European Council–DAC 6: Disclosure requirements relating to cross-border arrangements effective July 1

June 17, 2020

In brief

The European Council adopted — through Council Directive (EU) 2018/822, dated 25 May 2018 (DAC 6) — new reporting obligations in order to promote the automatic exchange of information in relation to reportable cross-border arrangements. DAC 6 is the sixth amendment to the original Directive on Administrative Cooperation (DAC) adopted in 2011. DAC 6 obligates intermediaries to report cross-border agreements that may be indicative of "potentially aggressive tax planning" to their respective national authorities. The scope of DAC 6 is wide, leaving it up to the European Union (EU) member nations to define what needs to be reported within the 'hallmarks' laid out in DAC 6.

The rule goes into effect July 1, 2020, with the first reports due August 31, 2020, requiring reportable transactions dating back to June 25, 2018 to be disclosed. As discussed below, The European Commission published a proposal that would defer reporting deadlines for certain arrangements.

In detail

What does DAC 6 mean for multinational corporations?

DAC 6 imposes mandatory reporting of cross-border arrangements affecting at least one Member State that falls within one of a number of 'hallmarks,' or categories setting out particular characteristics identified as potentially indicative of aggressive tax planning. The information reported will be contributed to a central directory accessible by the authorities of the Member States.

The 'intermediaries' are responsible for reporting the arrangement to the applicable source. DAC 6 defines an intermediary as "any person that designs, markets, organises or makes available for implementation or manages the implementation" of a cross-border arrangement. The broad scope of the definition means that a large number of corporations, or individuals, through their professional capacity, could be charged with reporting the arrangement to the applicable authority at every level of the arrangement. An intermediary may be exempt if it can show that another intermediary has reported the arrangement. The report must be made by the taxpayer where there is no intermediary, or the intermediary is subject to legal professional privilege.

What is the timeline for compliance?

The first reports are due on August 31, 2020 and will cover reportable cross-border arrangements dating back to June 25, 2018. After August 31, 2020, each Member State must take necessary measures to require the intermediaries to file information within their knowledge, possession, or control on reportable cross-border arrangements with the competent authorities within 30 days beginning at the earliest of (1) the day after the reportable arrangement is made available for implementation, (2) the day after the arrangement is ready for implementation, or (3) when the first step in the implementation of the reportable arrangement has been made. ***Note:*** In light of the COVD-19 pandemic, the reporting deadlines for certain arrangements may be deferred to a later date in 2020 or early 2021 (Proposal amending Directive 2011/2016 EU to address the urgent need for deferring certain time limits for the filing and exchange of information in the field of taxation due to the pandemic, COM (2020) 197 final (May 8, 2020)).

What transactions are reportable?

The Directive states that any 'cross-border arrangement' will be reportable and subject to the requirements of this Directive. Such arrangements are reportable if they fall within one of the hallmarks set out in Annex IV. ***Observation:*** The hallmarks are widely defined and leave room for debate whether 'ordinary' transactions will be reportable in addition to anything that indicates "potentially aggressive tax planning."

DAC 6 clarifies that an 'arrangement' is an all-encompassing term for any course of action, even if the action in question is not contractually binding. An arrangement can include a series of courses of action and may be comprised of more than one step or part.

An arrangement is 'cross-border' when it concerns more than one Member State or a Member State and a third country where:

- one or more participants in the arrangement carries on a business in another jurisdiction through a permanent establishment located in that other jurisdiction, and the arrangement forms part or all of the business of that permanent establishment, or
- one or more of the participants in the arrangement performs an activity in another jurisdiction without being resident for tax purposes or creating a permanent establishment in that jurisdiction, or
- the arrangement potentially impacts the automatic exchange of information or the identification of beneficial ownership

DAC 6 identifies the following information to be reported with every disclosure concerning a reportable transaction:

- identification information of taxpayers and intermediaries involved, including tax residence, name, date, and place of birth, and Tax Identification Number
- details of the relevant applicable hallmarks, i.e., what makes them reportable
- a summary of the arrangement
- the date on which the first step in implementation was or will be made
- details of the relevant local law
- the fiscal value of the reported cross-border arrangement
- identification of relevant taxpayers or any other person in any Member State likely to be affected by the arrangements.

How are the DAC 6 Hallmarks defined?

The DAC 6 Hallmarks are broad categories setting out characteristics identified as potentially indicative of aggressive tax planning. More specifically, if a transaction or an arrangement contains at least one of the five hallmarks, then it must be reported to the appropriate regulatory authority.

Several cross-border arrangements are only reportable if they meet a threshold 'main benefit' test, which is where one of the main benefits expected from an arrangement is a tax advantage. The exact definition of what constitutes a 'main

benefit' is not laid out in DAC 6 and will largely be up to the Member States to implement and adhere to a guideline.
Observation: The tax benefit test may be difficult to apply.

The hallmarks of DAC 6, described in Annex IV, are categorized as follows:

A. Generic hallmarks linked to the main benefit test

B. Specific hallmarks linked to the main benefit test

C. Specific hallmarks related to cross-border transactions

D. Specific hallmarks concerning automatic exchange of information and beneficial ownership

E. Specific hallmarks concerning transfer pricing.

For a transaction to meet the disclosure requirements, it must meet at least one of the hallmarks, further discussed below:

Category A: Generic hallmarks linked to the main benefit test

Category A focuses on generic characteristics that can be found in tax avoidance schemes and planning. Based on the detail provided in DAC 6, there are three arrangements that could fall into category A:

1. An arrangement where the taxpayer, or participant in the arrangement, enters into a confidentiality agreement regarding not disclosing how the arrangement could create a tax advantage

2. An arrangement where the intermediary is entitled to receive a fee for the arrangement, and that fee is (a) fixed relative to the amount of tax advantage of the arrangement, or (b) whether the tax advantage is actually derived from the arrangement

3. An arrangement that has substantially standardized documentation or standardized structure and does not require substantial customization for implementation

Category B: Specific hallmarks linked to the main benefit test

Category B focuses on arrangements with characteristics that could lend themselves to tax avoidance. The arrangements that fit this category fall under the main benefit test. Based on the detail provide in DAC 6, there are three arrangements that could fall into category B:

1. An arrangement where a participant takes contrived steps in acquiring a loss-making company in order to reduce an entity's tax liability

2. An arrangement that converts income into capital

3. Circular transactions resulting in the round tripping of funds — namely, through involving interposed entities without other primary commercial functions.

Category C: Specific hallmarks related to cross-border transactions

Category C focuses on cross-border transfers and payments that may or may not be considered aggressive tax planning. Arrangements under this category do not fit the requirements of the main benefit test. Based on the detail provided in DAC 6, there are four arrangements that could fall into category C:

1. Deductible cross-border payments between two or more associated enterprises where at least one of the following apply:

   (a) The recipient is not a resident for tax purposes in any jurisdiction, or

   (b) The recipient is a resident in a jurisdiction that either:

      i. has a corporate tax rate of 0% or does not impose corporate tax

      ii. is included in a country deemed non-cooperative by either the Member States collectively or within the framework of the OECD

iii. the transfer or payment is deemed exempt for tax

iv. the transfer or payment benefits from a preferential tax regime.

2. Deductions for the same depreciation on the asset are claimed in multiple jurisdictions

3. There is double tax relief in regards to the same item of income or capital

4. An asset transfer where the value of the payable materially differs between the jurisdictions

Category D: Specific Hallmarks concerning automatic exchange of information and beneficial ownership

Category D focuses on arrangements that hinder transparency and reporting. The arrangements that fall into this section also fall outside of the scope of the main benefit test. Based on the detail provided in DAC 6, there are two arrangements that could fall into category D:

1. An arrangement that may have the effect of undermining and circumventing the reporting obligations set out in DAC 6 or taking advantage of legislation that limits reporting and transparency. This can include one or more of the following:

   (a) use of an account, product, or investment that is not a 'financial account' but functionally behaves like a 'financial account'

   (b) the transfer of an account, product, etc. to a jurisdiction that is not bound by the automatic exchange of financial account Information with the relevant jurisdiction

   (c) the reclassification of income or capital into a class that is not bound by any rule mandating the automatic exchange of Financial Account Information

   (d) the conversion from a reportable to a non-reportable institution or account

   (e) an arrangement that makes use of legal entities, arrangements, or structures that limit reporting obligations

   (f) any arrangement that undermines or exploits due diligence procedures or weak regimes of anti-money laundering enforcement.

2. An arrangement that involves non-transparent legal or beneficial ownership chain, with the use of persons, legal arrangements, or structures:

   (a) that do not involve the furtherance of substantive economic activity, and

   (b) are incorporated, controlled, or established in a jurisdiction other than the jurisdiction where one of the beneficial owners reside, and

   (c) where the beneficial owners, (as defined in Directive (EU) 2015/849) are unidentifiable.

Category E: Specific hallmarks concerning transfer pricing

Category E focuses on arrangements that are not at arm's length or contain uncertain pricing or base eroding transfers. Based on the detail provided in DAC 6, there are three arrangements that could fall into category E:

1. An arrangement that involves and incorporates unilateral safe harbour rules;

2. An arrangement involving the transfer of intangibles that do not have a reliable comparable and that the projections of future cash flow is expected to come directly from that intangible, or the ultimate value of the intangible is uncertain at the time of the transfer; and

3. An arrangement involving an intragroup cross-border transfer of functions, risks, and/or assets, if the projected annual earnings before interest cause a more than 50% decrease in earnings before interest and taxes during the next three years.

What penalties could apply?

DAC 6 states that in order to improve prospects for its effectiveness, Member States should provide penalties for the violation of national rules that will be codified in their domestic legislation. The only guidance DAC 6 provides is that the

penalties should be “effective, proportionate and dissuasive.” The Member States, in turn, have implemented provisions providing significant sanctions for failure to comply with DAC 6 regulations. Penalties are specified for omissions, underreporting, falsities in reporting, and for late reporting.

Most Member States have not codified penalty exceptions; however, some have built in exceptions and mitigations based on findings of no wilful misconduct, absence of negligence, or ‘reasonable excuse’ (2020 No. 25, The International Tax Enforcement (Disclosable Arrangements) Regulations 2020 (UK) Part 3 ¶14). ***Observation:*** Most Member States do not waive penalties in cases where the intermediary took all reasonable steps to comply with the DAC 6 reporting requirements, but the information may not be accessible or attainable. This holds true even for arrangements made prior to DAC 6 implementation where information might not have been stored with reporting requirements in mind.

What does the local legislation look like?

As of early 2020, all 27 EU Member States (except for Greece) at a minimum have drafted their own transpositions of DAC 6 for implementation into domestic law. Member States are free to define, add, subtract, and clarify the provisions of DAC 6 as they see fit. ***Observation:*** Some Member States have implemented DAC 6 by using the language as a skeleton and expanding upon the reporting requirements. Therefore, it is important to review specific country requirements based on an entity's footprint.

Poland, for example, adopted and published legislation transposing the spirit of DAC 6 into their domestic law on October 23, 2018. The Polish legislation differs significantly from the EU’s broad legislation. For example, in addition to the five hallmarks laid out in DAC 6, the Polish legislation includes a more exhaustive list of what may be reportable. The Polish legislation extends the obligation of reporting not only to cross-border arrangements, but also to domestic tax arrangements if the taxpayer is a qualified beneficiary within the meaning of the law. The legislation includes four other specific hallmarks that do not require the main benefit test. In their most basic interpretation, the four other specific hallmarks do not require any loan, qualified impact on a deferred tax asset, income, certain foreign payments, or renumeration for intangibles exceeding a qualified threshold to be subject to the DAC 6 mandatory disclosure requirements. Poland’s transposition of DAC 6 imposes deadlines significantly earlier than the EU Directive. Under the Polish legislation, cross-border schemes implemented after June 1, 2018 and through January 1, 2019 were reportable before June 30, 2019 by intermediaries and before September 30, 2019 by taxpayers.

Another example of DAC 6 adoption is Belgium. On December 12, 2019, the Belgian Parliament adopted legislation implementing DAC 6. The Belgian directive is fully aligned with DAC 6 in terms of all taxes covered and the reporting deadlines; however, the Belgian legislation was published with an explanatory memo which provides guidance on the introduction and practice of defining aspects of DAC 6. For example, under the main benefit test for purposes of determining whether a tax advantage has been obtained, the legislation states that the analysis should consider whether one or more of the following elements exist: (1) if an amount is included in the taxable base; (2) does the taxpayer benefit from a deduction; (3) what losses are incurred for tax purposes; and (4) is there withholding tax is due.

Germany is a third example of a country that has adopted its version of DAC 6. The Bundestag adopted a transposition of DAC 6 on December 20, 2019, and the covered scope, reporting deadlines and taxes appear to align with DAC 6. Under the German transposition of DAC 6, a tax advantage would be considered to be reached if, through the arrangement, taxes are to be refunded, tax rebates granted or increased, tax claims waived or reduced, or the tax claim is prevented or shifted to other periods or tax dates. The law also points out that the relevant tax advantage is not limited to domestic German tax advantages in order to be reportable. One of the major differences in the German hallmarks is found in Hallmark C1, defining the corporate tax rate as one that is “less than or equal to 4%” and not 0% as it is in DAC 6.

Poland, Belgium, and Germany are not the only Member States that have altered or further defined the provisions of DAC 6. For example, Denmark requires transactions from October 29, 2014 to be reported, and Ireland expanded the scope of what qualifies as a reportable arrangement to include any implied promise or undertaking and non-legally enforceable arrangements. Another category where countries have adopted differing rules is creating exceptions to the definition of an intermediary. For example, the Netherlands provides that when an individual is acting on behalf of an advisory firm, the advisory firm qualifies as the intermediary, whereas, Hungary and France have special rules regarding tax lawyers acting as the reporting intermediaries in specific situations.

Unlike the examples listed above, not all Member States have significantly changed or further defined the provisions of DAC 6. For example, Cyprus, Croatia, Austria, Finland, Luxembourg, and Portugal have adopted legislation containing little to no deviation from DAC 6.

Despite Brexit, the United Kingdom implemented DAC 6 legislation that will come into effect on July 1, 2020 (2020 No. 25, The International Tax Enforcement (Disclosable Arrangements) Regulations 2020 (UK)). Broadly, the draft legislation is in line with the requirements of DAC 6 and refers directly to the Directive on a number of aspects. Specifically, the legislation is aligned on who should report, and the definitions of intermediary, tax advantage, cross-border arrangement, relevant taxpayer, etc. The UK has had a disclosure regime for tax avoidance schemes since 2004, and the country will use that regime as guidance when implementing and interpreting the hallmarks.

Observation: The above outlines some Member State adoptions and implementations of DAC 6, but does not include all countries nor does it include all the disclosure requirements, definitions, or clarifications. It is important to review each Member State's requirements and the applicability to an entity.

COVID-19

As COVID-19 continues to disrupt global economies, countries are beginning to alter their DAC 6 reporting deadlines in order to assist intermediaries and reduce the backlog of reportable arrangements for taxing authorities. In response to the COVID-19 pandemic, the European Commission published a proposal that would defer reporting deadlines for certain arrangements (Proposal amending Directive 2011/2016 EU to address the urgent need for deferring certain time limits for the filing and exchange of information in the field of taxation due to the COVID-19 pandemic, COM (2020) 197 final (May 8, 2020)).

The proposal would defer the time limit for exchanges of information on Reportable Financial Accounts by three months, or until December 31, 2020. The proposal also would change the date for reporting 'historical' cross-border arrangements (i.e., any arrangements implemented between June 25, 2018 and June 30, 2020) to November 30, 2020, instead of August 31, 2020. Along the same lines, the proposal extends the end date for what is considered a 'historical' cross-border arrangement from June 30, 2020 to October 1, 2020. The date for which exchange of information about reportable cross-border arrangements between Member States would be deferred from October 31, 2020 to January 31, 2021. Member States must approve the above changes and update their DAC 6 legislation accordingly.

Prior to this, certain Member States had begun to adjust reporting based on the pandemic. Poland, for example, had suspended the reporting obligation of tax arrangements under the country's DAC 6 law. On April 2, the Polish government published a statement suspending the deadlines for submitting information under DAC 6 until June 30, 2020; the law previously had required all domestic and cross-border transactions to be reported 30 days from the date that one of the trigger events described in the law occurs. ***Observation:*** As Poland was among the first of the Member States to begin collecting disclosures, most countries' DAC 6 reporting start dates have not lapsed. It remains to be seen whether other countries will delay reporting dates, or whether other substantial changes to Member State legislation will occur in light of the pandemic.

The takeaway

Complying with DAC 6 will involve complications in identifying information across multiple levels of company personnel and making arrangement-specific decisions within short reporting timeframes. There are inherent risks of either underreporting or overreporting. Intermediaries should be prepared to utilize a well-defined system that assists in identifying relevant arrangements and assists in the data collection to filing with automation built into the process.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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