

Mandatory reporting under the EU's new DAC 6 directive looms near

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The Directive on Administration Cooperation 2018/822/EU (commonly referred to as DAC 6) is a mandatory disclosure regime designed to increase transparency and curtail tax evasion by ensuring that European Union (EU) taxing authorities of member states have early access to information on potentially abusive tax schemes. Building on BEPS Action 12, DAC 6 reporting requirements are intended to deter those who promote aggressive tax planning schemes, as well as users of such schemes. Penalties for noncompliance can include significant monetary sanctions under local law as well as reputational risks for businesses, individuals and intermediaries. While reporting is generally required by intermediaries (discussed below), taxpayers who carry on any activity in the EU or that derive any income or profits in the EU are potentially subject to and may be affected by these rules, even if they are not residents and do not have a permanent establishment in the EU.

How does it work?

Similar to the Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS), DAC 6 reports will be filed via the automatic exchange of information (AEOI) portal for the taxing authority of each EU member state and the information reported will be automatically exchanged between EU member states through a centralized database. Transactions that involve one EU country and another EU country or an EU country with a non-EU country are all in scope and the rules mandate reporting these arrangements irrespective of whether they are justified or recognized under national or local laws.

Unlike FATCA and CRS, however, DAC 6 reporting is not limited to financial institutions and has much broader application and a wider scope of transactions to which it can apply. Specifically, DAC 6 reporting applies to any intermediary (including

lawyers, accountants, banks, brokers, asset managers, tax advisors, corporate service providers and other professionals) that advises taxpayers on cross-border transactions or is involved in the implementation of transactions that have the characteristics or hallmarks. The rules may, therefore, be particularly challenging for nonfinancial institutions and other corporate service providers who may not have been subject to FATCA or other information reporting regimes and therefore, do not likely have sufficiently robust systems, processes and governance structures already in place that can be leveraged for the purpose of complying with DAC 6.

Who and what is in scope?

For purposes of the directive, cross-border arrangements that involve one or more EU member states, or an EU member state and a third country are reportable. Purely domestic arrangements within one EU member state and arrangements having no link to any EU member state are not in scope. There is also no de minimis value for reportable arrangements. Reporting is generally required by intermediaries, but where no intermediary exists (or a professional privilege rule prohibits disclosure), the taxpayer may also have an obligation to file reports. An intermediary is broadly defined, in DAC 6, as any person that engages in the following:

- Designs, markets, organizes or makes available for implementation or manages the implementation of a reportable cross-border arrangement
- 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.

- Has an EU connection as a person who either:
 - Is a tax resident in a member state
 - Has a permanent establishment in a member state through which the services with respect to the arrangement are provided
 - Was incorporated in or governed by the laws of a member state
 - Is registered with a professional association related to legal, taxation or consultancy services in a member state

Based on this definition, it is imperative to flag potential intermediaries in your structure now and to begin reviewing arrangements and transactions that they may have helped to organize, implement or advise on since June 25, 2018.

What are hallmarks?

Any cross-border arrangement or series of arrangements that fulfill at least one hallmark has to be reported. The hallmarks are divided into two categories:

1. Generic: Those that are not required to meet the benefit test as a gateway criterion.
2. Specific: Those for which the main benefit test must be satisfied as a gateway criterion.

The main benefit test is satisfied if the main benefit, or one of the main benefits, a person may expect to derive is a tax advantage (taking into consideration all relevant facts and circumstances). Tax advantage is not defined in the directive, but it is stated that it will not include advantages relating to value-added tax, customs/excise duties or Social Security contributions. Examples of the specific hallmarks are:

- Certain uses and transfers of losses
- Converting income into capital
- Gifts or low taxed/exempt income
- Circular transactions
- Transactions between related parties that include exempt taxpayers
- Exempt or preferentially treated receipts
- Taxpayers in noncooperative jurisdictions

While recognizably broad, implementation of the rules is left to local jurisdictions, with much guidance still pending. There are potential exclusions from reporting, for example, of arrangements covered by legal (attorney/client) privilege, if recognized under local laws. Otherwise, the way that the directive is drafted means that it potentially applies to standard transactions with no particular tax motive. As such, ordinary transactions, such as securitization structures, standard corporate funding structures, cross-border leasing, and certain types of reinsurance funding structures may be reportable; and there is no exemption for arrangements with an underlying commercial purpose.

For arrangements that are reportable, the filer must disclose, among other things, identifying information for the intermediary and all relevant parties to the arrangement (i.e., name, tax ID, date of birth, etc.). In addition, any relevant hallmarks identified, a summary of the arrangement, the date the first step was implemented, the value of the arrangement, and information on other taxpayers affected by the arrangement must also be reported. It is, therefore, important to develop a process for tracking and storing this information now to ensure that all data required to satisfy reporting obligations is accessible on or before the date that the report is due.

What is the timing of DAC 6?

Although DAC 6 reporting does not start until 2020, the rules have a retroactive effect in that they require reporting of arrangements whose first steps were implemented on or after June 25, 2018. This, in effect, means intermediaries must have systems and processes for identifying and flagging reportable transactions back to June 25, 2018, and will need to educate key stakeholders on requirements and implement internal controls for managing risk now.

The rules require intermediaries to file reports with their respective taxing authorities on their AEOI portals within 30 days of the earlier of:

1. The date after the reportable cross-border arrangement is made available for implementation.
2. The date after the reportable cross-border arrangement is ready for implementation.
3. The date when the first step in the implementation of the reportable cross-border arrangement has been made.
4. The date when the intermediary provided aid, assistance or advice (only when an intermediary is involved).

Tracking all four dates identified above is critical for ensuring timely reporting/disclosure of transactions and arrangements.

What should you be doing now?

In order to ensure that you are prepared, those acting as intermediaries should focus on the following areas:

- Work to identify entities in your structure or organization that may generate reportable transactions.
- Develop a communications plan for alerting business areas and process owners of the rules, their impact and your companies' plan for compliance.
- Review and modify contractual agreements with third parties to ensure that DAC 6 requirements are addressed, and that indemnification clauses and other terms and conditions for compliance are included, and build in sufficient lead-time for budget and system modification requests in order to address these requirements.

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