HARNEYS

The 6th Directive on Administrative Cooperation (DAC 6) on cross-border reportable arrangements

What does it concern?

EU Council Directive (EU) 2018/822 (***DAC 6***) requires the mandatory reporting, principally by intermediaries but ultimately by taxpayers, of reportable cross border arrangements and the subsequent automatic exchange of information in relation to those arrangements between EU governments. The ostensible policy objective is to identify arrangements that indicate aggressive tax planning at an earlier stage than normal domestic tax reporting.

When did DAC 6 come into effect?

DAC 6 came into force as an EU Directive on 25 June 2018. In the context of the Covid-19 pandemic, an amending Directive was issued in June 2020 allowing for a six-month extension of the reporting deadlines such that the following timelines now apply:

- In relation to reportable arrangements whose first step of implementation occurred from 25 June 2018 to 30 June 2020, the deadline is 28 February 2021.
- In relation to reportable arrangements made available or ready for implementation or where the first step in its implementation was made, or in respect of which aid, assistance or advice was given, between 1 July and 31 December 2020, the deadline is 30 January 2021.
- Thereafter, reporting is due within 30 days after the earliest of the events referred to in the previous bullet point.

Has DAC 6 been implemented?

Like all EU Member States, Luxembourg and Cyprus were required to transpose DAC 6 into its national legislation by 31 December 2019.

Luxembourg did so on 25 March 2020 and subsequently introduced the extended deadlines described above. Limited practical guidance on the interpretation of DAC 6 and its implementation has been published.

Cyprus has not yet published anything by way of formal implementation of DAC 6 but it has indicated that the extended timelines will apply.

It is clear that the interpretation of DAC 6 will continue to evolve and that differences in its application may arise between different EU Member States and that intermediaries, whether in the same or different Member States, will have different views as to whether a particular arrangement is reportable or not.

What arrangements should be reported?

As part of the analysis whether an arrangement should be reported, the following questions should be addressed.

Is there an arrangement?

DAC 6 does not define the term “arrangement”. Therefore, it should be taken to include any scheme, transaction or series of transactions. Thus, any single step in creating or implementing a structure is technically an arrangement. However, there is a consensus emerging that arrangements arising from 25 June 2018 onwards in relation to structures put in place before that date, are not in scope.

Is the arrangement cross-border?

This will be any transaction or structure that has participants either in more than one EU Member State or in an EU Member State and a third country.

Is the arrangement reportable?

A cross-border arrangement will be reportable if it contains one of the so-called “hallmarks” and, in some cases, also meets the “main benefit test”. The latter test involves determining whether the main benefit, or one of the main benefits, of the arrangement is a tax advantage.

The hallmarks are divided into 5 categories as follows:

- Category A – these are features of an arrangement that suggest an objective of achieving a tax benefit, namely tax saving confidentiality clauses, fees linked to tax savings, and the use of standardised documentation or structures. Arrangements with these hallmarks will only be reportable if the main benefit test is satisfied.

  Category B – these are particular types of transactions that are indicative of a tax benefit objective, namely certain acquisitions of loss-making companies, transactions that result in the conversion of incomeinto capital or low or zero taxed income, or circular transactions. Arrangements with these hallmarks will also only be reportable if the main benefit test is satisfied.

- Category C – these are arrangements that involve a degree of arbitrage in the tax treatment between two jurisdictions and involving associated entities. Some of them will be caught without the need for a main benefit test, for example, where double tax relief or double deductions are available. Others will only be caught if

the main benefit test is also satisfied, for example where a tax deduction is available but the income is not taxed.

- Category D – these are arrangements that have features that indicate an undermining of Common Reporting Standard (CRS) objectives or the disguising of the beneficial owner of a structure. As the category suggests, obtaining a tax benefit is not a required feature for the arrangement to be reportable.

- Category E – these are hallmarks that arise in a transfer pricing context, such as the use of unilateral safe harbour rules or the transfer of hard-to-value intangibles, or intragroup transfers of activities or assets resulting in a 50 per cent reduction in the projected annual earnings of the transferor. These will not involve the application of the main benefit test.

Is the main benefit test satisfied?

The main benefit test is met when the main benefit or one of the main benefits that a person may reasonably expect to derive from the arrangement is the obtaining of a tax advantage.

Guidance is emerging regarding the application of this test. For example, it generally involves an objective comparison of the tax benefits associated with the arrangement with other benefits. Guidance is also emerging to the effect that, where a tax benefit is contemplated by existing tax rules, the test is not satisfied. Thus, there appears to be a basis for saying that simply using a particular country as a location for part of a structure due to the tax efficiencies available under the tax rules in that country, should not be sufficient to indicate that tax is one of the main benefits of the structure. Clearly there are a very large number of situations each of which will have its own features and will need to be specifically reviewed in this context.

Who should report what?

If an arrangement is a reportable cross-border arrangement, the primary reporting obligation is on "intermediaries" based in the EU. However, where there are no intermediaries, or if the intermediaries are not required to report, the obligation is on the taxpayer in question.

An intermediary is defined as any person that either:

- designs, markets, organises or makes available for implementation, or manages the implementation of, a reportable arrangement; or

- knows or could be reasonable be expected to know that they have undertaken to provide, directly or by means of other persons aid, assistance or advice with respect to such activities.

It is likely that trust and corporate service providers, fund administrators, fund managers, lawyers, tax advisors, banks and insurers would be intermediaries.

Where several intermediaries are involved in the same arrangement (as will often be the case), it is sufficient if one of them does the reporting and all the other intermediaries have the necessary proof of that. However, given the timing and practical arrangements involved, this process will need to be carefully co-ordinated if multiple reporting is to be avoided.

Intermediaries who are subject to legal professional privilege are not required to report. It appears that this is for the most part restricted to the legal profession. However, in Luxembourg it has been extended to chartered accounts and auditors.

The information to be captured is set out in detail in the relevant regulations. In essence, it comprises sufficient information to enable the relevant tax authorities to identify the taxpayers, the intermediaries, and the relevant features of the reportable arrangement.

What are the penalties of non-compliance?

Each Member State defines the penalties for non-compliance in their regulations, the intention being that they be effective, proportionate and dissuasive. However, it has become clear that there are material differences as between Member States as to what level of sanction is considered to meet those criteria.

Andrew Knight
+352 27 86 71 06
andrew.knight@harneys.com
Luxembourg

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