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DIRECTIVE ON ADMINISTRATIVE COOPERATION – DAC6/MANDATORY DISCLOSURE TAX REPORTING

Background

A new mandatory disclosure regime for tax reporting comes into effect on 1st July 2020 across the EU. This regime derives from an EU Council Directive 2018/822 (referred to as DAC6) passed back in June 2018. DAC6 has potentially a very wide effect and requires EU intermediaries (including banks, accounting firms, lawyers, corporate service providers and certain other persons) to make a disclosure to their tax authority in connection with certain types of cross border tax arrangements. Where no intermediary is required to make a filing then the taxpayer may need to make the disclosure instead.

The DAC6 regime originates from the OECD's BEPS Action 12 which recommended that all jurisdictions should bring into force a regime for the mandatory disclosure of aggressive tax planning arrangements. DAC6 is therefore the latest in the tools available to the EU tax authorities in the continuing global crackdown on perceived tax avoidance and evasion. It supplements a whole range of BEPS inspired recent changes to double tax treaties and domestic tax rules as well as the introduction of new reporting regimes including the common reporting standard (CRS), FATCA and country by country reporting.

The purpose of these new provisions is to facilitate the EU tax authorities in obtaining early access to tax planning information. The thinking of the EU Commission is that this will assist in protecting the tax base of Member States as they will be in a better position to challenge the tax planning and/or change tax law to crack down on similar future transactions at an early stage. Also, the DAC6 provisions are intended to deter taxpayers from entering into supposedly abusive tax schemes in the first place. The DAC6 regime is not dissimilar to the UK's disclosure of tax avoidance scheme (DOTAS) rules but is considerably wider in scope.

Who is an Intermediary?

An intermediary is any person that:

(a)

(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 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) has an EU connection.

This definition is very broad and includes lawyers, tax advisers, accountants and others who advise taxpayers on cross-border transactions. It can also encompass lawyers, banks and service providers who assist with the implementation of these transactions.

What is an EU connection?

To qualify as an intermediary for DAC6 purposes a person must be linked to an EU Member State. There will be a link where the intermediary is resident a Member State, is incorporated in or governed by the laws of a Member State or has a permanent establishment in a Member State through which the services relating to the tax arrangement are provided. There will also be an EU connection where the person is registered with a professional association which is connected to taxation, consultancy or legal services in a Member State.

What about legal privilege?

DAC6 permits Member States to exempt intermediaries from the disclosure requirements on a reportable cross-border arrangement where that obligation would breach the legal professional privilege under the national law of that Member State. However, this legal privilege defence is at the discretion of each Member State not all of which actually have such a principle that covers advisory work as opposed to litigation matters. In the DAC 6 implementing regulations in the UK a UK intermediary is exempt from disclosing 'privileged information'. Legal advice is usually privileged in the UK along with information provided to lawyers in the course of obtaining advice which is generally privileged as well. Therefore, the expectation would be that lawyers in the UK should be protected from making reports under DAC6 (unless the client has actually waived privilege). However, this is not apparently the view of HMRC which takes the view that much of the information that needs to be reported under DAC6 would be factual and that privilege should not therefore apply. HMRC's view is probably incorrect but clearly this gives rise to issues for a UK lawyer when deciding what needs to be disclosed. Similar issues may arise in other Member States.

When does the taxpayer have to report?

The intention in DAC6 is that reporting is done by the intermediary and if there is more than one they all have to report. However, sometimes there will be no intermediary involved or the intermediary will have no EU connection or the defence of legal professional privilege may be available. In these circumstances the disclosure obligation under DAC6 falls directly on the taxpayer.

What is a reportable cross-border arrangement?

A cross-border arrangement is one that relates to more than one Member State or that concerns a Member State and a third country (Switzerland for example). It follows that arrangements that fall entirely within a single Member State or which do not have any link to any Member State should fall outside DAC6. Note here that provided there is an EU connection it does not seem to matter that any tax benefits arising from the arrangements relate solely to the tax of a non-EU country.

A cross-border arrangement is only reportable if it has certain characteristics or features known as 'hallmarks'. The purpose of the hallmarks is to limit the application of DAC6 to those transactions which contain a potential tax avoidance risk. However, not all of the hallmarks contain a main tax benefit threshold test.

There are generic and specific hallmarks. Examples of generic hallmarks are arrangements which contain confidentiality conditions which prevent disclosure to others (including the tax authorities) of how the

arrangement could secure a tax advantage, where the intermediary is entitled to a success fee based on the scale of the tax advantage or where the documentation is in a standardised format. An example of a specific hallmark are arrangements which include circular transactions 'resulting in the round tripping of funds'. All of the hallmarks so far described will only apply if the main benefit or one of the main benefits which, taking into account all the relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage. (The term tax advantage is not defined in DAC6 but it will not cover advantages in relation to VAT, duties of customs and excise or social charges.)

Many of the specific hallmarks will apply regardless of whether the main benefit test is met. Examples of these are as follows:

- Claiming relief for double taxation for the same income in more than one jurisdiction;
- Deducting amounts by way of depreciation on the same asset in more than one jurisdiction;
- Arrangements which may have the effect of undermining reporting obligations under CRS;
- Arrangements which seek to hide beneficial owners;
- Arrangements related to transfer pricing that involve the transfer of hard to value intangibles.

What information needs to be disclosed and when?

Broadly, the following information will need to be disclosed under DAC6:

- Details of intermediaries and taxpayers;
- Details of the relevant hallmarks that make the cross-border arrangement reportable;
- A summary of the content of the reportable cross-border arrangement;
- The date of implementation of the first step of the arrangement;
- Details of the national law provisions forming the basis of the reportable cross-border arrangement;
- The value of the reportable cross-border arrangement;
- Member States that are likely to be interested in the reportable cross-border arrangement; and/or
- Identification of any other person in a Member State likely to be affected by the reportable cross-border arrangement.

Information needs to be filed with the relevant tax authority within thirty days from the first of the following:

- The day after the reportable cross-border arrangement is made available for implementation;
- The day after the reportable cross-border arrangement is ready for implementation; or
- The day when the first step in the implementation of the reportable cross-border arrangement has been made.

Once the information has been reported then the tax authorities of each Member State will exchange the reported information automatically with other Member States through a centralised database. Each Member State will set its own penalties for non-compliance with the DAC6 reporting requirements. These are required to be effective, proportionate and dissuasive.

Although the reporting provisions of DAC6 enter into force on 1st July 2020 the difficulty for many intermediaries and taxpayers will be that disclosure is required of reportable arrangements where the first step was implemented on or after 25th June 2018. This may present a difficult practical problem where full records have not been maintained. Such transactions need to be reported by 31st August 2020.

However, the European Commission has proposed extending the deadlines in relation to DAC6 reports as a result of the current Covid-19 pandemic. It is proposed that reports that would otherwise have been due on 31st July 2020 will now become due on 31st October 2020 whilst those for the period from 25th June 2018 due on 31st August 2020 will not now have to be filed until 30th November 2020 with the first exchange of information between Member States under DAC6 not being made until 31st January 2021.

Andrew Terry
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