected not to defer the reporting dates.

## What arrangements must be reported?

The rules apply to "reportable cross-border arrangements".

An arrangement will be "cross-border" if it "concerns" a Member State and either another Member State or a third country. Arrangements where all the parties are in one Member State, and there is no tax-related impact in any other jurisdiction, will not be "cross-border".

An arrangement will be "reportable" if it contains at least one of five "hallmarks". The hallmarks are broad and complex (see box below) but in summary they are:

**Category A hallmarks** apply where one of the main benefits of the arrangement is the avoidance of tax, and there are commercial features typically seen in tax avoidance schemes such as confidentiality conditions, fees geared to tax savings or standardised documents. We would expect that most jurisdictions would not consider generic confidentiality provisions and standard industry documents, such as ISDA/GMRA/GMSLAs, to fall within this hallmark, but some jurisdictions seem to be taking a very wide view of these hallmarks.

**Category B hallmarks** apply where one of the main benefits of the arrangement is the avoidance of tax, and there are technical features typically seen in tax avoidance schemes such as the sale of a loss-making company to reduce the tax liability of the purchaser, conversion of income into capital or circular transactions.

The **Category C hallmarks** do not all require a "main tax benefit". These Hallmarks cover arrangements where payments or transfers are made between associated enterprises and tax is not charged on the receipt, the payment is exempt from tax or benefits from a preferential tax regime, or the recipient is in a blacklisted country (which of course, following the announcement of the ECOFIN committee of the European Union on 18 February 2020, now includes the Cayman Islands).

**Category D hallmarks** are intended to relate to attempts to undermine the EU's common reporting standards (CRS) and other tax reporting regimes. They are defined by reference to the **effect** of the arrangements, not their purpose. Hence, they may catch many entirely commercial arrangements and the absence of a tax motive is not relevant.

The **Category E hallmarks** loosely relate to transfer pricing and apply to arrangements which involve the use of unilateral safe harbour rules from transfer pricing, certain arrangements involving hard-to-value intangibles and arrangements involving an intra-group cross-border transfer of functions, risks or assets, if the transfer results in a 50% reduction in the projected annual earnings of the transferor. Whether or not the main benefits of an arrangement include tax avoidance is not relevant.

A couple of jurisdictions (i.e. Poland and Portugal) have expanded on the above hallmarks in their local legislation, but most have not.

## What kind of transactions will be reportable in practice?

Many of the hallmarks will only apply to tax avoidance schemes. Few businesses have any desire to enter into such arrangements in the modern world – those that do should not be surprised to have a reporting obligation.

However, the scope of the categories of hallmarks means that a great many entirely commercial transactions will be potentially reportable, even though they would not generally be regarded as involving tax avoidance.

It remains unclear how all tax authorities will interpret the new rules, but the following lists examples of straightforward arrangements that may be reportable:

- As part of a securitisation, an EU bank transfers financial assets to a Cayman Islands subsidiary special purpose vehicle (SPV). The arrangements may contain a category C hallmark and thus be reportable. Alternatively, an SPV may sell all of its assets to a newly-established affiliate, which issues bonds to the market. This exhibits a category E hallmark and the absence of a main tax benefit is irrelevant.
- A Spanish branch of a German bank buys a computer and the bank claims depreciation in both its Spanish and German tax returns. DAC 6 does not provide an exemption where the depreciation is taken against the same profits so this could fall within the category C hallmarks.
- An individual in France transfers cash to his or her family in a country which does not automatically exchange financial account information with France (e.g. Egypt). The arrangement would contain a category D hallmark.
- As part of an intra-group reorganisation, a company in one jurisdiction sells most of its income-generating assets to an affiliate in another jurisdiction. This exhibits a category E hallmark. The absence of a tax benefit is irrelevant.
- A Dutch company makes a payment to a UK affiliate, who relies on the UK SME exemption from transfer pricing rules. This transaction may involve the use of a unilateral safe harbour (a category E hallmark) and it is irrelevant whether or not there is a tax benefit.

There is significant scope for tax authorities to take different approaches to applying the hallmarks, such that multi-national companies are left with different reporting obligations in different jurisdictions.

## Who has the obligation to report?

The Amendment places the reporting obligation, in the first instance, on intermediaries.

An "intermediary" is defined broadly, as any person (natural or legal) that designs, markets, organises or makes available for implementation or manages the implementation of a reportable cross-border arrangement. In the UK, this sort of intermediary is called a "promoter".

That definition is then widened further to include any person that knows, or could reasonably be expected to know, that they have provided aid, assistance or advice with respect to designing, marketing, organising, making available for implementation or managing the implementation of a reportable cross-border arrangement. In the UK, this sort of intermediary is called a "service provider". Importantly, a service provider is not an intermediary (and has no reporting obligation) if it "did not know" or could not "reasonably be expected to know" that they were acting in respect of a reportable cross-border arrangement.

The potential intermediary must also be resident (or have a permanent establishment) in a Member State, be registered to a professional association related to legal, taxation or consultancy services in a Member State or be incorporated in, or governed by the law of, a Member State.

This is an intentionally broad definition, and one that potentially captures a wide range of people involved in any one transaction, including holding companies, corporate treasuries or other group companies if they are incorporated in the EU and if they organise or manage the implementation of a group's cross-border arrangements. Further, banks, corporate services providers, agents and trustees which are involved in transactions will also be within the scope of the definition.

The reporting obligation on intermediaries is subject to legal professional privilege – and where privilege applies, the intermediary has no reporting obligation. However, the intermediary must then notify any other intermediary or, if there is so such intermediary, the relevant taxpayer of their disclosure obligation. There will be local law differences in how legal professional privilege operates. We note in addition that Luxembourg is currently proposing to exclude lawyers, accountants and obligors from the obligation to report.

If there is no intermediary to the arrangement, or legal professional privilege applies, then the obligation to report will lie with the taxpayer. Of course, an additional layer of complexity is the fact that legal professional privilege operates in different ways across the different EU jurisdictions.

## When must reports be made?

Whether the taxpayer or intermediary is subject to the reporting obligation, the required information will have to be filed with the competent authority within 30 days. This time limit will be triggered the day after the earliest of: (i) the day the arrangement is made available for implementation; (ii) the day the arrangement is ready for implementation; or (iii) when the first step in the implementation of the arrangement has been made.

The interpretation of the "triggers" for the filing deadlines is therefore critical to complying with the rules. All indications are that HMRC will take a pragmatic approach – both to ensure that the timeframe for reporting is practically achievable and to limit unnecessary reporting. It is not clear that other jurisdictions will take a similar approach.

## What information must be reported?

Individual Member States will set the precise content required in reports by taxpayers and intermediary, but the reports will have to include:

- the identification of intermediaries and relevant taxpayers and, where appropriate, the persons who are associated enterprises to the relevant taxpayer;
- details of the applicable hallmarks;
- a summary of the content of the reportable cross-border arrangement, including a reference to the name by which they are commonly known, if any, and a description in abstract terms of the relevant business activities or arrangements;

- the value of the reportable cross-border arrangement; and
- the identification of the Member State of the relevant taxpayer(s) and any other Member States which are likely to be concerned by the reportable cross-border arrangement.

## What are the consequences of failing to report?

The new Directive will require Member States to implement "effective, proportionate and dissuasive" penalties for any infringement of the national legislation implementing the reporting rules. However, the local approaches have differed widely. For example, the maximum penalty that can imposed on an intermediary in France in any one year is EUR 100,000, but the maximum penalty in the UK is GBP 1,000,000 and in Poland it is EUR 5,000,000 and imprisonment.

The UK has introduced a "reasonable procedures" defence in its draft legislation, which should give UK intermediaries comfort that innocent errors should not result in significant penalties. However, wherever intermediaries are, they will need to put in place robust procedures to ensure matters they work on are analysed and reported to the correct tax authorities as necessary.

## Will the new rules apply to the UK after Brexit?

The short answer is "yes". The terms of the Withdrawal Agreement provides that the UK must continue to implement and apply EU legislation as if it were still a Member State until 31 December 2020. Although in its report on the how the powers in section 84 of the Finance Act 2019 will be used in different EU Exit scenarios, HM Treasury made clear that it would be open to the government to make changes after the UK leaves the EU, we note HMRC has made clear more generally that it is committed to tackling aggressive tax arrangements and offshore non-compliance. Therefore, we would think it unlikely that the UK would make any material amendments to DAC 6 in the immediate future.

## What should intermediaries and taxpayers be doing now?

- Intermediaries that could be involved in transactions that are reportable should already be establishing systems to identify those that contain any of the hallmarks. The basic information could be collected using a computer or human system, but ultimately a tax team will need to be responsible for making the final judgement on whether to report based on local rules.
- MNEs that effect "own account" intra-group transactions, such as transferring assets or shares, will need to consider the potential application of hallmark E3 each time.
- Corporates and financial institutions with standard confidentiality provisions may want to check that they do not inadvertently trip up the confidentiality hallmark at A1, for example if they unwittingly transact with a counterparty who has a significant tax benefit from a transaction.
- The recent addition of the Cayman Islands to the EU Blacklist means that any deductible payment made to a Cayman resident recipient is now currently within the scope of the rules. This change is likely to be felt most by funds established in Cayman and financing transactions

that make use of Cayman companies. Unfortunately, this will continue to create a reporting obligation unless and until Cayman is removed from the EU Blacklist.

- In the UK, some companies are taking inspiration from the Corporate Criminal Offence by ensuring that key personnel have been trained to spot hallmarks based on the information available to them so that they can avail of the "reasonable procedures" defence contained in the UK rules.
- In some jurisdictions we are seeing intermediaries request that parties closer to the transaction (which themselves will need to comply with DAC 6) confirm whether or not it is reportable. Of course, this gives practical comfort on the applicability of DAC 6. However, this could also assist with demonstrating that the intermediary "did not know" that the transaction was reportable, as well as being part of any "reasonable procedures" defence.

## Further information

If you would like further information on any aspect of this briefing, or to discuss how your business can plan for the implementation of DAC 6, please speak to your usual Clifford Chance contact, or any of those listed overleaf.

### What are the hallmarks that make an arrangement reportable?

The **Category A hallmarks** are intended to capture typical commercial features of tax avoidance schemes, and cover arrangements where:

- the participant in the arrangement undertakes to comply with a condition of confidentiality;
- the intermediary is entitled to receive a fee that is fixed by reference to either the existence of a tax advantage or the amount of the tax advantage resulting from the arrangement; or
- the documentation and/or structure is substantially standardised and is available to more than one relevant taxpayer without a need to be substantially customised for each taxpayer.

The hallmarks only apply if the "**main benefit test**" is satisfied. This will be the case if the main benefit, or one of the main benefits which a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage.

The **Category B hallmarks** are intended to capture typical technical objectives of tax avoidance schemes, and cover arrangements where:

- a loss-making company is acquired in order to reduce the tax liability of the purchaser;
- income is converted into capital or other categories of revenue which are subject to either lower tax or are tax-exempt; or
- circular transactions are entered into resulting in the round-tripping of funds.

The **Category C hallmarks** are features which are shared by many tax avoidance schemes and many entirely commercial transactions. They cover arrangements where:

- deductible cross-border payments are made between two or more associated enterprises, the main benefit test is satisfied, and either:
  - the recipient is resident in a jurisdiction that does not impose any corporate tax, or imposes corporate tax at the rate of zero (or almost zero);
  - the payment benefits from a full exemption from tax in the jurisdiction where the recipient is tax resident; or
  - the payment benefits from a preferential tax regime in the jurisdiction where the recipient is tax resident;
- deductible cross-border payments are made between two or more associated enterprises, and (whether or not the main benefit test is satisfied) either:
  - the recipient is not tax resident in any tax jurisdiction; or
  - the recipient is resident in a non-EU jurisdiction which has been assessed as non-cooperative (i.e. put on a "blacklist") by the EU or the OECD;
- the same depreciation is claimed in relation to the same asset in more than one jurisdiction;
- relief from double taxation in respect of the same item of income is claimed in different jurisdictions; or
- assets are transferred and there is a material difference in the amounts treated as payable as consideration for those assets in the jurisdictions involved.

The **Category D hallmarks** are intended to relate to attempts to undermine the EU's common reporting standards (CRS) and other tax reporting regimes. However, they are defined by reference to the **effect** of the arrangements, not their purpose. The arrangements covered are those that involve:

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

(b) that are incorporated, managed, resident, controlled or established in any 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

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

The **Category E hallmarks** loosely relate to transfer pricing, and apply (regardless of whether the main benefit test is satisfied) to:

- arrangements which involve the use of unilateral safe harbour rules from transfer pricing (for example exemptions from transfer pricing for SMEs);
- certain arrangements involving hard-to-value intangibles; or
- arrangements involving an intra-group cross-border transfer of functions and/or risks and/or assets, if (broadly speaking) the transfer results in a 50% or greater reduction in the projected annual earnings of the transferor during the 3 year period after the transfer.

CLIFFORD CHANCE

# KEY CONTACTS WORLDWIDE

**Dan Neidle**
Partner

T +44 20 7006 8811
E dan.neidle
@cliffordchance.com

**Jemma Dick**
Senior Associate

T +44 20 7006 8383
E jemma.dick
@cliffordchance.com

**Jitka Susankova**
Counsel

T +33 1 4405 5435
E jitka.susankova
@cliffordchance.com

**Kristina Bexa**
Counsel

T +49 2114355 5676
E kristina.bexa
@cliffordchance.com

**Lucio Bonavitacola**
Partner

T +39 02 8063 4238
E lucio.bonavitacola
@cliffordchance.com

**Eric Davoudet**
Partner

T +33 1 4405 5272
E eric.davoudet
@cliffordchance.com

**Carlo Galli**
Partner

T +39 02 8063 4525
E carlo.galli
@cliffordchance.com

**Steve Jacoby**
Partner

T + 352 48 50 50 219
E steve.jacoby
@cliffordchance.com

**Stefan Menner**
Partner

T +49 69 7199 1273
E stefan.menner
@cliffordchance.com

**Alexandre Ooms**
Partner

T +32 2 533 5073
E alexandre.ooms
@cliffordchance.com

**Pablo Serrano**
Partner

T +34 91 590 9470
E pablo.serrano
@cliffordchance.com

**Michiel Sunderman**
Partner

T +31 20 711 9658
E michiel.sunderman
@cliffordchance.com

**David Harkness**
Partner

T +44 20 7006 8949
E david.harkness
@cliffordchance.com



66656-5-964-v0.21