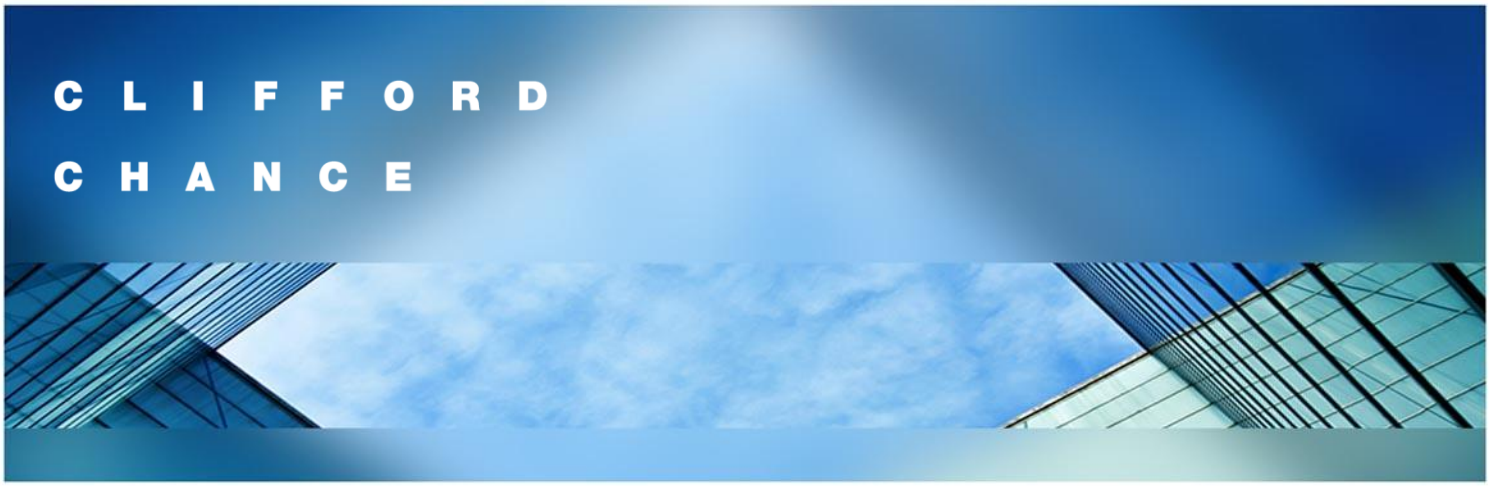

THE IMPACT OF DAC6 ON SECURITISATION STRUCTURES

The amendments to the EU Directive on Administrative Cooperation made in May 2018 were announced as a tool to give tax authorities greater visibility on aggressive tax planning. However, the drafting of the Directive and its implementation in the UK and throughout the EU is such that even standard transactions without any particular tax objective may be caught, giving rise to potentially wider reporting obligations than market participants had initially expected. In this briefing, we review the requirements of DAC6, identify the features (or "hallmarks") that are most relevant for securitisation structures, and discuss what steps market participants can take to ensure compliance.

Key issues

- DAC6 imposes reporting obligations in respect of a wide range of cross-border transactions, including many that have no particular tax objective
- Reporting obligations generally fall on "intermediaries" rather than taxpayers
- Differences in implementation of the Directive create additional complications and more than one report might sometimes need to be filed
- Most securitisation structures will not be reportable but market participants will need processes in place to check this, and to coordinate reporting on transactions

What is DAC6?

The EU Directive on Administrative Cooperation was amended in May 2018 ("**DAC6**") to require intermediaries, and in some cases relevant taxpayers, to report details of certain cross-border arrangements to their home tax authority, which will then automatically exchange the information with tax authorities in other Member States.

DAC6 is intended to give tax authorities greater visibility on aggressive tax planning. However, the scope of DAC6 is much wider and includes a range of transactions that in many cases will have no particular tax objective. The penalties for failing to comply vary from jurisdiction to jurisdiction, but in the UK the penalty can be up to £1 million.

DAC6 requires intermediaries, or where there are no intermediaries, relevant taxpayers, to report "cross-border arrangements" that exhibit certain "hallmarks". An arrangement will be "cross-border" if it concerns multiple countries, at least one of which is an EU Member State. Therefore, any transaction that is conducted entirely outside the EU will not be reportable, but any transaction that concerns a person or asset in the EU may be. The "hallmarks" are intended to describe tax avoidance structures and are set out in five categories (A to E) of an Annex to DAC6. While some hallmarks require a "main tax benefit" test to be met in order to be satisfied, others do not and many are drafted sufficiently broadly such that normal commercial transactions will be caught.

One of the main problems with DAC6 is that it essentially has retrospective effect, in that a reportable cross-border arrangement needs to be reported if it was (broadly) entered into after 25 June 2018. A reportable-cross border arrangement entered into between 25 June 2018 and 1 July 2020 originally needed to be reported by 31 August 2020 (although most EU Member States have elected to defer this for six months). A reportable cross-border arrangement entered into from 1 July 2020 needs to be reported within 30 days (although most EU Member States have elected to defer the deadline for the first such reports until 31 January 2021) [1]

Only "intermediaries" and, if there is no intermediary, "relevant taxpayers" (in each case, generally only if they are resident or acting from a permanent establishment in an EU Member State) are required to report. An "intermediary" is defined broadly as any person who 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". The defined term "intermediary" also includes any person who 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". A "relevant taxpayer" only has to report if there is no intermediary, and is defined as or any person to whom a reportable cross-border arrangement is made available for implementation, or who is ready to implement or has implemented the first step of a reportable cross-border arrangement.

And if all of the above seems too straightforward, it should be noted that DAC6 will be implemented and interpreted differently in each EU Member State. Therefore, a transaction that is not reportable in one Member State may be reportable in another. Further, the UK has already implemented DAC6 into UK law and has indicated that it does not intend to reverse this following the end of the Brexit transition period on 31 December 2020.

How could DAC6 impact securitisation structures?

In the majority of cases, securitisation structures will not meet any of the hallmarks – not least because it would be unusual for the "main tax benefit" test to be met[2] or for any investors to be considered to be "associated" with the SPV.

That said, we have seen some cases of securitisation structures meeting one or more of the hallmarks. For example, a European special purpose vehicle ("**SPV**") holding financial assets as part of a securitisation may make cross-border payments, say a fee or an interest payment, that is deductible in the EU jurisdiction and is not taxable in the hands of the recipient, which is in a low-tax or no-tax jurisdiction (e.g. Jersey or the Cayman Islands). If the payer and payee are associated enterprises – which may be the case if the payment is intra-group or in respect of a profit-participating note – then this may constitute a Category C hallmark, which does not always require the "main tax

1 Most notably, Germany, Austria and Finland have elected not to defer the first reporting dates.

2 We note in this regard that HMRC has indicated in its guidance that a tax advantage that is consistent with the policy objectives of the legislation will not typically meet the "main tax benefit" test.

benefit" test to be met in order for the transaction to be reportable. By way of another example, an SPV may sell all of its assets to a newly-established affiliate SPV, which issues bonds to the market. If the EBIT of the transferee SPV is likely to decrease by 50% or more over the next three years as a result of the transfer, then this will constitute a Category E hallmark. Again, this would not require the "main tax benefit" test to be met. Additionally, it is possible that the financial assets held by the SPV are themselves part of a reportable cross-border arrangement – for example, a loan in a single-asset CMBS may be advanced to obligors that are party to transactions that meet one or more of the hallmarks.

As mentioned above, the primary reporting obligation lies with intermediaries, rather than relevant taxpayers. The definition of "intermediary" under DAC6 is broad and could catch a large number of participants in a typical securitisation structure – including the issuer, account bank providers, trustees, arrangers and paying agents, as well as the lawyers[3] and other service providers that implement the transaction. The requirement to report is obvious in the case of a "promoter" – for example, the arranger of the securitisation. However, the position is less clear in the case of a "service provider" as a person will only be an intermediary if it knows or could reasonably be expected to know that it is assisting in the implementation of a reportable cross-border arrangement. This could include more peripheral parties, such as agents, trustees and account banks. There is clearly scope under DAC6 for multiple reports to be required for the same transaction. However, one important feature of DAC6 is that an intermediary does not have to report if it has evidence that another intermediary has reported the same information to a tax authority.

What steps should be taken by participants in securitisation structures?

In our view, any person who may be an intermediary in respect of historic transactions (i.e. entered from 25 June 2018) needs to take a risk-based approach to assessing which types of transaction may be reportable. We have drafted a separate briefing on how this could be achieved.

A market position has not yet emerged in respect of how to manage the identification and reporting of hallmarked transactions going forwards. However, in our view, there are some practical steps that parties should already be taking.

First, it will be important for participants to consider whether or not they are intermediaries when acting in a particular role in any EU Member State. Second, when entering into a transaction, the party seeking any tax advantage or else the party closest to the structuring of the deal (the "primary party"), should obtain advice on whether DAC6 is applicable. The rest of the transaction parties (i.e. potential intermediaries) should have reliance on such advice. Alternatively, if the transaction is straightforward, another approach would be for the primary party to confirm that the transaction is not reportable.

Third, if a transaction is reportable, the ideal solution would be for the primary party or its adviser to undertake to report in order to manage the financial and administrative burden of the inevitable multiple reporting obligations. The idea

[3] An intermediary is not required to report if it benefits from legal professional privilege as a matter of local law.

is that the report of the primary party or its adviser would "frank" the reporting requirement of the other intermediaries and thereby relieve them of the obligation to make their own reports. It might make sense for each relevant intermediary to have the opportunity to comment on the scope or content of the report in order to ensure that it contains all the information necessary for it to "frank" its own reporting requirements according to any local law implementation of DAC6. Each intermediary would then need to make sure it can obtain the evidence it requires to support non-reporting. This may require copies of the report itself to be shared amongst the parties.

It is for the parties to agree the extent to which reporting and information sharing arrangements should be included in the documents as contractual rights and obligations, but it would seem prudent to do this. Not just to ensure that filings are correctly made, but also because it may help to support the application of any "reasonable process" defence should there be any errors in the reporting.

If a transaction is reportable, it may not be possible for an intermediary to rely completely on "franking". For example, a transaction may not be reportable in the jurisdiction of the primary party but may be reportable in the jurisdiction of another intermediary. There may also be some potential issues post-Brexit – for example, a report made in the UK may not "frank" the reporting requirement of an intermediary that would otherwise need to report in an EU Member State. The position will need to be monitored as the transition period comes to an end and as the differences in the interpretation and implementation of DAC6 across EU Member States become more apparent.

Conclusion

Ultimately, each intermediary is responsible for its own compliance with DAC6. However, given the number and variety of transactions with which many potential intermediaries are involved, the market will need to arrive at practical solutions to facilitate compliance in respect of the deals that potentially meet any of the hallmarks – in particular, to ease the financial and administrative burden of multiple intermediaries making their own assessments on the applicability of DAC6 and filing separate reports. This may include the steps described above, or alternative workable approaches. This may not be fully possible until the differences between local law implementations and interpretations of DAC6 are fully appreciated. Until then, each party to an securitisation transactions will need to take pragmatic steps to manage its own position under DAC6.

CLIFFORD
CHANCE

AUTHORS

Chris Davies
Global Practice Area Leader for TPE

T +44 207006 8942
E chris.davies
@cliffordchance.com

Jemma Dick
Senior Associate

T +44 207006 8383
E jemma.dick
@cliffordchance.com

CONTACTS

Andrew Bryan
Knowledge Director

T + 44 207006 2829
E andrew.bryan
@cliffordchance.com

Kevin Ingram
Partner

T +44 207006 2416
E kevin.ingram
@cliffordchance.com

Emma Matebalavu
Head of London Finance

T + 44 207006 4828
E emma.matebalavu
@cliffordchance.com

Simeon Radcliff
Partner

T + 44 207006 2786
E simeon.radcliff
@cliffordchance.com

Christopher Walsh
Partner

T + 44 207006 2811
E christopher.walsh
@cliffordchance.com

Maggie Zhao
Partner

T +44 207006 2939
E maggie.zhao
@cliffordchance.com