DAC6: 7 things you need to know

The European Union's sixth version of its Directive on Administrative Co-operation (known as DAC6) has been called one of the most significant changes for multinational companies and their intermediaries in years. The mandatory disclosure regime applies to any person (individual, partnership, company or other legal entity) operating in the EU, or with interests in the EU. It obliges intermediaries and taxpayers to disclose cross-border arrangements that meet certain 'hallmarks' within the directive, and also requires an automatic exchange of relevant information of reported arrangements between EU tax authorities.

Here we've summarised the key takeaways from our DAC6 webinar held in March. Our panellists were:

- Hana Prochaska, Head of Business Development Europe, Aztec Group Luxembourg
- Anne-Cécile Vasseur-Jourdren Associate Director, Tax, Aztec Group Luxembourg
- Jacques Linon, Banking and Insurance Tax Leader for EY Luxembourg
- Isabelle Gervais, Partner at Elvinger Hoss Prussen

In case you missed the session, you can access the original recording here: DAC6: Navigating the new corporate tax landscape

1.Why was DAC6 introduced?

The adoption of mandatory European disclosure rules was seen as a necessary response based on three significant developments:

- Decreasing tax revenues for EU member states, due to more sophisticated tax planning structures taking advantage of increased mobility of both capital and persons across the European market.
- Damaging revelations such as the 'Panama Papers' and 'Paradise Papers' that uncovered tax fraud and aggressive tax avoidance schemes.
- The implementation of the recommendations of the OECD BEPS Action 12

‘ Mandatory disclosure Scheme’ inspired in part by the disclosure regimes already implemented notably in the US, Canada, the UK.

2. Who is affected?

The primary obligation to report to the EU tax authorities is on EU-based intermediaries, but under DAC6, the concept of intermediary is very broad. The directive defines two types of intermediary, with primary intermediaries termed ‘promoters’, and secondary intermediaries termed as ‘service providers’.

The promoters are the persons who design, market, organise, make available for implementation or manage the implementation of a cross-border arrangement.

As an example, a tax adviser who designs or markets tax planning strategies and a legal adviser who manages their implementation are likely to qualify as promoters.

Service providers are those persons who directly or indirectly provide aid, assistance or advice in relation to the design, organisation, marketing or implementation of cross-border arrangements. So, within this definition, the Aztec Group is a service provider.

The intermediary concept can therefore include a wide range of professionals such as law firms, audit firms, banks and financial advisers. For the asset management industry, the definition also includes portfolio managers, investment advisers, distributors and others.

Duties also arise for taxpayers in absence of intermediaries identified in the transaction and it is relevant for taxpayers to monitor MDR impacts on their transaction, who will report, and procedures to put in place.

3. The DAC6 impact on asset managers with EU assets

Within the asset management industry, immediate action is required in order to avoid the risk of adverse circumstances and substantial penalties. Even if an asset manager does not always fall within the category of primary intermediary, it may still fall within the definition of a service provider, particularly in circumstances where it is reviewing or otherwise supporting such investment activities.

Therefore, the first step for asset managers is to undertake an impact assessment that determines their intermediary status, and their reporting obligations, in one or more EU member states. For this reporting obligation, asset managers can rely on the reporting made by a service provider, such as the Aztec Group. But even in these cases, it is important to have appropriate processes in place.

The next step is to identify which activities qualify as cross-border arrangements. This will depend on whether the arrangements fulfil one or more hallmarks listed in the DAC6 directive. These hallmarks describe the features of cross-border arrangements that might present an indication of a potential risk of tax avoidance.

4. The Main Benefit Test

Many of the hallmarks are subject to an additional test called the 'main benefit test' (MBT), which will be met if the main benefit or or one of the main benefits of an arrangement is the obtaining of a tax advantage. In practice, while the vast majority of investment funds and investment structures taken as a whole are unlikely to fulfil the MBT – the rules are complex. Asset managers may not always have the full information themselves to determine whether their funds or investments are party to a reportable cross-border arrangement, and may need to reach out to other operators/parties in the transactions. Oversight duties are nevertheless relevant to consider also in the DAC6 MDR fields.

There is a delicate balance between under-reporting and over-reporting, and a service provider with the experience of being able to assess individual circumstances with an independent viewpoint may prove invaluable. We believe it is in the best interests of EU asset managers to consider reviewing – and potentially adapting – their existing due diligence and reporting procedures specifically for DAC6 purposes.

5. What impact is DAC6 having in the UK?

Now that the UK is no longer part of the EU, UK-based companies and individuals might be mistakenly operating under the belief that the DAC6 directive is no longer applicable. Therefore, it is important to remind such persons that one of the central pillars of the EU-UK Agreement is the Free Trade Agreement, which includes tax transparency issues. In other words, UK taxpayers are currently still

required to report those transactions that fall into Category D of the DAC6 hallmarks:

For us, we therefore believe it is essential for clients to have a secondary intermediary in place that is capable of determining whether (if any) transactions meet the Category D hallmark, as well as handling any necessary reporting requirements on other hallmarks that would apply with another operator/intermediary of the same group in the EU or through a service outsourcing. If a cross-border transaction is reportable on other hallmarks than category D, reporting must be organized despite the asset manager being located out of the EU.

6. What are the consequences of non-compliance?

Non-compliance carries serious penalties for intermediaries and also potentially for taxpayers. In Luxembourg, no, late, inaccurate or incorrect reporting can be fined up to 250,000 euros, in Germany, the penalty is 25,000 euros, while in Poland, the penalty could reach 5.8 million euros. An intermediary could find themselves in the difficult position of being fined different amounts across several EU member states.

There is also the potential for considerable reputational damage. Investors are increasingly focused on DAC6 obligations within their own due diligence. We are also seeing increased demand on fund managers to provide details of their DAC6 policies and information needed for DAC6 disclosure purposes, for example, in fund documentation and side letters.

Therefore, having a set of internal processes and reporting policies in place is the best way to mitigate the DAC6 penalty risk across different EU member states. This can be achieved by ensuring all the necessary documentation is available, arranging an appropriate escalation process and setting up a comprehensive audit trail of reported transactions and justifications for non-reportable transactions and fields of activities. But more importantly, intermediaries need to convince tax authorities they have a robust methodology and procedure in place that show they are engaged in the process and take the directive seriously.

7. What’s on the horizon for DAC6?

While DAC6 implementation is still in its earliest stages, the European Commission is already working on the seventh set of revisions to the directive. DAC7 will introduce a new reporting obligation on income generated by sellers on digital online platforms, such as eBay, Amazon and Facebook. Looking further ahead, DAC8 is expected to include crypto assets and e-money within the scope of the automatic exchange of information.

While intermediaries have an obligation to comply with the directive, we hope most view this as an opportunity rather than a burden. Those that take the initiative will demonstrate their awareness of the evolving tax reporting landscape, optimise their tax risk rating models and policies and profile in creating fair system for everyone.