Transparency required

Brendan Moran, Ed Griffiths and Anna Derdak discuss the new EU-wide obligations under DAC 6 and consider how it is working in Poland.

Council Directive (EU) 2018/822 (DAC 6) was published on 25 May 2018 and is the sixth directive to amend Directive 2011/16/EU (tinyurl.com/yb6ac47y). This latest amendment is directed at the mandatory exchange of information in tax in relation to reportable cross-border arrangements and looks set to introduce wholesale changes across Europe in the area of intermediary and taxpayer disclosure. In essence, DAC 6 requires intermediaries or taxpayers to disclose cross-border arrangements when certain ‘hallmarks’ that point toward potential tax-avoidance are present.

This article gives an overview of DAC 6, the status of its implementation in the UK and some insights from the early adoption in Poland where the authorities have been ahead of the curve by bringing in some of the key provisions sooner than required. It is broadly based on the UK disclosure of tax avoidance schemes (DOTAS) rules but could be much wider in scope.

This is likely to be an important issue for intermediaries and taxpayers after it has been fully implemented across Europe. Further, the future reporting obligations will date back to 25 June 2018, so it is already a live issue, even though not yet domestically implemented in most member states.

Reportable cross-border arrangements

In simple terms, a cross-border arrangement is one that concerns more than one member state, or a member state and a third country, and meets one of the broadly drafted conditions which mostly involve a cross-border element – such as, for example, not all of the participants being tax resident in the same jurisdiction. For a cross-border arrangement to be reportable, it must include one or more of the relevant hallmarks, essentially characteristics or features that indicate a risk of tax avoidance.

The hallmarks are widely drafted but generally can be divided between those that require the main benefit (or one of the main benefits) of the arrangement to be the obtaining of a tax advantage, and those that do not.

Some of the hallmarks are similar in scope to features that already require disclosure in the UK under the DOTAS regime. Examples of these are the hallmarks pertaining to conditions of confidentiality in the arrangements or where standardised documentation is available to numerous taxpayers. Some of the hallmarks are bespoke and aim, for example, to require disclosure if depreciation is taken for the same asset in multiple jurisdictions, or a tax deductible payment is made to an associate with no tax residency.

The hallmark Table provides a summary of the hallmarks.

Who is required to disclose?

The reporting obligation applies primarily to intermediaries; however, a secondary one also applies to the taxpayer. An intermediary is defined as someone with an EU connection who ‘designs, markets, organises or makes available for implementation or manages the implementation’ of a reportable cross-border arrangement.

Key points

- The DAC 6 regime will apply to arrangements dating back to 25 June 2018.
- Reportable cross-border schemes will include at least one identifying hallmark.
- The reporting obligations affect intermediaries, such as professional advisers, as well as taxpayers.
- Penalties will apply for failure to report arrangements.
- Poland implemented the directive on 1 January 2019.
As well as the above, intermediary also refers to any person who undertakes to provide aid, assistance or advice in respect of a reportable cross-border arrangement, or any person who could reasonably be expected to know that such aid, assistance or advice relates to a reportable cross-border arrangement.

Importantly, a relevant intermediary will be required to make a disclosure in relation to a reportable transaction in any member state under the local implementation of DAC 6 in that jurisdiction. This is potentially an extremely wide obligation.

In practice, such intermediaries are likely to include professional advisers such as lawyers, accountants and tax advisers, as well as banks, financial advisers and, more generally, parties involved in transactions who could be considered to fall under any of the categories above.

However, it is important for taxpayers to note that, if no intermediary is involved in an arrangement, or more likely the intermediary does not have an EU connection or is bound by professional privilege, the reporting obligation shifts to the taxpayer.

### Hallmark table

<table>
<thead>
<tr>
<th>Category of arrangement</th>
<th>Description</th>
<th>Main benefit test applicable?</th>
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<tbody>
<tr>
<td><strong>A</strong>: Generic hallmarks linked to the main benefit test – marketed tax avoidance schemes.</td>
<td>A participant in the scheme undertakes to comply with a confidentiality condition which requires them not to disclose how the arrangement could secure a tax advantage.</td>
<td>Yes</td>
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<td></td>
<td>An arrangement where the intermediary is entitled to receive a fee, and that fee is fixed with reference to the amount of tax saved or how effective the scheme is.</td>
<td>Yes</td>
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<td></td>
<td>An arrangement with standardised documents or structure.</td>
<td>Yes</td>
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<td><strong>B</strong>: Specific hallmarks linked to the main benefit test – structured arrangements in tax avoidance planning.</td>
<td>A participant in the scheme takes contrived steps to acquire a loss making company (loss buying).</td>
<td>Yes</td>
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<td></td>
<td>An arrangement that converts income into capital.</td>
<td>Yes</td>
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<td></td>
<td>An arrangement that includes circular transactions with no commercial function that results in ‘round tripping’ of funds.</td>
<td>Yes</td>
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<tr>
<td><strong>C</strong>: Cross-border arrangements and transfers – to capture innovative planning.</td>
<td>An arrangement that implements deductible cross-border transactions: • to a recipient not resident in any jurisdiction for tax purposes; • to a 0% or near 0% tax jurisdiction; • to a tax jurisdiction considered to be blacklisted by the OECD; • to a tax exempt recipient; or • to a tax jurisdiction where preferential tax treatment will be given to the recipient.</td>
<td>No</td>
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<td></td>
<td>An arrangement where deductions for the same depreciation on the asset are claimed in more than one jurisdiction.</td>
<td>No</td>
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<td></td>
<td>An arrangement where double tax relief may be sought in respect of the same item of income or capital in more than one jurisdiction.</td>
<td>No</td>
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<td>An arrangement where there is a material difference in the amount payable for an asset in different jurisdictions.</td>
<td>No</td>
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<td><strong>D</strong>: Arrangements which circumvent tax reporting and transparency obligations.</td>
<td>Arrangements which have the effect of undermining reporting obligations under agreements for the automatic exchange of information; this broad hallmark covers a number of activities.</td>
<td>No</td>
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<td><strong>E</strong>: Arrangements which relate to transfer pricing.</td>
<td>An arrangement that uses unilateral safe harbour rules.</td>
<td>No</td>
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<td></td>
<td>An arrangement that involves the transfer of hard-to-value intangibles where the financial assumptions or projections used in valuation are highly uncertain.</td>
<td>No</td>
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<td></td>
<td>An arrangement that involves intragroup cross-border transfers of functions, risks or assets and the projected annual earnings during the three-year period after the transfer are less than 50% of the projected annual earning had the transfer not been made.</td>
<td>No</td>
</tr>
</tbody>
</table>
**Information to be disclosed**

As might be expected, the focus of the information to be disclosed centres on providing the tax authority with relevant information relating to the particular arrangements. Accordingly, if a reportable cross-border arrangement exists, a taxpayer or intermediary would be expected to provide full details of the applicable hallmarks, a summary of the arrangements (including the value) and details of any member states concerned.

**Key timeline**

There are some key dates to remember when considering the implementation of DAC 6.
- **25 June 2018** – Transactions from this date are potentially reportable.
- **31 December 2019** – Deadline for implementing the directive into national law.
- **1 July 2020** – Reporting obligations to start by this date.
- **31 August 2020** – First reports required to be filed by intermediaries.

Given the retrospective nature of DAC 6, those who could be classed as intermediaries and taxpayers that carry on any activity in the EU or derive any income or profits in the EU would be advised to monitor and log any relevant cross-border arrangements entered into or implemented from 25 June 2018.

Subsequently, information on reportable cross-border arrangements must be filed with the relevant tax authority 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. Intermediaries providing aid, assistance or advice must file information within 30 days beginning on the day after they provided aid, assistance or advice.

The FA 2019 includes powers for the Treasury to introduce regulations that will allow the UK to implement DAC 6. It is not clear at this stage what form those regulations will take, but it is understood that the government will during this year conduct a formal consultation on how DAC 6 should be

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**Penalties for non-disclosure**

In brief, the directive has left it to the individual member states to set penalties and says little on what these should be other than to note that they should be ‘effective, proportionate and dissuasive’. As shown by the example of Poland below, these penalties could be significant.

For example, in the UK, the current DOTAS penalties are levied on a daily basis and can reach up to £1m in addition to individual penalties of up to £10,000 for specific failures; it is conceivable that these will continue to apply under DAC 6 or, indeed, could increase.

**UK position**

In accordance with the directive, intermediaries and relevant taxpayers are obliged to file information for the first time by 31 August 2020 for reportable cross-border arrangements implemented between 25 June 2018 and 1 July 2020. While the UK has yet to implement DAC 6, these time periods are set out in the directive so are to apply regardless of when transposition takes place.
Polish position

As noted, Poland has accelerated its introduction of DAC 6. We explain below the scope of the new Polish rules to illustrate how other EU states, including the UK, could implement DAC 6. In particular, if one member state takes a wide approach to implementation, this could encourage others to take similar approaches.

On 1 January 2019, the amendment to Poland’s tax ordinance came into force implementing DAC 6 and introducing a bundle of additional provisions on the exchange of information with tax authorities. As well as the requirement to notify cross-border schemes, intermediaries – such as promoters and facilitators – and taxpayers will need generally to consider the position of purely domestic tax schemes, that is arrangements meeting specific criteria and exhibiting specific hallmarks.

An arrangement is defined broadly as including actions that ‘contribute or could contribute to the occurrence or non-occurrence of a tax obligation’. While a de minimis threshold does exist, this broadly defined obligation and the generally imprecise criteria has led some advisers to consider that – unless the provisions are modified – reporting will in effect become a routine aspect of transactions, and indeed an aspect of anything that can be considered an ‘arrangement’ for these purposes.

Given that the rule change only occurred on 1 January of this year, there will be some additional lead-in time before the full practical effects of the legislation become clear. It should be noted that on 31 January 2019, the Ministry of Finance issued a ruling that provided for leniency in some circumstances. This was partly in response to taxpayers’ difficulty with the regime, which is indicative of the difficulty of implementing DAC 6 and the wider reporting requirements that it imposes. It should be underlined that, for a failure to report in time, the Fiscal Penal Code provides penalties that apply on a daily basis and can reach up to PLN21.6m (about £4.3m).

As well as a disclosure obligation, the Polish regime also requires parties to maintain internal procedures aimed at preventing the failure to provide information on schemes. They also involve processes such as appointing a responsible person and providing adequate training. Penalties of up to PLN10m (about £2m) can be levied for a failure to maintain sufficient internal procedures.

A further noteworthy aspect of the Polish regime is the interaction of reporting obligations between intermediaries. Under the new law, the primary reporting obligation rests on the entity that created the scheme in question. That party is obliged to disclose the arrangements and, in return, will receive a tax scheme number from the Polish authorities. Any other intermediary can then be released from their obligation by quoting the tax scheme number provided to them by the primary adviser or promoter. Moreover, advisers that are subject to professional secrecy – bound by client confidentiality – have only a limited reporting obligation, the other obligations rest with the client.

Stepping back, the reality of the implementation in Poland at present is that there is a great deal of uncertainty on the scope of the rules and this is causing significant difficulties for intermediaries, taxpayers and transactional activity. It is easy to see this being experienced across Europe as other member states start to implement the rules.

Outlook

As well as the financial penalties, one of the main lessons to glean from the Polish approach to DAC 6 is the potential for increased transparency in relationships between taxpayers and tax authorities across Europe and beyond. With increasing numbers of transactions involving at least some cross-border element, there is a greater chance that in at least some of the relevant territories a disclosure obligation of some form or description will exist. This is particularly likely to be the case if, as the Polish system suggests, disclosure is to become a standard part of a taxpayer’s compliance obligations.

Although we are still waiting for DAC 6 to be implemented in the UK, this is an EU-wide issue and any intermediary or taxpayer operating in Europe needs to consider these rules. It is not expected that Brexit will affect these regulations.

Given that the reporting requirement is to apply for any arrangements entered into from 25 June 2018, taxpayers and their advisers should be focusing their attentions on their historical obligations and keeping full records of potentially disclosable transactions.

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