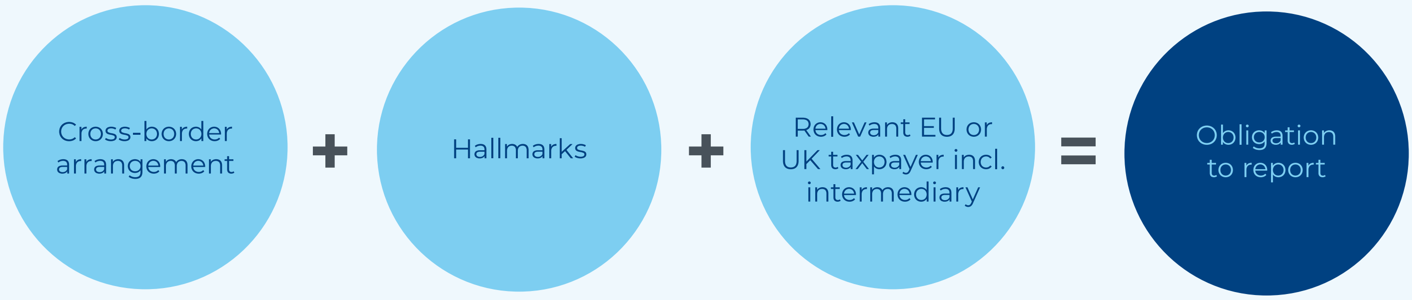
CROSS BORDER TRANSACTIONS INTO THE EU OR UK: WILL YOU BE CAUGHT BY THE NEW DAC6 REPORTING REQUIREMENTS?

This briefing is a step by step guide to the new EU disclosure requirements for certain cross-border transactions and/or arrangements.

Figure 1: DAC6 reporting obligation



What is DAC6?

In 2011, the European Union **(EU)** adopted Directive 2011/16/EU on the mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements. Amendments have been made by Directive 2018/822 **(DAC6)** which introduces additional reporting requirements intended to assist the EU Member States **(Member State(s))** to identify potentially aggressive tax arrangements. From a commercial perspective, DAC6 does not prohibit any kind of transaction but, rather, imposes an added level of transparency.

DAC6 requires disclosure to the relevant tax authority of all arrangements with:

- an EU cross-border element;
- where the arrangements fall within certain *hallmarks*; **and**
- in certain instances where the main or expected benefit of the arrangement is a *tax advantage* (Main Benefit Test).

In principal, the reporting obligation lies with the EU *intermediary* that designs, promotes, or implements the arrangement (e.g. tax advisors, accountants, lawyers etc.), but shifts to the *taxpayer* (i.e. the client) in certain cases (see Figure 1).

Mandatory disclosure will have far-reaching consequences both for us, as legal advisers, and for you, as our client. We, as the service providers in your transactions, may have to disclose any reportable arrangements to the relevant tax authority within 30 days from the date at which the arrangement is made available for implementation, or within the period of 30 days beginning on the day after we provide the aid, assistance or advice in respect of the arrangement, whichever is the earlier. In this Briefing, we go through the key features of DAC6 and the new UK regime and provide guidance as to when reporting obligations arise (both for us as your lawyers, or for you directly).

DAC6, the UK and Brexit

The UK adopted "The International Tax Enforcement (Disclosable Arrangements) Regulations 2020" **(UK Regulations)**, in early 2020, which transposed DAC6 into domestic law. While DAC6 ceased applying to the UK at the end of the Brexit transition period (11pm 31 December 2020), the UK Regulations apply regardless of the UK leaving the EU. However, they were amended on 31 December 2020 to narrow the scope of mandatory reporting within the UK. As detailed further below, in the UK, only cross-border arrangements falling under the Category D hallmark will be reportable. The change will apply to both historic, and future, cross-border arrangements.

The amendment to the UK Regulations is to be a temporary measure as the UK intends to consult on, and introduce legislation to implement mandatory reporting under the OECD Mandatory Disclosure Rules (the "MDR") over the course of 2021.[1] The MDR are designed to provide tax administrations with information on arrangements that (purport to) circumvent the Common Reporting Standard (CRS Avoidance Arrangements) and on structures that disguise the beneficial owners of assets held offshore. It is currently unknown whether any such legislation would significantly change the mandatory reporting obligations under the amended UK Regulations.

The penalties for non-compliance with DAC6 and the UK Regulations could be quite onerous. Under the UK Regulations, these affect both the intermediary, if there is one, and the taxpayer and include:

- Daily penalties (£600 per day);
- Penalties from £5,000 to £10,000 per failure;
- Tribunal proceedings: penalties up to £1 million / reputational risk.

Please note that this area of law is still undergoing change and there may be slight variations between the penalties imposed by each of the Member States.

What is a *cross-border arrangement*?

For the purposes of DAC6 and the UK Regulations, an arrangement is a cross-border one:

- if it concerns:
  - More than one EU member State or the UK and a Member State, **or**
  - An EU member State and a third country or the UK and a third country,
  - **and**
- meets any of the following conditions:
  - not all of the participants are tax resident in the same jurisdiction; **and/or**
  - at least one of the participants has dual EU or EU/UK tax residency; **and/or**

1 https://www.oecd.org/tax/exchange-of-tax-information/model-mandatory-disclosure-rules-for-crs-avoidance-arrangements-and-opaque-offshore-structures.htm

- at least one of the participants has a permanent establishment **(PE)** in a different EU jurisdiction or the UK and the arrangement forms part of the business of the permanent establishment; **and/or**
- at least one of the participants carries on activities in another EU jurisdiction or the UK without being tax resident or creating a PE situated in that jurisdiction; **and/or**
- such an arrangement has a possible impact on the automatic exchange of information or the identification of beneficial ownership.

N.B. Even if a transaction is not a cross-border one initially, if there are changes to the structure, it may then become reportable.

Who needs to report and where?

Any person that designs, markets, organises or makes available for implementation or manages the implementation of a reportable *cross-border arrangement* is an *intermediary*. An *intermediary* is, also, any person that knows or could be reasonably expected to know that they have provided such a function.

An *intermediary* can be an individual or a company, e.g. lawyers, accountants, consultants, banks, etc. Intermediaries **must report** information regarding the arrangement to the relevant tax authority in their Member State or in the UK (as applicable).

However, in the following situations, the reporting obligation shifts to the *relevant taxpayer,* i.e. the client as the person to whom the arrangement is made available:

- When the *intermediary* is a non-EU/UK intermediary, i.e. when it is neither:
  - tax resident in a Member State or the UK; **nor**
  - has a PE in a Member State or the UK through which the services in respect of the arrangement are provided; **nor**
  - incorporated in, or governed by the laws of, a Member State or the UK; **nor**
  - a member of a professional (legal, taxation or consultancy) association in a Member State or the UK.
- When there is no *intermediary*, i.e. an in-house arrangement;
- When an *intermediary* can claim legal professional privilege.

Matters involving two or or a Member State and a third country

The decision on which Member State needs to report will be in accordance with the order set out in DAC6.

Matters involving the UK and a Member State

Whilst HMRC has stated that it will recognise reports made in EU Member States, there has not been any reciprocal recognition from EU tax authorities as the reporting obligation is narrower in the UK. When a transaction involving the UK also involves EU Member States, then the primary reporting obligation falls on the intermediary or taxpayer in the EU Member State, regardless of which Category Hallmark is triggered.

Matters involving the UK and a third country

Where a matter involving the UK and a third country, then the reporting obligation falls on the intermediary or taxpayer in the UK in relation to a Category D Hallmark.

Evidence where another intermediary or taxpayer will report

When another intermediary or taxpayer files a report, those who would otherwise have filing obligations should obtain the “Arrangement Reference Number” or equivalent issued by the tax authority to the reporting intermediary or taxpayer, as evidence that a report was filed.

What is a reportable *cross-border arrangement*?

A cross-border arrangement involving the UK and a Member State or one or more Member States or a Member State and a third country will be reportable to the relevant tax authority in the EU under DAC6 if it falls within any of the Hallmarks set out in the table below. If an arrangement falls within categories A, B and certain subcategories under category C, it will only be reportable if it is also satisfies the Main Benefit Test. The Main Benefit Test is met if an expected tax advantage is the main benefit or one of the main benefits of an arrangement.

While a cross-border arrangement involving the UK and a Member State that triggers a Category D Hallmark will also be reportable in the UK, under the UK Regulations, the primary obligation to report falls to the EU-based intermediary or taxpayer, who will need to report to the relevant EU tax authority (as Member States will not recognize reports made in the UK). It will not be necessary to file a report in the UK as well as the Member State in these circumstances, however, the UK party must obtain the Arrangement Reference Number issued by the EU tax authority (as outlined above) as evidence that a report has been filed.

Where a cross-border arrangement involves the UK and a third country that triggers a Category D Hallmark it will be reportable to HMRC if it falls within Hallmark D in the table below.

Table 1: Hallmarks

Category A - Generic hallmarks linked to the Main Benefit Test
1. **Confidentiality condition** in a transaction not to disclose how a tax advantage is secured; or 2. **Fee agreements** based on the tax advantage calculation; or 3. **Standardised documentation/structure** relevant to more than one taxpayer.
Category B – Specific hallmarks linked to the Main Benefit Test
1. Acquiring **loss-making** companies to reduce tax liability; or 2. **Income conversion** into capital or lower-taxed revenue streams; or 3. **Circular transactions** with no primary commercial function.
Category C – Specific hallmarks related to cross-border transactions
1. Deductible cross-border payments **between associated enterprises** where: (a) Recipient not a tax resident in any jurisdiction; or (b) Recipient tax resident in: (i) jurisdiction with a **zero or near zero corporate tax** rate; or (ii) OECD[1] or EU **blacklisted** third-country state[2]; or (c) Payment has **full tax exemption** in resident's jurisdiction; or (d) Payment benefits from **preferential tax** regime in resident's jurisdiction; or 2. Deductions claimed in more than one jurisdiction for **same depreciation** on assets; or 3. Relief from **double taxation** claimed in more than one jurisdiction; or 4. **Transfer of assets** where there is a material difference between those assets being considered payable.
Category D – Specific hallmarks concerning the automatic exchange of information and beneficial ownership
1. Arrangements **undermining reporting** obligations; or 2. Arrangements involving **non-transparent legal or beneficial ownership** chain with the use of a person's legal arrangements or structures.
Category E – Specific hallmarks concerning transfer pricing
1. **Unilateral safe harbour rules** e.g. the use of transfer pricing safe harbour rules.; or 2. **Hard-to-value intangibles** at the time of transfer; or 3. **Intra-group cross-border transfers** of functions and/or risks and/or assets if the EBIT[3] during the three years after the transfer is less than 50% of the EBIT if the transfer had not been made.

Footnotes -

1 OECD = Organisation for Economic Cooperation and Development

2 https://tinyurl.com/wlegy6k and https://tinyurl.com/rtt5w2z

3 EBIT = Earnings Before Interest and Taxes

Table 2: Arrangement and reporting dates

Arrangement Date	Report Due by
25 June 2018 to 30 June 2020	28 February 2021
1 July 2020 to 31 December 2020	31 January 2021
1 January 2021 onwards	30 days from arrangement

What needs to be reported?

Under the EU/UK framework, intermediaries and taxpayers will have to report the following information regarding the reportable *cross-border arrangement*:

- identification of the intermediaries and relevant taxpayers, including tax residence, Tax Identification Number, etc.;
- details of the triggered Hallmark;
- a summary of the arrangement and its effect;
- the date of the first step towards the arrangement;
- details of the national provisions imposing the reporting obligation;
- the value of the arrangement;
- identification of the Member States involved in the arrangement (where Member States are involved);
- identification of any other person likely to be affected and to which Member State such person in linked.

What are the time limits?

DAC6 and the UK Regulations are effective as of 1 July 2020. However, as a result of the COVID-19 pandemic, on 19 June 2020 the European Parliament voted in favour of the EU Commission's proposed six-month deferral of the reporting deadline (originally, 31 August 2020), which the EU Council approved on 24 June 2020.[2]

Historic matters

Tax payers and intermediaries should have reviewed all cross-border arrangements from 25 June 2018 to 30 June 2020 (inclusive) and reported any relevant arrangements by 28 February 2021. Equally, any reportable arrangements between 1 July 2020 and 31 December 2020 should have been reported by 31 January 2021.

Matters going forward

From 1 January 2021 onwards, we will also have to disclose any arrangements that become reportable on or after that date within 30 days from the date after our instruction on the transaction, as originally provided by the UK Regulations. See *Table 2: Arrangement and reporting dates*.

Exchange of information between tax authorities

Prior to 31 December 2020, the UK was obliged to exchange tax information with Member States under DAC6. However, the free trade agreement negotiated between the UK and EU is silent on the issue of information exchange and it remains unclear (i) how reports relating to Category D cross-border arrangements will be shared between HMRC and other tax authorities; (ii) whether HMRC will have access to information relating to cross-border arrangements falling within hallmarks A, B, C or E; and (iii) whether HMRC will retain access to other information currently shared under the DAC6, given that the UK is no longer part of the EU.

Conclusion

DAC6 introduces new reporting requirements for transactions with a cross-border element. In the commercial world, this does not prevent businesses from carrying on their activities or entering into contractual relationships, which are, also, beneficial for tax purposes. Rather, the EU is setting up an automatic exchange of information platform between its Member States.

The new rules require a historical review of arrangements entered into from 25 June 2018 onwards. As of 1 January 2021, service providers, such as lawyers, will have to disclose any reportable arrangements to the relevant tax authority within 30 days from the date after their instruction on the transaction.

2 Most Member States, including the UK, deferred their reporting deadlines, however, Germany, Austria, and Finland did not.

As noted above, this area of law is very complex. HFW is happy to assist you with the analysis of your transactions; please contact our Risk & Compliance team or your usual HFW contact.

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