N. XENOFONTOS LLC

Understanding DAC6: The EU Directive on Cross Border Tax arrangements

Introduction

What it is & purpose

EU Council Directive 2011/16 in relation to cross-border tax arrangements, known as DAC6, has been in force since 25 June 2018. DAC6 aims at transparency and fairness in taxation.

The main purpose of DAC6 is to strengthen tax transparency and fight against aggressive tax planning.

Where it applies

DAC6 applies to cross-border tax arrangements, which meet one or more specified characteristics (hallmarks), and which concern either more than one EU country or an EU country and a non-EU country. It mandates a reporting obligation for these tax arrangements if in scope no matter whether the arrangement is justified according to national law.

What must be reported: DAC 6 hallmarks and the main benefit test

A hallmark is a characteristic or feature of a cross-border arrangement entailing its mandatory reporting if met.

A main benefit test ('MBT') would apply to generic hallmarks as well as several specific hallmarks. As per DAC 6, the MBT verifies if the main benefit, or one of the main benefits, having regard to all relevant facts and circumstances, that a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage.

The MBT compares the value of the expected tax advantage with any other benefits likely to be obtained from the transaction and has the advantage of requiring an objective assessment of the tax benefits.

The reporting obligation is defined by the directive's enumeration of "hallmarks" that present certain characteristics or features of a cross-border arrangement that suggest a potential risk of tax avoidance. Any cross-border arrangement (i.e., an arrangement that involves more than one EU member state or an EU member state and another country) that contains at least one of these hallmarks must be reported.

Certain arrangements have to be reported only if they meet the "main benefit test." In general, the main benefit test is met if one of the main purposes of a given arrangement is to gain a tax advantage.

The hallmarks can be broadly categorised as follows:

- **Hallmark category "A"**: arrangements whose tax benefits are subject to confidentiality arrangements that give rise to performance fees or mass marketed schemes;

- **Hallmark category "B"**: arrangements such as the contrived acquisition of loss-making companies, the conversion of income into capital or other forms of income, or so-called circular transactions;

- **Hallmark category "C"**: arrangements that give rise to tax deductions without a corresponding amount of taxable income, to certain double reliefs or deductions, or other such mismatches;

- **Hallmark category "D"**: arrangements that have the effect of undermining the CRS or the rules on identification of beneficial ownership and

- **Hallmark category "E"**: arrangements concerning transfer pricing.

Each of these specific categories contains a lengthy list of potential arrangements (as further described in Annex IV of the EU directive). The tax laws of the individual EU states may add further substance to the hallmarks.

Information to be reported

The information to be reported on cross-border arrangements includes:

- the intermediaries and relevant taxpayers (including name, place of residence, and tax identification number)
- details of the hallmarks
- summary of the arrangement
- the date on which the first step of implementation was made
- national provisions that form the basis of the arrangement
- the value of the arrangement
- member states likely to be affected by the arrangement
- any other persons likely to be affected by the arrangement

Who would have to report?

Under DAC 6, the primary disclosure requirement lies with the ***intermediary***, being a person with EU-nexus. The term "intermediaries" is defined broadly as any person (either an individual or a company) that designs, markets, organises or makes available for

implementation or manages the implementation of a reportable cross-border arrangement, or anyone who helps with reportable activities and knows or could reasonably be expected to know that they are doing so. This includes, but not limited to accountants, tax advisors, consultants, lawyers and bankers.

Except where national legislation gives the right to a waiver from filing information due to a legal professional privilege, which will most likely be the case in Cyprus, all of those intermediaries are required to file information that is within their knowledge, possession or control, to the tax authorities. In such case, however, intermediaries who are covered by legal professional privilege should instead notify, without delay, any other intermediary of their reporting obligations to file such information to the Cyprus Tax Authorities.

Only where no (reporting) intermediary is involved the disclosure requirement is shifted to the relevant taxpayer. Furthermore, an intermediary may be exempt from its reporting obligations if it has proof that another intermediary has reported the arrangement.

Where there would be more than one intermediary involved in the same reportable cross-border arrangement, the obligation to file information would lie with all the intermediaries simultaneously but an intermediary, if it can prove that the transaction has been already reported, is not obliged to report this transaction.

Where no intermediary located in the European Union is involved or if all intermediaries benefit from a legal professional privilege (see above), the reporting obligation falls on the relevant taxpayer.

Penalties

Failure to comply with DAC6 could mean facing significant sanctions under local law in EU countries and reputational risks for businesses, individuals, and intermediaries.

Where an intermediary or relevant taxpayer fails to report an arrangement to the Cypriot tax authorities, an administrative fine between €10,000 and €20,000 is expected to apply, the level of the fine determined according to the type of omission.

COVID 19 – Extension period

The Cyprus Tax Department issued a notice on 27 July 2020 announcing that in accordance with amendments made to the DAC6 Directive for an initial deferral of DAC6 reporting on cross-border arrangements, the submission of DAC6 information in Cyprus is extended as follows:

- Information on reportable arrangements carried out between 25 June 2018 and 30 June 2020 is due by 28 February 2021;

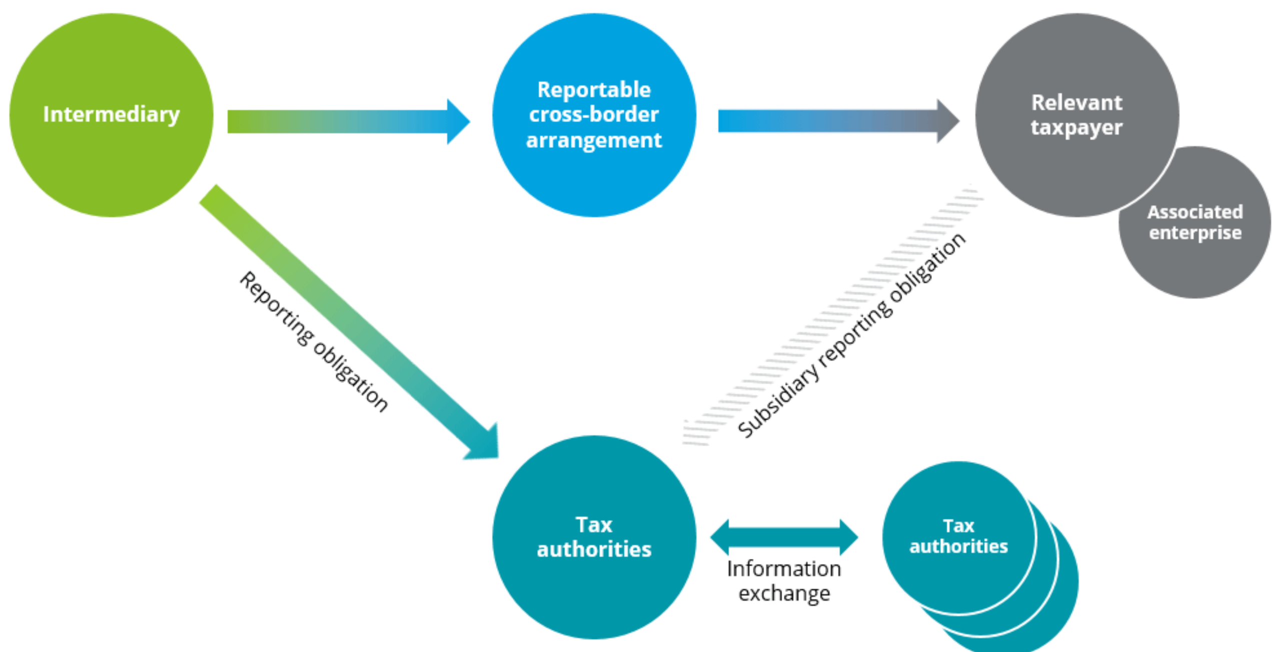
- Information on reportable arrangements carried out between 1 July 2020 and 31 December 2020 is due within 30 days starting from 1 January 2021;

- Information on reportable arrangements carried out from 1 January 2021 onwards is due within 30 days from the date an arrangement becomes available for implementation, it is ready for implementation, or the first step towards its implementation is taken, whichever occurs first; and

- The first periodic report on marketable arrangements is due by 30 April 2021.

The notice also provides that further guidance on the implementation of the DAC6 Directive and how to submit the information will be provided in a later notice.

Example



Concluding thoughts

Before executing any prospective transaction, one must consider whether it falls within the scope of the DAC6 requirements.

DAC6 is here to stay, however the criticisms made, and intermediaries will require strong corporate governance policies to be put in place.

Cyprus has yet to implement DAC6 nonetheless, the clock is ticking.

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