New EU Rules on Mandatory Disclosure of Cross-border Tax Arrangements by EU Intermediaries

On 25 May 2018, the Council of the European Union (EU) adopted a directive on the mandatory disclosure and exchange of cross-border tax arrangements[1]. This is the sixth update of the Directive on Administrative Cooperation and therefore referred to as DAC6. Under the new rules of DAC6, intermediaries such as tax advisors, accountants and lawyers that design, promote or implement tax planning schemes are required to report potentially aggressive tax arrangements to the tax authorities. Given the broad scope of definitions in the Directive, the reportable arrangements may include arrangements that do not necessarily have a main benefit of obtaining a tax advantage. In addition, the reporting obligation in principle lies with the EU intermediary, but shifts to the taxpayer in specific cases further addressed below. These new rules on mandatory disclosure will have implications both for us, as your intermediary, and for you, as our client. With this FAQs document we would like to inform you about the most important aspects of the reporting obligation and its potential implications.

1. What is covered by mandatory disclosure under DAC6 (or "the Directive")?

Intermediaries based in the EU will be obliged to submit information on reportable cross-border arrangements to their national tax authorities. Under the Directive a 'reportable cross-border arrangement' refers to any cross-border tax planning arrangement which bears one or more of the hallmarks listed in the Directive and concerns at least one EU Member State. The hallmarks are broadly scoped and represent certain typical features of tax planning arrangements which, according to the Directive, potentially indicate tax avoidance or abuse of direct taxes (e.g., income taxes). Certain arrangements (e.g., those that fall within the specific transfer pricing hallmark) will need to be reported even if they do not satisfy the "main benefit" (of obtaining a tax advantage) test. These include arrangements that involve hard-to-value intangibles or an intra-group cross-border transfer of functions, risks or assets.

Hallmarks

Main Benefit Test: "The main benefit or one of the main benefits of the tax scheme is to obtain a tax advantage."

Hallmarks Main Benefit Test		Hallmarks AEOI and BO
Generic	**Specific**	Schemes which may undermine automatic exchange of information
Confidentiality clause included in transaction	Certain tax loss arrangements	Schemes involving non-transparent legal or beneficial ownership chain
Fee structure reflects tax advantage	Conversion of income types which benefit from lower taxation or exemption	
Standardized tax arrangements available to more than one taxpayer	Circular transactions without primary commercial function	

[1] Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements.

Hallmarks Cross-border Transactions		Hallmarks Transfer Pricing
Depreciation on same asset in multiple jurisdictions	Tax-deductible payment to an associated enterprise (AE) resident in a jurisdiction with no/almost zero CIT	Use of unilateral safe harbour rules
Multiple relief from double taxation	Tax-deductible payment to AE resident in an EU/OECD-blacklisted jurisdiction	Transfer of hard-to value intangibles
Cross-border mismatch asset transfer	Tax-deductible payment to AE resident in a jurisdiction where the payment is fully exempt	Intragroup cross-border transfer of functions and/or risks and/or assets, subject to the EBIT of the transferor(s)
Tax-deductible payment to an associated enterprise with no tax residency	Tax-deductible payment to AE resident in a jurisdiction where the payment benefits from a preferential tax regime	

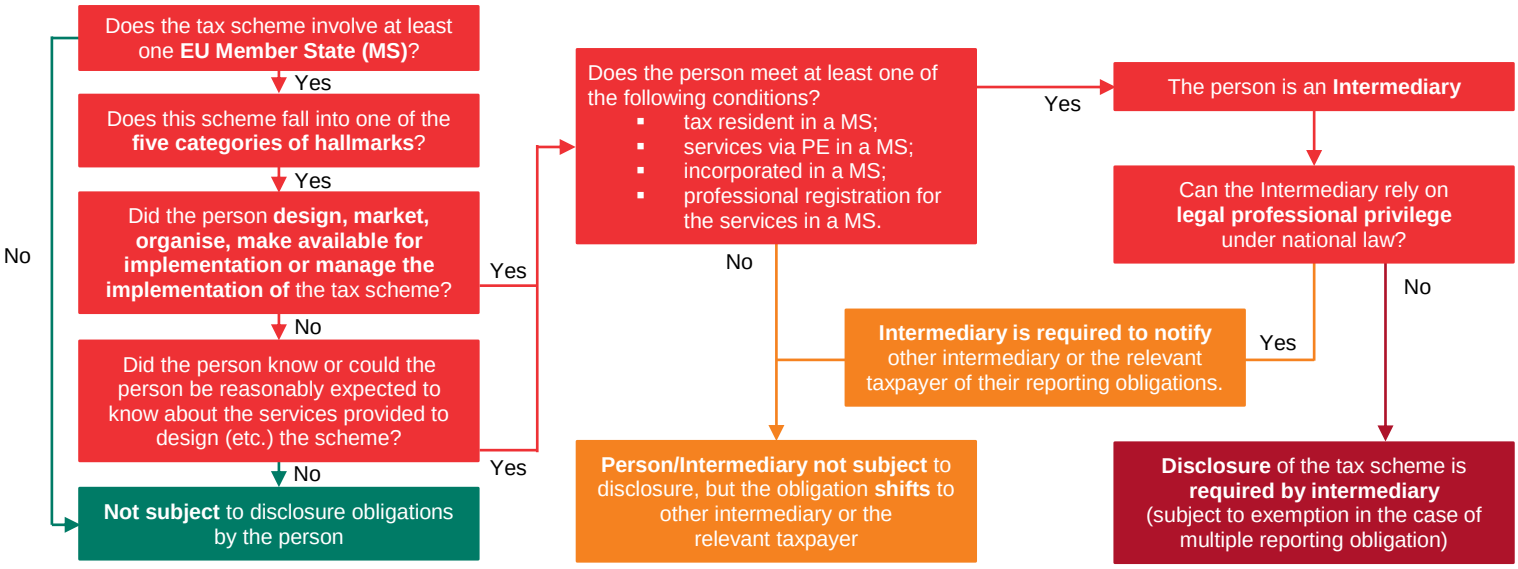
Require the main benefit test to be fulfilled

Do not require the main benefit test to be fulfilled

Under the Directive an 'intermediary' refers to any person that designs, markets, organizes, makes available for implementation or manages the implementation of a reportable cross-border arrangement. Additionally, it also means 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 to provide aid, assistance or advice with respect to a reportable cross-border arrangement. In practice, intermediaries include lawyers, accountants, tax and financial advisors, banks and consultants. If the intermediary is not located in the EU or is bound by professional privilege or secrecy rules, the obligation to report shifts from the intermediary to the relevant taxpayer. Information with regard to reported arrangements will be automatically exchanged by the competent authority of each EU Member State every 3 months through the use of a secure central directory on administrative cooperation in the field of direct taxation[2]. The information exchange will contain details such as the identification of intermediaries and relevant taxpayers, details on the relevant hallmarks and national provisions, details on the first step of implementation, details on the value of the reportable cross-border arrangement and identification of Member States that are affected or likely to be concerned by the reportable arrangement.

[2] Also known as the common communication network (CCN) developed by the European Union.

Reporting obligations flowchart

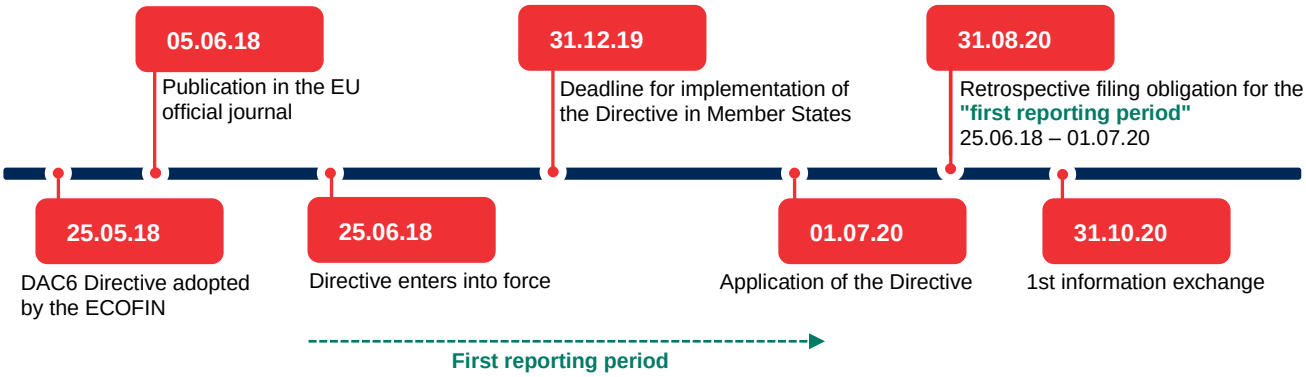


Non-compliance (by intermediaries or taxpayers) with reporting requirements will attract penalties as will be established in the national legislation of the respective EU Member State. The Directive prescribes that these penalties must be "effective, proportionate and dissuasive". The Directive also states that the fact that a tax authority does not react to a reportable cross-border arrangement does not imply any acceptance of the validity or tax treatment of that arrangement.

2. When do the new rules on mandatory disclosure start to apply?

EU Member States are required to transpose the Directive into national legislation by 31 December 2019 and apply the new rules from 1 July 2020. However, the Directive and thus the reporting obligation applies to transactions implemented as from 25 June 2018. Intermediaries and relevant taxpayers are obliged to file information for the first time by 31 August 2020 with respect to reportable transactions implemented between 25 June 2018 and 1 July 2020 ("first reporting period"). This means that records of any potentially reportable arrangements that have occurred from 25 June 2018 onwards should be kept. Subsequently, the first "regular" information exchange between EU Member States will have to take place by 31 October 2020.

Timeline



Following the first reporting period, information on reportable cross-border arrangements must be filed with the relevant tax authority every time within 30 days beginning on the day after the reportable cross-border arrangement is made available for implementation, is ready for implementation or when the first step has been implemented, whichever occurs first.

3. What does mandatory disclosure under DAC6 mean for you as our client?

When you instruct an intermediary in the EU in an engagement which qualifies as a "reportable cross-border arrangement", the intermediary will in principle be required to report the arrangement to the respective national tax authority. If the intermediary is legally qualified and professional privilege applies (which is to be determined by the Member States upon implementation of the Directive), or if you instruct an intermediary situated outside of the EU, the reporting obligation will shift to you and you will be responsible for complying with the reporting obligations. We note that according to the Directive in this scenario the intermediary will have the right to a waiver (to be granted by you) of privilege to enable it to make the report. It remains to be seen how EU Member States will implement these rules in their domestic legislation as we expect different rules given the options provided by the Directive to Member States.

4. What does mandatory disclosure under DAC6 mean for us as your intermediary?

When you instruct Baker McKenzie in an engagement which qualifies as a "reportable cross-border arrangement", we will be required to comply with our reporting obligations, unless professional privilege applies (as described above). When you engage multiple intermediaries, the reporting obligation in principle lies with all intermediaries involved in the same arrangement, however an intermediary can be exempt from reporting to the extent that it has proof that a report of the arrangement has been filed by another intermediary. When we are your intermediary, we will assess each individual arrangement and inform you of our or your (potential) reporting obligations. Each time we will outline the scope of the relevant reporting obligations to you and, where applicable, support you in complying with your reporting obligations.

5. Do you have any questions?

We are closely monitoring the implementation of the new rules in all EU Member States and will keep you informed on all relevant developments. Meanwhile, if you have any questions on the Directive and its potential implications for you, please do not hesitate to reach out to your contact at Baker McKenzie, or get in touch with Mounia Benabdallah, Partner in the International Tax Group, and/or Blanca Pares, EMEA Business Development Manager.