DAC6 - Knowns and unknowns about the nearing transposition of the "over transparency of intermediaries" Directive

Abstract: Getting through to a taxpayer via its tax advisor is no new policy. It first started 20 years ago in the US and moved on to the UK placing intermediaries under an obligation to report the so-called tax avoidance schemes. The EU is now joining the club with an unpredictable experiment enforcing common minimal standards in reporting "potentially aggressive tax arrangements". An experiment which is unpredictable primarily for multinational groups of enterprises to be faced with interpretations of 27 (28) jurisdictions which are still different from each other in terms of direct taxes. In preparing the unavoidable moment of DAC6 becoming enforceable in other jurisdictions as well, this paper sets out to bring together some of the myriads of questions and ambiguities, and some of the few certainties related to the new obligations, based on materials issued so far by the European Commission and other Member States.

Keywords: DAC6, hallmarks, cross border arrangements, tax intermediaries, directive, transfer pricing

by Adrian **LUCA**, Founding Partner at Transfer Pricing Services (TPS)

Requiring intermediaries to **file reportable cross-border arrangements. Six key words** are enough to give us the sense of DAC6 – the Council Directive (EU) 2018/822, which is the fifth amended version of Directive 2011/16/EU on administrative cooperation in the field of taxation.

However, it is clear for those encountering such latest Directive that it takes so many more words to latch on to it and catch its drift. Let alone the waste of words it would take to understand how to enforce it.

For us as rapporteurs, things will become increasingly complicated given that we are less than six months away from its mandatory transposition into national law and one year away from the first (also mandatory) reporting. And for what's in store for us we have a single word – MISTERY!

Amid such suspense, let us use the fewest possible words and embark on unscrambling the DAC6 straight from the declaration (see template in the text) which will somehow be filled in by us, tax advisors acting as intermediaries or, as required, by our relevant customers.

Section A: Identification of parties

Intermediary: Any entity in a Member State that implements and designs a reportable cross-border arrangement, which may, but is not required to, be affiliated to a professional (legal, fiscal, advisory) association. Where a legal professional privilege is applicable, such obligation is passed on to **the relevant taxpayer** (i.e. beneficiary of that arrangement). The relevant taxpayer is also under a reporting obligation whether or not they designed that arrangement *in house* or their respective intermediaries are not registered in the EU.

Associated enterprise: the standard definition is roughly followed, subject to the 25% participating interest threshold (capital/voting rights).

Section B - Hallmarks are deemed as indications of a potential tax avoidance risk. There are 18 such hallmarks, all of which are dealt with in Annex IV of the Directive (see attached table).

Some of these are well-known, identifiable as the *usual suspects* in fighting tax avoidance: intra-group transfers of hard-to-value intangibles, acquisitions of loss-making companies, hybrid arrangements leading to non-taxation. However, hallmarks also include those circumstances when various arrangements are implemented (e.g. non-transparent legal or beneficial ownership chains, confidentiality clauses).

However, there are hallmarks such as those classifiable as generic and some of the specific ones, which are disregarded if they fail to pass the "**main benefit test**". What does this mean? "That test will be satisfied if it can be established that the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage."

Section C – Summary of the content of the reportable **arrangement** The Directive's scope includes arrangements dealing with direct taxes that are entered into by two or more EU Member States or between a Member State and a non-EU state. The arrangements within the scope of reporting are just those which include at least one of the 18 hallmarks.

It is time we increase suspense and remind you that Brussels has given Member States leeway to increase their reporting scope as they deem fit, while being therefore able to also include arrangements at domestic level – and this is what Poland and Germany chose to do. More leeway is given to Member States about sanctions that can be imposed for failure to report, where Poland is the current runaway leader. Faithful to the non-committal wording of the DAC 6, Brussels merely transmitted they wanted sanctions to be "effective, proportional and with a deterrent effect". (to deter what? – see text enclosed)

But this is a different matter. For now let us note, as this section invites us, that description must still focus on the classical economic substance of a scheme/arrangement/transaction etc. For interpretations related to economic substance see the adjoining box.

Section D – Date of the first step in implementing an arrangement is a crucial milestone: as a matter of principle, this is

DAC6	REPORTABLE CROSS-BORDER ARRANGEMENTS	To be used by Tax Administration from EU

A. Identification

Intermediary	Name	Residence for tax purposes	TIN

Relevant taxpayers	Name	Date and place of birth (for individual)	Residence for tax purposes	TIN	Associated enterprises

B. Details of the hallmarks that make the cross-border arrangement reportable

C. Summary of the content of the reportable cross-border arrangement, description of the relevant business activities

D. The date of the first step in implementing the reportable cross-border arrangement

E. Details of the national provisions that form the basis of the reportable cross-border arrangement

F. The value of the reportable cross-border arrangement

G. The Member State of the relevant taxpayer(s) and any other Member States which are likely to be concerned

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

the starting date for the 30-day term inside which reporting must be completed. But this time-limit will run as of 1 July 2020, when the domestic legislation transposing the Directive becomes enforceable. However, since the Directive came into force on 25 June 2018, another requirement was issued for all the reportable arrangements implemented after such date to be reported by 31 August 2020 (i.e. during July-August).
In all of its explanatory materials (rather scarce as a matter of fact), the Commission strove (1) to assure us that "unlike DAC3, in DAC6 there is no retroactive effect." And this is because, with the national legislation being known by the end of 2019, the concerned parties would have enough time to become aware of the consequences of any non-compliance. Good thing that it is only about DAC3 (i.e. the exchange of information between tax administrations on

The 18 hallmarks listed in Annex IV

Categorie	Semne distinctive (hallmarks)	Observaţii (1)
A. Generic hallmarks linked to the main benefit test	The relevant taxpayer or participant undertakes to comply with a condition of confidentiality how the arrangements secure a tax advantage.	The concept of the confidentiality is linked to commercial secrets and the business know-how and it is not related to professional secrecy.
	An arrangement where the intermediary is entitled to receive a fee for the effective arrangement	
	Standardized documentation and/or structure	Standard banking contracts, such as mortgages, would not need to be reported, because the tax advantage represents an insignificant benefit as compared to other main benefits (e.g. satisfaction of housing needs)
B. Specific hallmarks linked to the main benefit test	Acquiring a loss-making company	
	Converting income into capital.	
	Circular transactions resulting in the round-tripping of funds with no other primary commercial function.	
C. Specific hallmarks related to cross-border transactions	Deductible cross-border payment between associated persons, if: ● The recipient is not resident for tax purposes in any jurisdiction; ● The recipient is in zero percent or almost zero tax jurisdiction*; ● The recipient is in the blacklisted countries; ● The payment is tax exempt or benefits from a preferential tax regime in the recipient jurisdiction*.	The tax at the rate of almost zero broadly refers to a nominal rate below 1%
	Deductions for the same depreciation on the asset are 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.	
D. Specific hallmarks concerning automatic exchange of information and beneficial ownership	An arrangement which may have the effect of undermining the reporting obligation under the laws concerning automatic exchange of information	The OECD work should be used as a source of illustration or interpretation.
	An arrangement involving a non-transparent legal or beneficial ownership chain with the use of structures that do not carry on a substantive economic activity supported by adequate staff, equipment etc.	
E. Specific hallmarks concerning transfer pricing	An arrangement which involves the use of unilateral safe harbour rules.	Rules on the safe harbours are "unilateral" when they depart from the international consensus, as enshrined in the OECD transfer pricing guidelines (TPG). "Intragroup" refers to the concept of "associated enterprise", based on the definition provided in Directive
	An arrangement involving the transfer of hard-to-value intangibles for which no reliable comparables exist and financial projections used in valuation are highly uncertain.	
	Cross-border transfer of functions and/or risks and/or assets ending in three years with a decrease of more than 50% in earnings before interest and taxes (EBIT).	

Source – Annex IV, DAC6

Note: Blue identifies those signs that can be considered only if they successfully pass the main benefit test
*presence of such circumstances, if not in conjunction with other elements, cannot be treated as a base to conclude that an arrangement does pass the main benefit test.

For the purposes of this text, (1) refers the 28 September summary record Working Party IV – Direct Taxation, prepared by the Commission Services on DAC6.

advance pricing arrangements, which has been enforceable as early as 2017)! (see also https://ec.europa.eu/taxation_customs/sites/taxation/files/intermediaries_platform.pdf)

Section E – Details on nations provisions that serve as basis for reportable cross-border arrangements. It will be one of the pieces de resistance of reporting, and it can be an indication, to put it bluntly, of how soon a new (relevant) tax audit is going to knock on the relevant taxpayer's door!

A handful of (soon to be) frequently asked questions

- **I submitted the declaration. What consequences should I expect?**

While the Commission says that an intention to commit acts of tax avoidance will not be presumed, it still admits that authorities may start investigations based on the avail-

Between artificial and advantageous. A "recommendation"

In interpreting the concept of tax advantages, it is useful (1) to review the EC Recommendation of 6 December 2012 on aggressive tax planning. It states that *„ An artificial arrangement or an artificial series of arrangements which has been put into place for the essential purpose of avoiding taxation and leads to a tax benefit shall be ignored. National authorities shall treat these arrangements for tax purposes by reference to their economic substance."*

In order to determine whether or not an arrangement or series of arrangement is artificial, one should consider whether: (a) the legal characterisation of the individual steps which an arrangement consists of is inconsistent with the legal substance of the arrangement as a whole; (b) the arrangement or series of arrangements is carried out in a manner which would not ordinarily be employed in what is expected to be a reasonable business practice; (c) the arrangement or series of arrangements includes elements which have the effect of offsetting or cancelling each other; (d) transactions concluded are circular in nature; (e) the arrangement or series of arrangements results in a significant tax benefit but this is not reflected in the business risks undertaken by the taxpayer or its cash flows; (f) the expected pre-tax profit is insignificant in comparison to the amount of the expected tax benefit.

able information. "Particular arrangements may be identified that tax administrations may wish to have closer look at." (1)
The Commission also states that sanctions – which must be "deterring" – are only applicable to breaches of the obligation to report and should not be treated as sanctions linked to how an arrangement is revealed by an audit to have been used.
The Directive keeps suspense up and comments that "the fact that tax administration does not react to a reportable cross-border arrangement shall not imply any acceptance of the validity or tax treatment of that arrangement."

- **Who decides whether or not a tax arrangement is aggressive after all?**

Just like *tax avoidance* is barely known to involve actions intended to help to avoid paying taxes while not being treatable as criminal tax evasion, aggressive tax arrangements are not clearly defined either. A choice was made for an indirect definition via hallmarks, but such hallmarks are also deliberately worded in a most generic manner.
And so it is that it is virtually up to rapporteur to identify their own level of "aggressiveness" and whether or not an individual cross-border arrangement should be reported (this state of affairs is recognised as such by, for instance, the Dutch legislation transposing the Directive).

- **Still, is there no EC guide stating what is and what is not acceptable?**

Such guide is very unlikely to happen. Explicative guides that have been issued at a domestic level so far (see Poland and Germany) may help to emphasize individual aspects, even by way of case studies, but do not go at such great lengths as clearly delineating any allowable margins in applying the new legislation.
And the Commission clarified (1) that the Directive "does not provide for the option for setting up a (white) list of reportable cross-border arrangements that do not need to be reported under DAC6."
Thus, overreporting, i.e. overcautious submission of an overflowing mass of information looks like a risk consciously taken by the EU authorities. By way of comparison, in the US, where a similar reporting legislation has been in place for almost 20 years, a more pragmatic approach has been chosen precisely to minimize overreporting: IRS issued a list of the types of tax avoidance transactions and a list of the transactions that may be interesting for their purposes. Alternatively, benchmarks are in place for any transactions where losses are claimed.

- **Why should I also report arrangements which obviously to not result in a tax advantage? What about the business losses?**

First of all, in tax authorities' eyes, "obvious" is … debatable anyway. As a matter of fact, the Directive itself leaves room for hallmarks that do not need to be correlated to the main benefit test.
However, even a tax administration that cares about its relationship with taxpayers such as UK's HMRC admits that "whilst we have tried to keep burdens to a minimum, you may have to tell us about schemes that may not be considered to be avoidance (DOTAS - Disclosure of tax avoidance schemes Guide, update 2018).
Coverage of losses will be yet another controversial matter. Question may always arise about the actual risk of an investor if a deduction as a tax advantage is higher than the investment in terms of economic substance,.
It is worth noting that, in their meeting in September 2018 (1) with experts from Member States, the Commission's experts provided "several examples of how B category hallmarks should be applied". However, those examples have not been made publicly available.
In the meantime, it could be useful a test introduced by the UK legislation (DOTAS) involving the bringing into the equation of a hypothetical ***informed observer***. What would a third party observer say who, while not being necessarily a tax expert, reviewed the case and the relevant circumstances? Would he conclude that an arrangement is highly unlikely to be marketable if not accompanied by the likelihood of gaining a tax advantage? If so, then in all likelihood that arrangement should be reported.

- **Is an intermediary providing just tax compliance services also bound by an obligation to report?**

The Directive provides a very broad definition for intermediaries. An intermediary is also that which "knows or is reasonably expected to know" that it helped to implement a reportable arrangement.
Not quite surprisingly, the definition omits to treat cases where an intermediary's role is limited to providing management or tax compliance services. Therefore an answer will vary with each set of specific circumstances. If an intermediation service only covers completion of declarations, it would not be "reasonable expectable" that such intermediary to be aware of any reportable arrangement.
The Polish authorities have been more lenient in this respect and established that reportables do not include any services related to compliance, disputes and transfer pricing as provided by any intermediary as part of its day-to-day business. However such derogation is not applicable if an intermediary provides recommendations that resulted in a tax advantage.

Intermediaries, close ranks (with your clients)!

An effect (maybe unintended) of this Directive is that a partnership between an intermediary (consultant, accountant, auditor, banker, or lawyer) and client (relevant taxpayer) will be even more … relevant now. Preparing for mid-2020 can only be done together. Taxpayer must agree to the professional secrecy clause that might bind its consultant/accountant to disclose data provided by client. For instance, based on the by-laws of the Romanian Chamber of Tax Consultants, a consultant is bound "to maintain professional secrecy, whose scope includes all information and data of any nature, in any form and on any medium as provided by client and the documentation prepared by its consultant, and properly manage and archive the same at its place of business."

As commented above, when, if bound by professional secrecy, an intermediary cannot report, then that obligation is passed on to the taxpayer/client.

It is high time that taxpayer and its intermediary together (re)check thoroughly anything that could be treated as an arrangement (this should apply to cross-border arrangements, but we are yet to check the final version of the domestic legislation!) that has been used since mid-2018. Be over-careful, though, about matters that are (apparently) not related to taxes that can still be classified as "reportable" under the Directive! Beyond the new bureaucratic burden and its thicket of imprecisions, the issue of "arrangements" is still governed by the classical assessment of economic substance and of risks' proportionality to functions and assets. The (European) modern taxation becomes virtually impossible without co-operation between taxpayer and its consultant/intermediary. DAC 6 is still another proof for it and not the last one at that!