GIBSON DUNN

EU MANDATORY DISCLOSURE RULES (DAC 6)

7 DECEMBER 2020

Agenda

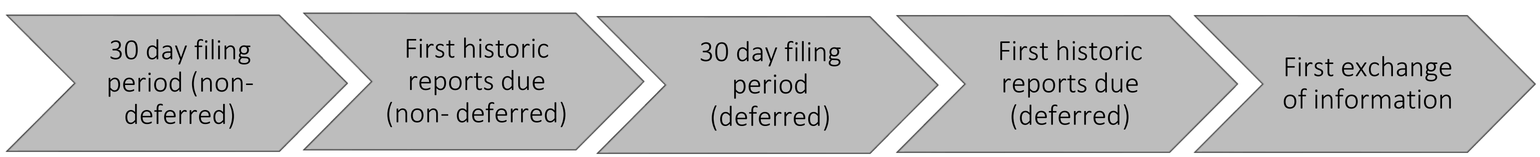
- Background
- Timeline
- DAC 6 jurisdictional differences
- Intermediaries
- Reportable cross-border arrangements
- Hallmarks
- Legal professional privilege
- Penalties
- DAC 6 issues list

Background

- The EU Council Directive 2011/16 (as amended), known as DAC 6, requires “intermediaries” (or potentially, taxpayers) to report, and tax authorities to exchange, information regarding reportable cross-border arrangements, which meet one or more specified characteristics (“hallmarks”), and which concern at least one EU country.
- 3 key concepts:
  - **Intermediaries** - defined as anyone who “*designs, markets, organises or makes available for implementation or manages the implementation*” of a reportable arrangement.
  - **Reportable cross-border arrangements (“RCBA”)**
  - **Hallmarks** - broad categories setting out particular characteristics identified as potentially indicative of aggressive tax planning.
- DAC 6 is very broad in scope and, notwithstanding the stated purpose of the measures as described in the recitals to the Directive, DAC 6 also applies to many standard transactions with no particular tax motive.
- Final regulations implementing DAC 6 in the UK were published on 13 January 2020. The International Tax Enforcement (Disclosable Arrangements) Regulations, SI 2020/25 came into force on 1 July 2020. HMRC guidance has also been published in connection with the application of the UK regulations.

Timeline - when

- DAC 6 came into force on 25 June 2018. The rules were due to apply from 1 July 2020, however, the EU Commission agreed to postpone the filing deadline on an *optional* basis by up to 6 months as a result of the COVID-19 pandemic.
- Historical RCBAs are ones in which the first step was implemented in the period from 25 June 2018 to 30 June 2020.
- Arrangements that become reportable in the period between 1 July 2020 and 31 December 2020 will need to be reported within 30 days of the domestic filing date (dependent on Member State deferral).
- Arrangements that become reportable after 31 December 2020 will need to be reported within **30 days.**
- Difficulties will arise as a result of some Member States opting not to defer filing deadlines (e.g. Germany and Finland) or adopting alternative deferral dates (e.g. Austria). This will be a concern where RCBAs involve multiple Member States with different filing deadlines.



From 1 July 2020 | 31 Aug 2020 | From 1 Jan 2021 | 28 Feb 2021 | 30 April 2021

DAC 6 – jurisdictional differences

- DAC 6 is an EU directive and as such it requires EU Member States to achieve a certain result but the detailed implementation is left within the discretion of Member States. Member States may go further than required e.g. Poland, and, notwithstanding Brexit, the UK has committed to implementing DAC 6 into national law.
- There are significant differences in how the various jurisdictions have implemented key aspects of DAC 6, including:
  - the interpretation of key terms such as the 'main benefit test' and operation of legal professional privilege.
  - application of the hallmarks.
  - the taxes in scope.
  - timeline, reporting requirements and penalties.
- These differences result in ambiguity in the application of DAC 6 in the various jurisdictions, particularly where intermediaries across the EU and the UK are involved in the same RCBA.
- Given these differences, detailed analysis of this presentation is focused on the UK (unless otherwise specified) but it should be noted that the UK's implementation of DAC 6 is not uniform across the EU.

Intermediaries – definition

- An intermediary is broadly defined in Article 3(21) of the DAC 6 directive as follows:

  "Any person that designs, markets, organises or makes available for implementation or manages the implementation of a reportable cross-border arrangement.

  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, directly or by means of other persons, aid, assistance or advice with respect to designing, marketing, organising, making available for implementation or managing the implementation of a reportable cross-border arrangement. *Any person shall have the right to provide evidence that such person did not know and could not reasonably be expected to know that that person was involved in a reportable cross-border arrangement. For this purpose, that person may refer to all relevant facts and circumstances as well as available information and their relevant expertise and understanding as any person that designs, markets, organises or makes available for implementation or manages the implementation of RCBAs (including any person who provides aid or assistance with the above reportable activities)."*

Intermediaries – definition

- The definition of intermediaries is extremely broad and those caught include (but are not limited to) financial advisers, lawyers, financial institutions and accountants.
- DAC 6 requires intermediaries to report information regarding RCBAs. However, if no intermediary is able to make a report under DAC 6, the relevant taxpayer is obligated to report the RCBA.
- Relevant taxpayer is defined in Article 3(22) of the DAC 6 directive as follows:

  “any person to whom a reportable cross-border arrangement is made available for implementation, or who is ready to implement a reportable cross-border arrangement or has implemented the first step of such an arrangement.”

- The requirement for a relevant taxpayer to report an arrangement to HMRC therefore only applies if there is no intermediary who is required to report the required information in relation to the arrangement, e.g.
  a) if the arrangement is designed and implemented by a company’s in-house tax team with no external help;
  b) any intermediaries involved in the arrangement do not have an EU nexus, and therefore have no reporting obligations;
  c) relevant intermediaries prevented from reporting because of operation of legal professional privilege rules under domestic laws.

Intermediaries – categories

- Two categories of intermediaries, both of which have implications on reporting obligations.
- The scope of involvement in a transaction will determine whether an intermediary is a promoter or service provider.

Promoter	Service Provider
- Designs, markets, organises, makes available for implementation or manages the implementation of RCBAs. - A promoter will almost invariably have a full understanding of the material aspects of the RCBA and will have an obligation to report the relevant arrangement.	- Undertakes to provide aid, assistance or advice (directly or by means of other persons) in relation to the designing, marketing, organising, making available for implementation or managing the implementation of RCBAs. - Only treated as intermediaries if they know (or could reasonably be expected to know) that they are involved in a RCBA.

Intermediaries – knowledge

- HMRC sets out guidance as to the requisite knowledge a person has to have in order to be considered an intermediary.
- The guidance provides that because a service provider will not always have full knowledge, they can argue that they are not an intermediary because they did not *know and could not reasonably have been expected to know* that they were involved in a RCBA.
- Scope of ‘reasonably expected to know’: there will be circumstances where, for example, banks and their advisers have access to steps papers that are only indirectly relevant to their role – it is unclear whether (and how) they would be reasonably expected to know that they were involved in a RCBA.
- The HMRC guidance provides that intermediary status cannot be avoided by wilful ignorance, artificial fragmentation of information within an organisation or a failure to ask the usual due diligence questions.
- The guidance does clarify that service providers do not need to undertake additional due diligence in order to determine whether there is a reportable arrangement.

Intermediaries – who needs to report

- The reporting obligation under DAC 6 is well known amongst certain classes of intermediaries in the professional services sector such as legal and accounting firms.
- However, other industries may also be affected in circumstances where the relevant organisation is considered an intermediary under DAC 6. For example, this may be applicable for hedge funds, private equity firms and banks.

  - *Hedge funds:*
  - A typical investment fund structure would encompass a wide range of service providers that would fulfil various functions (depending on the type of fund, investors in and/or investment of the fund). The impact of DAC 6 on fund structures will depend on whether the fund manager and/or the fund qualifies as an intermediary or as a relevant taxpayer within the meaning of the DAC 6 directive.
  - Issue of treaty shopping: this typically involves the attempt to indirectly access the benefits of a tax agreement between two jurisdictions without being a resident of one of those jurisdictions. Note, that this issue was the subject of the final Organisation for Economic Co-operation and Development (OECD) base erosion and profit shifting (BEPS) report on Action 6 - *Prevention of tax treaty abuse,* which comprised proposals designed to prevent treaty shopping and other treaty abuse, including the introduction of a “principle purpose test”. It has already led hedge funds and other alternative investment vehicles to review the substance of any entities in their existing structures availing themselves of tax treaty benefits.

Intermediaries – who needs to report

- *Hedge funds:*

- DAC 6 also aims to gather information about potential treaty shopping by virtue of Hallmark C3, whereby an intermediary would have to make a disclosure under DAC 6 if a RCBA resulted in obtaining a relief from double taxation in respect of the same item of income or capital in more than one jurisdiction.

- Some issues that hedge funds and fund managers need to be thinking about in relation to a reporting obligation under DAC 6 include:
    a) there are often multiple people involved in a hedge fund and each could be considered an intermediary. Analysis would be required in relation to who would take on the role of an intermediary.
    b) the complexity of hedge fund structures may mean that investors may have exposure to DAC 6 even if they don't invest in an EU entity. Analysis as to the hedge fund structure to ascertain DAC 6 exposure would be required.
    c) investors will become increasingly focused upon obtaining appropriate side letter or other comfort on DAC 6 issues in terms of fund and investment structuring.

Intermediaries – who needs to report

- *Private equity firms*

- Private equity firms sometimes have hundreds of entities across various jurisdictions. There may not be a specific tax motive in relation to the activities of such entities but it is important to note that tax authorities may take a different view as to the purpose of arrangements entered into by entities within a private equity firm.

- In addition, as a result of the complex structure of private equity firms, it will require detailed analysis to determine who would be considered an intermediary for DAC 6 purposes.

- The important message for private equity firms is to have a DAC 6 compliance process and keep a robust audit trail of DAC 6 analysis even if reports are not made.

Intermediaries – who needs to report

- *Banks*

- Banks are a good information tool for tax authorities as they often hold detailed information on clients.

- Banks will usually have systems in place for reporting obligations, e.g. under the common reporting standard (CRS). However, DAC 6 requires a deeper analysis and a technical tax judgement.

- Some banks will have millions of account holders and there will need to be a robust system in place for DAC 6 analysis – even if minimal reporting will actually be carried out.

- Hallmark D (*Specific hallmarks concerning automatic exchange of information and beneficial ownership*) will be relevant as it relates to the CRS. There will be a lot of work to review and training of staff.

Intermediaries – who needs to report

- *Banks*

- Banks may also be exposed by virtue of activities relating to:
  - Investment services – banks may not be the main intermediary in relation to these activities but may be considered a services provider and as such may have a reporting obligation under DAC 6.
  - Acquisition finance and corporate lending – activities such as loan financing and interest being paid to entities with bank accounts in different jurisdictions from where they are resident or tax resident may be caught by DAC 6.
  - Non-EU incorporated banks may have exposure to DAC 6 via branches located in the EU.

- The above industries may not need to make a report if they are able to rely on a report made by another intermediary such as law firms involved in the RCBA. However, the relevant law firm may not have an EU nexus and/or be prevented from disclosure under DAC 6 as a result of legal professional privilege rules in their jurisdiction.

Intermediaries – EU nexus and territoriality issues

- Pursuant to paragraph 21 of the DAC 6 directive, a person has to meet one of the following nexus conditions in order to fall within the DAC 6 reporting obligations:
  a) be resident for tax purposes in a Member State;
  b) have a permanent establishment in a Member State through which the services with respect to the arrangement are provided;
  c) be incorporated in, or governed by the laws of, a Member State; or
  d) be registered with a professional association related to legal, taxation or consultancy services in a Member State or the UK.
- HMRC guidance provides a hierarchy in reference to the above EU nexus test whereby an intermediary has reporting obligations in multiple jurisdictions. The guidance notes that pursuant to Article 8ab(3) of the DAC 6 directive, an intermediary should report in the Member State in which it is tax resident. The guidance continues to state as follows: "… *if the intermediary is not resident for tax purposes in any Member State, it should report in the Member State in which it has a permanent establishment (PE) through which the activities were provided in relation to the reportable arrangement. If the intermediary does not have such a PE, it should report in the Member State in which it is incorporated or by the laws of which it is governed. Finally, if there is no Member State in which it meets those conditions, it should report in the Member State in which it is registered with a relevant professional association".*
- Note that a non-EU lawyer may be considered an intermediary if they are dual qualified and registered with an EU legal professional association.

Intermediaries – EU nexus and territoriality issues

- Concern that the interpretation of the jurisdictional provisions in paragraph 21 of the DAC 6 directive may give rise to extra-territorial effect - particularly in relation to Article 21(d) (registration with professional association related to legal, taxation or consultancy services in a Member State or the UK).

- Determination of application of DAC 6 provisions *should* depend on context of the arrangement.
  - For example, an individual lawyer who is tax resident outside the UK but registered with the SRA and is providing tax planning services to UK clients would be captured by paragraph 21(d), while a registered foreign lawyer who is living and working abroad and providing services in relation to English law matters to non-UK clients would not fall under paragraph 21(d).

- The need to comply with DAC 6 outside the EU is onerous where the only EU connection a person has is registration with a professional association. Potentially this is out of the jurisdictional reach of DAC 6.

Intermediaries – EU nexus and territoriality issues

- HMRC guidance does not provide much comfort on the extra-territorial limitations but it does state as follows:
  - "*Some overseas firms are registered with professional associations in the UK because they employ (or have as partners or members) people who themselves are registered with the professional association in question. Where the registration of the firm itself does not give rise to any governance or oversight by the UK professional association, the firm itself will not qualify as a UK intermediary.*"
  - This clarification may be helpful in relation to the overseas firms but the individual partners and members within such firms may still be classified as intermediaries.

- Note that the UK courts are reluctant to find extra-territorial effect unless expressly enacted or plainly implied (*Clark (Inspector of Taxes) v Oceanic Contractors Inc.* [1983] 2 AC 130).

- Accordingly, the jurisdictional provisions of DAC 6 need to be interpreted proportionally and in a way that respects the UK courts' traditional approach to extra-territorial effect.

Intermediaries – partnership issues

- HMRC guidance does not explicitly provide that partnerships or limited liability partnerships (LLPs) would be considered the intermediary as opposed to the partners within such partnership or LLP.
- HMRC guidance provides as follows:
  - *Partnerships:* Partners in a partnership will be intermediaries in their own right if they undertake activities that bring them within the definition of intermediary.
  - *LLPs:* The guidance acknowledges that an LLP is a legal person in its own right, and is a separate entity from its members and so can be an intermediary in its own right. However, it also states that whether a member of an LLP is an intermediary in their own right will depend on the facts of the case.
- It makes commercial sense for partnerships and LLPs to be treated as the primary intermediary instead of the individuals working in such organisations. A partner or employee of a partnership or a member or employee of an LLP should not normally be an intermediary, except where there is a clear attempt to deliberately abuse the DAC 6 jurisdictional rules.
- In addition, jurisdictional rules should be applied at the level of the organisation instead of individuals within such organisation.

Intermediaries – exemptions

- There are limited exemptions for an intermediary to be excluded from their reporting obligations under DAC 6 as follows:

  - *Knowledge:* As previously discussed, an intermediary who has insufficient knowledge of a RCBA will not have a reporting obligation under DAC 6.

  - *RCBA has already been reported:* There may be several intermediaries across various Member States in connection with a single RCBA.
    - Disclosure only needs to be made once in respect to a RCBA and should generally be made in the Member State where the intermediary is tax resident or has a permanent establishment.
    - An intermediary may be exempt from making a report if it can evidence that another intermediary has reported the relevant RCBA. Note that there may be practical difficulties for intermediaries in obtaining evidence that reports made by other intermediaries involved in the arrangement are sufficient in order for the exemption to apply.

Intermediaries – exemptions

- There are limited exemptions for an intermediary to be excluded from their reporting obligations under DAC 6 as follows:

  - *Employees:* Regulation 13 of the UK DAC 6 rules provides that where an individual is an employee, and takes actions which would bring them within the definition of intermediary in DAC 6, the employee is not treated as being an intermediary. This only applies where the employer, or another firm connected with the employer, is the intermediary instead.

  - *Legal professional privilege:* An intermediary may also be unable to report a RCBA as a result of domestic legal professional rules (discussed later).

Reportable arrangements – what is reportable

- The DAC 6 reporting obligation applies to "reportable cross-border arrangements". A cross-border arrangement is defined as follows in the DAC 6 directive:

  "cross-border arrangement" means an arrangement concerning either more than one Member State or a Member State and a third country where at least one of the following conditions is met:

  (a) not all of the participants in the arrangement are resident for tax purposes in the same jurisdiction;

  (b) one or more of the participants in the arrangement is simultaneously resident for tax purposes in more than one jurisdiction;

  (c) one or more of the participants in the arrangement carries on a business in another jurisdiction through a permanent establishment situated in that jurisdiction and the arrangement forms part or the whole of the business of that permanent establishment;

  (d) one or more of the participants in the arrangement carries on an activity in another jurisdiction without being resident for tax purposes or creating a permanent establishment situated in that jurisdiction;

  (e) such arrangement has a possible impact on the automatic exchange of information or the identification of beneficial ownership.

  For the purposes of points 18 to 25 of this Article, Article 8ab and Annex IV, an arrangement shall also include a series of arrangements. An arrangement may comprise more than one step or part.

Reportable arrangements – what is reportable

- A reportable cross-border arrangement is defined as follows in the DAC 6 directive:

  "reportable cross-border arrangement" means any cross-border arrangement that contains at least one of the hallmarks set out in Annex IV.

Accordingly, a reportable cross-border arrangement comprises the following elements:

a) **An arrangement:** very broad definition and would include any agreement, schema, plan or understanding, whether or not legally enforceable, and all the steps and transactions that bring it into effect.

b) **Cross-border:** an arrangement is cross-border where it concerns either more than one Member State or a Member State and a third country. An arrangement 'concerns' multiple jurisdictions if those jurisdictions are of some material relevance to the arrangement. However it should be noted that some jurisdictions, such as Poland, provide that certain domestic arrangements are caught by its Polish mandatory disclosure reporting legislation.

c) **Reportable:** arrangements are reportable if they fall within one of a number of "hallmarks" - categories which are indicative of aggressive tax planning.

- A continuous assessment should be made if a matter changes as such change could result in the relevant arrangement becoming reportable under DAC 6.

Reportable arrangements – arrangements

- ‘Arrangement’ in the UK context is defined in section 84 of the Finance Act 2019 as including “any scheme, transaction, or series of transactions”. Accordingly, the scope of what could be an arrangement is potentially very broad.
- It will generally be necessary for intermediaries and relevant taxpayers to look at any arrangement holistically, rather than looking at an arrangement as a series of small steps or separate transactions.
- HMRC guidance states that where there is a pre-existing arrangement which is extended, this would not normally be viewed as a new arrangement, unless there is some material change to the arrangement.

Reportable arrangements – cross-border

- In order for an arrangement to be reportable, it must have a cross-border element. Note that this is not the case for jurisdictions such as Poland which provide that certain domestic arrangements are caught by its mandatory disclosure rules.

- An arrangement is a cross-border arrangement if it *concerns* either:
  - More than one EU Member State; or
  - An EU Member State and a third country.

- Whether or not an arrangement '*concerns*' multiple jurisdictions will be crucial in determining whether there is a reportable cross-border arrangement. HMRC guidance provides that in order for an arrangement to '*concern*' multiple jurisdictions, those jurisdictions must be of some material relevance to the arrangement. Whether any particular arrangement is of material relevance to, and therefore concerns, multiple jurisdictions will be a question of fact and degree.

- As discussed earlier, HMRC provides guidance as to which intermediary should report in circumstances where there are multiple intermediaries in respect of the same RCBA.

Reportable arrangements – cross-border examples

- HMRC guidance provides examples as to arrangements that concern multiple jurisdictions:

- **Example 1:** Company A in jurisdiction A sells shares it holds in company B, resident in jurisdiction B, to company C, also resident in jurisdiction A. There are no tax consequences in jurisdiction B directly as a result of the transaction. This transaction would not be considered as being of material relevance to jurisdiction B, so it would not “concern” more than one jurisdiction.

- **Example 2:** Company F, resident in jurisdiction F, makes a loan to company G, resident in jurisdiction G, and G pays interest to company F in return. The arrangement is cross-border: money flows from one jurisdiction to another, and the payments of interest from G to F may be deductible in G and taxable in F. Therefore the arrangement “concerns” both those jurisdictions and is a cross-border arrangement.

Reportable arrangements – when does it become reportable

- It is important to know the point at which an arrangement will become reportable as in the UK, after 31 December 2020, RCBAs will need to be reported within 30 days.
- Regulation 3(3) of the UK DAC 6 regulations provides that a cross-border arrangement which meets one or more of the hallmarks has to be reported within 30 days beginning on the earliest of—
  a) *the day after the day the reportable cross-border arrangement is made available for implementation;*
  b) *the day after the day the reportable cross-border arrangement is ready for implementation;*
  c) *the day the first step in the implementation of the reportable cross-border arrangement is made; and*
  d) *in relation to a UK intermediary within the second paragraph of Article 3(21) of the DAC, the day after the day the UK intermediary provided, directly or by means of other persons, aid, assistance or advice with respect to designing, marketing, organising, making available for implementation or managing the implementation of the reportable cross-border arrangement.*
- In relation to limb (a), i.e. when a reportable cross-border arrangement is made available, it would not be in HMRC's (or any tax authority's) interest to receive reports too early as the reported information may not be useful. However, any practices whereby intermediaries delay finalising tax advice in order to avoid a reporting obligation will fall foul of tax authorities.

Reportable arrangements – when does it become reportable

- In relation to limb (d), the point at which aid, assistance or advice should be treated as ‘provided’ will depend on the facts of the case. HMRC provides the following examples to illustrate possible scenarios:

    - *An accountant receives a request for advice on the correct treatment of a transaction. The accountant researches the issue and finds the answer. The advice is provided promptly by email. The date of the email will be the date the advice is provided.*
    - *In the same scenario, having found the answer, the accountant phones the client to let them know the correct treatment, but delays sending the final email to try to delay having to make a report. The advice was given when the phone call was made and the following day is when the 30 day period starts.*

Reportable arrangements – when does it become reportable

- In relation to limb (d), the point at which aid, assistance or advice should be treated as ‘provided’ will depend on the facts of the case. HMRC provides the following examples to illustrate possible scenarios:

  - *A lawyer is providing advice on a complex arrangement. Over several months, the lawyer and the client meet several times to discuss the arrangement, and the lawyer provides several drafts of the advice, and as the arrangement evolves, so does the content of the advice.*
  - *They have a final meeting where the lawyer sets out what the advice will say, and barring minor adjustments, the final written advice reflects that discussion and is provided promptly thereafter. While it could be argued that the meeting is the point where the advice is provided, in practice HMRC would accept that the 30 day reporting window started the day after the final written advice was sent, provided it was sent without undue delay. However, if there is evidence of a material delay in providing the final advice, this treatment will not necessarily apply, and HMRC may seek to impose a penalty on the basis that the reality is that the advice was provided at the meeting.*

Reportable arrangements – what needs to be disclosed?

- The information to be reported is listed in the DAC 6 directive is as follows:

a) the identification of intermediaries and relevant taxpayers, including their name, date and place of birth (in the case of an individual), residence for tax purposes, TIN and, where appropriate, the persons that are associated enterprises to the relevant taxpayer;

b) details of the hallmarks (detailed later) that make the cross-border arrangement reportable;

c) a summary of the content of the reportable cross-border arrangement and a description in abstract terms of the relevant business activities or arrangements;

d) the date on which the first step in implementing the reportable cross-border arrangement has been made or will be made;

e) details of the national provisions that form the basis of the reportable cross-border arrangement;

f) the value of the reportable cross-border arrangement;

g) the identification of the Member State of the relevant taxpayer(s) or any other person in any Member State likely to be affected by the arrangement.

Hallmarks: introduction

- In order for a cross-border arrangement to be reportable, one or more of the hallmarks set out in DAC 6 must apply.
- Certain hallmarks only make an arrangement reportable if it satisfies the “main benefit test”.

Main benefit requirement

- Substantially standardised documents
- Confidentiality obligation preventing disclosure regarding tax advantage
- Round tripping of funds e.g. via off-setting transactions
- Intermediary fee contingent on obtaining tax advantage / its size
- Related-party deductible cross-border payments where receipt not taxed / taxed at almost 0% / benefits from preferential regime
- Converting income into capital (or other revenue taxed more favourably)
- Contrived steps involving loss-buying

No main benefit requirement

- Depreciation deduction or double tax relief claimed in more than one jurisdiction
- Arrangements circumventing FATCA / CRS reporting (e.g. transfer of assets to non-compliant jurisdictions)
- Conduit arrangements rendering beneficial owners unidentifiable

No main benefit requirement

- Related-party deductible cross-border payments where recipient is resident in OECD / EU blacklisted country
- Asset transfer with material difference in consideration for tax purposes in relevant jurisdictions
- Intragroup function / risk / assets transfer with 50% reduction in EBIT (over following 3 years)
- Transfer of difficult to value intangibles
- Arrangement involving use of unilateral transfer pricing safe-harbour

Hallmarks – main benefit test

- The DAC 6 directive provides that the main benefit test will be satisfied if it 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.
- HMRC guidance states that the main benefit test as per the DAC 6 directive is an objective test. The guidance provides that: "…*it is not necessary to examine the specific motives or intentions of a person entering into an arrangement. In other words it does not matter if the person was seeking a tax advantage from the arrangement, or what other reasons they might have had for entering into the arrangement, what matters is whether the arrangement is such that a tax advantage is the main benefit or one of the main benefits that a person may reasonably be expected to derive from the arrangement."*
- In relation to the meaning of the main benefit test in the context of the UK, HMRC guidance provides as follows:

  "*The following general points can be made as to when a tax advantage will be regarded as the main, or one of the main, benefits. Generally, those who plan tax arrangements fully understand the tax advantage such schemes are intended to achieve. Therefore we expect it will be obvious (with or without detailed explanation) to any potential client what the relationship is between the tax advantage and any other financial benefits of the product they are buying.* ***The test is objective and considers the value of the expected tax advantage compared to the value of any other benefits likely to be enjoyed****. While the purpose of the person entering into the arrangements may be informative in considering whether a tax advantage is a main benefit or not, it will not be determinative."*
- Accordingly, the main benefit test as per the DAC 6 directive and HMRC guidance is described as an "objective test" – even though HMRC guidance does state that the purpose of entering into arrangements may be informative.

Hallmarks – main benefit test

- However, it should be noted that 'tax advantage' is not defined in the DAC 6 directive. The UK DAC 6 regulations define it as follows:

  "…tax advantage includes –

  a) relief or increased relief from tax;

  b) repayment or increased repayment of tax;

  c) avoidance or reduction of a charge to tax or an assessment to tax;

  d) avoidance of a possible assessment to tax;

  e) deferral of a payment of tax or advancement of a repayment of tax; and

  f) avoidance of an obligation to deduct or account for tax

  where the obtaining of the tax advantage cannot reasonably be regarded as consistent with the principles on which the relevant provisions that are relevant to the cross-border arrangement are based and the policy objectives of those provisions."

Hallmarks – main benefit test

- It is somewhat helpful that the UK DAC 6 regulations define a tax advantage as meaning only a tax advantage that cannot reasonably be regarded as consistent with the principles and policy objectives of the relevant legislative provisions. However, it is not always easy to determine the principles and policy objectives of a particular piece of legislation and consequently the tax advantage analysis in this context will not be straightforward.
- HMRC guidance provides the following examples in relation to policy objectives and the principles of the legislative provisions:
  - *In determining whether the main benefit test is met, it is essential to look at the arrangement as a whole. For example, an arrangement could be designed to take advantage of a mismatch between the domestic tax rules in two different jurisdictions. It might be consistent with the policy objectives of jurisdiction A that a deduction for a certain payment is allowed, and it might be consistent with the policy objectives of jurisdiction B that the receipt is not taxed. However, if it is reasonable to consider that the mismatch arising from the arrangement, when considered as a whole, is inconsistent with the principles of the relevant legislation, then the main benefit test may still be met.*
  - *In the UK, for example, anti-hybrid legislation is intended to prevent such mismatches from occurring. An arrangement seeking to circumvent the provisions of the hybrids legislation would therefore be inconsistent with the principles of UK domestic legislation which seeks to counteract hybrid mismatches.*

Hallmarks – main benefit test

- The interpretation of the main benefit test in the HMRC guidance, particularly in relation to the definition of "tax advantage", have similar concepts used in the test pursuant to the UK general anti-abuse rule (GAAR) legislation contained in Part 5 of the Finance Act 2013.
- Section 207(1) of the Finance Act 2013 provides as follows- "*Arrangements are "tax arrangements" if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements."*
- The HMRC GAAR guidance notes that the expression 'reasonable to conclude' shows that this is an *objective test.* The guidance states that "*it is neither necessary nor appropriate to enquire whether any particular person (for example the taxpayer himself, or a promoter of the arrangements, if there was one) actually had that intention".*
- Section 207(2) of the Finance Act 2013 further provides as follows – "*Tax arrangements are "abusive" if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances including—*
    a) *whether the substantive results of the arrangements are* ***consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions;***
    b) *whether the means of achieving those results involves one or more contrived or abnormal steps; and*
    c) *whether the arrangements are intended to exploit any shortcomings in those provisions."*
- The concept of abuse pursuant to section 207(2) is commonly referred to as the double reasonableness test. It is for HMRC to show, on the balance of probabilities, that the tax arrangements are abusive (*section 211(1)(a), Finance Act 2013*). It is not for the taxpayer to show that the tax arrangements are not abusive.

Hallmarks – main benefit test

- It should be noted that the definition of tax advantage in the UK DAC 6 regulations is not clear as to whether it is an EU tax advantage. HMRC guidance notes that "*arrangements may be in scope of the Regulations if they concern an EU Member State and a non-EU jurisdiction. The DAC only deals with taxes levied in EU Member States, but in considering whether a tax advantage arises, it is necessary to examine the tax consequences of the arrangement as a whole".*

- The UK definition and interpretation of the main benefit test may mean that it narrows the application of the hallmarks which are linked to the main benefit test. However, it means that to apply the main benefit test, consideration must be given to whether a tax benefit secured by a RCBA could reasonably be regarded as consistent with the policy of the relevant tax legislation.

Hallmarks – categories

Categories	Hallmarks	Main Benefit
Category A: Generic hallmarks related to cross-border transactions	A1 – Conditions of confidentiality A2 – Fixed fee arrangements A3 – Standardised documents or structures	A1: Yes A2: Yes A3: Yes
Category B: Specific hallmarks related to cross-border transactions	B1 – Acquiring loss making companies B2 – Income conversion B3 – Circular transactions	B1: Yes B2: Yes B3: Yes

Hallmarks – categories

Categories	Hallmarks	Main Benefit
Category C: Specific cross-border arrangements		
Category C1: Arrangements involving deductible cross-border payments made between two or more associated enterprises	C1(a) – Recipient is not a resident in any jurisdiction for tax purposes	C1(a): No
	C1(b)(i) – Recipient is tax resident in a jurisdiction that does not impose corporate tax or imposes corporate tax at a zero (or almost zero) rate	C1(b)(i):Yes
	C1(b)(ii) - Recipient is tax resident in a jurisdiction which is included in list of non-cooperative jurisdictions by EU or OECD	C1(b)(ii): No
	C1(c) – Payment benefits from a full exemption from tax in the jurisdiction where recipient is resident for tax purposes	C1(c): Yes
	C1(d) – Payment benefits from a preferential tax regime in the jurisdiction where the recipient is resident for tax purposes	C1(d): Yes

Hallmarks – categories

Categories	Hallmarks	Main Benefit
Category C2: Depreciation of assets	C2 **–** Deductions for the same depreciation on the asset are claimed in more than one jurisdiction	C2: No
Category C3: Relief from double taxation	C3 - Relief from double taxation in respect of the same item of income or capital is claimed in more than one jurisdiction	C3: No
Category C4: Transfer of assets	C4 - Transfer of assets whereby there is a material difference in the amount being treated as payable in consideration for the assets in those jurisdictions involved	C4: No

Hallmarks – categories

Categories	Hallmarks	Main Benefit
Category D: Automatic Exchange of Information		
Category D1: Reporting obligations	D1 – Arrangements which may have the effect of undermining the reporting obligation under EU legislation or any equivalent agreements on the automatic exchange of Financial Account information	D1: No
Category D2: Ownership chains	D2 - Arrangements involving a non-transparent legal or beneficial ownership chain that: - do not carry on a substantive economic activity; - 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; - have unidentifiable beneficial owners	D2: No

Hallmarks – categories

Categories	Hallmarks	Main Benefit
Category E: Transfer Pricing		
Category E1: Safe harbour rules	E1: Arrangements which involve the use of unilateral safe harbour rules	E1: No
Category E2: Ownership chains	E2: Arrangements involving the transfer of hard-to-value intangibles between associated enterprises whereby (i) no reliable comparisons exist and there is an uncertain projection of future cash flows and expected income	E2: No
Category E3: Intra-group cross-border transfers	E3: Arrangements involving an intragroup cross-border transfer of functions, risks or assets if the projected annual earnings before interest and taxes (EBIT), during the three-year period after the transfer is less than 50 % of the projected EBIT if the transfer had not been made	E3: No

Hallmarks – selected examples

- Hallmark A3 – *Standardised documentation and structures*

- This hallmark captures an arrangement "*that has substantially standardised documentation and/or structure and is available to more than one relevant taxpayer without a need to be substantially customised for implementation*."
- HMRC guidance recognises that the use of some documents with standardised features is common in many businesses, e.g. in the legal and financial sector. However, if such documents are not amended during the commercial negotiation process, this hallmark may be triggered.
- Main benefit test is applicable which filters out cross-border arrangements that are not tax-driven, or where any expected tax benefit may be regarded as consistent with tax policy.

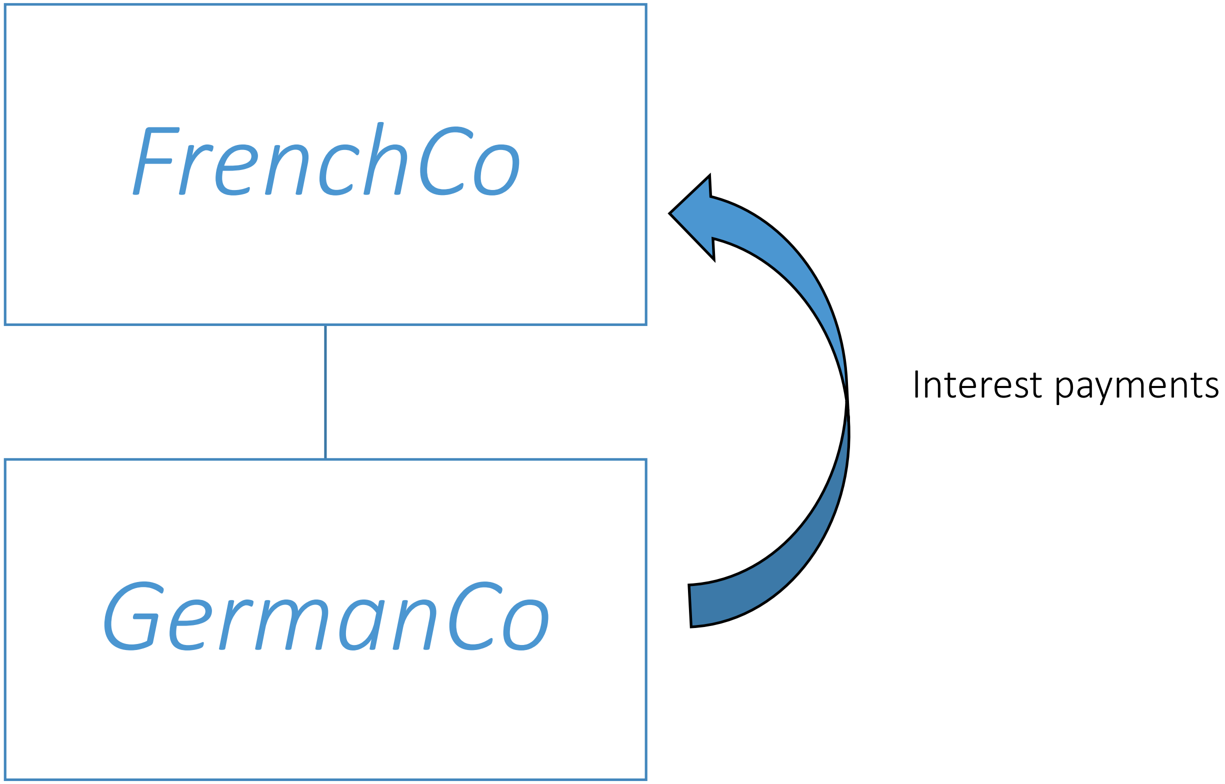
Hallmarks – selected examples

- Hallmark B2: *"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 exempt from tax."*

- The main benefit test applies to this hallmark, and, as such, the HMRC guidance confirms that the conversion of income into capital in ways which are entirely consistent with the underlying intent of the legislation upon which such conversions rely, will not produce a tax advantage.
- However, there will be situations whereby a capital sum is received instead of income as a result of the relevant arrangement. The key question is when such income can be said to be "converted" into capital.
- HMRC states in its guidance that arrangements would be outside this hallmark where such arrangements are 'normal commercial practice'.

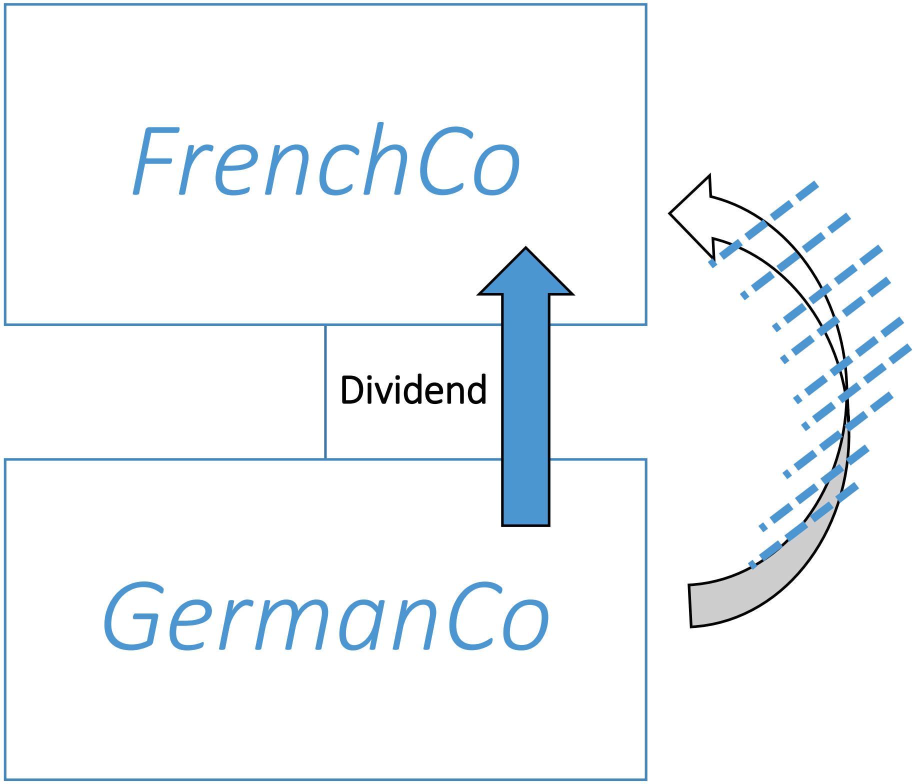
Hallmarks – case study 1

- *Hallmark B2*
- Intra-group loan from FrenchCo to its 100% subsidiary, GermanCo.
- GermanCo pays arms' length interest which is taxable in the parent FrenchCo.



Hallmarks – case study 1

- FrenchCo waives its right to repayment of the full loan.
- GermanCo therefore distributes annual dividend payments.
- Instead of receiving taxable interest income, FrenchCo receives tax free dividends.



Hallmarks – selected examples

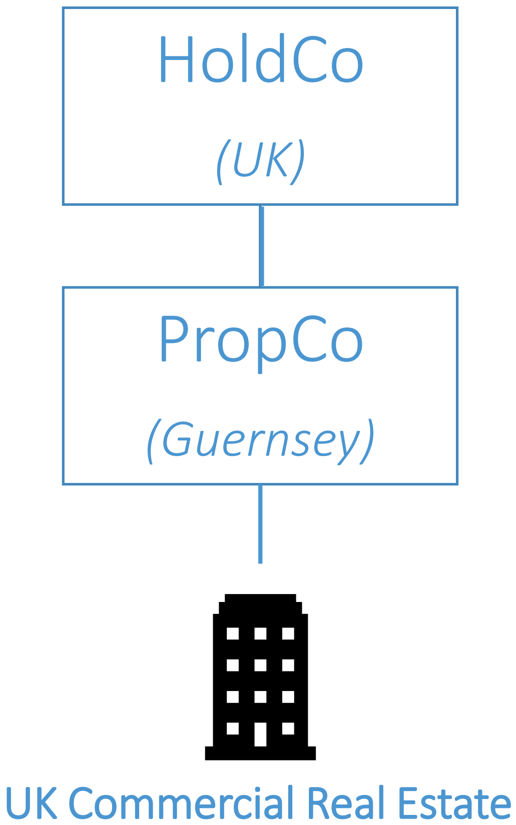
- Hallmark C1 - *Deductible cross-border payments*
  - Hallmark C1(a) applies where the recipient is not resident for tax purposes in any jurisdiction. Main benefit test is not applicable.
  - Hallmark C1(b)(i) applies where the recipient is resident for tax purposes in a jurisdiction that does not impose corporate tax, or imposes it at a rate of 0% or almost 0%. Main benefit test is applicable.
  - Hallmark C1(b)(ii) applies where the recipient is resident in a jurisdiction that is on the list of non-cooperative jurisdictions maintained by the EU or the OECD. Main benefit test is not applicable.
- E.g. UK tax resident company obtains deduction for interest paid to a 30% shareholder that is tax resident in Cayman Islands, which has a 0% corporate tax rate.
- However, HMRC guidance recognises that some jurisdictions do not have a concept of residency in their tax regimes, either because they work on a territorial basis, or because they do not charge corporation tax at all. In those circumstances, the recipient can be treated as being resident in the relevant jurisdiction.

Hallmarks – selected examples

- Hallmark E3 – *Intra-group cross-border transfers*
  - An arrangement involving an intragroup cross-border transfer of functions and/or risks and/or assets, if the projected annual EBIT during the three-year period after the transfer, of the transferor or transferors, is less than 50 % of the projected annual EBIT of such transferor or transferors if the transfer had not been made.
  - Main benefit is not applicable.
  - Example: Hallmark E3 applies to the following scenario
    a) UK company owns a Guernsey company which directly owns UK commercial real estate.
    b) UK company winds up the Guernsey company.
    c) Following the transfer of the UK commercial real estate to the UK company, the Guernsey company's EBIT is zero.

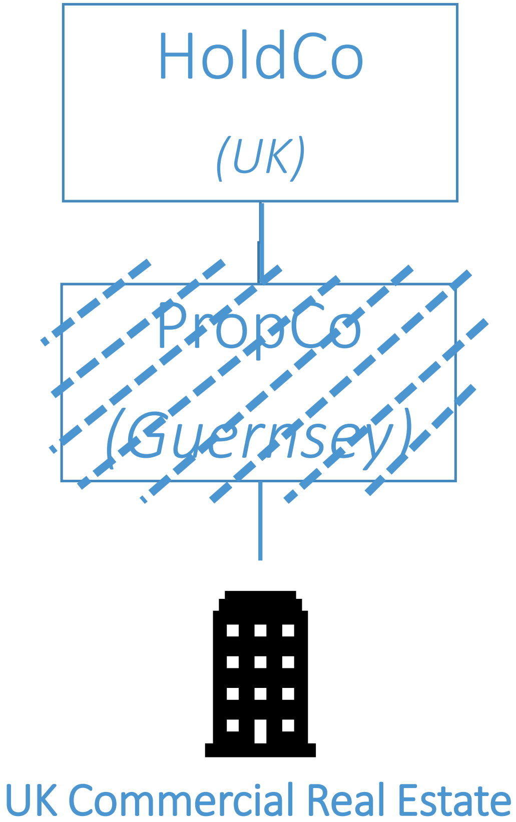
Hallmarks – case study 2

- *Hallmark E3*
- UK company owns a Guernsey company which directly owns UK commercial real estate.



Hallmarks – case study 2

- UK company winds up the Guernsey company.
- Following the transfer of the UK commercial real estate to the UK company, the Guernsey company's EBIT is zero.
- Hallmark E3 applies to this scenario.



Legal professional privilege – general

- The DAC 6 directive provides that each Member State may take the necessary measures to give intermediaries an exemption from disclosing information on a RCBA where the reporting obligation would breach legal professional privilege or equivalent (“**LPP**”) under the national law of that Member State.
- LPP in the UK primarily applies to lawyers. However, in some jurisdictions LPP may also apply to accountants, tax advisers, auditors, notaries and banks.
- Differing views are emerging among the Member States on whether LPP can be claimed for DAC 6 purposes. For example, in Germany, intermediaries may make a partial report of anonymised data if making a full report would breach an intermediary’s obligations under LPP. Note that certain jurisdictions, such as Italy, do not extend LPP or professional secrecy laws to tax matters.
- In the majority of Member States, an intermediary that claims LPP must notify any other intermediaries of this position, or the relevant taxpayer if no other intermediaries are involved.
- The operation of LPP under DAC 6 is not yet certain in the UK or across other EU Member States.

Legal professional privilege – UK

- The Law Society publishes guidance in relation to the operation of LPP under the UK DAC 6 regulations (https://www.lawsociety.org.uk/en/topics/tax/dac-6-and-lpp)
- In summary, the note includes the following guidance on LPP:
  - LPP protects confidential communications, and material evidencing such communications, between clients and/or their lawyers from being disclosed. In some circumstances it also protects communications between clients/lawyers and third parties.
  - There are two types of LPP:
    - legal advice privilege
    - litigation privilege
  - Legal advice privilege applies to confidential communications between solicitors and clients and all material forming part of the continuum of those communications (*Balabel v Air India [1988] 1 Ch 317*) for the dominant purpose of giving and obtaining legal advice and assistance. Legal advice privilege will arise not only where the communications directly concern the seeking or giving of legal advice, but may also arise where the communications consist of facts and are part of what the courts have called a "continuum of communication" between client and solicitor "aimed at keeping both informed so that advice may be sought and given as required" *(Three Rivers (No 6) [2005] 1 AC 610).* In *Property Alliance Group Limited v The Royal Bank of Scotland PLC [2015] EWHC 3187 (Ch)* Snowden J noted that lawyers are often tasked with investigating relevant information, and must be able to provide clients with candid factual briefings secure in the knowledge that such communications (and any records of them or decisions taken in consequence of them) can only be disclosed with the client's consent.

Legal professional privilege – UK

- Legal advice privilege has been construed broadly and includes advice on what should prudently and sensibly be done in the relevant legal context (as described in *Three Rivers (No 6) [2005] 1 AC 610*).

- The Law Society notes that legal advice privilege is likely to be more relevant than litigation privilege in the context of DAC 6.

- The Law Society also notes that there may be circumstances where a lawyer needs to report under DAC 6. For example, if they were to develop and market arrangements to potential clients that constitute reportable cross-border arrangements, information about their structure is not obtained or created in the course of providing legal advice to those clients.

- Such information would not be privileged, so it may be reportable under DAC 6.

Legal professional privilege – UK

- The UK regulations provide an exception from the disclosure obligation where to do so would be in breach of LPP.
- The UK guidance provides that where a lawyer is an intermediary but information that would be reportable is covered by LPP, the lawyer will not have to make a report. Instead, the lawyer "*must notify another intermediary or relevant taxpayers of the obligation to report in accordance with [regulation 7(2)].*"
- The Law Society guidance notes that Regulation 7(2) requires lawyers who are prevented from making a disclosure of arrangements on the ground of LPP to notify other intermediaries. The Law Society guidance continues to state the following:
    - *"In most cases, our view is that a lawyer is prevented by LPP from making a notification to another intermediary. That is because we consider notifying another intermediary that an arrangement is disclosable will in many cases disclose a key piece of confidential legal advice in the DAC 6 context because it reveals the lawyer's judgement that DAC 6 applies.*
    - *That judgement may also be based on privileged communications that enabled the lawyers to conclude that DAC 6 applies, although this might not be the case if, for example, the other intermediary worked for the same client and the DAC 6 issues had been generally discussed between the client, the lawyer and the other intermediary.*
    - *A similar analysis would apply to a notification to a relevant taxpayer who is not the lawyer's client."*
- The client may waive LPP, allowing the report to be made by the lawyer on their behalf.

Legal professional privilege – Germany

- In Germany, a three-pronged approach to LPP has been adopted which depends on the circumstances of the specific DAC 6 reportable arrangement and the decision of the taxpayer to waive LPP.
- The approaches can be summarised as follows:
  - *Approach 1: Intermediary makes a full report*

    The relevant taxpayer will waive their LPP. In such a situation, the intermediary would be required to make a full DAC 6 report to the German Federal Ministry of Finance.
  - *Approach 2: Taxpayer makes a full report*

    The relevant taxpayer chooses not to waive their LPP, and as a result, the taxpayer decides that they want to make the full DAC 6 report.
  - *Approach 3: Intermediary and taxpayer both make partial reports*

    The taxpayer does not waive their LPP; however, they also decide not to make a full report themselves. This means that the intermediary must make a partial report of anonymised data about the arrangement (primarily information about the design of the arrangement). Following this, the taxpayer must submit a second partial report containing the personal information relating to the arrangement.

- LPP does not apply to “marketable” cross-border arrangements.

Legal professional privilege – Belgium

- In Belgium, the Belgium Association of Tax Lawyers (BATL) published a note outlining their position in relation to various issues related to DAC 6 and its transposition into Belgian national law.

- One of the noted issues was in relation to the application of legal professional privilege.

- The BATL stated that DAC 6 is a rule of secondary EU law and must, therefore, be transposed by Member States into national law in compliance with primary EU law.

- The BATL concluded that the content of written exchanges between a lawyer and his client "*cannot be disclosed, as demanded by DAC 6, without violation of primary EU law that must be observed by the Member States".*

Penalties

- DAC 6 provides that Member States shall set penalties if a RCBA is not reported to tax authorities pursuant to domestic legislation. The Directive states that the penalties should be "effective, proportionate and dissuasive".

- The applicable penalties will differ across the EU Member States.

- The UK DAC 6 regulations provide that the default penalty for a one-off infringement is £5,000. However, if this penalty is considered "inappropriately low" (in cases of deliberate or repeated compliance failures), the penalty may be levied at £600 per day for the duration of the failure.

- Note that the UK DAC 6 regulations provide that a "relevant consideration" in determining imposition of penalties is whether the relevant person had reasonable procedures in place to identify RCBAs and comply with DAC 6 – demonstrating the importance of having robust DAC 6 compliance processes.

DAC 6 issues list

1) DAC 6 is an EU initiative but there are similar reporting obligations in a non-EU context. For example, Mexico is set to implement a new mandatory disclosure regime aimed at reducing international tax evasion.
2) Intermediaries should be working at preparing robust procedures in order to comply with DAC 6. However, if a professional services firm is found to be non-compliant by the relevant tax authorities, would they be able to claim under their professional indemnity (PI) insurance? It is currently an untested area as the regime is not yet live in many jurisdictions. The ability to claim under PI insurance will primarily depend on the relevant insurance clause but it is unlikely that such clauses would extend to include a breach of a tax reporting obligation.
3) As discussed, there may be multiple intermediaries involved in a RCBA. There are practical difficulties for intermediaries in relation to obtaining evidence that a report has been made in respect of the same RCBA. Firstly, the intermediaries involved in a transaction may not all hold the same information – and as such separate disclosures will be required. Secondly, intermediaries may not be willing to share information with other intermediaries and a culture of caution in the professional services sector may arise as a result of increasing compliance burdens.
4) In the UK, “historical” RCBAs i.e. whereby the first step in the implementation of the RCBA was made between 25 June 2018 and 1 July 2020, have to be reported by 28 February 2021. One of the issues with the concept of historical RCBAs is exactly when to apply the cut off in practical terms. It will not be as straightforward as examining all matters opened after 25 June 2018 as even though the cut off for the “first step” in the implementation is after 25 June 2018, the relevant RCBA may relate to a matter opened prior to that date.