



INSIGHTS

D.A.C.6 SPECIAL REPORT: MANDATORY DISCLOSURE REQUIREMENTS

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Insights Vol. 8 No. 2

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EDITORS' NOTE

In this month's edition of *Insights*, the articles address implementation of the Mandatory Disclosure Directive known as D.A.C.6 in nine countries that are Member States of the European Union. D.A.C.6 established a framework designed to shine a light on cross-border tax plans potentially viewed as aggressive by European tax authorities. All Member States must enact legislation requiring "gate keepers" for potentially aggressive cross-border arrangements – among them, bankers, lawyers, tax advisers, accountants, and the like – to file reports closely after the time services are provided or the plan is implemented and to coordinate reporting among all such service providers and in some cases the client. The information is then shared with tax authorities in other Member States and light is shined on the arrangement.

Each Member State enacts its own set of rules, so long as those rules reflect, at a minimum, the framework of the Directive. While D.A.C.6 applies throughout the European Union, the rules in each Member State have unique twists and turns, including the size of the penalty in the event of noncompliance. Evidence of those differences appears in the articles written by our local contributors, where some parse out local rules, others comment on penalties, and others focus on the importance of the local commitment to comply. Fears that all articles would read alike have not materialized.

Belgium

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- The Editors

EUROPEAN UNION'S NEW REPORTING OBLIGATIONS FOR TAX INTERMEDIARIES: KEY FEATURES OF THE BELGIAN ADMINISTRATIVE GUIDANCE – D.A.C.6

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Tags

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INTRODUCTION

The E.U.'s Directive 2018/822/E.U. introduced mandatory disclosure rules for aggressive cross-border arrangements for tax intermediaries ("D.A.C.6" or "the Directive").¹ On the surface, the Directive is a uniform European framework. In practice, however, the Directive's national implementation by Member States differs in several key aspects, such as the exclusion of purely domestic arrangements, the level and type of penalties, and the application of professional privilege. Likewise, the Directive's broad and vague terminology leads to differing interpretations among Member States.²

As a result, intermediaries and taxpayers are left in a quandary. They must chart their reporting path as to the interpretation of the Directive, while being under the threat of high penalties if the path ultimately results in a finding of noncompliance. Surprisingly, over-reporting is not a solution, as it may contravene data protection and professional secrecy obligations. In light of the situation, many Member States are currently publishing their own administrative guidance on the interpretation of the Directive.

In this article, the authors discuss the key features of the Belgian administrative guidance. They focus on the Explanatory Memorandum of the Belgian Law implementing

¹ Council Directive (E.U.) 2018/822/E.U. of 25 May 2018 as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, OJ L 139/1. The acronym "D.A.C." stands for "Directive on Administrative Cooperation."

² See B. Peeters and L. Vanneste, "European Union/International – DAC 6: An Additional Common EU Reporting Standard?", *World Tax Journal*, 2020, Vol. 12, n° 3, p. 502:

As DAC 6 applies a broad (and thereby vague) terminology, substantial differences in domestic application will appear. Different domestic implementations not only already reveal these differences in material, subjective and temporal scope, but the formal implementation is also far from uniform

For a comparative view of D.A.C.6's implementation in different Member States, see K. Resenig, "European Union - The Current State of DAC-6 Implementation in the European Union", *European Taxation*, 2020, Vol. 60, n° 12, pp. 527-535.

the Directive³ and the list of Frequently Asked Questions (“F.A.Q.”) recently published by the Belgian Revenue Service.⁴

REPORTABLE CROSS-BORDER ARRANGEMENTS

The Directive does not require intermediaries to reveal all tax tricks to the national tax authority. The reporting obligation covers only “reportable” (2.C.) “cross-border” (2.B.) “arrangements” (2.A.).

What is an “Arrangement?”

The Directive and the Belgian Law deliberately stop short of defining the term “arrangement” (*dispositif* in French, *constructie* in Dutch). In this fashion, the reporting obligation remains wide-ranging and covers continuously evolving tax-planning schemes.⁵

At first glance, the F.A.Q. follows a similar all-encompassing approach and indicates that

The concept of “arrangement” is extremely broad and covers any agreement, act, contract, convention, plan, scheme, project, structure, process of incorporation, transaction, or any combination of these elements, express or implied, written or oral, aiming to achieve a particular purpose or implementing a particular idea.⁶

Nonetheless, the F.A.Q. provides various helpful examples of what would and would not qualify as arrangements.⁷

- Transactions qualifying as arrangements include the migration of a company, the incorporation of a subsidiary, and the conclusion of a contract.
- Transactions not qualifying as arrangements are the mere application of a Belgian tax incentive, such as the Belgian innovation income deduction

³ Law of 20 December 2019, Belgian State Gazette, 30 December 2019 (hereinafter: “the Belgian Law”); For further details on the Belgian Law, see D.-E. Philippe et E. Yuksel, “Mandatory Disclosure of Aggressive Cross-Border Tax Planning Arrangements : Implementation of DAC 6 in Belgium”, *European Taxation*, 2020, vol. 60, n° 4, pp. 121-128 ; J. Malherbe, “La déclaration obligatoire des dispositifs transfrontières – Directive DAC 6 du 25 mai 2018 et loi du 20 décembre 2019”, *Revue Générale du Contentieux Fiscal*, 2020/1-2, pp. 29-40.

⁴ Belgian Circular Letter, “F.A.Q.: DAC 6 - Déclaration des dispositifs transfrontières”, available in French and Dutch at www.myminfin.be.

⁵ F.A.Q., no. 3.1.; See also Belgian Parliamentary Documents, House of Representatives, 2019-2020, n° 55-791/001, p. 8 (hereinafter: “Explanatory Memorandum”).

⁶ F.A.Q., no. 3.1 (our translation); See also Explanatory Memorandum, p. 8 (our translation):

Although the directive does not define the concept of ‘arrangement’, it refers to tax planning structures that allow shifting taxable profits towards more beneficial tax regimes or reducing the taxpayer’s overall tax bill.

⁷ F.A.Q., no. 3.1; Explanatory Memorandum, p. 7.

regime, the performance of certain services provided by intermediaries, such as the filing of tax returns, performing benchmark studies, providing accounting services or assisting the taxpayer during a tax audit or a tax due diligence review. In general, there is no arrangement where the relevant intermediary, participant or taxpayer remains passive.

What is a “Cross-Border” Arrangement?

Under the Directive and the Belgian Law, an arrangement is a cross-border arrangement when it concerns (i) more than one E.U. Member State or one E.U. Member State and a third country⁸ and (ii) one or more participants are tax resident in different jurisdictions or carries out activities in different jurisdictions.

In contrast with certain other Member States, such as Poland or Portugal, Belgium does not cover purely domestic arrangements.⁹ For arrangements with a cross-border aspect, the F.A.Q. specifies that an arrangement is not a cross-border arrangement in any of the following circumstances:¹⁰

- An entity in an E.U. Member State has a foreign shareholder
- An intermediary is located in a jurisdiction that is different from the participants' jurisdiction, unless the intermediary qualifies as a participant, within the meaning explained below
- The taxpayer and all participants are in countries outside the E.U., unless there is a permanent establishment within the E.U.
- A Belgian corporation sells the shares of another Belgian corporation to the Belgian permanent establishment of a foreign corporation

The Directive and the Belgian Law distinguish intermediaries from participants.

- Under the Directive, an “intermediary” is anyone who designs, markets, organizes, or makes available or implements a reportable arrangement or anyone who helps with reportable activities and knows or could reasonably be expected to know that it is doing so.¹¹ Belgian Law is in line with this broad definition.¹² The F.A.Q. mentions typical intermediaries, such as consultants, lawyers, auditors, accountants, notaries, in-house legal counsel, banks, and holding companies.
- Neither the Directive nor the Belgian Law define the concept of “participant.” The F.A.Q. indicates the following:¹³
 - The relevant taxpayer is always a participant.
 - An intermediary becomes a participant when he plays an active role in an arrangement. For instance, the mere fact that an intermediary



⁸ Directive, art. 1, (1), (b), 18; Belgian Income Tax Code, art. 326/1, 1°.

⁹ Explanatory Memorandum, p. 8.

¹⁰ F.A.Q., no. 3.2.1.

¹¹ Directive, art. 1, (1), (b), 21.

¹² Belgian Income Tax Code, art. 326/1, 4°.

¹³ F.A.Q., no. 3.2.2.

advises a resident of an E.U. Member State to use a foreign corporation in an arrangement does not make the intermediary a participant. Conversely, if the intermediary is a director of the foreign corporation that is recommended to a participant, the intermediary has taken an active role in the arrangement and is considered to be a participant.

- Any legal entity or person – such as a corporation, limited liability company, and the like – becomes a participant when it plays an active role in the arrangement.

When a Belgian tax resident transfers real property located outside of Belgium to another Belgian tax resident, the transaction is not a cross-border arrangement because the participants are residents of Belgium. The foreign property is not a “participant.”¹⁴ Similarly, the F.A.Q. mentions that the formation of a corporation outside of Belgium by two Belgian tax residents does not have any cross-border dimension, in principle. At the time of formation, the new corporation does not qualify as a “participant” because no activity has yet been carried on by the corporation. As a result, the two founders in the example are the only participants and the arrangement does not involve cross-border activity. The conclusion would differ if the two founders were tax resident in different jurisdictions, carried on activity in different jurisdiction, or one more played active roles in the arrangement.

When is a Cross-Border Arrangement Reportable?

Cross-border arrangements are reportable when at least one of the “hallmarks” set out in the Belgian Law is met. Belgian hallmarks are identical to those listed in the Directive. Hallmarks are broad categories setting out characteristics identified as indicative of aggressive tax planning.¹⁵ While some hallmarks automatically trigger a reporting obligation, others apply only if they meet a so-called “Main Benefit Test” (“M.B.T.”). The M.B.T. is met where a tax advantage is the main or one of the main benefits of an arrangement. However, the Directive does not define the concept of “tax advantage.” As a result, Member States have opted for slightly different interpretations.

Regarding the M.B.T., the F.A.Q. mentions that Belgium requires a “direct tax advantage” such as a tax deduction, an exclusion from the tax base, a deferral of tax, or the elimination of a withholding tax.¹⁶ Conversely, the mere application of a preferential foreign (non-Belgian) tax regime does not constitute a direct tax advantage. Under the Belgian M.B.T., a direct tax advantage covers taxes within or outside the E.U.

Regarding the hallmarks, the F.A.Q. provides various examples and sheds some light on the vague terminology of Belgian law.¹⁷ In broad terms, the following are the key elements that come out of the Belgian administrative guidance:

- Hallmark A3 – Standardized documentation and/or structure:¹⁸ This hallmark aims at so-called “mass-marketed schemes,” involving prefabricated tax products that can be sold and implemented without much professional

¹⁴ Explanatory Memorandum, p. 9.

¹⁵ Belgian Income Tax Code, art. 326/1, 3°.

¹⁶ F.A.Q., no. 5.2; Explanatory Memorandum, p. 12.

¹⁷ See Belgian Income Tax Code, art. 326/2.

¹⁸ F.A.Q., no. 4.1.5.

“Hallmarks are broad categories setting out characteristics identified as indicative of aggressive tax planning.”

assistance. For instance, the mere inclusion of the taxpayer's name on a readymade arrangement could lead to the application of this hallmark. In comparison, newsletters, brochures or leaflets providing general information about an arrangement are not considered to be standardized documentation. The same applies to internal working documents that merely reflect incomplete ideas or concepts.

- Hallmark B1 – Transfer of tax losses:¹⁹ This hallmark applies only where artificial steps are taken to (i) acquire a loss-making corporation, (ii) discontinue the corporation's principal historic activity, and (iii) utilize the losses. The order of steps is irrelevant, but all three must be present.
- Hallmark B2 – Conversion to low-tax income:²⁰ This hallmark applies only when pre-existing income is effectively converted into a new category of income that is taxed at a lower rate or is completely exempt from tax. However, this hallmark does not apply when a Belgian corporation issues a convertible bond to a foreign shareholder.
- Hallmark C4 – Transfer of assets:²¹ Transfers of assets between a Belgian corporation and its foreign permanent establishment are covered by this hallmark no matter which is the transferor or transferee. Also covered is the transfer of the shares of a subsidiary when the investment in the subsidiary constitutes a participation. The share investment in this circumstance constitutes an asset and the transfer of the asset across a border is covered by this hallmark.
- Hallmark D2 – Obscuring beneficial ownership:²² This hallmark refers to arrangements that have the effect of undermining the rules on beneficial ownership, the Common Reporting Standards or any other equivalent agreement on the automatic exchange of financial account information. According to the F.A.Q., this hallmark does not apply when the ultimate beneficial owner identification is made in accordance with the E.U.'s anti-money laundering legislation.
- Hallmark E1 – Unilateral transfer pricing safe harbor rules:²³ A unilateral safe harbor rule, whether implemented by an E.U. Member State of another country, is a deviation from a jurisdiction's transfer pricing regulation. Belgium does not have any unilateral safe harbor rules.²⁴
- Hallmark E2 – Transfer of a hard-to-value intangible asset:²⁵ The term "transfer" refers more to the economic reality of beneficial enjoyment rather than to legal title of the asset. Licensing or cost contributing agreements are covered. Transfers across a border between the head office of a corporation

¹⁹ F.A.Q., no. 4.2.3.

²⁰ F.A.Q., no. 4.2.4.

²¹ F.A.Q., no. 4.3.4.

²² F.A.Q., no. 4.4.4.

²³ F.A.Q., no. 4.5.3.

²⁴ *Id.*

²⁵ F.A.Q., no. 4.5.4.

and this branch are also covered. It does not matter whether the head office is the transferor or the transferee.

- Hallmark E3 – Transfer of a business:²⁶ Tax neutral, cross-border mergers and liquidations are not covered by this hallmark when functions, risks and assets have not been transferred in advance of the transaction.

“...the Belgian Ruling Commission will not take any position on the D.A.C.6 reporting obligation in an Advance Tax Ruling.”

ADVANCE TAX RULING

The F.A.Q. clearly mentions that the Belgian Ruling Commission will not take any position on the D.A.C.6 reporting obligation in an Advance Tax Ruling (“A.T.R.”).²⁷ The rationale is that the timeline for the reporting obligation is difficult to match with the timing of an A.T.R. application.²⁸

LEGAL PROFESSIONAL PRIVILEGE

The Directive allows intermediaries to waive filing information on reportable cross-border arrangements where the reporting obligation would breach a legal professional privilege (“L.P.P.”) under the national law of that Member State.²⁹ In such circumstances, each Member State must take the necessary measures to require intermediaries to notify any other intermediary without delay or, if there is no such intermediary, to promptly notify the relevant taxpayer of its reporting obligation.

In line with the Directive, the Belgian Law requires intermediaries bound by the L.P.P. to inform in writing any other intermediary or the relevant taxpayer of the fact that the reporting obligation shifts to them.³⁰

The Belgian L.P.P. exemption contains two peculiar provisions.

- The exemption under the L.P.P. rule does not apply when the transaction is a “marketable arrangement.”³¹ This is an arrangement that is “designed, marketed, ready for implementation or made available for implementation without a need to be substantially customized.”³²
- According to the Explanatory Memorandum of the Belgian Law, the L.P.P. exemption applies only where legal counsel has been retained to defend the

²⁶ F.A.Q., no. 4.5.5.

²⁷ F.A.Q., no. 2.6.

²⁸ In line with the Directive, the Belgian Law mentions that intermediaries must report within 30 days beginning: (i) on the day after the reportable cross-border arrangement is made available for implementation; (ii) on the day after the reportable cross-border arrangement is ready for implementation; or (iii) when the first step in the implementation of the reportable cross-border arrangement has been made, whichever occurs first (Belgian Income Tax Code, art. 326/3).

²⁹ Directive, art. 1, (2), 8ab, par. 5.

³⁰ Belgian Income Tax Code, art. 326/7, par. 1; The taxpayer may however waive the L.P.P., and request the intermediary to fulfil the reporting obligation on his behalf (Belgian Income Tax Code, art. 326/7, par. 2).

³¹ Belgian Income Tax Code, art. 326/7, par. 3.

³² Directive, art. 1, (1), (b), 24; Belgian Income Tax Code, art. 326/1, 6°.

taxpayer in a matter that is before judicial courts or where legal counsel is representing the taxpayer in actual or threatened litigation.³³

The Flemish Bar Council and the Belgian Association of Tax Lawyers disagree with this restrictive interpretation of the L.P.P. On August 31, 2020, they lodged claims for the suspension and annulment of the Flemish Decree implementing the Directive before the Belgian Constitutional Court. At the time of writing, the Belgian Constitutional Court requested a preliminary ruling from the Court of Justice of the E.U.³⁴ The request for a preliminary ruling concerns the compatibility of the Directive with Article 7 (right to respect for private life) and Article 47 (right to a fair trial) of the Charter of Fundamental Rights of the E.U. insofar as it requires legal counsel to notify other intermediaries of a need to report under D.A.C.6.

SANCTIONS

In case of noncompliance, the Directive requires Member States to provide for “effective, proportionate and dissuasive” penalties.³⁵ Member States interpret this requirement differently.³⁶ Poland, for instance, imposes fines of up to €4.7 million (8 million Polish zloty), whereas the maximum penalty in Ireland is €4,000.

Belgium appears to be on the reasonable side, with the following fines:³⁷

- Insufficient or incomplete reporting:
 - Without fraudulent intent, a fine is imposed in the range of €1,250 and €12,500.
 - With fraudulent intent, a fine is imposed in the range of €2,500 and €25,000.
- No reporting or late reporting:
 - Without fraudulent intent, a fine is imposed in the range of €5,000 and €50,000.
 - With fraudulent intent, a fine is imposed in the range of €12,500 and €100,000.

CONCLUSION

The Directive’s vague wording and undefined concepts are currently leading to significant differences in the application of D.A.C.6 among E.U. Member States. Moreover, as illustrated in the case of Belgium, administrative guidance is helpful.

³³ Explanatory Memorandum, p. 19; This approach is in line with the exemption from the reporting obligations laid down in the Belgian Law of 18 September 2017 related to the prevention of money laundering.

³⁴ Case C-694/20, Orde van Vlaamse Balies and Others v. Vlaamse Regering, 21 December 2021.

³⁵ Directive, art. 1, (2), 25a.

³⁶ For a comparison between E.U. Member States, see K. Resenig, op. cit., pp. 530-531.

³⁷ Belgian Income Tax Code, art. 445, par. 4; See also Belgian Royal Decree of May 20, 2020, Belgian State Gazette, June 4, 2020.

Nonetheless, intermediaries and taxpayers must form their own views about most practical questions. As a result, the intended harmonized approach remains a distant prospect. Uniform action with the E.U. remains a goal, but not a reality.

As with many other E.U. initiatives in the direct tax area, the Directive can be seen as another attempt to achieve a harmonization of the direct tax systems of Member States, even though the founding fathers of the E.U. made such harmonization subject to the unanimous consent of Member States, as only national governments are accountable to national parliaments which are empowered to impose direct taxes. It is a reality that unanimous consent is nearly impossible to reach among the 27 Member States. Consequently, E.U. bureaucracy leaves no occasion unused to fulfill its ultimate dream of harmonization achieved through the back door.



IMPLEMENTATION OF THE MANDATORY DISCLOSURE DIRECTIVE IN THE NETHERLANDS – D.A.C.6

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Tags

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INTRODUCTION¹

The E.U., Directive 2011/16/E.U. on administrative cooperation in the field of taxation (generally abbreviated as the ‘D.A.C.’) provides a framework for the exchange of information between the Member States. As such, the D.A.C. also forms the legal basis for the various tax transparency initiatives aiming to provide the authorities with additional tools to counter tax planning that is considered inappropriate. Over the past decade, Directive 2011/16/E.U. has been amended several times to accommodate these new initiatives. The latest in this series of amendments concerns the 6th (“D.A.C.6”) provided by Directive 2018/822/E.U., also known as the Mandatory Disclosure Directive (“M.D.R.”).

Building on Action Point 12 of the O.E.C.D. B.E.P.S. project, the M.D.R. has introduced an entirely new reporting obligation for “intermediaries,” and in certain cases, taxpayers in respect of cross-border tax planning structures which contain a possible risk of tax avoidance, at least within the spirit of the M.D.R. The information reported goes into a database in order to be automatically exchanged with other E.U. Member States that are relevant to the arrangement. The underlying idea behind the M.D.R. is that the information gathered should enable the tax authorities to identify undesirable planning in advance – and potentially take action against these practices.

In the Netherlands, the M.D.R. has been implemented through the Act Implementing the E.U. Directive on Reportable Cross-Border Arrangements (the “Dutch Implementation Act”). Even though the relevant legislation was enacted as of July 1, 2020, the actual duty to report was postponed until January 1, 2021, reflecting the COVID-19 global pandemic. However, such deferral did not alter the periods subject to reporting obligations.

Since the M.D.R. merely provides a minimum standard, certain other E.U. Member States may have implemented the M.D.R. more broadly. However, the Dutch Implementation Act is essentially a transposition of the provisions of the M.D.R.

It is a truism that the M.D.R. is characterized by rather broad and vague concepts, meaning that it leaves much room for interpretation – and raises many questions. Although the legislative history of the Dutch Implementation Act provides for some clarification, tax advisers in the Netherlands were anxiously waiting for the Guideline on Reportable Cross-Border Arrangements (“the Guideline”), ultimately published on June 24, 2020.

¹ Following the adoption of the E.U. Mandatory Disclosure Directive known as “D.A.C.6” in 2018, some further clarification was provided in the legislative history of the Dutch Implementation Act. Despite the fact that last summer the Dutch Tax Authorities published their Guideline on Mandatory Disclosure of Cross-Border Structures, clear and concrete guidance is often still lacking.

Unfortunately, the general sentiment is that the Guideline does not provide the clear and concrete guidance sought. This is somewhat disappointing, particularly in light of the fact that the M.D.R. imposes an inherent reputational risk on intermediaries, not to mention the considerable financial risk – with potential fines up to € 870,000 for not reporting, not correctly reporting, and over-reporting. Even though the Dutch Tax Authorities are precluded from imposing a fine where the intermediary or taxpayer has a reporting position – or in this context, a nonreporting position, legal certainty is key here.

This article zooms in on a number of aspects and features of the M.D.R. which are addressed in the Guideline, noting that there may be differences in interpretation between the various Member States with respect to the same provisions of the M.D.R. Some of these topics are rather generic, others specifically focus on certain specific Categories of Hallmarks (B, C and E) and the main benefit test (“M.B.T.”).

ARRANGEMENTS

As mentioned, the M.D.R. imposes an obligation on intermediaries and – in certain cases – relevant taxpayers to report information to the tax authorities on reportable cross-border arrangements (“R.C.B.A.’s”). In this respect, an arrangement may be reportable where it has at least one of the Hallmarks listed in the Annex to the M.D.R., while it has the required cross-border element if it involves at least one Member State and another country, which can be either another Member State or a third country.

It follows from the above that the concept of an “arrangement” plays a crucial role within the context of the M.D.R., as in each case it will need to be assessed whether an arrangement has a cross-border element and is potentially reportable. Clearly, this makes the identification and definition of an arrangement essential for purposes of the application of the Dutch implementation of the M.D.R.

In this respect, it is not helpful that the M.D.R. deliberately does not contain a clear and concrete definition of the term “arrangement” – by contrast, this term is intended to be neutral, as it may take many forms, such as an agreement or a transaction, and may consist of various elements. In line with this approach, an arrangement may consist of several steps or parts and may also comprise a series of arrangements.

The Guideline stipulates that the concept of an arrangement must be interpreted extensively and may include any kind of legal action. Also, it indicates that a series of arrangements or several related arrangements must be regarded as one larger arrangement: what matters most is that the arrangements serve the same purpose.

Furthermore, the Guideline clarifies that the point in time where an arrangement begins and ends depends on the type of arrangement as well as the applicable Hallmark, which would imply that the latter may well determine the extent of an arrangement. In turn, this would imply that elements of an arrangement that are not essential for the application of either the relevant Hallmark or the M.B.T., should not be considered part of the arrangement.

For instance, where an entity based in the E.U. finances a transfer of assets between two of its non-E.U. affiliates, that might not be relevant for the application of either the relevant Hallmark or the M.B.T. Even though the E.U. company is clearly involved with a set of transactions that must be regarded as one single cross-border

“Hallmark B2 concerns arrangements that result in the conversion of one category of income into another income category that is taxed at a lower rate or is completely exempt from tax.”

arrangement (“C.B.A.”), providing the financing is not relevant for the applicable Hallmark. As a result of this demarcation, the C.B.A. identified does not concern an E.U. Member State meaning that this should not constitute a reportable arrangement, after all.

Finally, an adjustment to an existing C.B.A. may lead to the conclusion that a “new” C.B.A. may need to be reported. This may be particularly relevant in those cases where a structure dates to a period prior to the adoption of the M.D.R. because such structure would otherwise not be reportable.

Therefore, it is important to monitor adjustments to existing structures closely, in order to determine if the adjustment constitutes an R.C.B.A., and if it does, the scope of required reporting.

Even though there is little guidance as to whether an adjustment leads to a new arrangement, it seems fair to say that a minor amendment should not have that effect. In this respect, the Dutch Tax Authorities have indicated that a mere contractual adjustment of the interest rate applicable to a loan should not result in a new reportable arrangement, while this conclusion may be different if the adjustment triggers the application of another Hallmark.

Since cross-border arrangements can only pose a potential risk of tax avoidance if the arrangement meets one or more of the Hallmarks, an adjustment should not lead to a new reportable arrangement unless it triggers a new Hallmark or if other intermediaries or taxpayers come into play as a result of the adjustment.

HALLMARK B – LINKED TO THE M.B.T.

The Guideline touches upon the application of a number of Hallmarks that often occur in practice, as well as the application of the M.B.T. provided for in the M.D.R.

Hallmark B2 concerns arrangements that result in the conversion of one category of income into another income category that is taxed at a lower rate or is completely exempt from tax. Legislative history of the Dutch Implementation Act does not contain any clarifications concerning the scope of this Hallmark, other than to clarify that, for Dutch personal income tax purposes, a shift from one “box” to another “box” falls within scope of Hallmark B2.

Nonetheless, the Guideline contains a number of clarifications. For instance, lower taxation may also result from a more favorable treaty allocation or a lower treaty rate. In relation to payroll taxes, the Guideline clarifies that a choice for a service agreement over an employment contract may well constitute a conversion in the sense of Hallmark B2, while applying for a fictitious cost deduction for expats under the Dutch 30% ruling does not constitute a conversion.

In connection with this Hallmark, an example addressed a remuneration package that partially consists of an equity incentive, since this often results in favorable tax treatment. Where a specific remuneration package that is granted upon commencement of employment does not include an equity incentive, but the arrangement is redesigned at a later point in time in order to reduce the tax burden, clearly there is a conversion. However, if the remuneration package already included an equity incentive from the start, no right to any income component existed prior to entering into the initial employment contract.



This raises the question whether a conversion is present in these circumstances, particularly whether it is relevant that the equity incentive was granted upon entering into the employment contract or only at a later stage.

In view of the above, the question rises whether Hallmark B2 is limited to actual conversions involving cases where there is an existing entitlement to an income component that, as a result of an arrangement, is converted and subsequently taxed at a lower rate or whether newly established structures where no prior entitlement to any income component existed may also fall within scope of this Hallmark. Since no limitation can be read in the wording, it would seem that no pre-existing entitlement to income must be present in order for a conversion to occur.

For that matter, an example included in the Guideline where services are provided under a service agreement instead of an employment contract also seems to indicate that Hallmark B2 may be applicable to newly established structures. From the outset, the preference for a service agreement over of an employment contract may well be driven by the wish to achieve tax savings. Hence it seems that a conversion as referred to in Hallmark B2 may also occur when establishing a new structure.

Although it would go too far to compare all possible alternative income components within this context, what is probably decisive here is whether it is commercially customary for the parties involved to provide such income components and whether in the case at hand the choice has been made on the basis of business considerations.

Hallmark B3 concerns arrangements involving circular transactions, often using intermediary entities with no other primary business purpose, or transactions that compensate or nullify each other or have other similar characteristics. According to the legislative history of the Dutch Implementation Act, providing a loan that is tainted pursuant to the Dutch anti-base erosion rules may be considered as a clear example of a Hallmark B3 arrangement. Other than that fact pattern, the legislative history does not provide any further explanation of the scope of this Hallmark.

The Guidance contains three examples of Hallmark B3 arrangements that would be reportable. Two of these are obvious, but the Guidance also contains an example where the application of Hallmark B3 is not so evident. In a nutshell, this concerns an arrangement where a Dutch company that has just realized a substantial taxable capital gain is subsequently acquired by a foreign entity that provides it with loans to acquire other companies. Subsequently, the Dutch company receives dividends from its participations and uses these to service the interest on the loan from its foreign shareholder. The interest paid is considered deductible and therefore reduces the tax burden on the capital gain realized.

Clearly, this type of arrangement, which is strongly reminiscent of the recent judgment of the Dutch Supreme Court in the case of Credit Suisse, is mainly aimed at eroding the Dutch tax base and perhaps should be reportable. However, it seems doubtful whether Hallmark B3 is applicable in this case, as there would seem to be no circular element. After all, the foreign company will not receive the amount lent until the maturity date of the loan. In the meantime, the flow of funds will only comprise the fruits of the amount lent, consisting of the dividends received and the interest paid by the Dutch company.

The phrase “circular transactions resulting in the circulation of funds” presumes that there is a set of legal transactions resulting in the return of funds to the entity that

initially paid them upon completion of the arrangement. If the above example falls within scope of this Hallmark, this may lead to an undesirable extension thereof, as any loan would seem to be covered.

To clarify Hallmark B3 In the E.U. context, the example has been used of group companies transferring their capital abroad and then bringing it back in order to benefit from the favorable regime for so-called foreign direct investment (“F.D.I.”) in their jurisdiction. Interestingly, in one of these examples, the capital does return to the same country, however to another group entity. This indicates that it may well be sufficient for the application of Hallmark B3 that the funds return to the same country.

In sum, Hallmark B3 concerns arrangement involving at least two legal transactions resulting in assets or their equivalent transferred by and then returning to the same taxpayer or at least the same country. Furthermore, these transactions must either take place through intermediate entities with no other primary business purpose or offset or cancel each other.

HALLMARK C – PARTIALLY LINKED TO THE MAIN BENEFIT TEST

Under the M.D.R., Category C Hallmarks consist of four types of arrangements, and of those arrangements, the M.B.T. comes into play only in relation to the first category, concerning deductible payments that, for some reason, are not materially taxed in the hands of the recipient. Even then, if the relevant item of income is not taxable by reason of the fact that the recipient is not resident anywhere or is based in a non-cooperative country, the M.B.T. is not applicable in the context of the first category. Therefore, the M.B.T. is relevant only where the payment is not taxable because the recipient is resident in a jurisdiction that is not blacklisted, but simply does not tax the income by virtue of very low statutory rates or the application of an exemption or preferential tax regime.

In the Dutch legislative history, it has been indicated that, in principle, the term “recipient” must be interpreted from a legal perspective, but that in the event of differences in tax qualification, the underlying participants of a transparent entity may be regarded as a “recipient” as well. From the example provided in the Guidance, it can be deduced that a potential C.F.C. levy imposed on a shareholder does not qualify as a pick-up of the payment.

Legislative history also shows that an imputed charge may qualify as a payment for this purpose, meaning that there need to be an actual payment in order for the Hallmark to apply.

Furthermore, it has been noted in legislative history that, within the context of Hallmark C1, the term favorable tax regime is broader than a “harmful tax regime” and that the mere fact that a regime results in a significantly lower level of taxation than normally applies in the relevant country does not by definition result in a favorable tax regime. In any case, legislative history indicates that the Dutch innovation box and the Dutch tonnage regime for shipping companies qualify as favorable tax regimes.

Where a foreign company benefits from a notional interest deduction, obviously that deduction may significantly reduce its effective tax rate from the level of the stated statutory rate. Within this context, the question may arise whether a deductible

“... the M.B.T. is relevant only where the payment is not taxable because the recipient is resident in a jurisdiction that is not blacklisted, but simply does not tax the income by virtue of very low statutory rates or the application of an exemption or preferential tax regime.”

cross-border payment must be construed as the application of an exemption or preferential tax regime where the recipient benefits from such notional interest deduction. It would seem that in the absence of a direct link between the payment received and the notional interest deduction, it is difficult to argue that the recipient benefits from an object exemption or favorable tax regime in that regard.

The Guideline contains several examples of arrangements that might potentially be covered by Hallmark C1. One example concerns a foreign company granting an interest-free loan to a Dutch company. In the Netherlands, interest expense is imputed, but no interest income is imputed abroad. It may be assumed that the foreign company is actually tax resident in the other jurisdiction and the relevant country is not blacklisted. Since no interest income is imputed at all, no object exemption would apply. Therefore, it would seem that the fact that the jurisdiction of the recipient deliberately does not take into account imputed interest income is construed as the application of a favorable tax regime. In this respect, within the E.U., the Code of Conduct Group determines which tax regimes must be considered as 'favorable'. For example, in Ireland, previously interest income was not imputed under certain conditions, but this did not lead to classification as a favorable tax regime.

The other items within the Category C Hallmark concern (i) double depreciation of the same assets in two or more countries and double claims for relief from double taxation in the absence of double inclusion of income and (ii) significant discrepancies in the valuation of cross-border transfers of assets. As mentioned above, the M.B.T. does not apply in those circumstances because tax considerations tend to play an essential role in these structured transactions.

Significant discrepancies in the valuation of assets covered by Hallmark C4 may also apply if a cross-border asset transfer takes place only for tax purposes, notably upon a transfer to a foreign branch. Furthermore, a substantial difference in valuation also occurs if one of the two countries involved does not recognize the transfer, at all.

The application of Hallmark C4 may well affect the application of the Dutch informal capital doctrine, which departs from the notion that an asset may be transferred below its fair market value, if only because the transferor's country may have a different view on the application or interpretation of the arm's length principle than the acquirer's country.

In practice, Dutch subsidiaries of U.S. multinationals often are made transparent for U.S. tax purposes through a check-the-box election. For U.S. tax purposes, typically this entails a deemed liquidation involving a deemed liquidation distribution of an existing Dutch entity as the assets of the Dutch company are treated as owned by the U.S. shareholder, giving rise to a cross-border asset transfer for U.S. tax purposes.

However, from a Dutch tax perspective, the U.S. check-the-box selection is a non-event and therefore no transfer takes place at all, which leads to a concrete example of a situation where one jurisdiction recognizes an asset transfer while the other does not.

The mere fact that both from a legal and tax perspective no asset transfer occurs in the Netherlands should not alter the conclusion that making the relevant check-the-box election gives rise to a reportable cross-border arrangement. Since the purpose of the M.D.R. is to identify mismatches between jurisdictions that allow cross-border tax planning, Dutch legislative history indicates that Hallmark C4 is applicable in those situations.

HALLMARK E – NOT LINKED TO THE MAIN BENEFIT TEST

Category E Hallmarks comprise three types of transfer pricing arrangements. However, since the M.B.T. does not apply to these Hallmarks, it is not relevant whether a tax benefit is obtained through the implementation of the arrangements.

Hallmark E2 pertains to transfers to affiliates of intangible assets which are difficult to value. Since shares in a company are not intangible assets for purposes of this Hallmark, it would seem that Hallmark E2 does not apply where instead of the underlying intangibles the shares in the company that owns the intangibles are transferred. Moreover, it would seem that Hallmark E2 is also not applicable to a migration of a company that owns the intangibles, simply because no transfer to an affiliate occurs.

Hallmark E3 concerns arrangements involving a cross-border, intra-group transfer of functions, risks, or assets, if the projected annual E.B.I.T. of the transferor, during the three-year period following the transfer, is less than 50% of the projected annual E.B.I.T. of that transferor were the transfer not to take place. The rationale of this feature is to detect profit shifts to other jurisdictions.

Considering this rationale, Hallmark E3 should also apply to a migration. However, it seems doubtful whether the literal wording of the relevant M.D.R. provisions would offer sufficient room for such interpretation, as these require a cross-border transfer within the group and a decrease of the E.B.I.T. of the transferor by more than 50% as a result of that transfer.

MAIN BENEFIT TEST

As mentioned above, certain Hallmarks lead to a reporting obligation only if the M.B.T. is satisfied as well. One may wonder why the M.B.T. does not apply to all Hallmarks, even though for some Hallmarks the tax benefit is typically a given.

The M.B.T. entails that the arrangement must (i) provide a tax benefit and (ii) that benefit is one of the main benefits or the sole main benefit that can reasonably be expected from the arrangement, determined by reference to all relevant facts and circumstances.

With reference to the European Commission's recommendation of December 6, 2012 on aggressive tax planning, Dutch legislative history indicates that a tax benefit is measured by comparing the amount of tax due by the taxpayer, taking into account the arrangement, with the amount that the same taxpayer would owe in the same circumstances if the arrangement had not taken place. This is often referred to as the "comparison test." If the amount of tax due in the first situation turns out to be lower or first becomes taxable in a later tax time, there is a tax advantage, and the first part of the test is satisfied.

According to the Dutch Implementation Act, the comparison test is not limited to the amount of tax due in the Netherlands, but rather concerns the worldwide amount of tax due by the taxpayer. The legislative history states that tax benefits can arise both within and outside the E.U.



“... Dutch legislative history indicates that a tax benefit is measured by comparing the amount of tax due by the taxpayer, taking into account the arrangement, with the amount that the same taxpayer would owe in the same circumstances if the arrangement had not taken place.”

Moreover, the prevention of a tax disadvantage may constitute a tax advantage within the meaning of the M.B.T. However, only an existing tax disadvantage should be taken into account, as the comparison is made with the existing situation.

If a tax benefit is identified, it will have to be determined whether this benefit can be considered as one of the most important benefits that can reasonably be expected from the arrangement or the sole benefit. This is to be determined based on the facts and circumstances of the case. In this respect, the legislative history indicates that if the tax advantage is achieved by adding artificial elements to the structure, the tax advantage must be one of the main benefits or the main benefit.

However, according to the Dutch Implementation Act arrangements without any artificial elements may still meet the M.B.T., which raises the question how to assess these cases. It would seem that the way to approach this is to identify any other benefits of the arrangement and value their importance, particularly by addressing the question whether the arrangement would also have been implemented absent the expected tax benefit.

Even then, it follows from legislative history that the M.B.T. is not tax avoidance if the desired tax consequences of the arrangement are fully in line with the objective and purpose of the relevant provision of the tax law. This means that arrangements which are set up in order to benefit from favorable tax regimes do not meet the M.B.T. if this set-up is fully in line with their underlying purpose of the law. This is often referred to as the “policy intent.”

In legislative history, the M.B.T. is illustrated by the example of a U.S. multinational that decides to transfer its Swiss based R&D department to the Netherlands because it intends to benefit from the Dutch innovation box regime. In this context, it is noted that where R&D activities are transferred to the Netherlands, generally the main benefit is not tax savings because transferring activities to another country typically entails that the economic situation changes.

CONCLUSION

Meanwhile the existence of the M.D.R. is a given and most practitioners understand and accept the desire to have an additional instrument as a deterrent for potentially tax-aggressive arrangements.

However, when considering the concept of a reportable arrangement, the mechanics of various Hallmarks, and the framework for assessment of the M.B.T., it seems clear that many ambiguities continue to exist, which may hinder practitioners from applying the M.D.R. correctly. The general perception is that its current design with open norms leads to undesirable uncertainty, not just for tax advisers, but also for the tax authorities themselves.

In anticipation of further clarification from the side of the Dutch tax authorities, as a first step towards addressing legal uncertainty, practitioners may seek guidance from their peers, by sharing experiences, best practices, and views.

THE IMPLEMENTATION OF THE D.A.C.6 E.U. DIRECTIVE IN GERMANY

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Tags

Arrangements
Cross-border
DAC6
Germany
Hallmarks
Intermediaries
Participants
Reportable

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INTRODUCTION

The E.U. Directive 2018/822 of 25 May 2018 (“Directive”)¹ introduced a new reporting obligation for potentially aggressive cross-border tax arrangements in order to provide the tax authorities with information about potentially aggressive tax arrangements.

The Directive was implemented into German law by the inclusion of several sections (sec. 138d to 138k) into the German General Tax Code (*Abgabenordnung*, or “A.O.”) in 2019, effective as of July 1, 2020, with an additional retroactive obligation to include all open tax arrangements that were set up from June 24, 2018.² Germany did not elect optional postponement of the D.A.C.6 implementation due to the COVID-19 crisis.

In Germany, a political discussion of plans for such reporting obligations dates back to 2007. However, in those days, the plans³ had not been pursued further because of heavy criticism in the tax community. In 2014 a similar proposal arose in the Federal Council.⁴ However, it was never enacted the implementation of Directive.⁵

German tax authorities have not yet published the final version of the administrative decree on D.A.C.6. The latest official draft version is dated July 14, 2020 (the “Draft Decree”).⁶

¹ Council Directive (E.U.) 2018/822 of 25 May 2018.

² Law on the introduction of an obligation to report cross border tax arrangements (“*Gesetz zur Einführung einer Pflicht zur Mitteilung grenzüberschreitender Steuergestaltungen*”), the “D.A.C.6 Implementation Law”, of 21 December 2019, Federal Law Gazette 2019 I, p. 2875 ff.

³ Draft of a Bill of law of 25 June 2007. Said bill of law has not been publicly released. It can be downloaded [here](#).

⁴ Resolution of the Bundesrat on combating international tax arrangements, in the preliminary preparatory working papers of the Federal Council (“*Bundesrats-Drucksache*”) of 23 May 2014, 205/14, p. 2 *et seq.* The Federal Council (“*Bundesrat*”) is one of the two legislative bodies in Germany. It represents the German Federal States.

⁵ Details are provided by Johanna Hey, memorandum on the constitutionality of the introduction of a general reporting obligation for tax arrangements (“*Gutachten zur Verfassungsmäßigkeit der Einführung einer allgemeinen Anzeigepflicht für Steuergestaltungen*”) of February 2018, p. 5 *et seq.*

⁶ Draft version of the administrative decree on the application of the provisions on the reporting obligation for cross border tax arrangements (“*Entwurf eines BMF-Schreibens betreffend die Anwendung der Vorschriften über die Pflicht zur Mitteilung grenzüberschreitender Steuerverwaltungen*”) of 14 July 2020, IV A 3 – S 0304/19/10006: 008.

SCOPE OF THE REPORTING REQUIREMENT

Covered Taxes

The reporting requirement is limited to tax arrangements regarding German and E.U. taxes. U.S. taxes or the taxes of non-E.U. Member States are not covered.

Not all kinds of taxes trigger a reporting obligation. However, individual and corporate income taxes⁷ and trade taxes⁸ can lead to cross-border arrangements that are covered. In addition, real estate transfer tax,⁹ land tax,¹⁰ and inheritance and gift tax can lead to a cross-border arrangement that is covered by the Directive.¹¹

On the other hand, tax effects resulting from V.A.T.¹² or customs, E.U. harmonized excise duties or social security contributions or other fees are excluded and cannot trigger a D.A.C.6 reporting obligation.

Tax Arrangements

The definition of the term “tax arrangements” in the Draft Decree is abstract and broad. For that reason, it has limited use in practice. A tax arrangement is defined as a deliberate process of creation that changes factual and/or legal events with tax relevance through transactions, arrangements, actions, operations, agreements, commitments, obligations or similar events.¹³

At least of a certain practical use is the additional statement that a deliberate and active induction or change of a structure, process or situation is required.¹⁴ In principle, this should prevent an intentional deferral of action until a statutory time period passes from being a tax arrangement.¹⁵ A case in point is the deferral of dividend declaration until after the passing of the minimum holding period for applying the participation exemption for dividend income.¹⁶

Nonetheless, the definition of tax arrangement does not provide much help in causing a cross-border arrangement from being reportable.

Cross-Border Element

The tax arrangement must be a cross-border tax arrangement. This cross-border element requires that

⁷ *Einkommensteuer or Körperschaftsteuer.*

⁸ *Gewerbesteuer.*

⁹ *Grunderwerbsteuer.*

¹⁰ *Grundsteuer.*

¹¹ *Erbschaft- und Schenkungsteuer.*

¹² *Umsatzsteuer.*

¹³ Draft Decree, no. 9.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Such as Art. 10 (3) a) of the double tax treaty between Germany and the U.S.A. of July 4, 2008.

- either more than one E.U. member state are affected by the tax arrangement, or
- at least one E.U. member state and one or more countries in nonmember states, such as the U.S. are affected by the arrangement.

Hence, even cross-border tax arrangement without German nexus might be reportable in Germany if not reported already in another competent E.U. jurisdiction by the same or another intermediary.¹⁷

In addition, one of five alternative prerequisites must be met:

- The first alternative¹⁸ is that not all of the participants in the tax arrangement are resident for tax purposes in the same jurisdiction. Hence, this alternative would not be met if all participants are tax resident in the U.S.A. The one-country exception is not limited Germany.
- The second alternative¹⁹ is that one or more of the participants in the tax arrangement is simultaneously tax resident in more than one jurisdiction. If the U.S. consider U.S. citizens as U.S. tax residents, while Germany considers somebody as German tax resident if that person has his domicile or habitual abroad in Germany, this alternative should be met. The same should apply if, for example, a corporation is considered U.S. tax resident because it is formed under the laws of a State of the U.S. such as Delaware, while it is also considered German tax resident as its effective place of management is in Germany.
- The third alternative²⁰ is met if one or more participants in the tax arrangement carries on a business in another jurisdiction through a permanent establishment and the tax arrangement relates to the business of that permanent establishment. This would be the case of a U.S. corporation with German or Dutch permanent establishment, where the tax arrangement relates to German or Dutch activity. If, however, the activity of the U.S. corporation relates solely to a U.K. permanent establishment, this alternative is not met if not relevant to the Dutch or German permanent establishment. No E.U. member state is affected by the tax arrangement between the U.S. corporation and its U.K. permanent establishment.
- The fourth alternative²¹ is met if one or more participants in the tax arrangement carries on an activity in another jurisdiction without being tax resident or creating a permanent establishment in that jurisdiction. A typical case is the real estate investment of a foreign investor in Germany. In order to limit the extent of that alternative, the Draft Decree requires that such activity in the other jurisdiction must be substantial as to taxes and provides a respective example.²²

¹⁷ See below under 6.3 for details on the measures to exclude double reporting and under 7. For details on the interaction between several intermediaries.

¹⁸ Sec. 138d (2) no. 2 lit. a) AO.

¹⁹ Sec. 138d (2) no. 2 lit. b) AO.

²⁰ Sec. 138d (2) no. 2 lit. c) AO.

²¹ Sec. 138d (2) no. 2 lit. d) AO.

²² Draft Decree, no. 36.

In the example, a German corporation X purchases German real estate from a German corporation Y. Both are tax residents in Germany. X provides digital services to customers in Germany and Italy. The real estate purchase as potential tax arrangement has no connection with the digital services to Italian customers. Thus, the Italian activity is not substantial as to taxes under the purely German tax arrangement. Hence, there is no cross-border tax arrangement.

- The fifth alternative²³ relates to tax arrangements that have possible impact on the European automatic exchange of information (roughly this can be compared to F.A.T.C.A.) or the identification of beneficial ownership (money laundering related concept).

The Intermediary

If there is a cross-border tax arrangement on reportable taxes, the further analysis refers to the intermediary. The intermediary can be described as the master mind behind the tax arrangement and the person generally in charge of the reporting of a reportable tax arrangement. Hence, it is also the primary person, who must assess whether there is a reportable tax arrangement.

The intermediary is defined by reference to certain activities with respect to a reportable cross-border tax arrangement. It is the person who designs, markets, organizes or makes available for implementation or manages the implementation of a reportable cross-border tax arrangement. Hence, many professionals can qualify as intermediary, such as lawyers, tax advisors, banks, investment managers or insurance companies. This list is not exhaustive.

For German D.A.C.6 reporting obligations, German tax residents, E.U. tax residents or even third country tax residents, such as a U.S. tax resident, can qualify as intermediary.

The Draft Decree provides certain guidance and relief as to each of the activities that makes a person an intermediary. For example, a person does not design a tax arrangement when it merely assesses a tax arrangement planned, designed or developed by the relevant taxpayer on its own or by a third party.²⁴ Hence, an expert opinion on the tax consequences of a pre-designed tax arrangement should not trigger intermediary status on the expert.²⁵ Furthermore, the mere abstract reproduction of the wording (*i.e.* of the law and the presentation of the administrative decrees, the case law of the (tax) courts) should also not trigger the intermediary status.²⁶

There are also cases that do not use an intermediary, such as a fact pattern involving a mere inhouse restructuring by the relevant taxpayer planned for and implemented by itself. In such case, the relevant taxpayer must fulfill the tasks normally assigned to the intermediary. It must analyze whether reportable cross-border tax arrangement results from the restructure and must report the arrangement to the competent tax authority.

²³ Sec. 138d (2) no. 2 lit. e) AO.

²⁴ Draft Decree, no. 55.

²⁵ *Id.*

²⁶ *Id.*



The Hallmarks

In accordance with the Directive, the German implementation distinguishes two types of Hallmarks which must be realized in order to give rise to a D.A.C.6 reporting requirement. On one hand, there are Hallmarks for which one of the main benefits of the arrangement is the reduction of taxes (so-called “main benefit test” (“M.B.T.”)). On the other hand, there are certain Hallmarks that do not require a finding under the M.B.T.²⁷

The M.B.T. is required for those Hallmarks that are not necessarily viewed as potentially aggressive tax arrangements in appropriate fact patterns. The M.B.T. of sec. 138d (2) no. 3 lit. a) A.O., thus, requires in addition that from the perspective of a prudent observer and in an overall assessment at least one of the main benefits of an arrangement is the tax advantage that results from the transaction. In this respect, the nontax advantages must outweigh the tax advantages to such an extent that the tax advantages are reduced to mere relics.²⁸ Hence, a tax arrangement does not escape the M.B.T. solely by providing proof of considerable nontax reasons.²⁹

Hallmarks That Require a Finding Under the M.B.T.

The Hallmarks that require a finding as to the main benefit are the following:

- An arrangement where the relevant taxpayer or a participant in the arrangement undertakes to comply with a condition of confidentiality which may require them not to disclose to other intermediaries or the tax authorities how the tax arrangement could realize a tax advantage.
- An arrangement where the intermediary is entitled to receive a fee for the arrangement and that fee is fixed by reference to the amount of the tax advantage derived from the arrangement or includes an obligation on the intermediary to partially or fully refund the fees where the intended tax advantage derived from the arrangement was not partially or fully achieved.
- An arrangement that has substantially standardized documentation or structure and is available to more than one relevant taxpayer without a need to be substantially customized for implementation.
- An arrangement whereby a participant in the arrangement takes contrived steps which consist in acquiring a loss-making company, discontinuing the main activity of such company, and using its losses in order to reduce the participant's tax liability, including through a transfer of those losses to another jurisdiction or by the acceleration of the use of those losses.
- An arrangement that has the effect of converting income into capital, gifts, or other categories of revenue which are taxed at a lower level or that are exempt from tax.

“In accordance with the Directive, the German implementation distinguishes two types of Hallmarks which must be realized in order to give rise to a D.A.C.6 reporting requirement.”

²⁷ The German legislator did not further categorize the hallmarks. Therefore, the categories set out in the annex of the D.A.C.6 Directive are not reflected and thus the distinction of various specific hallmarks into specific hallmarks, for which the main benefit test applies, and specific hallmarks, for which it does not apply, is not implemented as categorization type in Germany.

²⁸ Draft Decree, no. 108.

²⁹ *Id.*

- An arrangement which includes circular transactions resulting in the round-tripping of funds, namely through involving interposed entities without other significant commercial function or transactions that offset or cancel each other.
- An arrangement that involves deductible cross-border payments made between two or more associated enterprises where the recipient is tax resident in a jurisdiction, that does not impose any corporate tax or imposes corporate tax at the rate of zero or almost zero.
- An arrangement that involves deductible cross-border payments made between two or more associated enterprises where the payment benefits from a full exemption from tax in the jurisdiction where the recipient is resident for tax purposes.
- An arrangement that involves deductible cross-border payments made between two or more associated enterprises where the payment benefits from a preferential tax regime in the jurisdiction where the recipient is resident for tax purposes.

Other Hallmarks for which the M.B.T. is not Relevant

The Hallmarks that do not require a finding as to the main benefit are the following:

- An arrangement that involves deductible cross-border payments made between two or more associated enterprises where the recipient is not tax resident in any tax jurisdiction.
- An arrangement that involves deductible cross-border payments made between two or more associated enterprises where the recipient is tax resident in a jurisdiction that is included in a list of third-country jurisdictions which have been assessed by Member States collectively or within the framework of the O.E.C.D. as being noncooperative.
- An arrangement that involves deductible cross-border payments made between two or more associated enterprises where depreciation deductions for the same asset are claimed in more than one jurisdiction.
- An arrangement that involves deductible cross-border payments made between two or more associated enterprises where relief from double taxation in respect of the same item of income or estate is claimed in more than one jurisdiction.
- An arrangement that includes transfers of assets with a material difference in the amount being treated as payable in consideration for the assets in those jurisdictions involved.
- An arrangement which may have the effect of undermining the reporting obligation under the laws implementing the E.U. automatic exchange of financial account information under common reporting standard.
- An arrangement involving a nontransparent legal or beneficial ownership chain with the use of persons, legal arrangements or structures that do not carry on a substantive economic activity supported by adequate staff, equipment, assets and premises and that are incorporated, managed, resident,



controlled or established in any jurisdiction other than the jurisdiction of residence of one or more of the beneficial owners of the assets held by such persons, legal arrangements or structures and where the beneficial owners of such persons, legal arrangements or structures, as defined in sec. 3 of the German Money Laundering Act, are made unidentifiable (a “nontransparent chain”).

- Arrangements concerning transfer pricing arrangements involving the use of unilateral safe harbor rules.
- Arrangements concerning pricing for the transfer of intangibles or rights in intangibles for which, at the time of the transfer between associated enterprises, no reliable comparable elements exist, and at the time the transaction was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain, making it difficult to predict the level of ultimate success of the intangible at the time of the transfer (“hard to value intangibles”).
- Arrangements concerning transfer pricing arrangements involving an intra-group cross-border transfer of functions, risks assets, or other advantages, if the projected annual earnings before interest and taxes (“E.B.I.T.”) of the transferor during the three-year period after the transfer are less than 50% of the projected annual E.B.I.T. of such transferor had the transfer not been made. In this Hallmark it is assumed that the associated enterprises must act in accordance with the principles of proper and conscientious business managers. These regulations also apply to permanent establishments.

Guidelines for the Interpretation of the Hallmarks

The guidelines for the interpretation of all of the Hallmarks in the Draft Decree are not voluminous much uncertainty continues to exist. However, with respect to the Hallmarks in connection with confidentiality clauses, standardized documentation, and anti-hybrid Hallmarks concerning the deduction of business expenses that are paid to a resident of a low tax jurisdiction, several bits of guidance appear useful.

- Regarding a confidentiality clause that requires nondisclosure of the rational of a tax planning arrangement, the Draft Decree suggests an exception that allows disclosure to the tax administration and other intermediaries having comparable reporting obligations with regard to the transaction.³⁰ It also advises that confidentiality clauses with respect to the preparation of tax declarations, bookkeeping, annual audits, engagement letters for due diligence reports and the due diligence report itself does not fall under this Hallmark.³¹
- With respect to the use of standardized documentation and structure, the Draft Decree provides a list of standardized legal and tax advice that are not proscribed under Hallmark, if occurring in isolation That list includes standard forms *inter alia* with respect to the following tasks:

³⁰ Draft Decree, no. 120.

³¹ Draft Decree, no. 121.

“Nonetheless, circumstances that comprise an isolated event in this context are not explained. In addition, the exception applies in general, which means that a certain residual risk remains regarding exceptions.”

- Setting up a company
- Granting a loan or license
- Settlement of payment and securities transactions
- Amending continuing obligations solely to meet arm's length conditions

Nonetheless, circumstances that comprise an isolated event in this context are not explained. In addition, the exception applies in general, which means that a certain residual risk remains regarding exceptions. However, it seems that standardized documentation can be used if it is limited to setting-up of a company, issuance of loans or licenses, secondment of employees, payment services, and standardized leasing contracts.³²

- In case of a tax arrangement that involves deductible cross-border payments made between two or more associated enterprises where the recipient is tax resident in a jurisdiction that does not impose any corporate tax or imposes corporate tax at the rate of zero or almost zero percent, the Draft Decree defines “almost zero” as up to 4%,³³ which is much higher than the 1% European standard threshold.³⁴

The White List

The German legislator empowered the tax administration to provide a “White List.” Tax arrangements or tax aspects on that list do not qualify as tax advantage arrangements if they concern solely German tax. While the idea of having a White List was well appreciated by practitioners, in the end the list is quite short and considered as the absolute minimum. It is not likely to be expanded prior to the publication of the final version of the Decree.

Procedural Aspects

Competent Authority

The competent authority for D.A.C.6 reporting is the Federal Tax Office (*Bundeszentralamt für Steuern*). It is designated to receive reports of intermediaries that are tax resident in Germany. It can also receive reports from intermediaries that are not German tax resident where the intermediary is tax resident outside the E.U. and fulfills one of the following three requirements set out in sec. 138f (7) A.O.:

- The intermediary has a permanent establishment in Germany, through which the services with respect to the tax arrangement are provided.
- The intermediary is registered in the German commercial register or another German public professional register.
- The intermediary is registered with a professional association related to legal, tax, or consultancy services in Germany.

³² Draft Decree, no. 130.

³³ Draft Decree, no. 150.

³⁴ Summary Record prepared by the E.U. Commission Services, E.U. Working Party IV -Direct Taxation of 24 September 2018, p. 5.

Hence, a French corporation with German permanent establishment is not required to report in Germany (but probably in France). A U.S. corporation with German permanent establishment is required to report with the Federal Tax Office in Germany.

A failure to report based on gross negligence or a willful disregard of the rules result in the imposition of a fine of up to €25,000 for each failure to report. While such maximum amount may be rather low compared to other E.U. Member States, the extent of the failures add up.

Legal Professional Privilege

In principle, lawyers, tax advisors or other groups providing services that give rise to a professional privilege recognized by German law opt out of the full reporting under certain requirements if released by the taxpayer.

This does not lead to a full reporting obligation of the taxpayer, but to a reporting obligation that is split. The lawyer, tax advisor or other intermediary has an obligation to file a partial report of non-individualized information. The report may include the following:

- A summary of the content of the reportable arrangement
- The details on all applicable Hallmarks
- The date on which the first step in implementing the reportable arrangement
- The details of the relevant national provisions
- The value of the reportable arrangement.

The taxpayer is, then, obliged to report the individualized information in its partial reporting. In the end, a full report is filed, comprised of two partial reports.

The intermediary must inform the taxpayer about the taxpayer-related information it reported to the Federal Tax Office. The taxpayer must include in its partial report the registration number and the disclosure number of the intermediary's partial report. The 30-day reporting period for the taxpayer begins to run when it receives the required information from the intermediary.

Reporting in Another E.U. Member State

Several intermediaries that work on the same tax arrangement transaction are each responsible to report independently on that arrangement. However, once the Federal Tax Office receives a report on a particular tax arrangement or has been advised properly that a report was already filed with the competent authority of another E.U. Member State in accordance with the local D.A.C.6 requirements of that Member State, the obligation of a German intermediary is deemed to be satisfied.

For the foregoing rule to apply, the German intermediary must, upon request, submit proof that the tax arrangement was reported. Initially, degree of proof that was required to be submitted was not clear. However, the Draft Decree provides a practical solution – it is sufficient to provide the registration I.D. number (called the “arrangement I.D. number or reference number”) and the disclosure I.D. that relates to the

initial reporting by the other intermediary.³⁵ The German Tax Administration requires that the intermediary who wants to benefit from the foregoing process must have been reported by the initial intermediary in its reporting.³⁶

Reporting Another Intermediary

If an intermediary knows that at least one other intermediary is involved, it must include general personal information about that other intermediary the D.A.C.6 reporting filed with the Federal Tax Office. Once an intermediary files a D.A.C.6 report with the Federal Tax Office, it receives a registration number, which must be provided to all other intermediaries. Once the registration number is obtained, other intermediaries do not receive a further registration number for that tax arrangement from the Federal Tax Office.

CONCLUSION

In Germany, the reporting requirements are continuously increasing. This triggers high costs for all participants. It is doubtful whether the aim of all such new requirements will be reached, including, the avoidance of truly abusive tax structures. If the tax authorities are inundated with excessive data, abusive structures can be missed. In addition, German tax authorities do not have enough personnel to monitor cross-border arrangements and may require initial screening through the use of artificial intelligence. Perhaps it would have been a better alternative for the German tax authorities to expand its team of tax auditors so that audits could be concluded on a more rapid basis. In Germany, the tax examination teams often focus on tax periods that ended more than five years in the past.



³⁵ Draft Decree, no. 98.

³⁶ *Id.*

D.A.C.6 IMPLEMENTATION IN LUXEMBOURG – RISK OF MULTIPLE REPORTING OBLIGATIONS EXISTS

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Tags

Arrangements
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Luxembourg
Participants
Reportable

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INTRODUCTION¹

D.A.C.6 is the latest European Union Directive on Administrative Cooperation. It requires Intermediaries, and in some cases taxpayers, to report a wide range of “potentially aggressive tax planning arrangements” to tax authorities. The Directive became effective on July 1, 2020. It imposes obligations to report transactions entered into from June 25, 2018. It introduced the concept of “Hallmarks” into European tax law, albeit with a sense somewhat different to its more everyday usage.²

LEGISLATIVE BACKGROUND

European Council Directive (E.U.) 2018/822 of 25 May 2018 regarding the mandatory exchange of information in the field of taxation in relation to reportable cross-border arrangements, known as D.A.C.6, introduces mandatory reporting obligations on intermediaries who play a role in reportable cross-border arrangements (“C.B.A.’s”) entered into by taxpayers. D.A.C.6 formed the basis of the Luxembourg draft Bill (*Projet de Loi*) No 7465 dated the August 8, 2019. On March 21, 2020, the Luxembourg Parliament approved the law of 25 March 2020 (“L.L.2020”) and stated that the provisions would be applicable from July 1, 2020. D.A.C.6, however, foresees a retroactive effect with respect to any C.B.A. where “the first step in implementing” occurred between June 25, 2018 and July 1, 2020.

The main purpose of D.A.C.6 is to enhance transparency through the imposition of mandatory reporting obligations on “gate keepers” (*i.e.*, intermediaries) of arrangements that contain Hallmarks of potentially aggressive tax planning. This information is shared with other tax authorities in the E.U. It was inspired by the Final Report on Action 12 of the O.E.C.D. B.E.P.S. Project. However, the Mandatory Disclosure Rules (“M.D.R.”) of D.A.C.6 are broader in that they impose an obligation to disclose potentially aggressive tax planning arrangements.

Due to the COVID-19 pandemic, the implementation of these rules was delayed. Any reportable C.B.A.’s where the first step was implemented between June 25, 2018 and July 1, 2020 should have been reported by February 28, 2021. Additionally, any reportable C.B.A.’s which took place between July 1, 2020 and the present must be reported within 30 days from January 1, 2021. The first exchange of information between the Member States under D.A.C.6 is scheduled to occur by April 30, 2021.

¹ The authors acknowledge the insights obtained from Thierry Pouliquen, Andrew Knight, Simon Gorbett, and Graham J. Wilson during the preparation of this article.

² While the term “hallmark” is generally a positively affected word, being a symbol of certifying the standard of purity attributed to an object/ article, the hallmarks referred to within D.A.C.6 are the contrary and have negative features.

This article will consider the position in Luxembourg in relation to the transposition of D.A.C.6 and examine guidelines such as the Circular of the Luxembourg Tax Authority (“L.T.A.”) (formally the *Administration des Contributions Directes* or “A.C.D.”) as well as the commentaries on the draft law and the State Council opinion. References will be made to relevant existing law that may lead to duplicate reporting of the same facts.

TRANSPPOSITION OF D.A.C.6 IN LUXEMBOURG

Almost Identical Transposition of D.A.C.6

There are three means of legislating within the European Union: by Directive, by Regulation, and by Decision. As stipulated by Article 288 of the Treaty on the Functioning of the European Union, Directives are implemented in the following way.

A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods.

In comparison to Regulations and Decisions, Directives must be transposed into national law by each Member State. As a Directive, D.A.C.6 provides for a general legal framework that can be considered as the minimum standard for achieving its stated purposes. While transposing D.A.C.6 into national law, the E.U. Member States were required to specify certain provisions but were also free to broaden its scope. However, the reality with respect to Directives has been to move away from the “framework” style of Directive as embodied in Article 288 and towards the issuance of more detailed provisions. This shift leaves the Member States less wriggle room when transposing the Directive into national law. As such, Member States seem to be reluctant to depart from the wording of the Directives and the wording of domestic legislation frequently follows the exact wording of the Directives.

The Luxembourg legislative procedure, which is unicameral, nevertheless requires formal consultation by the Government with several nongovernmental organizations, the most important of which is the State Council (*Conseil d’Etat*). While N.G.O.s are consulted according to the subject matter of a proposed law, the State Council is consulted on all proposed laws and has the power to delay, although not amend, legislation. Commentaries by the State Council are often illuminating, as are the commentaries that accompany practically every proposed law in Luxembourg, whatever the subject matter.

The wording of L.L.2020 aligns closely with the text of D.A.C.6. The main definition of the terms such as “C.B.A.’s,” “intermediary,” “relevant taxpayer,” “associated enterprise,” “Hallmarks,” and “marketable arrangement” – are identical to the definitions within the D.A.C.6. Thus, L.L.2020 adopted the five categories of Hallmarks in D.A.C.6:

- General Hallmarks linked to the main benefit test (“M.B.T.”)
- Specific Hallmarks linked to the M.B.T.
- Specific Hallmarks related to cross-border transactions, with only some being subject to the M.B.T.



- Specific Hallmarks concerning automatic exchange of information and beneficial ownership
- Specific Hallmarks concerning transfer pricing

Luxembourg decided to transpose D.A.C.6 as an autonomous law and not merely as an amendment to the law of 29 March 2013 (itself as amended) on administrative cooperation in the field of tax, which transposed Directive 2011/16/UE. Therefore, L.L.2020 needed to define the notion of “financial accounts” and “persons” and to specify that the L.L.2020 applies to all taxes except V.A.T., customs duties, excise duties, and compulsory social security contributions.

The main scope of the reporting obligation was not extended beyond the scope expressly set down in D.A.C.6. For example, no additional Hallmarks were included and no reporting in relation to purely domestic arrangements is required.

Some Specifics of L.L.2020

D.A.C.6 authorizes the Member States to provide waivers from intermediary reporting. Thus, Member States may

* * * take the necessary measures to give intermediaries the right to a waiver from filing information on a reportable C.B.A. where the reporting obligation would breach the legal professional privilege under the national law of that Member State.

Initially limited to lawyers in the draft Bill 7465, L.L.2020 provides an exemption from reporting obligations for lawyers, chartered accountants (*experts-compatibles*) and auditors (*réviseurs d'entreprises*) reflecting the important role of accountants in providing tax advice to businesses and also reflecting the growing number of accounting firms that are associated with legal practices to a greater or lesser degree.

D.A.C.6 further requires E.U. Member States to introduce effective, proportionate, and dissuasive penalties for failure to comply with the provisions of the national laws that implement the Directive.

To this end L.L.2020 provides that intermediaries and relevant taxpayers may incur a fine that will be fixed by the Luxembourg Tax Administration up to an amount of EUR 250,000 in cases involving (i) failure to report information, (ii) late transmission of information, (iii) transmission of incomplete information, and (iv) transmission of inaccurate data.

Additionally, in cases where an intermediary is within the scope of legal professional privilege, a fine may be levied where an intermediary fails to notify other intermediaries or relevant taxpayers within the relevant ten-day notification period. The commentaries to the draft law indicate that the level of the penalty imposed will consider the circumstances of the case as well as the intentional character of the breach. Those commentaries also refer to the effective, proportionate, and dissuasive criteria of the penalties decided. The practice of enforcing tax reporting rules by means of having the tax administration impose fines occurs regularly in Luxembourg.³

³ See for example the European Court of Justice case of *Berlioz*: C-682/15.

INTERPRETATION OF THE RULES AND AVAILABLE GUIDANCE

Official Guidance?

The fact that D.A.C.6 itself is very broad in terms of its definitions and the Hallmarks may lead to different interpretations within the E.U. Member States. The wording of the L.L.2020 aligns closely with the text of D.A.C.6 and consequently does not provide much information on the definitions and Hallmarks. Most unfortunately the same is true of the commentaries to the draft law.

The State Council noted, in its opinion dated January 14, 2020, that the Luxembourg Government commentaries do not provide sufficient clarification allowing for a better understanding and, therefore, a possibly better assessment of whether a C.B.A. must be reported. In the same opinion, the State Council suggested some clarifications that have not been followed by the Luxembourg Government. Nevertheless, the L.T.A. followed some of the suggestions made by the State Council when the L.T.A. published its circular.

The L.T.A. Circular

The L.T.A. published a circular, most recently amended on February 12, 2021 (the “Circular”), providing further details in relation to the implementation of L.L.2020. It is our understanding that several Member States produced guidelines are more fundamental and categorical than those from Luxembourg and did so much sooner than Luxembourg.

The Circular contains only a few further details and clarifications in relation to the definitions or interpretation of the Hallmarks, specifically with regard to the M.B.T., which appear to stem from the opinion of the State Council. Apart from this, it contains mainly guidelines about the practical aspects of the reporting obligations, including (i) forms and communication methods to report information, (ii) languages that should be used, and (iii) scope of information to be provided to the L.T.A. However, some very important practical issues have not been dealt with and these items are discussed below.

Some of the details provided by the Circular are as follows.

Cross-Border Arrangement

In terms of the definition of a C.B.A., the Circular specifies there is no C.B.A. within the meaning of Article 1 (1) a-d if (i) all participants concerned with the arrangement are tax resident in the same Member State (which is not Luxembourg), and (ii) the intermediary is not to be considered as a participant of an arrangement, and (iii) the intermediary is the only one to present a link with Luxembourg. At the same time, it clarifies that this reasoning does not apply when the arrangement may have consequences on the automatic exchange of information or on the identification of the beneficial owner.

Clarifications on Intermediary Definition

Regarding the term of “made available for implementation” in relation to the definition of an intermediary, the Circular clarifies the time when the reporting clock begins to run. The activity

“The fact that D.A.C.6 itself is very broad in terms of its definitions and the Hallmarks may lead to different interpretations within the E.U. Member States.”

* * * is made available when the intermediary has provided the relevant taxpayer with the contractual documents or made them accessible to him otherwise, while specifying that an effective implementation, however, is not required.

The Circular further specifies that an intermediary who exercises, in relation to a C.B.A., exclusively activities such as the design, marketing, organization of a C.B.A., or the provision of such an arrangement for implementation, is not to be qualified as a participant in the arrangement unless this intermediary is also active in the arrangement that he himself has imagined, proposed, set up, made available for implementation or has managed the implementation for the benefit of the relevant taxpayer.

Participant of an Arrangement

Participants include not only the relevant taxpayer but also their commercial and contractual partners regarding the arrangement in question, such as buyer and seller of a property or lenders and borrowers.

Marketable Arrangement

Interesting to see is that the Circular expressly states that Hallmark A3, involving, an arrangement that has substantially standardized documentation and/or structure and is available to more than one relevant taxpayer without a need to be substantially customized for implementation, is not automatically considered as a marketable arrangement.

Professional Secrecy- Notification Obligation

Where the exemption for professional secrecy applies, the Circular clarifies that the exempt intermediaries are required to notify other intermediaries involved, including non-Luxembourg intermediaries, meaning that those intermediaries will, if they consider the transaction as reportable, make the reporting to the tax authorities of their respective Member States of residence. It also specifies that any intermediary or relevant taxpayer may, after receiving notification of a reporting obligation by an intermediary subject to professional secrecy, revise the initial assessment made by the notifying intermediary and may conclude that the arrangement is not reportable, based on the facts and circumstances. In the event the notified intermediaries and the taxpayer erroneously determine that no report is required, the exempt intermediary likely will not face a penalty for noncompliance on its part.

The Main Benefit Test

L.L.2020 subjects certain Hallmarks to the M.B.T. This means that even if the facts indicate that terms of the Hallmark have been met by the arrangement, reporting is required only if the following M.B.T. conclusion is reached:

[I]t 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.

Commentaries on draft law note that under paragraph 81 of Action 12 of the O.E.C.D. B.E.P.S. Project, the analysis calls for a comparison of the value of the expected tax benefit with the value of other benefits that may arise from the transaction based on an objective assessment of the tax benefits.

The Circular clarifies that the M.B.T. is not met when the tax advantage concerned is obtained from an arrangement that is in accordance with the purpose or the aim of the applicable legislation and the legislator's intention. In that case, that arrangement or transaction need not be reported. It further clarifies that to determine whether the arrangement is in accordance with the legislator's intention, all elements of the arrangement must be taken into consideration. An example of where the M.B.T. is met involves an arrangement that takes advantages of the subtleties or nuances of a tax system, or inconsistencies between two or several tax systems, to reduce the tax due. In these circumstances, the arrangement or transaction would be reported.

The Circular further confirms the view of the legislator within the draft bill that the M.B.T. must be met with respect to direct and certain indirect taxes, such as inheritance tax. It would not apply where the tax advantage is linked to V.A.T., customs duties, excise duties and compulsory social security contributions. Whether the tax advantage was obtained in an E.U. or a non-E.U. country does not affect the application of this exception.

The concept of the M.B.T. is not a new phenomenon. It has already been seen within the General Anti-Abuse Rule ("G.A.A.R.") provided under the Anti-Tax Avoidance Directive 2016/1164, however under different criteria. Directive 2016/1164 has been transposed by Luxembourg in the law of 21 December 2018. Under the G.A.A.R., nongenuine arrangements or a series of arrangements that are put in place for the main purpose, or one of the main purposes, of obtaining a tax advantage that defeats the object or purpose of the applicable tax law should be ignored for the purposes of determining the tax liability. An arrangement under the G.A.A.R. is regarded as nongenuine to the extent that it is not put into place for valid commercial reasons which reflect economic reality. Because the M.B.T. under D.A.C.6 does not have the same objective requirements, the scope of its application under D.A.C.6 is much broader.

Point 14 of the preamble of D.A.C.6 states the following:

[I]t is appropriate to recall that aggressive cross-border tax-planning arrangements, the main purpose or one of the main purposes of which is to obtain a tax advantage that defeats the object or purpose of the applicable tax law, are subject to the general- anti-abuse rule as set out in Article 6 of Council Directive (E.U.) 2016/1164.

Examples of Hallmarks

For each Hallmark, an intermediary must analyze arrangements on a case-by-case basis and consider all Hallmarks under D.A.C.6 and existing laws to ensure compliance. The discussion that follows addresses several Hallmarks, but not all.

B2: Conversion of Income in Context of Classes of Shares

Classes of shares with different economic rights such as preferred shares or tracking shares, are commonly used by Luxembourg companies and held both by investment funds and others.



The redemption of a class of shares by a Luxembourg company might be viewed as an arrangement falling within Hallmark B2, which relates to the conversion of income into capital or low or zero taxed income. In particular, this is because the shareholder in such case may be considered to be receiving a return in the form of a capital gain that is free of withholding tax rather than receiving a dividend that might be subject to withholding tax.

The conversion of the income should be assessed, in principle, at the level of the shareholder. Moreover, Hallmark B2 is subject to the M.B.T. This being said, the reporting of any repurchase of the classes of shares must be analyzed on a case-by-case basis.

For instance, in the case of a Luxembourg company held by a Luxembourg investment fund in the form of a tax-exempt opaque company, the redemption of an entire class of shares should not be considered as falling under the Hallmark B2 since any income received by such an investment fund is tax-exempt. Nevertheless, the repurchase of the entire class of shares would have to be analyzed in light of the M.B.T. to complete and support the absence of reporting of the C.B.A..

A3: Standardized Documentation and B2: Income Conversion in the Context of Life Insurance

As a preliminary remark, in many European countries, life insurance is seen as a good thing, whether it contains a greater or lesser element of savings or investment. This may also be linked to pension considerations. This means that in many countries one or more of the three principal components of life/pension insurance are the following:

- The payment of the premium by the policy holder
- The investment by the insurer/pension fund
- The eventual payment to the beneficiary

Each provides tax benefits, which may or may not be limited by ceilings or other standards. These advantages may include (i) the tax deductibility of premiums by the policy holder, (ii) the exemption or low taxation of investment income and gains in the hands of the insurer/pension fund, and (iii) the exemption or lower taxation of payments to a beneficiary or withdrawals by a beneficiary. This is a huge business and is heavily based upon standardized contracts. In 2017 life insurance premiums in the E.U. totaled €710 billion.

Hallmark A3 (Standardized documentation) and Hallmark B2 (Income conversion) might have an impact on Luxembourg life insurance contracts. Both Hallmarks are subject to the M.B.T. A life insurance contract is not automatically reportable under those Hallmarks and therefore needs to be analyzed on a case-by-case basis.

Regarding Hallmark A3, the commentaries of the draft law specify, by referring to paragraph 104 of Action 12, the following:

[This Hallmark] covers “prefabricated” tax products that can be used as they are, or after limited modifications. In order to set up such an arrangement, the customer does not need significant support in the form of professional advisory services.

On December 12, 2020, the Luxembourg Insurance and Reinsurance Association (*Association des Compagnies d'Assurance et Réassurance* or "A.C.A.") published on its website a post called "Frequently Asked Questions" on D.A.C.6 (F.A.Q.) constituting a nonbinding common interpretation of A.C.A. members presented and discussed with the Ministry of Finance and the L.T.A.

According to these F.A.Q., the A.C.A. suggests that Hallmark A3 should not apply to life insurance contracts, to the extent that those contracts are in compliance with the Luxembourg law, regulations, other binding measures or best practices, are in principle personalized to the client (e.g., determination of the beneficiary, choice between different types of investments and vehicles), and a certain degree of advice is provided.

Moreover, through life insurance contracts, the policyholder has the possibility to

[* * * invest] in a wide variety of instruments in order to constitute, using the income derived by these investments, a capital sum that can be repaid or bequeathed to one or more beneficiaries, generally with some preferential tax treatment, if certain specific conditions are met.

In this respect, life insurance contracts might be viewed as an arrangement falling within Hallmark B2, which relates to the conversion of income into capital or low or zero taxed income.

Based upon a particularly narrow view of the nature of an insurance contract, in the F.A.Q., the A.C.A. considers that, to the extent that the insurance company is the legal and beneficial owner of the invested assets, the policyholder does not benefit from any conversion of its income throughout the duration of the life insurance contract, and therefore Hallmark B2 is not automatically satisfied. In addition, if Hallmark B2 were to be considered as satisfied, the application of the M.B.T. to the policy would need to be analyzed.

E3 - E.U. Cross-Border Merger

Hallmark E3 refers to the following fact pattern:

[A]n arrangement involving an intragroup cross-border transfer of functions and/or risks and/or assets, if the projected annual earnings before interest and taxes (E.B.I.T.) during the three-year period after the transfer, of the transferor or transferors, are less than 50 % of the projected annual E.B.I.T. of such transferor or transferors if the transfer had not been made.

This Hallmark is not subject to the M.B.T. As a result, many transactions commonly used in Europe to effect corporate reorganizations can be caught by Hallmark E3. This despite the fact that there is specific European legislation which is intended to facilitate such transactions, including mergers, demergers, migrations, and liquidations, where tax deferral and/or reduction is a natural consequence alongside the other usual advantages sought in such reorganizations.

Whether Hallmark E3 is applicable to all sorts of mergers will likely depend on the activities, functions, risks, and assets carried on and held by the companies involved, keeping in mind that the Hallmark E3 is part of specific Hallmarks concerning transfer pricing.

Where an absorbed target company carries out shareholding and financing activities, transfer pricing issues generally should not be relevant. Therefore, profit that might be generated by those activities should not correspond to the E.B.I.T. notion referred to under Hallmark E3, rendering the cross-border merger potentially not reportable.

Conversely, if the absorbed target company carries on a commercial activity generating profitable operating revenues, besides its shareholding and financing activity, such profit should correspond to the E.B.I.T. notion referred to under Hallmark E3. As, a merger will inevitably reduce the E.B.I.T. of the absorbed company to nil, the cross-border merger could potentially qualify as a reportable C.B.A.

DOUBLE COUNTING OR THE INTERACTION OF REPORTING MECHANISMS

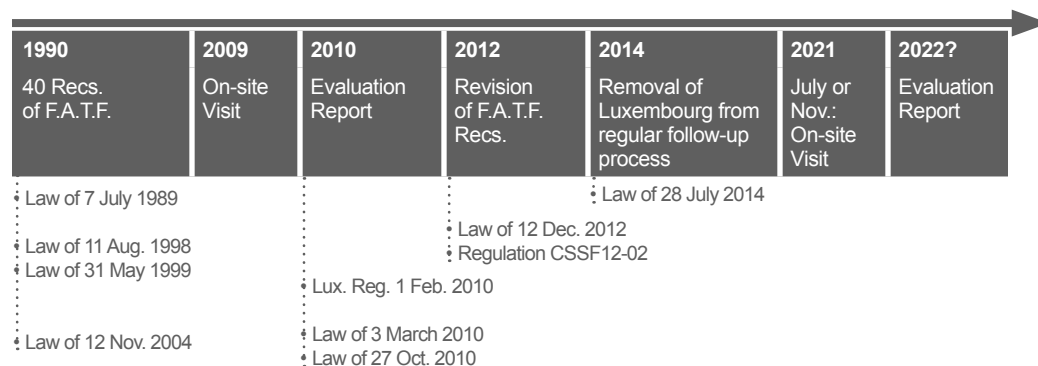
Law of 12 November 2004 on the fight Against Money Laundering and Against the Financing of Terrorism, as Amended (A.M.L. Law) and All Hallmarks of D.A.C.6

Figure 1 shows that the journey of the A.M.L. Law goes back to 1990 when the 40 recommendations published by the Financial Action Task Force (“F.A.T.F.”) were implemented in Luxembourg in the law of 7 July 1989. A few years later, the recommendations were transposed into the Luxembourg criminal code and finally into the law of 12 November 2004.

In 2009/10, F.A.T.F. undertook an on-site visit to Luxembourg as part of its general plan to verify the implementation of the F.A.T.F. recommendations by the E.U. Member States. A mutual evaluation report was issued in 2010 indicating recommendations as to how strengthen certain aspects of the Luxembourg system in relation to its actions to counter money laundering and terrorist financing (“A.M.L./T.F.”). Luxembourg consequently enacted several additional laws strengthening its A.M.L./T.F. system. Finally, in February 2014, the F.A.T.F. recognized that Luxembourg made significant progress in addressing deficiencies identified in the February 2010 mutual evaluation report so that it should be removed from the regular follow-up process.

The next ten-year evaluation process was scheduled for the spring of 2020. Due to COVID-19, it was first delayed until the autumn of 2020 and is now due to take place in July or November 2021, with the report to potentially follow in 2022. Luxembourg is extremely concerned about ensuring that it will receive a favorable evaluation report from the F.A.T.F. To be fair, this is, entirely justified given the rigorous procedures that have been put in place and which are well policed.

Figure 1: F.A.T.F. and Luxembourg



“Where an absorbed target company carries out shareholding and financing activities, transfer pricing issues generally should not be relevant.”

The first and only anti-money laundering Directive (“A.M.L.D.”) on the fight against money laundering that existed in 1991 was transposed into Luxembourg Law in 1993. In 2001, a second directive was transposed into the current A.M.L. Law. In 2005 the 3rd A.M.L. was adopted and covered not only anti money laundering but also terrorist financing. Over the years additional A.M.L. Directives have been issued. To date, the A.M.L. Law has been amended as a result of the growing problem of tax fraud and money laundering six times, the last one being by the law of February 25, 2021.

The evolution of the Directives on Administrative Cooperation (D.A.C.) in the field of taxation in the European Union is enormous. So far, the original Directive 2011/16/E.U. (“D.A.C.1”) has been amended five times by the following Directives with the object and purpose of strengthening the administrative cooperation between the E.U. Member States. As can be seen by the dates, the main, or one of the main, motivations was the fall-out from the 2008/9/10 financial crisis and the perceived need to raise tax revenues without raising taxes.

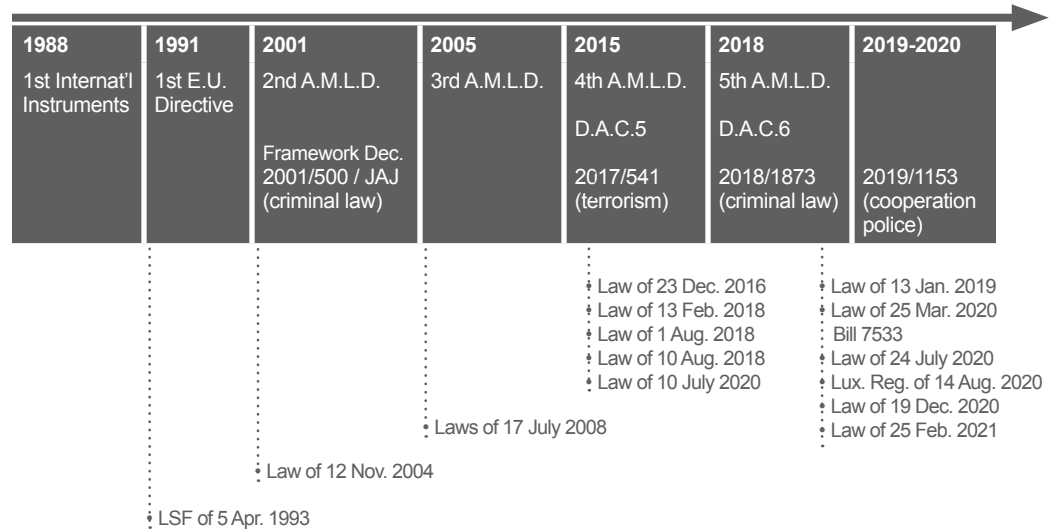
- **Directive 2014/107/E.U.**: This Directive introduced an automatic exchange of information on financial accounts and the related account holders (“D.A.C.2”), implemented in Luxembourg by the law of 18 December 2015 on the common reporting standard (C.R.S.).
- **Directive 2015/2376/E.U.**: This Directive addressed the automatic exchange of tax rulings and advance pricing agreements (“D.A.C.3”), implemented into Luxembourg law by the law of 23 July 2016.
- **Directive 2016/881/E.U.**: This Directive introduced the automatic exchange of country-by-country reports (“D.A.C.4”), implemented in Luxembourg by law of 23 December 2016.
- **Directive 2016/2258/E.U.**: This Directive ensures that tax authorities have access to beneficial ownership information collected pursuant to 4th E.U. A.M.L. Directive (“D.A.C.5”), implemented into Luxembourg legislation by the law of 1 August 2018.
- **Directive 2018/822/E.U.**: This Directive addressed automatic exchange of reportable C.B.A.’s (“D.A.C.6”).

D.A.C.7 was issued earlier this month (March 2021) and addresses tax transparency on digital platforms. D.A.C.8 has been proposed on reporting of crypto assets.



Figure 2: Development of the Legislative and Regulatory Framework Over the Past Three Decades on A.M.L.

Historical Overview of Anti-Money Laundering Law (E.U.)



Luxembourg Law of 18 December 2015 Transposing E.U. Directive 2014/107, Known as “D.A.C.2,” Relating to the Mandatory Automatic Exchange of Information in Tax Matters (C.R.S. Law) and Hallmark D1 (Automatic Exchange of Information)

The C.R.S. Law requires financial institutions to report financial accounts held by account holders that are tax residents in a C.R.S. jurisdiction. At the same time, separate reporting obligations under L.L.2020 may be triggered if the specific Hallmarks concerning automatic exchange of information (Hallmark D1) are considered to be satisfied. This Hallmark is not subject to the M.B.T.

In comparison to the C.R.S. Law, the reporting obligation under Hallmark D1 is not addressed only to financial institutions but extends to include intermediaries or if there is no intermediary to the “relevant taxpayer.” The scope of Hallmark D1 is extremely broad and reporting under Hallmark D1 covers arrangements that may have the effect of undermining the reporting obligations under the C.R.S.

As a result, an intermediary is left with considering two sets of rules when an arrangement falls within the scope of Hallmark D1. The preamble to D.A.C.6 however points to the M.D.R. developed by the O.E.C.D. and related commentary as a source of illustration and interpretation which might be useful in analyzing whether the reporting arrangement is consistent with the C.R.S. law. Nevertheless, in the circumstances where Hallmark D1 applies, the intermediary or the taxpayer should consider whether C.R.S. Law have been complied with, too.

Luxembourg Law of 13 January 2019 Creating a Register of Beneficial Owners Transposing the 4th E.U. A.M.L. Directive, as Amended by the 5th E.U. A.M.L. Directive (R.B.E. Law) and Hallmark D2 (Concealment of Beneficial Owner)

Hallmark D2 is not linked the M.B.T. and looks at arrangements where the intermediary or taxpayer intends to conceal the beneficial owner by using offshore entities

“Hallmark D2 is not linked the M.B.T. and looks at arrangements where the intermediary or taxpayer intends to conceal the beneficial owner by using offshore entities and structures with no real substance.”

and structures with no real substance. O.E.C.D. examples look to fact patterns in which undisclosed nominee shareholders are used or where control is exercised indirectly rather than by means of formal ownership. Beneficial ownership may also be obscured where arrangements are based in jurisdictions where there is no requirement to maintain information on beneficial ownership. This Hallmark should not be triggered in the first place if A.M.L. obligations and R.B.E. Law have been complied with during the identification process and the beneficial owner is recorded on the Luxembourg beneficial owner register.

Law of 10 February 2021 introducing Defensive Measures Towards Blacklisted Countries and Hallmark C1 b (ii) (Blacklisted Countries)

This law denies, under certain circumstances, the deduction of interest and royalties owed by Luxembourg corporate taxpayers to associated enterprises and individuals established or based in noncooperative tax jurisdictions (E.U. “blacklisted countries”). As of February 22, 2021, those jurisdictions include American Samoa, Anguilla, Dominica, Fiji, Guam, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, the U.S. Virgin Islands, and Vanuatu. Hallmark C1.b(ii) is not subject to the M.B.T. and target situations where arrangements involve tax-deductible payments to a resident in blacklisted countries. The fact that those arrangements are now reportable to the tax authorities under the Hallmark C1.b(ii) may permit the L.T.A. to apply the law of 10 February 2021 and sanction those arrangements.

Law of 23 July 2016 Transposing Directive 2015/2376/E.U. on Automatic Exchange of Tax Rulings, known as “D.A.C.3” and Hallmarks, Particularly Hallmark E (Concerning Transfer Pricing)

As of January 1, 2017, all cross-border advance tax rulings and advance pricing agreements issued, modified, or renewed by the L.T.A. are subject to automatic exchange of information with all other E.U. Member States. In this respect, if an arrangement falls within one of the Hallmarks or in particular Hallmark E, it must be reported. Moreover, if the arrangement is considered to be exchanged under the law of 23 July 2016, this will lead to unnecessary double exchange between the E.U. tax authorities and ultimately to an increase of workload for the tax authorities.

CONCLUSION

As we have seen from the above, it has taken eight years to move from D.A.C.1 to D.A.C.6 and the process is ongoing with D.A.C.7. Perhaps the E.U. will soon get it right.

- D.A.C.6 itself is very broad in terms of its definitions and Hallmarks. This may lead to different interpretations across the different E.U. Member States. Luxembourg followed the wording of D.A.C.6 rather closely. Thus, there is a serious need for further guidance in Luxembourg concerning L.L.2020, in particular the definitions and the interpretation of the Hallmarks.
- The limited clarification within the commentaries to the draft law and the State Council opinion, which as indicated, have not been followed by the Luxembourg Government, as well as the rather practical guidance from the L.T.A., are not sufficient.

- L.L.2020 concerns C.B.A.'s, which indicates that more than one intermediary will almost certainly be involved in a particular arrangement. Thus, different intermediaries may have different views as to whether a particular arrangement is considered as reportable or not.
- Depending on the decision taken by the intermediaries involved, this may result in unnecessary multiple and even overlapping filings in relation to the same arrangement, increasing the workload of not only of the intermediaries but also the tax authorities (all of course paid for by the taxpayer directly or indirectly).
- According to L.L.2020, an intermediary for which the exemption applies under the professional legal privilege must notify "any other intermediary" involved, and in the absence of an intermediary not subject to the legal professional privilege, the relevant taxpayer.
- The State Council notes, in its opinion dated March 10, 2020 on the draft law, that given the definition of the term intermediary, "any other intermediary" means the other intermediary regardless of whether it benefits from an exemption from the reporting obligation for a C.B.A.. This leads to an unnecessary and inconsistent multiplication of notifications to the various intermediaries.
- The Circular states that "the intermediary subject to professional secrecy is required to notify the reporting obligations to the persons to whom they fall and of which he is aware, whether he is an intermediary or a relevant taxpayer." But it is still not clear whether "to whom they fall" excludes intermediaries benefiting from an exemption from the reporting obligation, which does not put an end to the concerns.
- The fact that the intermediaries and tax authorities must also consider above mentioned existing laws while analyzing a C.B.A. leads to an increase of work and expenses. Thus, specific guidelines from the Luxembourg Government are long overdue to avoid such unnecessary reporting and increase of workload.

This being said, and to the extent that Member States tend to replicate the text of Directives as mentioned above, it may be time for the E.U. Commission to go beyond providing more and more precise Directives by providing detailed rules as to how expedient and efficient implementation, including simple reporting, should be made.

D.A.C.6 – THE ITALIAN WAY

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Tags

Arrangements
Cross-border
DAC6
Hallmarks
Intermediaries
Italy
Participants
Reportable

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INTRODUCTION

In the context of the various initiatives in the field of tax transparency, the European Union (“E.U.”) issued E.U. Council Directive 2018/822 of 25 May 2018 (“D.A.C.6” or “Directive”), which introduced a broad mandatory reporting obligation for intermediaries and taxpayers involved in cross-border arrangements that meet certain features, commonly referred to as “Hallmarks.”

The Italian Government implemented D.A.C.6 with Legislative Decree no. 100/2019 (the “Legislative Decree”). The Legislative Decree follows the wording of the Directive, Annex I to the Legislative Decree includes the list of Hallmarks to be considered for identifying reportable cross-border transactions, which matches Annex IV of the Directive.

On November 17, 2020, the Italian Ministry of Finance published a decree containing specific clarifications for certain key aspects, including definitions of terms used in connection with the Hallmarks (the “Decree”).

On November 26, 2020, the Director of the Italian Tax Authority (the “I.T.A.”) issued Regulation no. 364425/2020 providing for technical rules and procedures.

On February 10, 2021, after the first reporting deadline of January 31, 2021, the I.T.A. issued Circular no. 2/E (the “Circular”) which provides certain clarifications regarding who must report, the scope of the report, and several interesting examples of cross-border arrangements that are reportable. Because the Circular was published after the first reporting deadline passed, no penalties are applied where complete reports have been filed by February 28, 2021.

Both the Legislative Decree and the Circular specify that the absence of any action by the I.T.A. in response to a report of an intermediary or taxpayer does not mean that the underlying transaction has been accepted as compliant with substantive provisions of Italian tax law. That determination can be made only after the completion of an I.T.A. examination. Similarly, the filing of a report under D.A.C.6 by an intermediary or taxpayer should not be viewed as an admission that an abusive arrangement has taken place.

This article provides a brief overview of the Italian implementing regulations and focuses on recent clarifications contained in the Circular with respect to Hallmarks contained in Categories A, B, C and E.

WHO IS REQUIRED TO REPORT?

In principle, the new mandatory reporting obligation lies with both intermediaries and taxpayers. Intermediaries have the primary obligation to report. The reporting obligation lies with the taxpayer only when the intermediary is exempt or does not have access to all information.

Intermediaries

According to the Legislative Decree, the intermediary is the person who

- designs, markets, organizes, or makes available for implementation or manages the implementation of a reportable cross-border arrangement (the “Promoter”); or
- provides, directly or indirectly, assistance or advice in relation to the reportable cross-border arrangement (the “Service Provider”).

The Circular clarifies that the term of “intermediary” encompasses (i) financial entities subject to reporting obligations under the Common Reporting Standard, such as banks, insurance companies, and fund asset managers and (ii) advisors already subject to anti-money laundering regulations, such as lawyers, accountants, and notaries. Based on the clarifications contained in the Circular, the reporting obligation is fundamentally the same for the Promoter and the Service Provider, but the latter is required to report a cross-border arrangement to the extent that it appears to be “reportable” on the basis of its experience and the available information, without an obligation to collect further information. This is commonly referred to as the “standard of knowledge.”

To be subject to the reporting obligations under D.A.C.6, the intermediary must meet at least one of the following territorial requirements:

- It is resident in Italy for tax purposes.
- It has a permanent establishment in Italy through which it provides services in respect of the reportable cross-border arrangement.
- It is incorporated in Italy or is regulated by Italian laws.
- It is registered with an Italian professional providing legal, tax or consultancy services.

Where more than one intermediary meets the above-mentioned territorial requirements, the obligation to file the report on the cross-border arrangement lies with all intermediaries involved in the same reportable cross-border arrangement.

As to the Service Provider that advises or assists a client in relation to a reportable cross-border arrangement that is already in place prior to the effective date of D.A.C.6, the Circular specifies that no reporting obligation exists to the extent that it does not participate in an update or an improvement of the existing arrangement.

Should the intermediary be an organization, the individual who must comply with the reporting obligation depends on the nature of the intermediary. Where the intermediary is a company or an entity with legal personality, the legal representative of the organization is obligated to file the report. Where the intermediary is an entity

“According to the Legislative Decree, the definition of the term ‘taxpayer’ encompasses any person that implements a reportable cross-border arrangement or to which a relevant arrangement is made available.”

without legal personality, the person who is in charge of the professional engagement relating to the reportable cross-border arrangement is obligated to file the report.

Intermediaries are exempt from the reporting obligation in several circumstances:

- The first is that they receive from clients or others relevant information on reportable cross-border arrangements while examining the client’s legal position or providing legal assistance in connection with a proceeding before a judicial authority.
- The second is that they have evidence that a reportable cross-border arrangement has been reported by another intermediary and the report contains the same information that they would otherwise be required to file.
- The third is that filing it could trigger exposure to their own criminal liability (self-incrimination).

Taxpayers

Taxpayers are required to report cross-border arrangements where (i) there is no intermediary, (ii) the intermediary is exempt from reporting and there are no other intermediaries, or (iii) the intermediary does not provide the taxpayer with the evidence that the same information has already been reported.

According to the Legislative Decree, the definition of the term “taxpayer” encompasses any person that implements a reportable cross-border arrangement or to which a relevant arrangement is made available. The Circular clarifies that, to qualify as a taxpayer, a person must know the key features of the arrangement.

To be subject to the reporting obligations under the D.A.C.6 regulations, a taxpayer must meet at least one of the following territorial requirements (the “Italian Taxpayer”):

- It is resident in Italy for tax purposes.
- It has a permanent establishment in Italy through which benefits are available from the reportable cross-border arrangement.
- It receives income or generates profits within the Italian territory, although it does not meet the foregoing requirements.
- It carries on its business in the Italian territory even if it does not meet the foregoing requirements.

Regarding the reporting obligation on a taxpayer that receives income or generates profits within the Italian territory, the Circular clarifies that the criteria for identifying income that is deemed to be originated or derived within the Italian territory are those set forth under Article 23 of the Italian Income Tax Code,¹ without taking into account the effect of any applicable Double Tax Treaty. Regarding the reporting obligation on a taxpayer that carries on its business in the Italian territory, the Circular specifies that a reporting obligation exists even where a nonresident person carries on its business in Italy without creating a permanent establishment in Italy.

¹ Presidential Decree no. 917 of 22 December 1986.

Where a reportable cross-border arrangement involves more than one taxpayer meeting the territorial requirement, the Circular specifies that the reporting obligation lies with the taxpayer that agreed to the arrangement with the intermediary or, absent the intermediary, with the taxpayer who managed its implementation. Should the Italian Taxpayer not be an individual, the reporting obligation is imposed on the legal representative, even if the taxpayer does not have legal personality.

As pointed out in the Circular, the distinction between an intermediary and a taxpayer may be blurred. In particular, the Circular clarified that a taxpayer may fall under the definition of “intermediary” if an entity belonging to a multinational group designs, organizes or makes available to another group entity a reportable cross-border arrangement for implementation by a sister company, in which case the entity designing the arrangement is a Promoter. Additionally, a taxpayer may be an intermediary if it provides assistance or advice to another group entity in relation to an arrangement, in which case the advising entity is a Service Provider.

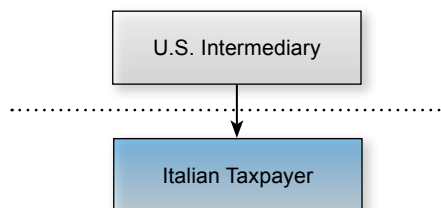
Taxpayers are exempt from the reporting obligation in two circumstances. The first is when they have evidence that the same information regarding a reportable cross-border arrangement has been reported by the intermediary. The second is where it could trigger their own criminal liability (self-incrimination).

WHAT ARE REPORTABLE CROSS-BORDER ARRANGEMENTS?

Identifying the arrangements that are subject to the reporting obligation requires an understanding of various provisions contained in both the Legislative Decree and the Decree.

First, the arrangement must relate to cross-border situations in order to be reportable. Consequently, it must be “a scheme, agreement or project concerning Italy² and one or more foreign jurisdictions,” meaning that at least one of the participants (either an intermediary or the taxpayer) has a connection with the Italian territory.³ At the same time, another participant or the same participant has a connection with another jurisdiction. This could happen in various ways, as illustrated under the following fact patterns.

- Not all the participants in the arrangement are resident in Italy for tax purposes. This is illustrated in the following diagram:⁴

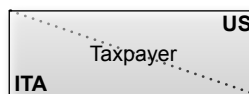


² See Article 2, para. 1, letter a) of the Legislative Decree.

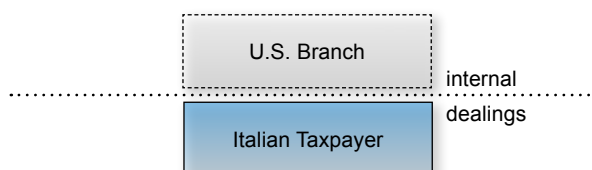
³ See the territorial requirements illustrated in the previous section.

⁴ It is based on the Example 2 contained in the Circular (page 29).

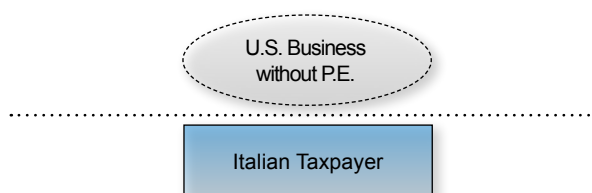
- One or more of the participants in the arrangement are simultaneously resident for tax purposes both in Italy and in another jurisdiction. This is illustrated in the following diagram:⁵



- One or more of the participants in the arrangement carry on a business in another jurisdiction through a permanent establishment situated in that jurisdiction and the arrangement forms a part or the whole of the business of that permanent establishment. This is illustrated in the following diagram:⁶



- One or more of the participants in the arrangement carry on an activity in another jurisdiction without being a tax resident of that jurisdiction or creating a permanent establishment situated in that jurisdiction. This is illustrated in the following diagram:



- The arrangement has a possible impact on the automatic exchange of information or the identification of beneficial ownership.

Second, for a cross-border arrangement to be reportable, it must include at least one of the tax avoidance risk indicators (“Hallmarks”) contained in the five categories (Categories A through E) listed in the Annex 1 to the Legislative Decree which exactly mirrors the content of the Annex IV to the Directive. As illustrated below, the presence of certain Hallmarks is not always sufficient by itself to trigger reporting, but become so if a specific test is met.

As provided for by the Decree, Hallmarks under Categories A, B, C, and E trigger the reporting obligation only in cases where the transaction can result in a reduction in taxes⁷ due by a taxpayer in one of the E.U. Member States or in another jurisdiction that signed an *ad hoc* agreement with Italy for the exchange of information for D.A.C.6 purposes.⁸ In line with the scope of the Directive, the tax reduction feature covers all taxes, except for V.A.T., customs duties, and excise duties.

⁵ It is based on the Example 4 contained in the Circular (page 30).

⁶ It is based on the Example 9 contained in the Circular (page 32).

⁷ See Article 6 of the Decree.

⁸ Please note that, at the time of this document, no specific agreements for the exchange of information for D.A.C.6 purposes has been signed by Italy yet.

“According to the Circular, the tax reduction is the tax advantage that it is expected to be derived from the cross-border arrangement.”

Regarding Italian taxes, the Circular refers to

- Italian corporate income tax (I.R.E.S.),
- Italian individual income tax (I.R.P.E.F.),
- regional tax on productive activities (I.R.A.P.),
- final withholding taxes and substitute taxes,
- local taxes,
- indirect taxes (such as the registration tax, stamp duty, mortgage, and cadastral taxes), and
- wealth taxes on financial assets held abroad (I.V.A.F.E.) and on immovable properties held abroad (I.V.I.E.).

According to the Circular, the tax reduction is the tax advantage that it is expected to be derived from the cross-border arrangement. It must be calculated as the difference between taxes payable as a result of the cross-border arrangement and taxes that would have been paid without such arrangement (the “Tax Reduction Test”). The Circular specifies that the tax reduction may result in (i) a reduction in the taxable income or resulting taxes, (ii) a relief from double taxation or an increase in that relief, (iii) a tax refund or an increase in the amount refunded, (iv) the deferral of a tax payment and (v) the elimination or a reduction of withholding taxes.

The Circular states that the existence of a tax reduction must be made without taking into account that the reduction may be offset by specific Italian tax provisions (such as C.F.C. rules and anti-hybrid rules). It is not clear that the mandate to ignore corrective provisions is valid. This was pointed out in a submission by the Association of Italian Joint Stock Companies,⁹ which explained that entering into a transaction that results in the imposition of Italian tax under C.F.C. legislation or anti-hybrid rules does not appear to be potentially aggressive within the meaning of D.A.C.6.

For Hallmarks listed under Categories A and B and several under C, transactions are reportable only if the tax reduction meets the “main benefit” test (“M.B.T.”). Under the M.B.T., no reporting is required if nontax advantages that are obtained from a transaction are viewed to be greater than the identified tax advantages. In that set of circumstances, it cannot be said that the main benefit of entering the transaction is the resulting tax benefit. Both the Decree and the Circular clarify that the M.B.T. takes into account only the tax advantage of an Italian Taxpayer, meaning that tax advantages that will be derived by a taxpayer resident outside Italy are not considered. Finally, the benchmark that is applied under the M.B.T. is that the tax advantage must exceed 50% of all the benefits to be derived by an Italian Taxpayer, including both tax and nontax advantages.¹⁰ The M.B.T. does not require an analysis of the taxpayer’s intentions. Hence, it is an objective test rather than a subjective test.

To identify the nontax advantages deriving from the cross-border arrangement, the Circular clarifies that it is necessary to take into account reduction in costs or any

⁹ Assonime, Consultation document no. 9/2018.

¹⁰ See Article 7, para. 2 of the Decree.

increase in revenues. These advantages must be objectively quantifiable based on accounting and nonaccounting documentation, such as provisional budgets. In addition, the Circular clarifies that if a cross-border arrangement includes both a Hallmark for which the M.B.T. is required and a Hallmark for which the M.B.T. is not required, the arrangement must be reported under the last-mentioned Hallmark. Hence, the M.B.T. becomes irrelevant to the reporting obligation.

HALLMARKS

Category A - Generic Hallmarks Linked to the M.B.T.

Hallmark A1 applies to arrangements where at least one of the participants undertakes to comply with a condition of confidentiality that prohibits disclosure of how the arrangement secures a tax advantage. For this Hallmark to apply, the Circular clarifies that it is sufficient that the confidentiality is required with regard either to an intermediary or the Tax Authority. In addition, this Hallmark applies even if the confidentiality is required of any person that is not involved in the arrangement.

Hallmark A2 applies to an arrangement where the intermediary is entitled to receive a fee or, remuneration for the arrangement, and that fee is fixed by reference to the amount of the tax advantage derived from the arrangement, even if no tax advantage is actually derived by the Italian Taxpayer. The Circular points out that this Hallmark applies only if an intermediary is involved in the cross-border arrangement.

Hallmark A3 applies to an arrangement that has substantially standardized documentation and/or structure and is available to more than one taxpayer without a need to be substantially customized for implementation. Regarding this Hallmark, the Decree clarifies that it does not cover standardized arrangements to obtain a specific tax incentive provided by Italian tax law. In this regard, the Circular specifies that this Hallmark does not cover the drafting of documentation to be used for requesting the refund of tax credits or withholding taxes or the application of any tax incentive.

Category B - Specific Hallmarks Linked to the M.B.T.

Hallmark B1 applies to an arrangement whereby a participant undertakes contrived steps which consist of (i) acquiring a loss-making company, (ii) discontinuing the main activity of that company and (iii) using the losses to reduce the acquiring company's tax liability in Italy or elsewhere. The Circular clarifies that

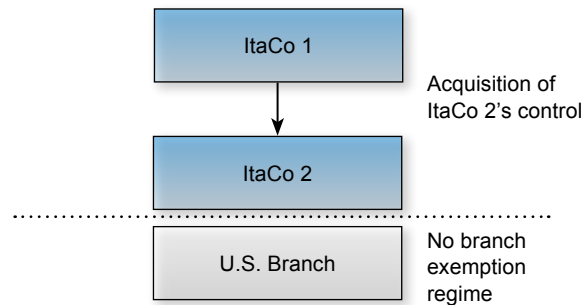
- acquisition of a company is determined by reference to the acquisition of the control of a company in accordance with Article 2359 of the Italian Civil Code,¹¹
- the discontinuation of the main activity of the acquired company must be real, and
- Hallmark B1 covers cases where, *inter alia*, the losses are used in a jurisdiction other than the one where the losses have been originated.

¹¹ Pursuant to Article 2359 of Italian Civil Code, "controlled companies" means: 1) companies in which another company has got the majority of votes exercisable in ordinary shareholders meetings; 2) companies in which another company has got sufficient votes to exercise dominant influence in the ordinary shareholders meetings; 3) companies that are under the dominant influence of another company by virtue of particular contractual arrangements.



In broad terms, Hallmark B1 is intended to cover the following fact pattern:

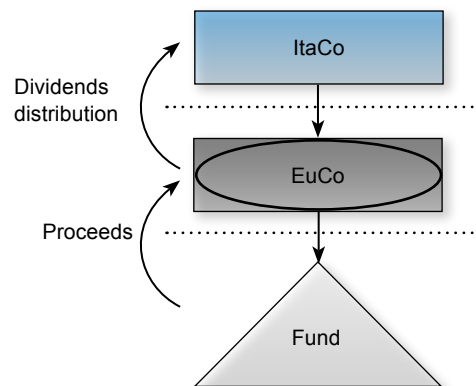
ItaCo 1 is a company resident in Italy for tax purposes. It carries on its business in the U.S. through a loss-making permanent establishment. ItaCo 1 did not opt for the branch exemption permitted under Italian law. ItaCo 2, a company resident in Italy for tax purposes, acquires the control of ItaCo 1 in accordance with Article 2359 of Italian Civil Code. ItaCo 1 is merged into ItaCo 2, ItaCo 1's main activity is interrupted, and its losses are used to reduce ItaCo 2's tax liability.¹²



Hallmark B2 applies to an arrangement that has the effect of converting income into capital, gifts, or other categories of revenue that are taxed at a lower level or are completely exempt from tax.

In broad terms, Hallmark B1 is intended to cover the following fact pattern.

ItaCo, a company resident in Italy for tax purposes, sets up EuCo, a fiscally transparent entity located in an E.U. Member State. ItaCo makes a capital injection into EuCo to allow the latter to invest in the Fund, a foreign collective investment fund. Since EuCo is treated as an opaque entity for Italian tax purposes, the proceeds distributed by the Fund flows through EuCo and arrive in the hands of ItaCo as dividends. In principle, 95% of the dividends are exempt from Italian taxation. If Fund's profits were distributed directly to ItaCo, the distribution would be fully subject to tax in Italy.



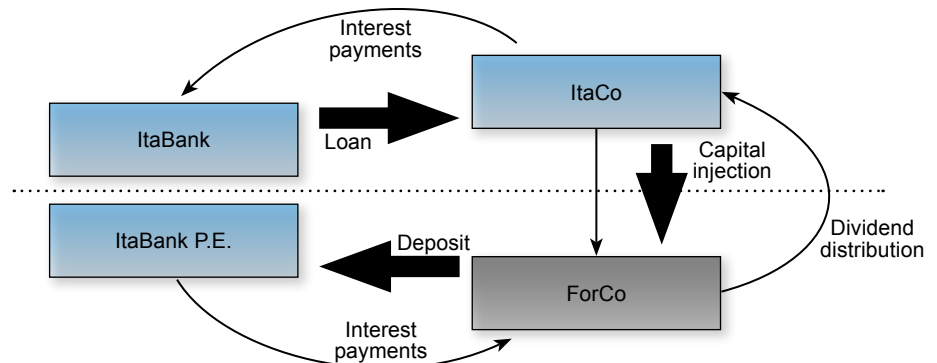
¹²

It is based on the Example 9 contained in the Circular (page 77).

Hallmark B3 applies to an arrangement which includes circular transactions resulting in the round-tripping of funds, namely through (i) involving interposed entities without other primary commercial function or (ii) transactions that offset or cancel each other or that have other similar features.

In broad terms, Hallmark B1 is intended to cover the following fact pattern:¹³

ItaBank, a bank resident in Italy for tax purposes, makes a loan available to ItaCo. ItaCo uses the borrowed funds to inject capital in ForCo, a loss-making foreign company. ForCo deposits the funds with ItaBank P.E., a foreign branch of ItaBank, which pays interest to ForCo as remuneration. Interest income is offset with losses at the level of ForCo. The interposition of ForCo results for ItaCo in (i) the deduction of interest payments made to ItaBank under the loan and (ii) the 95% exemption from Italian corporate income tax of dividends received from ForCo.



Category C - Specific Hallmarks Related to Cross-Border Transactions

Hallmark C1 applies to an arrangement that involves deductible cross-border payments made between two or more associated enterprises where at least one identified condition occurs.

- The recipient is not resident for tax purposes in any tax jurisdiction.
- The recipient is resident for tax purposes in a jurisdiction, but that jurisdiction
 - does not impose any corporate income tax or imposes corporate income tax at the rate of zero or almost zero, meaning an effective corporate income tax rate that is less than 1%; in addition, the M.B.T. must be met in order for the arrangement to be reportable; or
 - is included in a list of jurisdictions that are noncooperative for E.U. purposes (the “E.U. List”) or are noncooperative within the framework of the O.E.C.D. (the “O.E.C.D. List”). Since both lists are updated periodically, the Circular specified that the taxpayer/intermediary must refer to the list in effect when the reporting obligation arises, as discussed below.

¹³

It is based on the Example 15 contained in the Circular (page 84).

“The test used to judge the existence of associated enterprise for purposes of Hallmark C1 and E is the same as in the Directive. This test appears to be broader than the test that is relevant for Italian transfer pricing purposes.”

- The payment benefits from a full exemption from tax in the jurisdiction where the recipient is resident for tax purposes. In this regard, the Circular specifies that the Hallmark applies when the payment received by the payee is not subject to tax in the payee’s jurisdiction as a result of (i) a tax exemption, (ii) a set-off, or (iii) a tax credit. According to I.T.A., this Hallmark should not apply if the tax relief applies as a result of the tax exempt status of the payee under the laws of its jurisdiction; in addition, the M.B.T. test must be met regarding the arrangement in order for it to be reportable.
- The payment benefits from a preferential tax regime in the jurisdiction where the recipient is resident for tax purposes. The Circular clarifies that the term “preferential tax regime” refers to those harmful tax regimes illustrated in the O.E.C.D. B.E.P.S. Action 5 “Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance.” The assessments of preferential tax regimes carried on by the Forum on Harmful Tax Practices (“F.H.T.P.”) periodically identify those tax regimes that, although they are “preferential,” do not qualify as “harmful;” in addition, the M.B.T. test must be met in order for the arrangement to be reportable.

For an arrangement to come within the scope of Hallmark C1, all the covered arrangements must take place between “associated enterprises.” The test used to judge the existence of associated enterprise for purposes of Hallmark C1 and E is the same as in the Directive. This test appears to be broader than the test that is relevant for Italian transfer pricing purposes. Since Hallmarks apply also to transactions that are not subject to transfer pricing regulations, taxpayers will need to adopt different standards of identifying intra-group transactions, one for transfer pricing purposes and one for Hallmarks C1 and E.

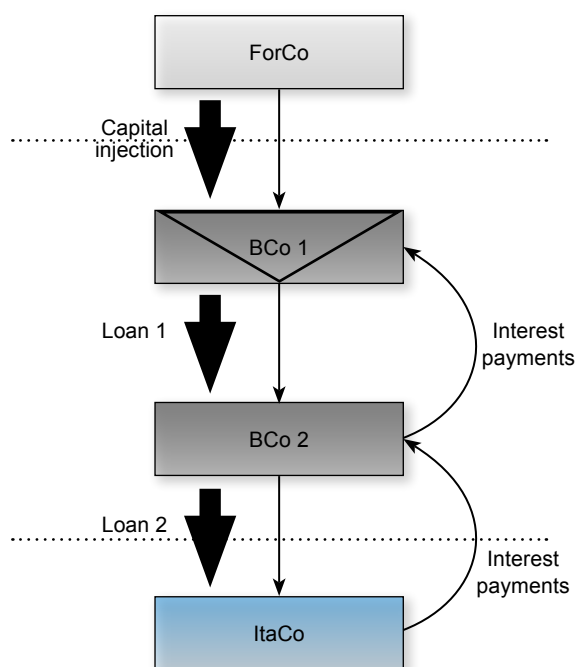
For the application of the Hallmark C1, the Circular clarifies the definitions of the terms “payment” and “recipient” of the payment. According to the I.T.A., the concept of payment refers to any item that is deductible for tax purposes. In this regard, the definition also includes hypothetical or notional payments occurring between a permanent establishment and its head-office or between two permanent establishments of the same company. As to the definition of a recipient, a set of rules is adopted by the Circular.

- Where a conduit company is interposed between two associated companies, the interposed company is to be disregarded, even though it is the formal recipient of the payments and is not an associated company.
- Where the recipient is an entity that is treated as fiscally transparent under the laws of its jurisdiction, such as limited liability partnerships in U.K., or a C.V. in the Netherlands,
 - the recipient is its partner to the extent that the partner’s jurisdiction qualifies the entity as fiscally transparent, or
 - the recipient is the entity itself to the extent that the partner’s jurisdiction qualifies the entity as opaque for tax purposes. Should the entity’s partners not be subject to tax in the entity’s jurisdiction, the entity should not qualify as a resident for tax purposes in any tax jurisdiction. This case would fall under the first category of Hallmark C1 for which only M.B.T. is not applicable.

- In cases where a notional payment is made by the head-office to a permanent establishment for which the branch exemption regime has been opted, the recipient is the head-office to the extent that the jurisdiction where the permanent establishment is located does not recognize the separate existence of the permanent establishment. This case would fall under the third category of Hallmark C1, for which the M.B.T. must be met, also.

In broad terms, the first category under Hallmark C1 is intended to cover the following fact pattern.

ForCo, a company resident outside the E.U. for tax purposes, wholly owns BCo1, a company resident in the Netherlands for tax purposes. BCo 1 is treated as tax transparent in the Netherlands while it is treated as opaque for tax purposes in the ForCo's jurisdiction (so-called "reverse hybrid"). ForCo injects capital into BCo1 which uses these funds to make available a loan in favor of BCo2, its subsidiary which is also resident in the Netherlands for tax purposes (the "Loan 1"). BCo 2 enters into a loan agreement with ItaCo, an associated enterprise being resident in Italy for tax purposes (the "Loan 2"). The Loan 2 mirrors the terms and conditions of the Loan 1. As a result, BCo 2 offsets the interest income received by ItaCo against the interest payments made to BCo 1. The overall structure produces a deduction of interest payments at the level of ItaCo without the inclusion of the related income in any jurisdictions.



Hallmark C2 applies when depreciation deductions are claimed for the same asset in more than one jurisdiction. According to the I.T.A., this Hallmark applies where differences in ownership concepts¹⁴ exist for accounting purposes in two or more countries and those differences lead to the claiming of depreciation deductions more than once for the same asset. This Hallmark is not affected by the M.B.T.

¹⁴

Legal vs. economic ownership.



Hallmark C3 applies when relief from double taxation in respect of the same item of income or capital is claimed in more than one jurisdiction. The Circular provides the following example of an arrangement that is covered by Hallmark C3.¹⁵

TaxCo is an intermediary that is resident in Italy for tax purposes. It advises on a structure applicable to ACo, which is a tax resident of State A, and BCo, which is tax resident of State B. ACo, enters into a securities lending agreement with BCo regarding the shares of CCo, which is a tax resident of State C. ACo is the lender and BCo is the borrower. The loan covers a period during which CCo pays a dividend. BCo collects the dividend net of the withholding tax that has been levied in State C and remits the amount to Company A without the imposition of withholding tax in Country B. Each of ACo and BCo claim a foreign tax credit for the withholding tax levied in State C.

Hallmark C4 applies when an arrangement provides for the transfer of assets between companies in two jurisdictions and a material difference exists in those jurisdictions between the transaction price payable for the assets and market value. The Circular clarifies the following requirements for application of Hallmark C4:

- The transaction price must be at least 10% lower than the arm's length market value.
- The arm's length market value is determined under concepts of transfer pricing regulations applicable to controlled transactions.
- The asset is not an operating asset, with examples being immovable assets (real property) and financial assets.

Category E - Specific Hallmarks Concerning Transfer Pricing

Category E encompasses certain Hallmarks applicable to cross-border, intra-group transactions which may be evaluated in ways that are not consistent with arm's length transfer pricing principles due to complexity of the transaction or the nature of the assets involved. The Hallmarks contained in this category are not linked to the M.B.T. Consequently, the transactions falling under this category must be reported even if tax reduction is not the main benefit of the transaction.

Two grey areas exist for this category.

- The term "associated enterprise" is mentioned only for Hallmark E2. As a result, it is not clear whether transactions covered by the other Hallmarks under Category E apply when parties are not associated.
- As with Hallmark C1, the definition of "associated enterprise" appears to be broader than the definition that is relevant for Italian transfer pricing purposes, meaning that, since the Hallmark applies to transactions that may not be subject to transfer pricing regulations, taxpayers will need to adopt different standards of tracing of intra-group transactions.

Hallmark E1 applies to an arrangement which involves the use of unilateral safe harbor rules.

¹⁵

It is based on the Example 21 contained in the Circular (page 97).

“The Circular clarifies that ‘safe harbor’ rules are a set of rules that operate as automatic presumptions of appropriateness for transfer pricing purposes and, if followed by a taxpayer, exempts the taxpayer from certain compliance obligations normally imposed by applicable transfer pricing regulations.”

The Circular clarifies that “safe harbor” rules are a set of rules that operate as automatic presumptions of appropriateness for transfer pricing purposes and, if followed by a taxpayer, exempts the taxpayer from certain compliance obligations normally imposed by applicable transfer pricing regulations. These rules are unilateral when they depart from the O.E.C.D. Transfer Pricing Guidelines. According to the I.T.A., safe harbors rules may provide taxpayers with tax planning opportunities. For instance, if safe harbor rules apply to simple or small transactions, taxpayers may be tempted to divide larger transactions into a series of smaller transactions to come within the safe harbor rules.

According to the I.T.A., the Hallmark also covers practices that result in a series of agreements systematically entered between Tax Authorities and taxpayers, having effects substantially similar to those of safe harbor rules. Examples include cost-plus mark-up percentages for distribution activities without any analysis of the actual activities performed and regardless of the actual profits generated by the taxpayer. The Circular does not address whether certain unilateral measures can be removed from coverage of the general rule for tainted safe harbors.

Hallmark E2 applies to an arrangement involving the transfer of hard-to-value intangibles. The term “hard-to-value intangibles” covers intangibles or rights in intangibles for which, at the time of transfer between associated enterprises (i) no reliable comparable exists and (ii) the projections of future cash flows or income expected to be derived from the transferred intangible or the assumptions used in valuing the intangible are highly uncertain. As a result, it is difficult to predict the level of ultimate success of the intangible at the time of the transfer.

Hallmark E2 encompasses all those transactions involving the transfer of ownership in intangible assets or rights to use intangible assets. This Hallmark applies to assets such as patents, trademarks, know-how, copyrights, and similar items, which by their nature are hard-to-value. The Circular uses as guidance the definition of the hard-to-value intangibles provided by the O.E.C.D. Transfer Pricing Guidelines.¹⁶

The Circular provides the following example of an arrangement that is covered by Hallmark E2.

USCo, a company formed in the U.S., and for that reason a tax resident of the U.S. It is the sole owner of ItaCo, a company that is tax resident in Italy. USCo and ItaCo enter into an agreement of sale under which ItaCo transfers a hard-to-value patent to USCo. Immediately thereafter, USCo grants the right to use the patent to ItaCo through a license agreement.

Hallmark E3 applies to an arrangement involving an intragroup, cross-border “transfer of functions and/or risks and/or assets” (referred to as “Eligible Transfers”), where the projected annual earnings before interest and taxes (E.B.I.T.) of the transferor during the three-year period following the transfer are less than 50% of the projected annual E.B.I.T. of such transferor if the transfer had not been made. The Circular refers to Chapter IX of the O.E.C.D. Transfer Pricing Guidelines on business restructuring for guidance under this Hallmark. As a result, Hallmark E3 should cover business restructurings (such as mergers, demergers, etc.) that result in the actual relocation of functions and/or risks and/or assets.

¹⁶

See paragraph 6.190 of the O.E.C.D. Transfer Pricing Guidelines.

The Circular provides that the computation of E.B.I.T. begins with gross margins for operating companies and the spread between interest income and cost of funds for financial institutions. Interest costs of financial institutions that are unrelated to lending activity are ignored. For both operating companies and financial institutions, general and administrative costs are deducted, exclusive of interest and taxes. Financial statement information is to be used in making calculations.

Where the average E.B.I.T. of the seller during the three-year period following the transfer is negative whereas a positive average E.B.I.T. would have existed in the absence of the transfer, the Circular indicates that the Hallmark applies. On the other hand, if the seller projected a negative average E.B.I.T. in the absence of the transfer, but as a result of the transfer the average E.B.I.T. is positive or less negative than originally projected, the Circular indicates that the Hallmark will not be applicable.

Finally, the Circular does not address the relationship between the Hallmarks under category E. As a result, no guidance is given whether Hallmark E2 or Hallmark E3 applies where an Eligible Transfer involves a hard-to-value intangible.

WHEN MUST THE CROSS-BORDER ARRANGEMENT BE REPORTED?

Should an arrangement qualify as a reportable cross-border arrangement, the following rules apply regarding the deadline for filing a report with the I.T.A.

- For the Promoters, filing is required within 30 days from the day after the earlier of (i) the date on which the reportable cross-border arrangement is made available for implementation and (ii) the date on which implementation begins.
- For the Service Provider, filing is required within 30 days after the date on which assistance or advice is directly or indirectly provided regarding the implementation of the reportable cross-border arrangement.
- For the Italian Taxpayer, filing is required within 30 after the date on which the Promoter or Service Provider that is exempted from the reporting obligation informs the Italian Taxpayer that the reporting obligation lies with the taxpayer. The Circular clarifies that, in any case, the Promoter or Service Provider is required to advise the Italian Taxpayer of the duty to report within the applicable guidelines of the preceding bullets.
- Regarding marketable reportable cross-border arrangements, an intermediary is subject to follow-up reporting every three months after the first reporting takes place.

PENALTIES

Penalties for non-compliance with the D.A.C.6 mandatory reporting regime vary depending on the nature and the severity of the infringement. In the case of a failure to report within the abovementioned deadlines, penalties range from €3,000 to €31,500. If the reporting is filed within 15 days from the relevant deadline, penalties are reduced by 50%. In the case of an incorrect or incomplete reporting, penalties

range from €1,000 to €10,500. Again, if the correct reporting is filed within 15 days from the relevant deadline, penalties are reduced by 50%.

The Circular clarifies that, where the intermediary is a company or entity with legal personality, the penalties are imposed on the legal entity, itself. On the other hand, if the infringement is made by an entity without legal personality, the penalties are imposed on the individual who is required to report. That person is the individual who is in charge of the professional engagement relating to the reportable cross-border arrangement.



FRENCH ADMINISTRATIVE PRONOUNCEMENTS ON D.A.C.6

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Tags

Arrangements
Cross-border
DAC6
France
Hallmarks
Intermediaries
Participants
Reportable

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INTRODUCTION

Before the European Directive was enacted and then transposed into domestic law, France adopted rules to tackle tax fraud, starting with measures aimed at residents holding undisclosed funds through foreign bank accounts.

In December 2012, the Cahuzacgate¹ was the trigger for the law of 6 December 2013.² M. Cahuzac was a former Minister of Economy and Finance. While in charge of leading his government's fight against tax fraud, he was found to have concealed bank accounts abroad for two decades. Hidden funds in Switzerland and Singapore amounted to at least €3.5 million.

Since 2013, France enacted a variety of measures to tackle tax fraud. A dedicated regularization unit was set up to allow French taxpayers to voluntarily disclose foreign bank accounts, income, and assets with the promise of lower penalties. Once the automatic exchange of information became effective among many countries by the end of 2017, the regularization unit was closed. By 2019, information on foreign bank accounts was gathered by this automatic exchange.

The law of October 23, 2018, authorized the Government to legislate by way of Ordinance the transposition into French law of the European Directive of 25 May 2018,³ called D.A.C.6. The Ordinance⁴ finally entered into force on July 1, 2020 and is codified under articles 1649 AD et seq. of the French Tax Code ("F.T.C."). And since, the French tax authorities have issued detailed guidelines.⁵

The French regularization unit and the automatic exchange of information were directly inspired by the Actions of the B.E.P.S. project. Similarly, D.A.C.6 is the European translation of the set of recommendations for the design of mandatory disclosure rules when aggressive tax planning arrangements appear (B.E.P.S. Action 12).

D.A.C.6 goes further than the B.E.P.S. recommendations since it fits into a more global framework of transparency to combat fraud and tax evasion. All Member States of the European Union ("E.U.") were required to transpose the Directive into their own legislation by December 31, 2019.

¹ French Minister of Economy and Finance for 2012 and 2013.

² Law related to the combat tax fraud and serious economic and financial crime.

³ E.U. directive 2018/822.

⁴ Ordinance no. 2019-1068, related to automatic and mandatory exchange of information in tax area in relation to reportable cross border arrangements dated October 21st, 2019.

⁵ B.O.F.I.P. dated November 25th, 2020.

After a delay in recognition of Covid, intermediaries and taxpayers have a 30-days following the triggering event to report cross border arrangements within the scope of D.A.C.6. This article describes the French legislation in the light of administrative guidelines and highlights areas of divergences between the French rules under D.A.C.6 and those adopted by other Member States.

WHO SHOULD REPORT AND WHEN?

Who Should Report?

According to D.A.C.6, intermediaries have a primary obligation to disclose cross border arrangements (“C.B.A.’s”). French regulations implement that obligation.⁶ The reporting obligation switches to the taxpayer when reporting by intermediaries cannot be achieved. This situation occurs when

- there is no intermediary,
- the intermediary is outside of the jurisdiction of the E.U. Member State, and
- when the reporting obligation would breach the legal professional privilege of the intermediary under the law of France.

One should not underestimate the possible reach of these reporting obligations for taxpayers established or active in France. Taxpayers, such as French subsidiaries or permanent establishments (“P.E.’s”) of multinational groups should be aware and attentive to the transactions having a tax impact in France. The French subsidiary or P.E. may be subject to the reporting obligations because no intermediary was involved in a reportable transaction or because an in-house department designed the transaction and qualifies as an intermediary, itself.

Under French law, the taxpayer means “any person to whom a reportable cross-border arrangement (“R.C.B.A.”) is made available for implementation, or who is ready to establish an R.C.B.A. or has implemented any step or part of such an arrangement.” The definition is broader in scope than the one provided by the Directive as it can apply to a taxpayer even when no first step has been taken.

The French guidelines add useful guidance regarding pass-through entities. For such entities, the partners or members who are liable to tax in France are “taxpayers” and not the pass-through entity itself, except if an election has been made by a pass-through entity to become subject to corporate income taxes (“C.I.T.”) in its own right.

For example, one can easily imagine a US headquarter company designing a cross border arrangement (“C.B.A.”) that is used by a French subsidiary. The French subsidiary is the taxpayer having the reporting obligation, unless an intermediary⁷ has a nexus with France or a Member State without being exempt from reporting by reason of attorney-client privilege.

The concept of an intermediary is broadly interpreted and includes a natural person or a legal person whether acting in its professional capacity or otherwise.

⁶ F.T.C. Art 1649 AE.

⁷ A Promoter or a Service Provider that knows enough about the arrangement to assess its reportable nature.



Intermediaries are divided in two categories, “Promoters” and “Service Providers.” The time when Promoters and Service Providers must file a report differs from that of a taxpayer.

Promoters are any person that designs, markets, organizes, or makes available for implementation or manages the implementation of an R.C.B.A. Service Providers include persons who know or could reasonably be expected to know that they have undertaken to provide aid, assistance, or advice, directly or indirectly, in relation to the and R.C.B.A., based on available information and relevant expertise and understanding.

This is exactly the definition of the Directive and therefore, the definition of intermediary is very large and is not limited to certain professional categories. Promoters could be lawyers, tax advisors, bankers, and accountants. The term also includes an in-house department of a company that otherwise fulfills the definition of Promoter, such as an in-house tax team that designs a C.B.A. Accountants, auditors, insurance companies, wealth managers, asset managers of investment funds, lawyers specializing in company law or financial law, bankers, notaries, family offices, etc. might fall in the category of Service Providers if they participate in implementation rather than design of an R.C.B.A.

The French regulations however provide detailed definitions of the terms “design,” “market,” and “implementation” of such arrangements. Under the French legislation, the obligation to report is a simple presumption and Service Providers are entitled to demonstrate by all ways of proof that they did not know and could not reasonably have known that they provided aid, assistance, or advice in relation to an R.C.B.A.

Unlike some Member States, France did not expressly indicate that the Service Providers have no duty of investigation with respect to the facts and circumstances of any given transaction. Instead, the law states that the assessment to report must be made based on available information. This might imply an absence of additional due diligence obligation for the Service Provider.

The mere fact that the presumption can be countered by any elements of proof is a relief. Indeed, some Member State require the written proof in this respect. Unlike some other Member State, the French legislation and guidelines do not limit in any other ways the definition of Service Providers based on a sufficient involvement or an active involvement.

When a French lawyer provides advice containing general tax considerations, or if a taxpayer asks his accountant to prepare a general tax memorandum – for example, a comparison between the holding regimes in the Netherlands and in France – whether or not in a view to implementing a C.B.A., the lawyer or the accountant can be viewed as an intermediary at this early stage, without any further involvement.

The French guidelines provide an express exemption to reporting obligations for financial institutions in relation to ancillary banking services (*i.e.*, the granting of a loan, the opening of an account, the transfer of funds) – excluding exceptional banking operations. Indeed, financial institutions are rarely “actively” involved.

The only relief the French guidelines provide applies to Service Providers that are first involved in an R.C.B.A. after the arrangement has been implemented or after the advice has been provided. In that fact pattern, a Service Provider has no reporting obligation. To illustrate, a statutory auditor who first learns about an R.C.B.A.

during an audit that occurs at or after yearend or a tax advisor who merely provides a second opinion about an R.C.B.A. without suggesting any amendments to the existing arrangement is not a Service Provider.

An Intermediary with Nexus in France

An intermediary must fulfill its reporting obligations in France where there is a territorial nexus between the intermediary and France. A territorial nexus is defined as (i) having a tax residence in France, (ii) having a P.E. in France through which the services with respect to the R.C.B.A. are provided, (iii) being incorporated in France, (iv) governed by the laws of France, or (v) being registered with or authorized by a professional association in France in relation with the legal, taxation or consultancy services. The last item of nexus likely draws U.S. law firms having an office in France into the D.A.C.6 rules in France when advising on a C.B.A. involving France.

For intermediaries that are liable to reporting obligations in more than one Member State regarding an R.C.B.A., reporting should be made with the competent authorities of only one Member State. Here, a priority rule applies. The foregoing list of contacts that comprise territorial nexus is applied to both Member States. The first time that nexus exists to only one Member State determines the Member State that receives the report. For example, if an intermediary has its head office in France and a P.E. that provided services in the Netherlands must file the reportable information in France as tax residence trumps the location of a P.E.

When the reporting has been filed by another intermediary in another Member State, French nexus fades away and the French intermediary is exempt from reporting obligation.

To be exempt, the French intermediary must prove that reporting has been made in another Member State. In France, the proof demonstrating that the R.C.B.A. has been filed in another Member State encompasses all means available. This is less burdensome than the rule in certain other Member States, which require written proof of reporting or even the “unique reference number” under which the R.C.B.A. was reported. Some countries even require a summary of the R.C.B.A.

This can be quite a challenge when within the E.U., multiple filing obligations arise. One intermediary should report the transaction unless the intermediary or the taxpayer is able to provide the proof the transactions has been filed with the tax authorities.

Because of the 30-day time period for reporting, an intermediary must promptly identify the transaction, other intermediaries, coordinate who will report, obtain the proof of reporting, and if necessary communicate its proof to the other intermediaries. No need to say that strong internal processes and procedures will be useful.

In addition, uncertainty remains where one Member State considers a C.B.A. to be reportable while the other does not require the arrangement to be reported. For example, an intermediary located in a foreign Member State through a P.E. in France, designs an arrangement that affects the tax base in France and the C.B.A. qualifies as reportable from a French perspective, but not from the other Member State’s perspective. The priority rule for nexus requires the intermediary to report in the foreign Member State, so one should question if the R.C.B.A. will be reported.

“To be exempt, the French intermediary must prove that reporting has been made in another Member State.”

The Exemption of Intermediary Bound by the Legal Professional Privilege

When the intermediary is bound by legal professional privilege, reporting the R.C.B.A. is prevented. This exemption has raised many questions and critics from tax practitioners both in and outside the E.U.

In this situation, the intermediary must notify the other intermediaries, in writing, of the reason why he or she cannot perform the reporting obligation based on the professional-client privilege, which leads to a shift of the reporting duty to the other intermediaries. In the absence of other intermediaries, the intermediary should notify the taxpayer in writing, of the reason why reporting cannot be performed. This leads to a shift of the reporting obligation to the taxpayer. Of course, the taxpayer may waive its rights under the privilege, thereby allowing the intermediary to fulfill the reporting obligation. From the viewpoint of the attorney, the waiver must be in writing and must be unequivocal.

In France, this exemption applies only to members of the legal profession, as they can be sanctioned by the criminal code if in breach. For others, a confidentiality obligation based on contractual obligations⁸ will not be sufficient to trigger an exemption.

The French concept of legal privilege is broad and is not limited to (i) litigators who represent a taxpayer before judicial courts or (ii) an intermediary that determines the legal position of the taxpayer.⁹ Accordingly, lawyers, notaries, and certified public accountants (*“Experts-comptables”*) are within the scope of the legal professional privilege.

The French guidelines provide a detailed procedure in order to inform other intermediaries or the taxpayer and the steps for an efficient and legal waiver of the professional privilege. The notification to the taxpayer should include all information the intermediary is aware of, or that is under its control or possession, in order for the taxpayer to be in a position to report the C.B.A.

The French legislation also allows a notified intermediary or the taxpayer to revise the initial assessment regarding the facts and circumstances of the reportable nature of the arrangement. Should either conclude that there is no obligation to report, the initial intermediary that is bound by the professional privilege cannot be held responsible if the C.B.A. is ultimately deemed reportable by the tax authorities.

Timing and Information for Filing

Intermediaries generally must file information that is within their knowledge, possession, or control on an R.C.B.A. within 30 days, beginning at the earliest of the following times:

- On the day after the R.C.B.A. is made available for implementation
- On the day after the R.C.B.A. is ready for implementation
- When the first step in the implementation of the R.C.B.A. been made

⁸ This is true for example in Portugal.

⁹ This approach, in line with the exemption from the reporting obligations laid down in the Anti-Money Laundering Directive (2015/849), has been chosen by Belgium.



For an intermediary that is a Service Provider, the 30-day window begins on the day the intermediary first provides aid, assistance, or advice in relation to designing, marketing, or making available the C.B.A.. When a French lawyer provides a detailed tax memorandum to a client with respect to a reportable C.B.A., the 30-day period likely begins at the moment the lawyer/advisor sends the tax advice to the client, even if the client fails to implement the arrangement. However, as of the date of this article, no final decision on point has been reached.

In computing the 30-day period, calendar days are used, not business days as used by the O.E.C.D. or other countries.

In practice, it is difficult to identify the date on which an intermediary makes an arrangement available to a taxpayer. Indeed, there are as many starting points and delays as there are situations. Much depends on whether the intermediary's obligation derives from its qualification as Promoter, Service Provider, taxpayer, Service Provider who receives notification from another intermediary bound by the legal privilege, or service provider receiving notice from a person resident in another E.U. Member State.

Regarding the content of a report, a wide range of data relating to the arrangement, the tax benefit, and the taxpayer concerned must be reported to the French tax administration. The report may be made in French or English. It should contain the following information:

- A summary note describing the arrangement and the Hallmarks, if possible, in English language, on which the scheme rests
- Legal information on the intermediaries and taxpayers
- An estimate of the valuation of the arrangement

The method of valuing the arrangement is an open question. When some countries have taken a more conservative approach and define the valuation as the estimation of the tax advantage, the French legislation indicates that the valuation of the arrangement relates to the amounts at stake in the transaction – reported at nominal value which depending on the facts of the transaction, might differ from the Fair Market Value (“F.M.V.”).

The information to be reported is the same no matter which Hallmark triggers the reporting obligation. The mention of the Hallmark present in the transaction is the only specific information.

Filing should be done electronically on the French tax authorities' portal. According to French law,¹⁰ insufficient or incomplete reporting of information or lack of notification to intermediaries or taxpayers is subject to a fine up to €10,000 (or €5,000 for a first offence every three years). The amount of the fine applied to a single intermediary or taxpayer may not exceed €100,000 per calendar year.

REPORTABLE CROSS-BORDER ARRANGEMENT

Once it is understood who should be attentive to the reporting obligation, the challenge is to identify R.C.B.A.

¹⁰ C.G.I. art. 1649 AD and following.

Identification of Cross-border Arrangements

As the D.A.C.6 directive does not provide a definition, the French legislation¹¹ refers to the O.E.C.D. to provide a broad definition. Hence, the definition of the term “C.B.A.” mirrors the definition of the term “arrangement or transaction” in article 29 of the O.E.C.D. Model Convention on Income and on Capital (“O.E.C.D. Model Treaty”). The guidelines provide a nonexhaustive but longer list of operations that could qualify as an arrangement, such as an agreement, understanding, scheme, transaction or a series of transactions whether or not legally enforceable.

Arrangements include the creation, assignment, acquisition or transfer of income itself, or the property or right in respect of which such the income accrues. These terms also encompass arrangements concerning the establishment, acquisition or the dissolution of a legal entity or the subscription to financial instruments.

The definition is so broad that, in the view of many commentators, an arrangement may include many subparts such that it is difficult to know if one should declare one arrangement or several arrangements, in particular when different Hallmarks are present.

The French guidelines provide examples from the O.E.C.D. Model Treaty. Included is an arrangement where steps are taken to ensure that meetings of the board of directors are held in a different country in order to claim that the company has changed its residence.

By itself, waiting cannot be considered to be an arrangement. This covers situations in which a taxpayer merely waits for a certain deadline to expire or a certain time period to end before it carries out a transaction in order to benefit from a tax exemption, such as waiting for the dividend distribution in order to dividend to benefit from the participation exemption.

Under the French legislation, to be an R.C.B.A., (i) the arrangement should concern France and another State, whether or not in the E.U. and (ii) one or more of the participants in the arrangement should be resident or have activities in more than one State.

The group of participants in an arrangement refers to the taxpayer, associated enterprises being active in the arrangement, and any other person active in the arrangement. The final version of the French guidelines exclude intermediaries from the definition of participants.¹² This is in accordance with the Directive, which does not count intermediaries as participants.

A participant may be defined as any entity participating in the arrangement that is affected or affects the legal or economic position of other entities (also participants) whose role leads to a potential tax avoidance outcome or meets a Hallmark requirement. Such a definition of participant involves the taxpayer and third parties.

As regards the notion of “cross-border” of C.B.A., French law is not perfectly aligned with the definition of D.A.C.6 and is narrower insofar as it only covers arrangements

“By itself, waiting cannot be considered to be an arrangement. This covers situations in which a taxpayer merely waits for a certain deadline to expire or a certain time period to end before it carries out a transaction in order to benefit from a tax exemption. . .”

¹¹ F.T.C. art. 1649 AD.

¹² Unlike some M.S. that would include intermediaries when they directly and materially interfere with the arrangement or when their intervention gives rise to the application of a hallmark.

that concern France. As a result, for arrangements in which an intermediary, a taxpayer, or an associated enterprise is located in France but is involved with an arrangement that only relates to countries other than France, no report is required in France. In comparison, once an arrangement implicates France, the arrangement falls within the scope of R.C.B.A. even though none of the participants have a residence or an activity in France. A potentially significant number of situations might be concerned.

To be reportable, a C.B.A. should be aggressive. In order to determine if a C.B.A. is “aggressive”, the key issue is now to identify whether it contains at least one of the “Hallmarks.”

Identification of the Hallmarks of a Cross-Border Arrangement

A Hallmark is a characteristic of an arrangement that could indicate a potential risk of tax avoidance. The mere existence of a Hallmark is enough to be an indication of a potential risk of tax avoidance. The goal of the reporting mechanism is to identify the tax planning arrangements that the tax authorities may wish to review.

In general terms, French Hallmarks are the same as those set out in D.A.C.6 and are drafted in the same terms. There are generic and specific Hallmarks linked to the Main Benefit Test (“M.B.T.”) and specific Hallmarks related to cross-border transactions .

Generic and Specific Hallmarks Linked to the M.B.T.

Generic Hallmarks and some specific Hallmarks trigger a reportable obligation only when the M.B.T. is met, such as Hallmarks A, B and C1b(i), c, and d. The M.B.T. is met if the main benefit or one of the main benefits that can reasonably be expected from an arrangement is obtaining a tax advantage considering all the relevant facts and circumstances.

In France, this M.B.T. definition is similar to the French general anti-abuse rule (“G.A.A.R.”),¹³ which has been enriched with a new concept allowing the French tax authorities to challenge a transaction, namely the mini abuse of law concept (“*mini abus de droit*”). This new legal ground enables the French tax authorities to disregard acts implemented to obtain, as the main purpose or one of the main purposes, a tax benefit which is contrary to the aim or the purpose of the tax legislation. As a result, intermediaries and taxpayers could be torn between a willingness to comply with the reporting obligations under D.A.C.6 and a fear of pleading guilty to a mini abuse of law.

French case law decided many years ago holds that the choice of the most favorable tax solution does not, in itself, constitute an abuse of law.¹⁴ Indeed, between two paths, the taxpayer is never forced to choose the one that is less advantageous from a tax point of view. One should wonder how this definition will be articulated with the case law that is bound to develop as compliance with D.A.C.6 will increase or be sanctioned.

¹³ F.T.C. art. L64 A.

¹⁴ *Conseil d'Etat*, March 21, 1986, *Société Auriège*.

“The Hallmarks in Categories A will only give rise to a reporting obligation if the M.B.T. has been met.”

Generic Hallmarks

The Hallmarks in Categories A will only give rise to a reporting obligation if the M.B.T. has been met.

Hallmark A1 – Confidentiality Clause

This first Hallmark is an arrangement where the relevant taxpayer or a participant in the arrangement undertakes to comply with a condition of confidentiality which may require them not to disclose how the arrangement could secure a tax advantage *vis-à-vis* other intermediaries or the tax authorities.

French tax authorities indicate that agreements with a nondisclosure clause regarding information on estate planning arrangements to other intermediaries or to the French tax authorities are within the scope of Hallmark A1. Consequently, a simple confidentiality clause to any third party in an agreement related to estate planning arrangements will meet Hallmark A1, even where there is no express mention to other intermediaries or to French tax authorities – if the M.B.T. is met.

France makes an exact transposition of the Directive, in comparison with other Member States whereby the confidentiality could be induced by circumstantial factual elements even when there was no confidentiality clause in the arrangements.

Hallmark A2 – Success Fees in Relation to a Tax Benefit

The French legislation follows the Directive and adds the need for a direct link between the tax benefit achieved and the fees received by the intermediary.

Hallmark A3 – Use of Substantially Standardized Documentation and/or Structures

The last general Hallmark concerns any arrangement that has substantially standardized documentation and/or structure and is available to more than one taxpayer without a need to be substantially customized for implementation.

Following D.A.C.6, the French guidelines provides examples to illustrate its application:

- The French Equity Savings Plan (*Plan d'Épargne en Actions* or P.E.A.), for which documentation is standardized is outside the scope of Hallmark A3 as these saving plans and their tax benefits result from a national law rather than arrangements designed by intermediaries.
- On the contrary, employees' share-ownership arrangements which aim to convert salaries into capital gains will meet the definition of Hallmark A3 as soon as the capital gain is taxable at a lower rate than salaries, even if no standard model of employee's equity plan is used and each plan is different. Consequently, French guidelines consider that a cross-border management package available to some managers only will be in the scope of Hallmark A3.

French guidelines do not define “substantially standardized documentation and or/structure” in relation to groups of companies. Hence, this term can have broad scope. To illustrate, it seems to cover internal standard intercompany loan agreements or support services agreements within a group and standardized agreements for transactions with clients or suppliers. To limit an overbroad interpretation of this Hallmark, some Member States provide a detailed definition and expressly excluded intercompany services agreements, license agreements, loans agreement, and secondment agreements.

Specific Hallmarks

The Hallmarks of Category B (specific Hallmarks linked to the M.B.T.) only focus on income taxation. They mention three techniques developed to obtain tax benefits and include the acquisition of a loss making company (Hallmark B1), the conversion of income (Hallmark B2) and the round-tripping of funds (Hallmark B3).

As under Category B, the link with the M.B.T. applies, but functions in this context as evidence that the applied techniques are expected to obtain a tax benefit. However, if the tax benefit is not one of the main benefits, the arrangement does not need to be reported.

Hallmark B1- Exploiting Tax-Deductible Losses

An arrangement meets Hallmark B1 if a participant¹⁵ in the arrangement takes artificial steps in order to acquire a loss-making company, discontinue its main activity, and use its tax losses in order to reduce tax liability. The transfer of losses may be to another jurisdiction or to accompany that can accelerate the use of those losses.

The guidelines note that the acquisition of companies whose operations have already ceased at the time of acquisition or that are generating profits at the time of acquisition is also not covered by the Hallmark. However, this Hallmark is not clear as to whether a company with loss carry-forwards must generate profits for a minimum period of time to be excluded from Hallmark B1.

French guidelines implement the exact wording of the Directive and emphasize the fact that the three criteria are cumulative, which means that the intention when acquiring a loss-making company and implementing the arrangement is necessary for the arrangement to be within the scope of Hallmark B1.

Hallmark B2 – Conversion of Income to Reduce Taxes Due

An arrangement meets Hallmark B2 if it has the effect of converting income into capital or gifts or other categories of revenue that are taxed at a lower effective rate or that are exempt from tax or not subject to taxation. Here again, the French guidelines follow the wording of the Directive.

The definition of a conversion and the determination of when it occurs are unresolved questions. Is the lower tax rate sufficient for Hallmark B2 to apply or must a real change in the nature income occur?

The French guidelines illustrate the application of the Hallmark with two examples. One involves a conversion of service remuneration into dividends and the other involves income derived from a life insurance contract.

Another unanswered question is whether a stream of income must exist at the time of the change in its character or whether Hallmark B2 is applicable merely when one makes a decision prior to the recognition of any income? In comparison to guidelines of other Member States, the French guidelines do not provide any indication that the absence of a pre-existing situation does not prevent the application of Hallmark B2.



¹⁵

See definition §16.

Hallmark B3 – Circular Transactions Resulting in the Round-Tripping of Funds

Hallmark B3 applies to arrangements that include circular transactions resulting in the round-tripping of funds, namely through interposed entities without another primary commercial function. It also applies to transactions that offset or cancel each other.

French guidelines specify that Hallmark B3 refers to arrangements involving transactions that result in a circular movement of funds that otherwise meet one or more of the following conditions:

- Presence of interposed entities without a primary business function in the arrangement
- Presence of transactions that offset or cancel each other
- Presence of other equivalent characteristics

The guidelines indicate further that this Hallmark targets arrangements in which funds originating in a Member State pass through one or more intermediary companies established in Member State or a state outside the E.U. in order to benefit from favorable tax treatment after which the funds return to the Member State of origin.

The guidelines, however, do not address the factual and temporal connection between two offsetting transactions. For instance, it is currently not clear whether offsetting transactions that occur after a significant period of time has passed would be considered as non-reportable.

SPECIFIC HALLMARKS RELATED TO CROSS-BORDER TRANSACTIONS CONCERNING AUTOMATIC EXCHANGE OF INFORMATION AND ACTUAL BENEFICIARIES AND TRANSFER PRICING

Specific Hallmarks – Cross-Border Transactions

Hallmark C – Deductible Cross-Border Payments Between Associated Enterprises

The first list of Hallmarks under Category C refers to arrangements that involve deductible cross-border payments made between two or more associated enterprises where one or more of the following conditions occur:

- The recipient is not resident for tax purposes in any tax jurisdiction.
- Although the recipient is resident for tax purposes in a jurisdiction, that jurisdiction
 - does not impose any corporate tax or imposes corporate tax at the rate of zero or almost zero, or
 - is included in a list of jurisdictions that are noncooperative, as determined collectively by E.U. Member States or are noncooperative within the framework of the O.E.C.D.

- The payment benefits from a full exemption from tax in the jurisdiction where the recipient is resident for tax purposes.
- The payment benefits from a preferential tax regime in the jurisdiction where the recipient is resident for tax purposes.

All four situations require deductible cross-border payments between associated enterprises, resulting in a favorable tax treatment at the level of the recipient.

Arrangements qualifying under Hallmark C1(a) and (b)(ii) are always reported. The M.B.T. is not a relevant consideration.

Under Hallmark C1(a), where the recipient not a resident in any tax jurisdiction, D.A.C.6 seems to presuppose that the payment will not be taxed. It does not address the treatment of a payment to a nonresident that has been subjected to withholding tax in the source State. It also fails to address income that is attributed to a P.E. of the nonresident recipient that is taxed in the State where the P.E. is located.

Hallmark C1(b)(ii) appears to be more logical. When a tax authority of the recipient entity is unwilling to exchange information, it becomes difficult for tax authorities of Member States to assess the main benefit.

French guidelines adopt the wording of the Directive and clarifies some elements of this Hallmark:

- The term “recipient” is defined as the person liable to pay tax on the payment. The French guidelines also provide for a specific identification of the recipient for pass-through entities.
- A corporate tax rate is considered to be “almost zero” when its effective tax rate is not more than 2%. France’s choice of a 2% rate is within the average of Member States; some have chosen a lower rate, 1%, and some have chosen a higher rate, 4% or 5%.
- France’s choice to take into account the effective tax rate, and not the statutory rate, has been made by very few countries.
- In connection with the term “payment,” it is assumed that Hallmark C1 is intended to apply to deductible payments such as interest, royalties, or rents. Other Member States have clarified that the notion of payment encompasses all types of payments, whether or not income is ultimately realized.
- In connection the list of noncooperative jurisdictions, the definition used by the French guidelines are not identical to those of D.A.C.6, since it refers to the O.E.C.D. list. As this list is regularly updated, the applicable list is the one in force on the date of the triggering event for the reporting obligation.

Hallmark C2 – Deductions for the Same Depreciation of an Asset That are Claimed in More Than One Jurisdiction

Here again, French law and guidelines have used the same wording as the Directive. Hallmark C2 concerns only cases where the tax deduction for depreciation of the same asset is claimed in more than one jurisdiction without an accompanying double inclusion of income recognized for accounting and tax purposes.

Hallmark C3 – Relief from Double Taxation in Respect of the Same Item of Income or Capital Claimed in More Than One Jurisdiction

In such cases, the arrangement that gives rise to the tax relief must be reported, unless double relief is in accordance with the intention of the French or European legislator. Arrangements based on treaty shopping should be reported, which in principle, is consistent with Action 6 of B.E.P.S.

Here again, French law and guidelines have used the same wording as the Directive. The French tax authorities were careful to clarify that this Hallmark does not apply to provisions designed to eliminate double taxation under an existing bilateral tax treaty, provided that the use of the provision is not contrary to the legislator's intention.

Taxpayers located in countries with anti-hybrid rules, implemented under A.T.A.D. 2 and Action 2 of B.E.P.S., must report hybrid arrangements.

Hallmark C4 – Transfers of Assets Where There is a Material Difference in the Amount Being Treated as Payable in Consideration for the Assets in the Jurisdictions Involved

The definition used in the French Tax Code is similar to the one in the Directive. This Hallmark covers transfers of assets where the valuation methodology significantly differs by jurisdiction. As an example, one jurisdiction uses net book value in measuring the transaction and the second jurisdiction uses market value.

The French guidelines specify that merger and similar transactions realized in accordance with the E.U. Mergers Directive are excluded from the scope of this Hallmark.

This Hallmark makes no distinction between intra-group transfers, internal transfers between a legal entity and a P.E. in another country, and transfers to third parties.

Finally, questions exist as to which valuation differences are significant or material. For example, assume one Member State excludes from the scope of this Hallmark differences that are consistent with legislative intent. At the same time, a second Member State indicates that a difference in values used of up to 25% is not characterized as material difference.

Specific Hallmarks – Automatic Exchange of Information on Ownership

Category D refers to the rules defined by the O.E.C.D. in 2018 in the *Model Mandatory Disclosure Rules for Common Reporting Standards ("C.R.S.") Avoidance Arrangements and Opaque Offshore Structures*. C.R.S. was developed by the O.E.C.D. in 2014. It calls on jurisdictions to obtain information from their financial institutions which will be exchanged automatically with other jurisdictions on an annual basis. C.R.S. has rules that set out the financial account information to be exchanged, the financial institutions required to report, the different types of accounts and taxpayers covered, and common due diligence procedures to be followed by financial institutions.

The C.R.S. rules were transcribed in D.A.C. 2. Hallmarks D1 and D2 reflect the new 2018 model established by the O.E.C.D. and reinforce the application of the C.R.S. in the E.U.



For the application of Category D, an arrangement is not considered to have the effect of avoiding C.R.S. merely because the reporting obligation has not been met, provided that the failure to report does not undermine the purposes of the legislation. D.A.C.6 and the French legislation and guidelines transcribe these rules without adding any comments or information.

Specific Hallmarks – Transfer Pricing

The specific transfer pricing related Hallmarks under Category E cover safe harbor rules (Hallmark E1), hard-to-value intangibles (Hallmark E2), and intra-group transfers that result in profit shifting (Hallmark E3).

The transfer pricing Hallmarks have a very broad reach and apply without regard to the M.B.T. A purely business driven transaction cannot be reportable under these Hallmarks. That results from the divergence in the definition of associated enterprises for Category E and for transfer pricing purposes. For transfer pricing purposes, a 25% interest in an entity generally is not sufficient to constitute control over the transfer prices between related parties. But for D.A.C.6 purposes, a 25% ownership interest is sufficient to trigger the reporting obligation under Category E. Consequently, taxpayers must adopt a new set of transaction tracking rules to ensure compliance with Category E.

Hallmark E1 – Arrangement Which Involves the Use of Unilateral Safe Harbor Rules

Hallmark E1 is met in respect of an arrangement that involves the use of unilateral safe harbor rules. However, neither the Directive nor the French legislation provide a definition of a “safe harbor rule.” The O.E.C.D. recommendations provide for a definition that could be of used. They provide that a safe harbor rule is a provision applicable to a category of taxpayers or transactions that provides relief from certain obligations normally imposed under by the general transfer pricing rules of a State.

The French guidelines limit the unilateral safe harbors that are reportable to safe harbors in the transfer pricing area, and not to other possible safe harbor tax rules. One such safe harbor that should not be reportable when used is a thin-capitalization safe harbor.

Further, the French guidelines state that safe harbor rules that are accepted by the O.E.C.D. are not considered unilateral safe harbor rules within the meaning of this Hallmark. One example of an O.E.C.D. safe harbor is an administrative simplification measures that does not directly concern the determination of the arm’s length price. Here, the tax authority and a taxpayer may agree in advance on the determination of transfer prices applicable to transactions with associated enterprises as part of an advance pricing arrangement. A second example is a 5% markup of costs for low value-added services.¹⁶

Hallmark E2 – Arrangement Involving the Transfer of Hard-to-Value Intangibles

An arrangement involving a transfer of hard-to-value intangibles will meet the Hallmark E2 requirements. Again, the definition used in the French legislation and guidelines is similar to that of the D.A.C.6.

¹⁶ O.E.C.D. 2017 Guidelines, Ch. VII.

“The Directive also does not specify what it means by reliable comparable transactions. The guidelines suggest that the comparability criteria set out by the O.E.C.D. for intangible assets should be used wherever possible.”

The guidelines define the term “hard-to-value intangibles” in line with the definition from D.A.C.6 and O.E.C.D. transfer pricing guidelines. This Hallmark covers situations where (i) the intangible is only partially developed at the time of the transfer, (ii) there will be a delay in achieving commercial exploitation, or (iii) there has never been commercial exploitation of the intangible prior to the transfer. In contrast, where market prices have already been established for patents or trademarks, no hard-to-value intangibles should be deemed to exist for purposes of Hallmark E2.

Where multiple intangible assets are transferred under a uniform economic process, the transfer is reported only once. The report must include all intangible assets concerned. The purpose of this treatment is administrative simplicity.

Neither the Directive, nor French law, nor the tax authorities have yet addressed whether Hallmark E2 applies to transfers between a headquarters in one Member State and branch located outside that State. In addition, neither the Directive nor French law addresses whether Hallmark E2 applies only to sales of intangible property or whether it applies also to transactions involving the transfer of use of intangible assets, such as licenses involving trademarks or patents.

To be considered hard-to-value, reliable comparable transactions of assumptions must not exist at the time the transaction is concluded so that projections of future cash flows and expected income from the transferred intangible are highly uncertain. The Directive also does not specify what it means by reliable comparable transactions. The guidelines suggest that the comparability criteria set out by the O.E.C.D. for intangible assets should be used wherever possible.

To understand the reach of this Hallmark, consider the transfer of intellectual property from Mexico to the U.S. for purely business reasons. This leads to new royalty arrangements or cost arrangements with entities resident in a Member State of the E.U. (not simply an assignment of existing arrangement). Query. Is this a transfer of use of a hard-to-value intangible? Because of its consequences in the E.U. for taxpayers, would the transfer trigger a reporting obligation and if so, by whom?

Hallmark E3 – Transfer Halving the Transferor’s E.B.I.T. During the Next Three Years

An arrangement will meet Hallmark E3 if it involves an intra-group cross-border transfer of functions, risks, or assets, provided that the projected annual earnings before interest and taxes (“E.B.I.T.”) of the transferor during the three-year period following the transfer are less than 50% of the projected annual E.B.I.T. of the transferor were the transfer not made. Even if realized at fair market conditions, a transfer of assets, a risk or a function may lead to reportable transaction because Hallmark E3 is not linked to the M.B.T.

The definitions used in France again similar to the one in the Directive. However, the following clarifications have been made by the French tax authorities:

- E.B.I.T. is defined by the French General Chart of Accounts – French G.A.A.P.
- The decline in earnings is assessed on the basis of the information available at the time of the transfer, and the decline must be inherent to the functions and/or risks and/or assets transferred.
- Mergers and similar transactions are excluded from this Hallmark.

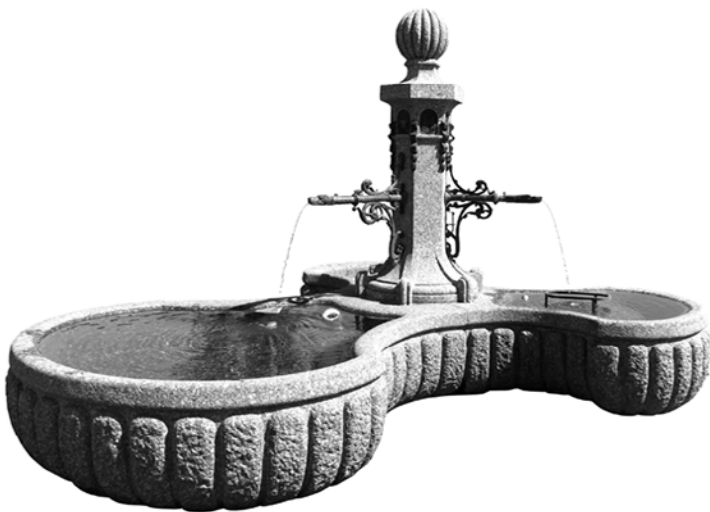
The concept of E.B.I.T. does not include interest, dividends, and capital gains. Thus, the use of E.B.I.T. does not seem to be relevant for holding companies. This raises the question of whether holding companies are indirectly excluded from Hallmark E3. or whether a criterion other than E.B.I.T. should be substituted. Other Member State have chosen to use another aggregate for holding companies, since interest and dividends are not included in the operating result.

Here again, one can think of a very insignificant transaction like the transfer of a small sale function from a Dutch subsidiary to a French subsidiary that could come within the scope of Hallmark E3. Such a transfer of an intra-group function might result in the requirement to report R.C.B.A., although tax is not a driver in the transaction.

CONCLUSION

As shown, the French legislation attempts to meet the basic requirements set by D.A.C.6. Nonetheless, several aspects of the law remain uncertain and require clarification.

In addition, Member States publish their local implementation legislation, it is becoming obvious that national implementation of D.A.C.6 could ultimately differ considerably across the E.U. For this reason, it is to be expected that compliance with the reporting obligations will be problematic in the absence of a detailed knowledge of the domestic legislation of each Member State. This need for actual knowledge affects intermediaries as well as taxpayers.



UPDATE ON SPANISH MANDATORY DISCLOSURE REGIME – D.A.C.6

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Tags

Arrangements
Cross-border
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Participants
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INTRODUCTION

After the implementation of European Union Council Directive n. 2018/822 (“the Directive”), enacting the sixth amendment of the Directive of Administrative Cooperation, known as D.A.C.6, all Member States of the European Union were obliged to transpose the contents of the Directive into national law. This means that each Member State was required to establish a regime of mandatory disclosure of cross-border arrangements, establish a procedure for the automatic exchange of information among Member States by December 31, 2019, and make the transposition enforceable by July 1, 2020. This established a transitory regime for reportable arrangements where the first step was taken between June 25, 2018, and July 1, 2020.

BACKGROUND

The contents of the Directive include the mandatory disclosure by intermediaries or taxpayers of certain cross-border arrangements (“C.B.A.’s”) and structures that (i) could be used for aggressive tax planning and (ii) have the potential to be used as tax avoidance or evasion techniques. Mandatory automatic exchanges of C.B.A.. information among E.U. Member States would then occur.

In Spain, the exchanges of information are authorized by Law number 10/2020 (“the Spanish Law”), which modifies the Spanish General Taxation Act and was approved on December 29, 2020. The regulations that further develop the procedures have been issued in draft form (“the Draft Spanish Regulation”). In addition, a draft order issued by the Spanish Tax Authorities still must approve different forms to report the C.B.A.’s affected by the mandatory disclosure regime (the so-called, Forms 234, 235 and 236). However, this draft order has not been approved as of the date of publication of this article.

The transposition of the Directive into Spanish Law followed a bare approach, using the wording of the Directive without elaboration. This approach has raised questions surrounding interpretation of both the Spanish Law and the Draft Spanish Regulation, which will be explored in this article, following a brief comparison of the wording of the Directive and the Spanish legislation implementing the D.A.C.6.

The Spanish Law establishes general references to the Directive for many definitions and terms. In addition, it provides even more references to the Draft Spanish Regulation that is meant to develop the Spanish Law. Consequently, the Draft Spanish Regulation establishes the terms of the disclosure, the determination of the way to calculate the value of the “tax effect” of the C.B.A., and the terms of the obligation to communicate the disclosure or waiver by one intermediary to other intermediaries or to the taxpayer.

As previously mentioned, the Draft Spanish Regulation has not yet been approved. This creates uncertainty regarding the specific terms of the obligations contained in the Spanish Law. The Draft Spanish Regulation published in 2019 helps shed some light on these matters, but also raises questions on the interpretation of certain aspects of the reporting regime. Indeed, the delay in publication and approval of both the Spanish Regulation and the Order issued by the Spanish Tax Authorities establishing the forms to be used, means that, currently, neither intermediaries nor taxpayers have final guidance on the required way to comply with reporting obligations. Beyond the internal complications that this may present, failing to establish a proper procedure for the disclosure in due time puts Spain at risk of an infringement proceeding by the European Commission.

Given the lack of definitions in the Spanish Law and the provisional status of the Spanish Regulation, there is neither administrative doctrine nor jurisprudence that may shed light on the correct interpretation of the D.A.C.6 as implemented by Spain.

This article addresses the opinion of Spanish scholars in relation to the foreseeable issues that may derive from the implementation of the D.A.C.6 in Spain, considering the current wording of the Spanish Law and the Draft Spanish Regulation.

MAIN ISSUES SURROUNDING THE IMPLEMENTATION OF THE D.A.C.6 IN SPAIN

Lack of Definition of Certain Terms

Significant definitional problems have arisen in Spain because terms used in the E.U. Directive are not further explained in the Spanish Law. A similar issue arises in the Draft Spanish Regulation.

The main issues relate to scope of the Directive, which is the disclosure of C.B.A.'s. Different language versions of the Directive may have introduced differences in interpretation and transposition to domestic law. Such is the case of the translation of “cross-border arrangement” into Spanish. In Spanish, the word used is “mechanism” (*mecanismo*), which is not defined in the Directive nor the Spanish Law. The Draft Spanish Regulation defines a tax planning mechanism as an “agreement, legal transaction, scheme or operation,” but some of these concepts have no recognized technical definition in Spanish tax law.

Comparing the use of the terms mechanism and arrangement, and noting the definition provided for in the Draft Spanish Regulation, questions arise regarding whether the definition of an “arrangement” (mechanism in Spanish) for purposes of the Directive and the Spanish Law implies the participation of more than one party. The uncertainty stems from the fact that unilateral decisions seem to be excluded from the definition and thus of the disclosure obligation. For example, it is unclear whether a change in tax residence, while complying with exit tax obligations, would comprise an arrangement under the terms of the Directive, considering there is only one party involved.

Regarding the cross-border characteristic of the arrangements, it is defined by the Directive as an arrangement that concerns (the Spanish word for “affects” is used in the Spanish Law) more than one Member State. While this characteristic is essential for determining the scope of the reporting obligation on an intermediary, there is no

clarification in the Draft Spanish Regulation or the Spanish Law as to what exactly the term comprises. This may prove to be problematic when the intermediary's knowledge of the scope and reach of the arrangement is limited. It is not unlikely in this type of pattern for the intermediary to have no knowledge of the client's involvement with another Member State. Moreover, if there is only one intermediary or the client has separate dealings with all intermediaries, there may be no notification by one intermediary to a second intermediary where neither has knowledge of the other.

The Draft Spanish Regulation contemplates that the Tax Authorities will publish lists of relevant cross-border arrangements that have been disclosed, including the relevant legal regime, qualification, and classification in tax terms. If and when published, the list will assist intermediaries to better understand the scope of the reporting obligation. It may be somewhat less helpful if the list is not updated on a regular basis when and as new arrangements are encountered.

The Directive's recitals and the Spanish Law's preamble give importance to the goal of D.A.C.6 in relation to clamping down on aggressive tax planning designed to achieve tax avoidance or evasion. The use of the term "tax planning" raises the question of whether commercial arrangements that are not carried out for tax reasons are automatically excluded from the scope of the obligations.

In principle, a balance exists between pure cross-border business transactions and transactions containing identified Hallmarks. The balance may fall one way or the other depending upon whether the main benefit test ("M.B.T.") applies to the Hallmark. Currently, it is unclear whether an intermediary must consider the effects of the arrangement (as provided in the Spanish Law) and if they result in tax savings (as provided in the Draft Spanish Regulation) without considering the main purpose or aim of the arrangement. Another question left unanswered is whether a transaction is reportable if it reflects a tax incentive enacted under Spanish law, where without the incentive, the operation would not have been carried out. An example is the formation and use of an E.T.V.E. formed under Spanish law for purposes of holding shares of companies often based in South America. Some tax advisors have suggested that a test based on valid business motives should be applied for special tax regimes formed under Spanish law, provided the rules are followed by the taxpayer as contemplated in the legislation. Other commentators have suggested the opposite.

The approach of the Spanish Government to simply refer to the Directive can create many gaps in legislation, even if the approach is a valid legislative exercise that saves both time and resources at the time of transposition into law. These gaps could be addressed when the Draft Spanish Regulation is adopted in final form, but only if the Spanish Tax Authorities put in the time and effort to apply D.A.C.6 rationally.

Concept of "Intermediaries" and Its Scope

The Directive defines an intermediary as any person that designs, markets, organizes, or makes available for implementation or manages the implementation of a reportable cross-border arrangement. It also states that an intermediary will be any person that, having regard to the relevant facts and circumstances and based on available information and the relevant expertise and understanding required to provide such services, knows, or could be reasonably expected to know, that they have



undertaken obligations to provide, directly or by means of other persons, aid, assistance or advice with respect to designing, marketing, organizing, making available for implementation or managing the implementation of a reportable C.B.A. After defining who could potentially be an intermediary, the Directive follows with a clarification that in order to be considered an intermediary, one must perform at least one of the identified acts within a Member State. Neither the Spanish Law nor the Draft Regulation clarify this 151 word sentence and many questions remain unanswered.

The first is whether in-house advisors fit into this description. It is common for larger companies to have an internal department that provides internal tax advice to the company or to companies falling within a single group. In this sense, a question arises as to whether these in-house advisors are considered to be intermediaries for the purpose of the Directive or are merely representatives of the taxpayers. This may affect whether a C.B.A. is reportable by the internal group of advisors.

The second question surrounds the fact that the Directive's definition establishes two kinds of intermediaries. The first is a primary intermediary that creates a plan leading to the C.B.A. or implements the C.B.A. The second is an auxiliary intermediary, who knows or could be expected to know that they have participated in the creation or implementation of an C.B.A.

Regarding primary intermediaries, some degree of uncertainty exists in Spain as to the degree of participation required in order to have a primary obligation to report a C.B.A. when many different advisors are involved. Phrased differently, when an arrangement is tailored for a specific taxpayer by many advisors, it is not clear which advisor should be considered the intermediary with the primary or the initial obligation to file a report. Is the advisor that aids in the creation of the plan but is unaware of its implementation, the intermediary with the primary obligation? In connection with a bespoke arrangement that proposes variations to an ordinary business transaction, is the entire transaction a reportable C.B.A. and is the party that proposes the variation the intermediary with the primary obligation to report? If there is no report, are all advisors exposed to penalties for nonfiling?

As for secondary intermediaries, their determination can be excluded by way of the "did not know" test, but the scope of the definition can be interpreted as either wide or restricted depending on the facts and the view taken. Some commentators argue that a wide interpretation can give rise to many involuntary violations of the obligation to disclose. It is not uncommon for several advisors to cooperate in the implementation of a plan. In those circumstances, it is common for most not to know the full set of steps of an arrangement and its tax implications. Do those secondary persons face liability for filing an incomplete disclosure under Spanish Law if they report all they know but less than the entire transaction? Further clarity is required when the Draft Spanish Regulation is adopted in final form.

Where a client uses several advisors with each focusing on a particular aspect of a plan based on its area of expertise, no single intermediary has knowledge of the full picture of the C.B.A. In this context, should an advisor on corporate law be able to claim it was unaware that the transaction turned out to be a reportable C.B.A.? Is the answer different if the advisor is a law firm with a tax department and a corporate law department, but only the latter is retained to provide services? No answer is given to this in the Spanish Law or the Draft Spanish Regulation.

"... when an arrangement is tailored for a specific taxpayer by many advisors, it is not clear which advisor should be considered the intermediary with the primary or the initial obligation to file a report."

Finally, regarding relations between primary and secondary intermediaries, clashes may occur in their respective obligations to disclose. If the secondary intermediary's services regarding tailored arrangements end before the first step of implementation begins, when does it face a reporting obligation? Does the secondary intermediary have an obligation to report a C.B.A. within 30 days after rendering its service but prior to the period for the primary intermediary's obligation to disclose begins to run? What is included in the report if its assignment is theoretical, without values assigned to the transaction?

While the Spanish Law establishes the obligation of the intermediaries to communicate to other intermediaries and the taxpayer that they have disclosed the relevant information, thus exempting the others from disclosure obligations, the exemption may not be operative if the first reporter does not disclose all of the required information.

These issues were identified by the Spanish Association of Tax Advisors ("A.E.D.A.F.") in a request for a tax ruling filed with the Spanish General Directorate for Taxes. However, as of the date of publication of this article, no response has been received, leaving intermediaries with uncertainty.

Legal Professional Privilege, Waiver of Report, and Conditions of the Waiver

The Directive allows Member States to provide intermediaries with a waiver of the reporting obligation for C.B.A.'s where reporting comprises a breach of legal professional privilege under the national law of that Member State.

The Spanish Government decided to include this waiver in the transposition of the Directive, but it did so "regardless of the economic activity" carried out by the intermediary and provided that it acted as a passive advisor. The Spanish Law also goes a step further than the Directive and provides that the taxpayer may expressly authorize its legal advisor to report on the arrangement. This must be done by means of a written communication to the intermediary.

While professional privilege is provided for under the Spanish Constitution, there is no substantive legal regulation developing the scope and terms of this privilege. This means that while most professional sectors have developed a privilege concept in their codes of conduct, professional privilege is recognized only for certain professionals, including lawyers, and the scope of the privilege is quite general.

This raises issues of inconsistency between the wording of the Directive and the wording of the Spanish transposition. The Directive allows for Member States to provide for a waiver if it is in accordance with national law, which can be interpreted to mean that only legally recognized professional privilege may be covered by the waiver. On the other hand, the Spanish Law establishes the waiver regardless of economic activity, which can be interpreted as a recognition of the waiver to all advisors and intermediaries, even if their professional privilege is not covered by the Spanish Law. This may be understood as a breach of the Directive, but the main issue it raises is of uncertainty for tax advisors that are not lawyers. Can those advisors access the reporting waiver because "tax advisory" services are given, even though that is not a recognized independent profession with a specific code of conduct in Spain?

Another inconsistency between the Spanish transposition and the Directive is the requirement under Spanish law that intermediaries wishing to access the waiver must have acted in a passive way regarding the arrangement. The exact terms of the Spanish Law for the recognition of the waiver to intermediaries include a specific condition precedent to the waiver. Translated into English, the intermediary must have

*** provided advice on the designing, marketing, organizing, making available for implementation or for the managing of the implementation of a reportable cross-border arrangement, with the sole objective of evaluating its compliance with the applicable legal standards and without providing or ensuring its implementation.

This provision is much clearer than the simple reference to “neutral advisory” included in the terms of the Draft Law, but the determination of its limits may prove to be difficult in practice.

Finally, the waiver of the obligation in the Directive or in the Spanish Law does not imply an exemption from disclosure. Rather, it shifts the reporting obligation to the taxpayer or other intermediaries by requiring the professional to notify the other intermediaries or the client. Regrettably, as of the date of publication of this article, no mechanism has been devised for intermediaries benefitting from waivers to communicate with intermediaries linked to another Member State.

Main Benefit Test

The whole purpose of D.A.C.6 is to communicate information relating to C.B.A.’s that include the presence of certain tax avoidance Hallmarks. The Spanish Law makes a direct reference to the Hallmarks established in the Directive, without any sort of clarification as to their meaning. The Draft Spanish Regulation adopts the principle of the M.B.T. as explained in the O.E.C.D. provisions on reporting, but does so in an enhanced way. In any event, the mere reference in the Spanish Law to the Hallmarks of the Directive leaves many gaps in the meaning of the Spanish Law, notwithstanding the Draft Spanish Regulation.

Regarding the M.B.T., the Directive’s annex establishes that the M.B.T. will be satisfied if one of the main benefits which a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage, having regard to all relevant facts and circumstances. It then establishes generic and specific Hallmarks that are linked to the M.B.T., meaning that no reporting is due if the M.B.T. is not met.

As mentioned earlier, the Draft Spanish Regulation defines the term “tax advantage” by reference to “tax savings,” thus redefining when the M.B.T. will be met and broadening its scope. Tax savings include any reduction in the taxable base or the tax liability, including the deferral of tax that would otherwise be due in the absence of the arrangement. In addition, the term includes deferred tax savings that arise from liabilities, deductions, or credits that may be realized in following years.

Tax saving is not the same as tax advantage as used in the Directive. Tax advantages are defined in the directive as tax benefits derived from defeating the purpose of the applicable law. Tax savings, on the other hand, are defined so as to include cases where the applicable law’s purpose is met and where the entities or persons involved in the arrangement are simply making use of tax incentives or special tax regimes that have been provided for by the legislator. It is difficult to reconcile the

“Tax savings include any reduction in the taxable base or the tax liability, including the deferral of tax. . .”

purpose of D.A.C.6, which is to combat aggressive tax planning, with entering into transactions that are consistent with applicable law and that would not be aggressive but for the implementation of D.A.C.6.

The circumstances where tax reduction is a main characteristic of a transaction are not well defined. This raises the question of whether the value of the tax benefits must be measured against the reasonably expected economic value of the operation, if conducted as planned.

The Hallmarks related to cross-border payments raise serious questions as to the expectations that an intermediary will be able to identify expected tax benefits when there is limited knowledge of the entire transaction. It is unreasonable to expect that a secondary intermediary can collect all relevant information to know of its obligation and to file a required report in a full and complete way.

No clarifications are made regarding the specific Hallmarks related to the M.B.T. Consequently, some degree of uncertainty remains as to the circumstances in which the conversion of income into capital has as a main benefit the reduction of tax. Similar uncertainty exists when considering when a circular transaction, a lower taxed form of completing a transaction, or merely entering a transaction that ends with a complete tax exemption can ever reflect a valuable business purpose that defeats the M.B.T.

The Draft Spanish Regulation provides that a transaction entered into with a jurisdiction that is noncooperative will be measured with Spanish list of noncooperative jurisdictions that is revised infrequently in comparison to the latest O.E.C.D. or E.U. list. This is contrary to the wording of the Directive, which determines noncooperative jurisdictions according to the O.E.C.D. or the E.U. standard, and moreover it is broadening the Hallmark's scope by determining that some third party jurisdictions included in the list according to a provision of national law are noncooperative when they are cooperative in the eyes of the E.U. or the O.E.C.D. In this regard, draft legislation has been proposed to update the tax regulations regarding noncooperative jurisdictions so that it is in line with O.E.C.D. and E.U. principles.

Useful clarifications have been made regarding Hallmarks concerning the automatic exchange of information, beneficial ownership, and transfer pricing, but it remains to be seen whether the final version of the Spanish Regulation will be identical to the Draft Spanish Regulation.

Again, the Draft Spanish Regulation has not yet been approved, which may mean that modifications should be anticipated.

Obligation to File Information

As mentioned above, the transposition of D.A.C.6 into the Spanish Law includes the obligation imposed on intermediaries to file reports disclosing certain C.B.A.'s and the obligation to communicate among themselves and with taxpayers. It also includes the imposition of penalties for the violations of those obligations.

The Draft Spanish Regulation generally is based on the Directive when proposing the conditions triggering the obligation to report and the person who must report. However, the actual content of the report is somewhat broader than the Directive. For example, the Draft Spanish Regulation requires information on both national and international activities. The data that is gathered may prove useful to the

Spanish Tax Authorities when communicating with other Member States, but may also impose undue obligations on intermediaries and taxpayers. For example, an intermediary that is a tax law expert in Spain will need to understand provisions contained in the law of other Member States, even if that intermediary is not an expert in that law. This begs the following question – how does a Spanish tax advisor measure the value of the tax effects of the arrangement in another member state? Is it acceptable to provide that the value is unknown? Even if acceptable, is it prudent to provide that the value is unknown? Is a guess at value acceptable? Whichever path is taken, the risk is that none of these responses is comprehensive enough for Spanish Tax Authorities.

Regarding which intermediary has the primary obligation to file a report and the scope of the relevant information in the report, no clarification is provided by the Draft Spanish Regulation. Past experience suggests that it is not uncommon for one advisor to design an arrangement for a taxpayer without ever knowing whether the taxpayer implements the arrangement. It may also be possible that one advisor has an initial obligation as an intermediary, but due to the limited scope of its role, another person would be considered the reporting intermediary because of substantially greater assistance in bringing the arrangement into fruition. Between the two intermediaries, there seems to be no answer in the Draft Spanish Regulation as to which intermediary is actually obligated to file what information.

Another question exists regarding proportionality. When balancing the value of reporting to the Spanish Tax Authorities with the burden to intermediaries, is it fair to impose burdens at the time of implementation when the Spanish Tax Authorities already have knowledge of the arrangement from a prior filing of a tax ruling request? For example, when a party submits a request for a tax ruling with the Spanish Directorate for Taxes, the Public Administration is usually provided with all relevant information on the transaction. If we follow the interpretation that information must be filed no matter what, the reporting obligation does not appear to be proportional as both Spain and the other Member State are aware of the particulars of the transaction.

The issues raised above could be addressed in a comprehensive and complete final version of the Spanish Regulation that develops rules for the disclosure of certain cross-border arrangements, but limits the obligations of intermediaries when tax rulings covering cross-border arrangements involving Spain and a Member State have been obtained from Spanish Tax Authorities by a Spanish taxpayer and those authorities have communicated the ruling to affected Member States.

Violations and Penalty Regime

As mentioned above, the transposition of the Directive into the Spanish Law includes a penalties regime to deal with violations of six separate duties related to the two main obligations of filing information and of communication among intermediaries and the taxpayer. The duties include (i) timely filing, (ii) containing complete, exact and true information, (iii) made through the proper means. Where an intermediary is exempt from reporting, an obligation is imposed on that intermediary to share information with other intermediaries or the taxpayer.

Violations of the foregoing obligations are punishable by fines. The Spanish Law establishes minimum and maximum fines, and the amount of the maximum fine may depend on the fee charged by the recalcitrant intermediary or the value of the tax saving derived from the C.B.A. It is up to the intermediary or taxpayer to prove the value that sets the maximum limits.



“While the transposition of the Directive should have been fully completed by July 2020, the Spanish Law was not approved until the end of December 2020. In addition, no final version of the Draft Spanish Regulation has been adopted as of the date of publication of this article.”

The determination of these values presents certain difficulties. The first difficulty is that an intermediary may have provided advice over a period of time without knowing initially that the transaction is a C.B.A. How does that intermediary apportion its fee between (i) advice in general and (ii) advice as to a C.B.A.?

Another difficulty relates to the fact that there is no provision that applies to the information that should be disclosed for a C.B.A. in which the first step is taken between the date of entry into force of the Directive (June 15, 2018) and its entry into application (July 1, 2020). Imposing a penalty that is determined retroactively to an act during that period violates several cardinal principles of Spanish law, viz., the rule of law, legal certainty, and non-retroactivity of unfavorable provisions. Regrettably, any action to limit penalties is not likely to be accepted by Spanish Tax Authorities and may be viewed by the European Commission to be an infringement by Spain.

While the transposition of the Directive should have been fully completed by July 2020, the Spanish Law was not approved until the end of December 2020. In addition, no final version of the Draft Spanish Regulation has been adopted as of the date of publication of this article. This delay affects the implementation of D.A.C.6, because while the obligation to disclose exists in Spain from late 2020, the means of filing reports are nonexistent as of the date of publication of this article as the draft order mandating the use of certain forms has not been finalized, forcing taxpayers and intermediaries into a situation of involuntary violation. While it is anticipated that the Spanish Tax Authorities will not punish intermediaries for noncompliance with reporting obligations resulting from the failure of the Spanish Government to implement the reporting regime on a timely basis, the lack of answers in this area remains worrisome.

CONCLUSION

The current situation in Spain in connection with D.A.C.6 is that of an orphaned obligation: while the D.A.C.6 has been transposed into the Spanish Law and reporting obligations now exist, there are no means to comply with the reporting obligations, as the Spanish Regulation has not yet been approved. Much uncertainty exists as to the scope of the reporting obligations and the consequences of noncompliance.

It is imperative for the Spanish Government to approve the Spanish Regulation developing D.A.C.6 obligations under Spanish law in way that is more comprehensive than the draft that has been proposed.

D.A.C.6 IN IRELAND – KEY FEATURES OF THE ADMINISTRATIVE GUIDANCE

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Tags
Arrangements
Cross-border
DAC6
Hallmarks
Intermediaries
Ireland
Participants
Reportable

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INTRODUCTION¹

Following the introduction of Council Directive (E.U.) 2018/822 (“the Directive”), which entered into force on June 25, 2018, certain “intermediaries,” including lawyers, banks, accountants, and fund managers, and certain taxpayers are required to disclose “potentially aggressive tax planning schemes with a cross-border element” to the tax authorities in the jurisdictions where they are located. This disclosure is known as “D.A.C.6” reporting. The aim of the regime is to tackle aggressive tax planning by increasing scrutiny of the previously unseen activities of tax planners and advisers.

Despite the focus on “aggressive” arrangements, the reporting obligations can in principle catch a wider range of transactions and matters. The disclosure regime is intended to apply to cross-border transactions that could potentially be used for aggressive tax planning. As such, it is likely that cross-border arrangements that are not used for aggressive tax planning will be reportable because they bear a Hallmark that is listed in one or more of the categories discussed below.

The rules apply to “cross-border arrangements” that will be reportable if one or more relevant “Hallmarks” are applicable. The meaning of both terms is addressed below.

WHAT IS A “CROSS-BORDER ARRANGEMENT”?

The Directive provides that a “cross-border arrangement” (“C.B.A.”) is an arrangement concerning (i) more than one E.U. Member State or the U.K. or (ii) an E.U. member state or the U.K. and a third country, where in either case at least one of the following conditions is met:

- Not all the participants in the arrangement are resident for tax purposes in the same jurisdiction.
- One or more of the participants is simultaneously resident for tax purposes in more than one jurisdiction.
- One or more of the participants carries on a business in another jurisdiction through a permanent establishment situated in that jurisdiction and the arrangement forms a part or the whole of the business of that permanent establishment.

¹ Views expressed on the Irish Revenue's opinions regarding D.A.C.6 are taken from its published briefing, which can be found at www.revenue.ie under tax & Duty Manual 33-03-03 (updated to March 2021).

- One or more of the participants carries on an activity in another jurisdiction without being resident for tax purposes or creating a permanent establishment situated in that jurisdiction.
- The arrangement has a possible impact on the automatic exchange of information or the identification of beneficial ownership.

“Arrangement” is not fully defined in the Directive, but it includes a series of arrangements and may comprise more than one step or part of a broader arrangement.

A C.B.A. is reportable if it contains at least one “Hallmark.”

WHAT IS A RELEVANT “HALLMARK”?

The Hallmarks are grouped under five broad categories (A – E) and are features or characteristics which are commonly seen in aggressive tax planning arrangements, although as noted above, several of the Hallmarks are more broadly defined and can apply to normal commercial transactions. A high level summary of each of the Hallmarks is set out below.

Certain Hallmarks require the “main benefit or one of the main benefits” of the arrangements to be the obtaining of a tax advantage. This is known as the “main benefit test” (“M.B.T.”).

CATEGORIES	HALLMARKS	M.B.T.?
Category A <i>Commercial characteristics seen in marketed tax avoidance schemes</i>	The taxpayer or participant is under a confidentiality condition in respect of how the arrangements secure a tax advantage.	Yes
	The “intermediary” is paid by reference to the amount of tax saved or whether the scheme is effective.	Yes
	The transaction uses substantially standardized documentation and/or structures which are not substantially customized for implementation.	Yes
Category B <i>Tax structured arrangements seen in avoidance planning</i>	The transaction involves the acquisition of a loss-making company.	Yes
	Income is converted into capital which is taxed at a lower level or exempt from tax.	Yes
	Circular transactions result in the round-tripping of funds with no other primary commercial function.	Yes



CATEGORIES	HALLMARKS	M.B.T.?
Category C <i>Cross-border payments, transfers broadly drafted to capture innovative planning but which may pick up many ordinary commercial transactions where there is no main tax benefit</i>	Deductible cross-border payments are made between “associated enterprises” defined in Lines (i) to (iv) and one of payments described in Line 1 to Line 5 below apply. Enterprises are “associated” if one enterprise (i) holds > 25% of the voting rights in another enterprise, (ii) owns > 25% of the share capital of another enterprise (directly or indirectly), (iii) is entitled to > 25% of the profits of another enterprise, or (iv) exercises significant influence over the management of another enterprise.	
	1. Payment to a recipient not resident for tax purposes in any jurisdiction.	No
	2. Payment to a recipient resident in a jurisdiction which levies a 0% or near 0% corporate tax rate.	Yes
	3. Payment to a recipient resident in E.U. or O.E.C.D. blacklisted countries.	No
	4. Payment which is tax exempt in the recipient’s jurisdiction.	Yes
	5. Payment which benefits from a preferential tax regime in the recipient jurisdiction.	Yes
	Deductions for depreciation are claimed in more than one jurisdiction.	No
	Double tax relief is claimed in more than one jurisdiction in respect of the same income.	No
	An asset transfer takes place where the amount treated as payable is materially different between jurisdictions.	No
Category D <i>Arrangements which undermine tax reporting and transparency under the Common Reporting Standard</i>	Arrangements which have the effect of undermining reporting requirements under agreements for the automatic exchange of information.	No
	Arrangements which obscure beneficial ownership and involve the use of offshore entities and structures with no real substance.	No
Category E <i>Unilateral safe harbors</i> <i>Transfers of hard-to-value intangibles</i> <i>Transfers of items + >50% reduction in E.B.I.T. of transferor</i>	Arrangements involving the use of unilateral transfer pricing safe harbor rules.	No
	The transaction involves transfers of hard to value intangibles for which no reliable comparable exist and where financial projections or assumptions used in the valuation are highly uncertain.	No
	A cross-border transfer of functions/risks/assets is projected to result in a more than a 50% decrease in E.B.I.T. during the next three years.	No

WHEN DOES THE REPORTING APPLY?

The disclosure regime became effective in all Member States on July 1, 2020. However, Ireland, along with many other Member States, exercised an option given in Council Directive (E.U.) 2020/8765 to defer the first disclosures of information to January 31, 2021, and February 28, 2021, to cover the legacy periods. The Directive was transposed into Irish law by the European Union (Administrative Cooperation in the Field of Taxation) (Amendment) Regulations 2020. Thereafter, reports are due within 30 days from the first step of the transaction implementation.

WHAT DO THE IRISH AUTHORITIES CONSIDER TO BE A TAX ADVANTAGE?

According to the Revenue, the term “tax advantage” is defined broadly to include the avoidance or reduction of a charge to tax, a relief from tax, repayment of tax and the deferral of tax or the avoidance of an obligation to deduct withholding tax.

A tax advantage may be obtained or intended to be obtained in respect of any tax levied by, or on behalf of, an E.U. Member State, except for value-added tax, customs duties, excise duties and compulsory social security contributions.

Fees for documents issued by public authorities and consideration due under a contract are excluded from the scope of taxes covered by the disclosure regime.

WHAT DOES THE M.B.T. MEAN TO THE IRISH TAX AUTHORITIES?

The Revenue have stated in the published guidance notes that the M.B.T. applies a reasonable awareness test. The specific language used in the Directive refers to scenarios where the main benefit or one of the main benefits that a person (having regard to all facts and circumstances) “may reasonably expect to derive from an arrangement is the obtaining of a tax advantage.”

Accordingly, in the context of a C.B.A., what is important is whether it would be (i) reasonable for a person (ii) to expect to derive a tax advantage as a main benefit from such arrangement. In this regard, the word “reasonable” is based on the common law “reasonable man test.” The reasonable man test asks what a “reasonable person of ordinary prudence” would do in a given situation. It is an objective test. The word expect, as used in this context, is a verb which means to regard something as likely to happen.

Therefore, what is not important, in the context of this test, is the particular facts or circumstances of the participants as that would be a subjective test. Rather, what is important, in the context of this test, is whether a hypothetical reasonable person could expect to obtain tax benefits from the arrangement and that such benefits would be a main benefit of that arrangement. As the reporting is generally performed by intermediaries, this approach is logical.

The test involves asking a hypothetical question of what a reasonable person would reasonably expect, given the facts of a particular arrangement.

“... what is not important, in the context of this test, is the particular facts or circumstances of the participants as that would be a subjective test.”

The main benefit test requires an objective comparison of the value or significance of an expected tax advantage *vis-à-vis* any other benefit likely to be obtained from an arrangement. Such a comparison is to be carried out in the context of the arrangement itself and the range of benefits expected to arise from entering the arrangement.

If, having carried out such a comparison, it is determined that a tax advantage is the main benefit or one of the main benefits that is likely to be obtained from the arrangement, then the test will be satisfied. If, on the other hand, it is the case that a tax advantage is one of a number of benefits that are likely to be obtained from an arrangement, but not a main benefit, then the tax advantage will simply be the “icing on the cake” and the test will not be satisfied.²

WHAT IS THE VIEW OF THE IRISH AUTHORITIES ABOUT CONFIDENTIALITY?

According to Revenue, arrangements involving the use of confidentiality conditions will be reportable in any of three circumstances:

- The confidentiality condition has the effect of limiting disclosure of the expected tax advantage *vis-à-vis* other intermediaries and/or the tax authorities.
- It is reasonable to conclude, from an objective standpoint, that the confidentiality condition is intended to secure a tax advantage *vis-à-vis* other intermediaries or the tax authorities.
- A tax advantage is the main benefit or one of the main benefits which, having regard to all the relevant facts and circumstances, a person may reasonably expect to obtain from the arrangement.

For an arrangement to bear this Hallmark, it is not necessary that the confidentiality condition refer explicitly to the limitation on disclosure. It is only necessary that the confidentiality condition has the effect of limiting disclosure of the expected tax advantage *vis-à-vis* other intermediaries or the tax authorities.

Examples of confidentiality conditions include

- nondisclosure agreements,
- steps that discourage potential users from taking external advice,
- use of promotional material referring to nondisclosure,
- steps that discourage users from keeping promotional material or other details of how the arrangement operates, and
- discouraging users from communicating directly with the Revenue or another tax authority.

² *Commissioners of Inland Revenue v. Sema Group Pension Scheme Trustees*, 74 TC 593 at 637.

WILL CONFIDENTIALITY PROVISIONS ALWAYS TRIGGER DISCLOSURE?

No. According to the Revenue, the use of such agreements will not trigger reporting unless it is reasonable to conclude, from an objective standpoint, that the confidentiality condition is intended to secure a tax advantage vis-à-vis other intermediary or the tax authorities and the tax advantage is the main benefit or one of the main benefits which, having regard to all the relevant facts and circumstances, a person may reasonably expect to obtain from the arrangement.

WHEN DOES THE USE OF STANDARDIZED DOCUMENTS NOT RESULT IN MEETING THE HALLMARK?

A strict application of the standardized documents Hallmark is likely to result in a significant volume of transactions being reported to the Revenue that are not used for tax avoidance purposes. To alleviate the administrative burden this may place on intermediaries and taxpayers, Finance Act 2020 introduced section 817RI. The section provides that the use of certain tax reliefs and exemptions will not trigger reporting under this Hallmark where the relief or exemption in question falls into any of the following categories:

- It benefits from equivalent reporting exclusions under Ireland's domestic mandatory disclosure regime.
- It is provided for in legislation.
- It involves some degree of Revenue oversight, certification, or approval.
- It is used in a routine fashion for *bona fide* purposes.

Examples of such reliefs and exemptions include documents that are used in regard to (i) approved profit-sharing plans, (ii) approved salary reduction arrangements, and (iii) approved retirement benefit arrangements.

WHAT ARE THE UNILATERAL SAFE HARBOR RULES OF HALLMARK E1?

This hallmark applies to arrangements that involve the use of unilateral safe harbor within the meaning of the O.E.C.D. Transfer Pricing Guidelines, which provides as follows:

A safe harbour in a transfer pricing regime is a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations otherwise imposed by a country's general transfer pricing rules. A safe harbour substitutes simpler obligations for those under the general transfer pricing regime. Such a provision could, for example, allow taxpayers to establish transfer prices in a specific way, e.g. by applying a simplified transfer pricing approach provided by the tax administration.³

³

Paragraph 4.102 of the O.E.C.D. Transfer Pricing Guidelines.

“A strict application of the standardized documents Hallmark is likely to result in a significant volume of transactions being reported to the Revenue that are not used for tax avoidance purposes.”

DO BILATERAL APA'S NEGOTIATED WITH TAX AUTHORITIES OF MORE THAN ONE STATE COME WITHIN THE SCOPE OF THE CATEGORY E HALLMARK REGARDING UNILATERAL SAFE HARBORS?

No. Only arrangements involving the use of unilateral safe harbors come within the scope of The Category E Hallmark. Examples include standard mark-ups for trading companies. Therefore, bilateral advance pricing agreements concluded between tax authorities do not fall within the scope of Category E Hallmarks.

Consequently, the following types of arrangements will not be considered to involve the use of unilateral safe harbor rules:

- Arrangements involving the use of administrative simplification measures that do not directly involve the determination of arm's length prices, for example, simplified documentation requirements in the absence of a pricing determination.
- Arrangements that adopt the simplified approach to low value intra-group services. The Revenue has issued guidance regarding its simplified approach to low value intra-group services. Revenue's practice of accepting a mark-up of 5% of the cost-base without requiring a taxpayer to provide a benchmarking analysis is consistent with international guidance in this area.
- Arrangements involving the use of provisions that exclude certain categories of taxpayers or transactions from the scope of transfer pricing rules. For instance, Small and Medium Enterprises are currently outside the scope of Ireland's transfer pricing rules.
- Where a particular category of taxpayer or transaction falls within the scope of a unilateral safe harbor rule, but the arrangement does not rely on or involve the use of that rule.

WHEN DO INTRA-GROUP TRANSFERS OF FUNCTIONS, RISKS, AND ASSETS FALL WITHIN THE SCOPE OF CATEGORY E HALLMARK?

Category E contains a Hallmark involving the transfer of functions, risks, and assets when the transfer could be part of a plan to move profits to another jurisdictions. Here, the key to the application of the Hallmark is an intragroup cross-border transfer of functions, risks, or assets combined with a substantial reduction of operating profits by the transferor.

The second leg for application of the Hallmark is that the projected annual earnings computed without taking into account interest and taxes – typically referred to as earnings before interest and taxes ("E.B.I.T.") of the transferor for the three-year period following the transfer are less than 50% of the projected annual E.B.I.T. of the transferor(s) if the transfer had not been made. E.B.I.T. is defined and computed according to applicable accounting standards. In essence, the tainted transaction

keeps the business within a corporate group, but moves the income generating activity to a low-tax country as a means of substantially transferring E.B.I.T. to the new location.

This Hallmark generally does not apply where the following two conditions are present:

- The transferor is projected to make a loss were the transfer not to proceed.
- The projected post-transfer operations of the transferor project reduced losses, zero earnings, or a positive E.B.I.T.

As the projected E.B.I.T. was negative before the transfer, this Hallmark should not apply as each of the three outcomes cannot be said to represent a 50% reduction in E.B.I.T.

WHAT COMPUTATIONS ARE REQUIRED IN DETERMINING WHETHER THE CATEGORY E HALLMARK IS APPLICABLE TO A MOVE OF FUNCTIONS, RISKS, AND ASSETS?

The Revenue advises that, to establish whether this hallmark is met, it will be necessary for a taxpayer to produce two sets of projections for the three-year period following the transfer. The first is based on the projected position of the transferor without the transfer taking place. The second is based on the projected position of transferor with the transfer taking place. Each set projections should take into account all relevant facts and circumstances at the time the reporting obligation arises under the disclosure regime.

IF A REPORT MUST BE FILED, WHO FILES THE REPORT?

In general, an intermediary files the report. However, if the intermediary is bound by professional privilege that would be violated by making the report, the intermediary is obligated to advise the taxpayer to file its own report. Full information must be transferred to the taxpayer by the intermediary.

Note that a person required to file a report to the Revenue in respect of a reportable C.B.A. is not required to include in the return information that is not within its knowledge, possession, or control.

HOW MUCH INVESTIGATION IS REQUIRED OF THE PERSON MAKING THE REPORT?

A person required to file a report regarding a C.B.A. must take all reasonable steps necessary to obtain the required information. Reasonable steps are the steps a person in this situation would ordinarily be expected to take in the course of ordinary commercial due diligence on a transaction of that nature. However, there is no specific obligation to actively seek out information that the intermediary and/or the relevant taxpayer does not hold in the first place.



WHO ARE THE INTERMEDIARIES?

There are two categories of intermediary for D.A.C.6 purposes.

The first category of intermediary is any person that designs, markets, organizes, makes available for implementation, or manages the implementation of a reportable cross-border arrangement.

This category of intermediary will comprise those that actively design and advise on tax planning schemes for their clients, such as lawyers specializing in tax law and professional tax advisors. It will also include companies in corporate groups that design and advise on such schemes using in-house experts for implementation by other group members.

The second category of intermediary is any person that, having regard to the relevant facts and circumstances and based on available information and the relevant expertise and understanding required to provide such services, knows or could be reasonably expected to know that such person has undertaken to provide, directly or by means of other persons, aid, assistance or advice with respect to designing, marketing, organizing, making available for implementation or managing the implementation of a reportable cross-border arrangement.

This category of intermediary is likely to encompass a much broader range of persons than the first category. It may include accountants, auditors, wealth managers, lawyers, insurance companies, asset managers of investment funds and bankers. As with the first category of intermediary, it will also include companies in corporate groups that design and advise on such schemes using in-house experts for implementation by other group members.

HOW DO THE IRISH AUTHORITIES VIEW THE LEGAL PRIVILEGE EXCEPTION?

An intermediary is exempt from the obligation to file a report of the specified information with the Revenue if a claim to legal professional privilege in respect of that information could be maintained in legal proceedings. Where only part of the specified information is subject to professional privilege, the exemption will apply only in respect of that part of the specified information.

For the purpose of this exemption, the term “legal professional privilege” will be interpreted in accordance with Irish law. Therefore, except for those cases where litigation is in actual contemplation, legal privilege will generally apply only to confidential legal advice given to a client by a lawyer and will not extend to documentation prepared in the ordinary course of a transaction or to the identity of the parties involved. Furthermore, as the privilege is that of the client, not the legal professional, the client may elect to waive its right to legal privilege to the extent necessary to allow the legal professional to disclose the information to Revenue.

Intermediaries should analyze whether their interactions with their clients in respect of arrangements within the meaning of section 817RA are privileged and discuss with all clients that benefit from the legal professional privilege whether

“Different levels of penalties are provided for under Irish law, depending on the nature of the infringement.”

they wish to waive their rights under applicable privilege. The decision belongs to the client once properly informed of the scope of the exemption, taking into account all facts and circumstance, with regard to matters for which legal counsel has been retained.

Where an exemption from disclosure applies due to legal professional privilege, an intermediary is required to notify, without delay, the relevant taxpayer of its obligation to file a return of information with the Revenue. For the purpose of this obligation, “without delay” should be taken to mean as being as soon in time as the intermediary becomes aware that an exemption applies due to legal professional privilege.

WHAT IS THE VIEW ABOUT MAKING A MISTAKE IN A DISCLOSURE?

Where a decision is taken that an arrangement is not disclosable, but it subsequently transpires that the conclusion is not supported by applicable law implementing D.A.C.6, an intermediary has the right to establish to the satisfaction of Revenue that the decision was arrived at in an objective way, considering all relevant facts and circumstances and based on available information. Where, on the other hand, the Revenue forms the view that the failure to comply is not justified, penalties for noncompliance may be imposed.

WHAT PENALTIES ARE IMPOSED FOR NONCOMPLIANCE WITH REPORTING OBLIGATIONS?

Different levels of penalties are provided for under Irish law, depending on the nature of the infringement.

The maximum penalty is generally €4,000⁴ where the compliance failure relates to the obligations of an intermediary in relation to marketable arrangements for the following compliance failures:

- The failure of an intermediary to inform another intermediary or the relevant taxpayer of their disclosure obligations where a reporting exemption applies due to legal professional privilege.
- The failure of a relevant taxpayer to provide the Arrangement identification number to any other relevant taxpayer.
- The failure to comply with reporting obligations that apply in relation to the “lookback” period.

If the failure to comply continues after imposition of the initial penalty, a further penalty of €100 may be imposed for each day on which the failure continues

Where the compliance failure does not relate to marketable arrangement, the maximum penalty is €500 for each day on which any of the following compliance failures occur:

⁴

Section 817RH(1)(a).

- The failure of an intermediary to file a return of information with the Revenue, with the exception of the reporting obligations that apply in relation to the “lookback” period.
- The failure of an intermediary to provide any other intermediary and each relevant taxpayer with the Arrangement identification number.
- The failure of a relevant taxpayer to file a return with Revenue.

If the failure continues after daily penalties are imposed, a further penalty of €500 may be imposed for each additional day on which the failure continues.

Where the failure to comply relates to the obligation of a relevant taxpayer to include the Arrangement identification number in its annual return of income, a maximum penalty of €5,000 may apply.

While the legislation prescribes the maximum penalties that may be imposed, it will ultimately be for the courts to decide whether a person is liable to a penalty and, if the person is so liable, the amount of that penalty. Once the amount of the penalty is asserted, the Revenue procedure will be to make an application to the relevant court for a determination on the matter.

When determining the amount of a penalty that is to apply, the Court is to have regard for the following:

- If the person is an intermediary, the amount of any fees received or likely to have been received by the person in relation to the reportable cross-border arrangement.
- If the person is a relevant taxpayer, the amount of any tax advantage gained or sought to be gained by the person from the reportable cross-border arrangement.

WHAT IS THE PROCESS FOR FILING A REPORT?

Returns are filed electronically on the Revenue Online System (“R.O.S.”), <https://www.revenue.ie/en/online-services/index.aspx>. It is possible that multiple returns of the same transaction will be made. Whenever possible it is requested that the same Arrangement identification number should be used.

Before filing a report online, a person must register, either in their own account or through an intermediary, with the R.O.S. filing system.



D.A.C.6 IMPLEMENTATION IN CYPRUS

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Tags

Arrangements

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DAC6

Hallmarks

Intermediaries

Participants

Reportable

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INTRODUCTION

As a member of the E.U., Cyprus is subject to the same obligation as all other E.U. states to implement the Directives on Administrative Cooperation (“D.A.C.”) including D.A.C.6, for which the Cyprus Ministry of Finance (“M.O.F.”) submitted draft legislation in 2019. The D.A.C.6 draft legislation under consideration in the Cypriot Parliament, with discussions ongoing before the appropriate Parliamentary Committee. Several amended drafts of the implementing legislation were submitted, but with the COVID-19 emergency measures, the legislative process ground to a halt in March 2020. The process started up recently and the law was passed by the end on March 18, 2021.

Reporting deadlines have been extended twice, currently to June 30, 2021. An additional extension of the deadline for filing information on reportable cross-border arrangements (“R.C.B.A.’s”) set out in the D.A.C.6 Directive has been granted. The submission deadline for D.A.C.6 has been extended up to June 30, 2021, for the following cases:

- R.C.B.A.’s carried out between June 25, 2018 and June 30, 2020, that should have been reported by February 28, 2021.
- R.C.B.A.’s carried out between July 1, 2020 and December 31, 2020, that should have been reported by January 31, 2021.
- R.C.B.A.’s carried out between January 1, 2021 and May 31, 2021 and which should have been (or should be) be reported within 30 days from the earliest of
 - the day made available for implementation,
 - the day they were ready for implementation, or
 - the day on which the first step towards implementation has been (or will be) made.
- R.C.B.A.’s for which secondary intermediaries have provided (or will provide) assistance, aid or advice between January 1, 2021 and May 31, 2021, that should have been or should be reported within 30 days following the next day where such assistance, aid or advice was provided.

However, application of D.A.C.6 is immediate due to its retroactive effect. Deadlines for the commencement of exchanges between countries have also been extended as a result of the various extensions.

GENERAL CONSIDERATIONS AND CONCERNS

The Cypriot Government recognizes that the application of D.A.C.6 is challenging for smaller countries in the E.U. The government department that will monitor the D.A.C.6 law implementation is yet to be fully staffed in view of the COVID-19 situation. The various lockdowns have challenged the Government's capacity to provide appropriate training and briefing. The Cypriot Government is aware that many medium to small professional firms likely will most likely experience difficulties in installing and maintaining the necessary internet systems required for reporting. This will lead to outsourcing of reports to larger firms. In addition, this will lead to sharp increases in operating and compliance costs and fees that may adversely affect Cypriot competitiveness in the international business sector.

The M.O.F. is aware that the scope of D.A.C.6 reporting obligations is broad and that it may capture arrangements that arise for commercial reasons more than for tax planning reasons. Consequently, the M.O.F.'s view on the Main Benefit Test ("M.B.T.") is to compare the value of (i) tax advantages against (ii) other benefits and considerations on a case by case basis.

The Cypriot Tax Department defines tax benefit as any of the following advantages:

- The grant of relief or an increase in previously granted relief on tax
- Avoiding tax or reduction of tax
- Deferral of tax payments
- Avoidance of an obligation to withhold tax

The cardinal element of the proposed law is that the tax advantage reported under D.A.C.6 must be seated in the E.U. This means that an arrangement resulting in a tax benefit which affects only the tax base of a non-E.U. jurisdiction does not fall within the M.B.T. Hence, Hallmarks for which the M.B.T. must be met are removed from reporting when the C.B.A. reduces tax in a country other than a Member State of the E.U.

Ultimate beneficial owners of Cypriot companies are monitored in existing compliance rules. If any individual who is a tax resident of a Member State of the E.U. secures tax treatment in Cyprus that adversely affects the tax base of that E.U. Member State, information on that cross border arrangement ("C.B.A.") will be captured by the law and will be reportable once the D.A.C.6 legislation is enacted.

The objectives of the M.O.F. are identical to those of the E.U. Consequently, the reporting obligation in Cyprus will include targeting and capturing potentially aggressive tax planning arrangements resulting in tax base erosion of one or more E.U. Member States. It will not matter whether C.B.A.'s of a Cypriot company are with an E.U. Member State or a country that is not an E.U. Member State. If the Member State's tax base is of a kind that could be adversely affected by a transaction, reporting will be required by intermediaries.

In addition to D.A.C.6, the Cypriot Government will continue to adhere to all previous directives on administrative cooperation in the field of taxation. These include the following:

- Targeting attempts at circumventing mandatory automatic exchanges of financial information (such as C.R.S.)
- Exchanges of information on cross border tax rulings
- Country-by-country reporting
- Facilitating access to anti-money laundering information by tax authorities

Regarding reportable arrangements to be included in D.A.C.6, the M.O.F. has adopted the minimum standards under which D.A.C.6 reporting will not be required for local arrangements and for arrangements with non-E.U. states where the tax base of an E.U. Member State is not affected adversely.

The internal taxes that will be addressed by the Cypriot legislation include only the Income Tax, the Special Defense Tax, and the Capital Gains Tax. No other direct or indirect taxes are covered by the proposed law. Penalties for noncompliance with various reporting obligations may not exceed €20.000 per R.C.B.A.

BASICS TO BE ADOPTED BY CYPRUS

The D.A.C.6 basic provisions addressed by the legislation and enacted are as follows:

- **The M.B.T. and the Hallmarks falling within the M.B.T.** This includes standardized documentation that is actively promoted and sold off-the-shelf, thus potentially leading to aggressive tax planning potentially eroding the tax base in any E.U. Member State, is well defined. The net is cast widely to catch even usual commercial arrangements therefore analysis of a cross border arrangement is quite a difficult and complex task.
- **The Hallmarks not requiring a finding as to the M.B.T.** These R.C.B.A.'s are defined widely. Among other elements, R.C.B.A.'s will include the following:
 - Transactions between Cypriot companies and companies and other entities based in E.U. and O.E.C.D. blacklisted countries
 - Transactions between Cypriot companies and recipients of income who are not tax resident in any country
 - Transactions otherwise resulting in deduction of depreciation on the same asset in multiple jurisdictions
 - Transfers of assets significantly projected to reduce valuation of the transferor's income stream
- **Automatic Exchanges of Information ("A.E.O.I.")**. Arrangements which circumvent A.E.O.I. by utilizing jurisdictions that are not regulated or compliant must be reported.
- **Transfer Pricing**. Transfer pricing elements such as exploiting the existence of safe harbor rules, and transfer of hard-to value intangibles in an arrangement.

DEFINITION OF INTERMEDIARIES

In general, the Cypriot Government has adopted the definition of an intermediary that is provided by D.A.C.6. Consequently, intermediaries include all persons devising, drafting, advising on, and marketing tax planning arrangements. Also included are persons that assist in implementing those arrangements.

On the other hand, exemption has been granted to those providing tax compliance and auditing services. Lawyers have also been exempted due to professional confidentiality regulations in Cyprus, as with other E.U. Member States. However, these exemptions are conditional. The exempted professional is required to review and analyze the objectives of the client's arrangements and must provide notice to clients that, because of the exemption for the accountant, tax return preparer, or lawyer, the client is required to ensure that its tax advisers and primary intermediaries have reported the R.C.B.A. and must provide the relevant report reference number. If the other intermediaries fail to report, clients must be advised that the reporting obligation shifts to them. Failure by exempted persons to carry out notification responsibilities may give rise to penalties for noncompliance.

The complication in Cyprus, is that clients typically are Cyprus registered companies with ultimate beneficial owners that are resident outside Cyprus. This poses a problem for resident directors in Cyprus, who bear the responsibility of noncompliance. To protect company directors, the M.O.F. strategy will require lawyers, auditors, and tax compliance firms to maintain detailed documentation in order to avoid the statutory penalties.

“To protect company directors, the M.O.F. strategy will require lawyers, auditors, and tax compliance firms to maintain detailed documentation in order to avoid the statutory penalties.”

FURTHER CYPRUS CONSIDERATIONS

- Cyprus adopted the position in the draft law, that E.U. approved tax schemes implemented in Cyprus such as the I.P. Box regime, Tonnage Tax regime in the shipping industry, and the N.I.D. (Notional Interest Deduction) do not fall within the proposed D.A.C.6 law.
- Regarding Hallmarks that are applicable without reference to the M.B.T., the Cypriot position is that most of these will only be applicable provided the arrangements in question are with legal entities based in countries on the E.U. and/or O.E.C.D. Noncooperative Jurisdiction lists. Cyprus implements strictly rules attacking transactions with companies based in listed jurisdictions.
- Cyprus has adopted the common goal of E.U. tax authorities to react proactively and decisively when tax rules may facilitate aggressive and harmful tax practices.
- The M.O.F. has adopted a policy that ensures access to a level playing field for large and small taxpayers.

About Us

Ruchelman P.L.L.C. is a boutique law firm based in New York City. It was founded in 1989 by an alumnus of a legacy firm that is now Deloitte's.

Our firm provides a wide range of tax planning and commercial legal services to clients across the Americas, Asia, Europe, and the Middle East. Clients include global investors, multinational corporations expanding into the U.S., and U.S. businesses with international operations. Our core practice focuses on cross-border transactions.

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Special features include an annual examination of the use of holding companies in European tax planning and a look at the year in review.

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