INFORMATION SHEET NO.142

# DAC6 – Mandatory disclosure of reportable cross-border arrangements

*May 2020*

## Introduction

On 25 May 2018, the EU Council issued Directive 2018/822/EU, which amends Directive 2011/16/EU on mandatory automatic exchange of information, in relation to reportable cross-border arrangements. Commonly known as DAC6, its purpose is to facilitate the obtaining and the automatic exchange of comprehensive and relevant information between the tax authorities of Member States about potentially aggressive tax arrangements.

Considering that most such arrangements span more than one jurisdiction, the obtaining and automatic exchange of such information should provide the tax authorities of Member States with an early warning system, thus enabling them to promptly react against any harmful tax practices and close potential loopholes.

It should be noted that any reporting under DAC6 does not necessarily imply that the cross-border arrangement in question is not legal or that it equates to aggressive tax planning. The wording of the Directive is so broad and expansive that it also captures transactions that are not necessarily driven by tax planning motives.

All EU Member States are obliged to enact DAC6 into their local legislations. Application of its provisions commences in 1 July 2020, with retrospective effect as from 25 May 2018 (more details below).

Towards this end, the **Cyprus** Ministry of Finance has prepared and circulated a draft bill, which is aligned with the requirements of DAC6. The draft bill is expected to be enacted into law prior to 1 July 2020, upon which date DAC6 becomes applicable. Subsequent to the enactment of the legislation, it is expected that the Cyprus tax authorities will issue further guidance regarding the application of the Directive in practice.

## What is DAC6

In a nutshell, DAC6 requires the mandatory reporting by **EU intermediaries** of certain **cross-border arrangements** to the tax authorities of their home Member State, in case where such arrangements meet at least one of the defined **hallmarks**, and which concern either more than one Member State, or a Member State and a third country. Each of the aforementioned terms in bold fonts is explained in the following sections.

The deadline for filing information on reportable cross-border arrangements is within 30 days beginning on the day that: (a) the arrangement is made available for implementation, or (b) the arrangement is ready for implementation, or (c) the first step in the implementation of the arrangement has been made, whichever occurs first.

Notwithstanding the above, DAC6 has **retrospective effect** from 25 May 2018. As such, any reportable arrangements of which the first implementation step takes place between 25 May 2018 and 30 June 2020 need to be reported by 31 August 2020.

## Reportable cross-border arrangements

A cross-border arrangement is defined as an arrangement (or a series of arrangements) 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 tax resident in the same jurisdiction.

b) One or more of the participants in the arrangement is simultaneously tax resident 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.

If an arrangement is considered to be a cross-border arrangement (i.e. it meets at least one of the above conditions), then it becomes **reportable** if it further meets at least one of the **hallmarks** set out in the next section. These hallmarks are essentially characteristics or features of a cross-border arrangement that presents an indication of potential tax avoidance or abuse.

## Hallmarks

There are five categories of hallmarks as defined by DAC6, which are set out below in a general outline.

For categories A, B and certain elements of category C, an arrangement will be reportable only if it is also captured by the **'main benefit test'**, i.e. if it can reasonably be expected that the main benefit (or one of the main benefits) to be derived from entering into the arrangement, having regard to all relevant facts and circumstances, is the obtaining of a tax advantage.

NOTE: The Directive applies to all taxes levied by EU Member States (with the exception of VAT, custom duties, excise duties and compulsory social contributions). As such, it is understood that the definition of 'tax advantage' implies an EU-nexus, i.e. tax advantage obtained in any EU Member State.

**Category A**: Generic hallmarks linked to the 'main benefit test'. Includes arrangements where:

- A confidentiality clause exists in respect of how a tax advantage may be secured.
- The intermediary is entitled to performance fees, based on whether a tax advantage is actually derived, or based on the amount of tax saved.
- The structure/ documentation is largely standardised and the arrangement is available to more than one taxpayer (mass-marketed schemes).

**Category B**: Specific hallmarks linked to the 'main benefit test'. Includes certain tax planning features, specifically:

- Acquisition of a loss-making company.
- Conversion of income into capital, gifts, or other categories of revenue that are either tax exempt or taxed at a lower rate.
- Circular transactions resulting in round-tripping of funds, namely through involving interposed entities without other primary commercial function, or transactions that offset or cancel each other or that have similar features.

**Category C**: Specific hallmarks related to cross-border transactions. Certain of these hallmarks are also subject to the 'main benefit test', specifically deductible cross-border payments to associated enterprises subject to zero (or almost zero) tax rate, or subject to a full tax exemption, or benefiting from a preferential tax regime.

The rest of the hallmarks in this category do not require the main benefit test to be fulfilled, and include:

- Tax deductible cross-border payments between associated enterprises where the recipient is not tax resident in any tax jurisdiction, or is tax resident in an EU/ OECD blacklisted jurisdiction.
- Deductions for depreciation are claimed in more than one jurisdiction.
- Double tax relief is claimed in more than one jurisdiction.
- Transfer of assets, where there is a material difference in the amount being treated as payable between the involved jurisdictions.

**Category D**: Specific hallmarks concerning the automatic exchange of information and beneficial ownership. Includes arrangements that may have the effect of undermining the rules (or the absence thereof) on beneficial ownership or the rules on automatic exchange of information.

**Category E**: Specific hallmarks concerning transfer pricing, including the use of unilateral safe harbour rules, the transfer of hard-to-value intangibles, and arrangements involving cross-border transfer of functions/risks/assets between associated enterprises that result in significant (>50%) profit shifting.

## Who needs to report

Under DAC6, the obligation to provide information on reportable cross-border arrangements primarily lies with **intermediaries**, and in certain circumstances with the taxpayer himself.

**Intermediaries** are defined as either:

- any persons (physical or legal) that design, market, organise or make available for implementation or manage the implementation of a reportable cross-border arrangement; or

- any persons that 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.

The definition is quite broad and potentially captures professionals such as consultants, accountants, financial advisers, lawyers, banks, trust companies etc, who may not necessarily be providing tax advisory services. As such, DAC6 provides for an 'ignorance defence', whereby professionals have the right to provide evidence that they did not know, and could not reasonably be expected to know, that they were involved in a reportable cross-border arrangement, having regard to the relevant facts and circumstances and based on available information and their relevant expertise.

To be considered an intermediary within the context of DAC6, a person needs to meet at least one of the following additional conditions:

- be tax resident in an EU Member State;
- have a permanent establishment in a Member State through which the services with respect to the arrangement are provided;
- be incorporated in, or governed by the laws of, a Member State;
- be registered with a professional association related to legal, taxation or consultancy services in a Member State.

It is further noted that the **reporting obligation shifts to the taxpayer himself** in cases where the intermediary is non-EU (as per the above conditions), or where no intermediary is involved at all (e.g. an in-house arrangement), or when the taxpayer is notified that an intermediary has the right to a waiver due to legal professional privilege.

## What needs to be reported

Once the competent authority of each Member State receives information on reportable cross-border arrangements from intermediaries (or taxpayers), it shall communicate certain information by means of automatic exchange to the competent authorities of all other Member States, within one month from the end of the quarter in which the information was filed. The first exchange will take place by 31 October 2020.

The information to be communicated shall contain the following, as applicable:

- Identification of intermediaries and relevant taxpayers, including their name, date and place of birth (in cases of individuals), tax residence, tax identification number, persons that are associated enterprises to the relevant taxpayer (where appropriate).
- Details of the hallmarks that make the cross-border arrangement reportable.
- Summary of the arrangement, including the name by which it is commonly known (if any), and a description in abstract terms of the relevant business activities or arrangements.
- The date on which the first step for implementation of the arrangement has been or will be made.

- Details of the national provisions (local law) that form the basis of the arrangement.
- The value of the arrangement.
- Identification of the Member State of the relevant taxpayer(s) and any other Member States which are likely to be concerned by the arrangement.
- Identification of any other person in a Member State likely to be affected by the arrangement, indicating to which Member States such person is linked.

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| The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained. Totalserve will be glad to assist you in this respect. Please do not hesitate to contact us. |