Understanding DAC6: here's what our clients are asking us

Anne-Cecile Vasseur-Jourdren, Associate Director – Luxembourg, considers the key issues surrounding DAC6 that clients need to be aware of

On 25 May 2018, the European Union (EU) passed the sixth version of its Directive on Administrative Cooperation, commonly known as DAC6. Since then, DAC6 has been transposed by Luxembourg, the Netherlands and the UK, and local versions of the DAC6 law are now effective.

Why has DAC6 been introduced?

In a nutshell, DAC6 has been created to help increase transparency and put an end to cross-border tax evasion. It has been designed to discourage aggressive tax arrangements or opaque structures, and is seen by the EU as a necessary measure to counteract the design and implementation of harmful tax structures.

It's important to note this is a mandatory disclosure regime that potentially affects all multi-national companies with business operations in the EU and in the UK. The new regime also applies to the intermediaries of these companies, including central administration firms, banks, law firms, and tax advisory firms. Failure to comply with the new requirements could lead to significant fines and reputational damage, which is why intermediaries like Aztec will be working closely with clients to ensure compliance with the local DAC6 reporting requirements.

What needs to be reported?

Intermediaries must report cross-border tax arrangements between two different countries that meet certain criteria, known as hallmarks. The DAC6 Directive concerns not just transactions that are tax-motivated, but also 'regular' transactions not driven by tax planning motives but could be viewed as having a detrimental 'potential tax effect'.

While the DAC6 Directive establishes minimum reporting requirements, each of the 27 EU member states, and the UK, can implement local variations and additional obligations. For example, DAC6 addresses direct taxes and international arrangements, but some jurisdictions are choosing to expand its reach to value-added tax (VAT) and domestic arrangements.

What does the local law require?

The local DAC6 law requires mandatory reporting of Cross Boarder Reportable Arrangements (CBRA). Each reportable transaction requires a separate report that discloses (among other things) the nature of the arrangement, the parties involved, the date the arrangement was made and the value of the arrangement.

A mandatory CBRA report will be required if the transaction falls within one or more of five distinct 'hallmarks' categories. Each hallmark sets out particular characteristics that have been identified by the EU as potential indicators of aggressive tax planning:

- Hallmark A: commercial characteristics seen in a marketed tax avoidance scheme.
- Hallmark B: planning arrangements structured as tax avoidance.
- Category C: cross-border transactions into a low-income tax jurisdiction.
- Category D: automatic exchange of information or common reporting standings which undermine tax reporting transparency.
- Category E: transfer pricing reports, including hard to value intangibles.

How will CBRA reports be made?

It will be the responsibility of financial services providers such as Aztec to determine whether CBRA reports are necessary. We shall be legally required to complete each report –file it and return it to the relevant tax authority – within 30 days of the arrangement being known to us and determined as reportable.

The local DAC6 law may also state that certain kinds of intermediaries, such as lawyers, do not need to report any CBRAs, but are legally obliged to notify both the client and its intermediary of the existence of a CBRA within ten calendar days. Clients may also be required to disclose all CBRA reports on the relevant annual tax return.

What key reporting dates should clients be aware of?

As DAC6 was introduced back in 2018, any cross-border arrangements made between 25 June 2018 and 30 June 2020 must be retroactively reviewed and assessed. Any arrangements that trigger at least one of the five hallmarks must be disclosed by 31 August 2020. We anticipate that the rolling 30-day window for reporting new arrangements will apply from 1 July 2020.

However, from now through July, Aztec will be focusing on the historical reporting and fulfilling the retroactive reporting requirements. We will also be implementing systems and processes to manage the reporting obligations on an ongoing basis.

How is the Aztec Group responding to the DAC6 reporting requirements?

As the financial intermediary, it's our job to carry out the monitoring and assessment – both on an historical and future basis – to determine whether an arrangement triggers a hallmark and therefore should be reported. We began by creating a DAC6 Expert Group which is responsible for interpreting the law and creating practical steps and internal guidance for implementation. We have also been working closely with EY in Luxembourg, the Netherlands and in the UK, with a view to establishing 'best practice' in this area, and to measure the impacts of the new legislation from a services perspective.

Lastly, we have created several working groups to make sure no areas of the legislation are left unattended, and that our clients are being treated fairly throughout the process. This includes making sure we work with our clients to help them understand the additional cost of DAC6 monitoring, and introducing a new fee structure that takes into account the monitoring and reporting requirements.

Does this legislation apply to other jurisdictions outside of the EU and UK?

The Channel Islands is also adopting its own Mandatory Disclosure Requirements

(MDR), inspired by OECD guidelines in this respect. The Channel Islands' MDR laws are expected to come into force later this year, and we will be publishing an update on the requirements on behalf of clients once this has been officially announced.

Summary

As it stands, the scope of DAC6 is intentionally very broad, which means individual jurisdictions are responsible for transposing the DAC6 Directive into their local laws and publishing their own guidance. As we move forward, we will be working closely with clients to help them develop workflow processes to simplify the gathering of data needed to identify reportable arrangements, and to help establish a 'business as usual' monitoring and reporting approach.

We want to reassure our clients and keep them updated on the steps we've been taking to make sure we are ready to comply with the DAC6 Law. We will continue to monitor updates from the local tax authorities, and will also be publishing a dedicated Q&A document that will cover any questions or concerns that clients might have.