

**DAC6:
Mandatory Reporting and Automatic Exchange of
Information Program
For Cross-Border Arrangements**

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Marco Rossi, Marco Q. Rossi & Associates
mrossi@lawrossi.com - www.lawrossi.com

DAC6: Some General Considerations

- **Council Directive (EU) 2018/822 (“DAC6”):**
 - Sixth amendment of the original Council Directive 2011/16/EU on Administrative Cooperation.
 - A previous amendment enacted the automatic exchange of information on financial accounts (Common Reporting Standard or “CRS”).
 - A previous amendment enacted the automatic exchange of information on advance cross-border tax rulings.
 - A previous amendment enacted the mandatory automatic exchange of information on country-by-country reporting for MNEs.
- **DAC6 broadly reflects OECD’s recommendations in BEPS Action 12.**
- **International Tax World is a minefield:**
 - Increasing challenges and expensive compliance for taxpayers;
 - Significant pressure on tax counsel and advisors;
 - Huge administrative burden on tax agencies.

DAC6: Tax Policy Rational

- **The “usual suspects”:**
 - Protecting the national tax base;
 - Ensure fairness (clamping down on tax avoidance and tax evasion; contrasting aggressive cross-border tax-planning arrangements).
- **Who is the “foe”:**
 - international tax arbitrage (but where does it come from, and what is it exactly? (see 1998, H. David Rosenbloom, *International Tax Arbitrage and the “International Tax System”* (and Commentary by Reuven S. Avi-Yonah).
- **Who is the “savior”:**
 - general anti tax avoidance rules and judicial doctrines that developed and took hold in the EU over the last few years (see ATAD’s general anti tax avoidance rule, beneficial ownership clause, wholly artificial arrangement doctrine, etc.), statutory anti-hybrid rules.
- **DAC6 is the enforcer** (mandatory disclosure and automatic sharing of information among tax authorities throughout the EU).

Comments

- **“International tax arbitrage” is a controversial concept:**
 - Differences in the tax treatment of a cross border transaction under the national tax laws of different countries are the norm, not the exception, and reflect the nature and normal state of affair of international taxation;
 - The “international tax system”, namely, a coherent set of principles above and beyond countries’ national tax laws, as a frame of reference insuring consistency, coherence and harmony, does not exist;
 - The single tax principle is a fallacy (what tax, on what, where, upon whom?);
 - Different tax rules on entity’s classification, character and source of income, tax status of taxpayer, timing of a deduction or inclusion, different country from country, are all legitimate and rational and cannot be classified as right or wrong, better of worse;
 - Tax Treaties are just a method for the resolution of competing tax claims of two contracting states.
- **Tax policy rationales:**
 - Administrative efficiency,
 - Compliance costs and burden,
 - Obstacles to cross border business, resulting in reduce growth and loss of revenue.

DAC6: Dangerous Misconceptions

- ***DAC6 only applies within the EU:***
 - Although DAC6 is an EU directive, a taxpayer does not need to be headquartered in the EU to be affected. US companies that have entities in the EU, conduct cross-border business with a PE in the EU, or engage in cross border transactions with an EU counterpart, even without a subsidiary or fixed base in the EU, must comply as well.
- ***Reporting responsibility lies only with the EU-based intermediary:***
 - The duty to report falls upon intermediaries and advisors who are resident, have a fixed base, or are registered with a professional organization (e.g., bar association) in the EU. If none, the duty to report falls directly upon the taxpayer (even if resident or based outside of the EU). It's crucial that there is a coordinated effort across the business to make sure compliance takes place and that there are no open and unchecked assumptions about who has responsibility for what.
- ***Only big transactions need to be reported:***
 - It's not the size of the transaction that determines whether it should be reported. Reportability is based on meeting the DAC6 hallmarks for reportability. Even routine transactions like purchasing an asset can meet reportability criteria, so it's essential that taxpayers and intermediaries understand all the nuances of the DAC6 regulations Sixth amendment of the original Council Directive 2011/16/EU on Administrative Cooperation.
- ***The main tax benefit (when relevant) must be within an EU country:*** a non-EU cross border transaction that generates a tax benefit (whether this may be) in a non-EU country may be reportable

DAC6: Dangerous Misconceptions

- *DAC6 doesn't follow the path of typical reporting, where you explain what's already happened:* DAC6 requires transactions to be reported as they're unfolding (reporting is due when the cross-border arrangement is made available, is ready for implementation, or the first step towards its implementation has been taken).

DAC6: Relevant Dates and Deadlines

- **Entry into force and initial application dates:**
 - Entry into force date: June 25, 2018.
 - Original application date: July 1, 2020.
 - Postponed application date: January 1, 2021.
 - Retroactive to cross-border arrangements dating back to original entry into force date (06/25/2018).
- **Deadlines:**
 - August 1, 2020 (now February 1, 2021), for cross border arrangements falling within the period June 25, 2018-July 1, 2020 (now January 1, 2021).
 - General deadline: within 30 days beginning on one of the days below, whichever occurs first:
 - the day after the reportable cross-border arrangement (“RCBA”) is made available for implementation;
 - the day after the RCBA is ready for implementation;
 - the first step in the implementation of the RCBA has been made.
 - Within one month of the end of the quarter (October 31, 2020 now April 30, 2021): automatic exchange of information among tax authorities throughout the EU.

Comments

- **The clock starts running the day following the day on which:**
 - Cross-border arrangement is made available for implementation;
 - Cross-border arrangement is ready for implementation;
 - The first step in the implementation of the cross-border arrangement has been made.
- **A cross-border arrangement must be reported as soon as it is finalized and ready to be executed (not after it has been carried out);**
- **A cross-border arrangement must be reported even if it does not go through and is not finalized;**
- **All parties involved must keep themselves informed and be aware of the status and progress of a cross border deal they are involved in, and make sure whether the 30-day reporting time has started running.**

What Transactions Are Reportable

- **“Cross-border arrangement”**: an arrangement concerning either more than one Member State or a Member State and a third country where at least one of the following conditions are met:
 - Not all the participants in the arrangement are tax resident in the same jurisdiction;
 - One or more of the participants in the arrangement is simultaneously resident in more than one jurisdiction;
 - 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 the permanent establishment);
 - One or more of the participants in the arrangement carries on an activity in another jurisdiction without being tax resident or creating a permanent establishment in that jurisdiction;
 - Such arrangement has a possible impact on the automatic exchange of information or the identification of beneficial ownership.
- **“Reportable cross-border arrangement”**:
 - Any cross-border arrangement that contains at least one of the hallmarks set in Annex IV of the Directive.
 - “Hallmark” means a characteristic or feature of a cross-border arrangement that presents an indication of a potential risk of tax avoidance.

Comments

- **Nexus with the EU: the “concerning” standard.**
 - The term ”concerning” is overbroad. Any minimum connection with the EU might be sufficient to trigger the duty to report.
- **The cross-border nature of the arrangement:**
 - Minimum requirement: an “activity” carried out in another jurisdiction, even though it does not arise to the level of a permanent establishment in the host country.
 - Is a physical nexus or presence is required?
 - Is the sale of goods and services to customers, without any physical presence in the host country, sufficient to constitute an “activity” carried out in the other jurisdiction?
 - Is an investment that generate income from a source in the host country an “activity” carried out in another jurisdiction?

Hallmarks

- **Five categories of hallmarks:**

- A. Generic Hallmarks linked to the main benefit test;
- B. Specific Hallmarks linked to the main benefit test;
- C. Specific Hallmarks related to cross-border transactions;
- D. Specific Hallmarks concerning automatic exchange of information and beneficial ownership;
- E. Specific Hallmarks concerning transfer pricing.

Main Benefit Test

- **Main Benefit Test (“MBT”):**
 - the test will be satisfied if it can be established that the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage.
 - Note: tax benefit does need to be the only or the main benefit: a main benefit which is a tax advantage is sufficient.
- **Tax Advantage:** its meaning is not clear, impossible to determine (advantage with respect to what?)
- **Compare it to the PPT of Tax Treaties:** e.g., article 10(10) of Italy-US Tax Treaty: *“The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the shares or other rights in respect of which the dividend is paid to take advantage of this Article by means of that creation or assignment”*.

General Hallmarks Linked to MBT (A)

1. An arrangement where the relevant taxpayer or a participant in the arrangement undertakes to comply with a condition of confidentiality which may require them not to disclose how the arrangement could secure a tax advantage vis-à-vis other intermediaries or the tax authorities.
2. An arrangement where the intermediary is entitled to receive a fee (or interest, remuneration for finance costs and other charges) for the arrangement and that fee is fixed by reference to:
 - (a) the amount of the tax advantage derived from the arrangement; or
 - (b) whether or not a tax advantage is actually derived from the arrangement. This would include an obligation on the intermediary to partially or fully refund the fees where the intended tax advantage derived from the arrangement was not partially or fully achieved.
3. An arrangement that has substantially standardized documentation and/or structure and is available to more than one relevant taxpayer without a need to be substantially customized for implementation.

Comments

- **Confidentiality agreements** are common in cross-border investments and business transactions
- **Substantially standardized documentation** (which does not need to be substantially customized), is common to many cross-border investments.
- The two general hallmarks have the potential to reach a vast number of cross-border arrangements, resulting in overreporting and overwhelming flow of information to tax administrations.
- The ultimate outcome might be substantial non-compliance or significant inefficiency.

Specific Hallmarks Linked to MBT (B)

1. An arrangement whereby a participant in the arrangement takes contrived steps which consist in acquiring a loss-making company, discontinuing the main activity of such company and using its losses in order to reduce its tax liability, including through a transfer of those losses to another jurisdiction or by the acceleration of the use of those losses.
2. An arrangement that has the effect of converting income into capital, gifts or other categories of revenue which are taxed at a lower level or exempt from tax.
3. An arrangement which includes circular transactions resulting in the 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 other similar features.

Comments

- The “conversion of income character” hallmark is extremely broad.
- Example: whenever an individual uses an entity to carry out an investment in real estate, the individual investor converts personal rental income taxable to him personally, into business income taxed at the entity level (and capital gain or dividend income taxed at individual level).
- Does this transaction achieve a tax benefit? What is the comparison or frame of reference to use to determine the MTB test?
- Is this very simple transaction really a reportable cross-border arrangement?

Specific Hallmarks Related to Cross-Border Transactions (C)

1. An arrangement that involves deductible cross-border payments made between two or more associated enterprises where at least one of the following conditions occurs:
 - (a) the recipient is not resident for tax purposes in any tax jurisdiction;
 - (b) although the recipient is resident for tax purposes in a jurisdiction, that jurisdiction either:
 - (i) does not impose any corporate tax or imposes corporate tax at the rate of zero or almost zero; or
 - (ii) is included in a list of third-country jurisdictions which have been assessed by Member States collectively or within the framework of the OECD as being non-cooperative;
 - (c) the payment benefits from a full exemption from tax in the jurisdiction where the recipient is resident for tax purposes;
 - (d) the payment benefits from a preferential tax regime in the jurisdiction where the recipient is resident for tax purposes;
2. Deductions for the same depreciation on the asset are claimed in more than one jurisdiction.
3. Relief from double taxation in respect of the same item of income or capital is claimed in more than one jurisdiction.
4. There is an arrangement that includes transfers of assets and where there is a material difference in the amount being treated as payable in consideration for the assets in those jurisdictions involved.

Specific Hallmarks Concerning Automatic Exchange of Information or Beneficial Ownership (D)

- 1. An arrangement which may have the effect of undermining the reporting obligation under the laws implementing Union legislation or any equivalent agreements on the automatic exchange of Financial Account information, including agreements with third countries, or which takes advantage of the absence of such legislation or agreements. Such arrangements include at least the following:
 - (a) the use of an account, product or investment that is not, or purports not to be, a Financial Account, but has features that are substantially similar to those of a Financial Account;
 - (b) the transfer of Financial Accounts or assets to, or the use of jurisdictions that are not bound by the automatic exchange of Financial Account information with the State of residence of the relevant taxpayer (does this include the USA?);
 - (c) the reclassification of income and capital into products or payments that are not subject to the automatic exchange of Financial Account information;
 - (d) the transfer or conversion of a Financial Institution or a Financial Account or the assets therein into a Financial Institution or a Financial Account or assets not subject to reporting under the automatic exchange of Financial Account information (does this include banks in the USA?);
 - (e) the use of legal entities, arrangements or structures that eliminate or purport to eliminate reporting of one or more Account Holders or Controlling Persons under the automatic exchange of Financial Account information; (f) arrangements that undermine, or exploit weaknesses in, the due diligence procedures used by Financial Institutions to comply with their obligations to report Financial Account information, including the use of jurisdictions with inadequate or weak regimes of enforcement of anti-money-laundering legislation or with weak transparency requirements for legal persons or legal arrangements (is the the USA?).

Specific Hallmarks Concerning Automatic Exchange of Information or Beneficial Ownership (D)

2. An arrangement involving a non-transparent legal or beneficial ownership chain with the use of persons, legal arrangements or structures:
 - (a) that do not carry on a substantive economic activity supported by adequate staff, equipment, assets and premises; and
 - (b) that are incorporated, managed, resident, controlled or established in any jurisdiction other than the jurisdiction of residence of one or more of the beneficial owners of the assets held by such persons, legal arrangements or structures; and
 - (c) where the beneficial owners of such persons, legal arrangements or structures, as defined in Directive (EU) 2015/849, are made unidentifiable.

- What if an Italian resident taxpayer establishes an irrevocable trust, under a foreign trust law, and administered by a foreign trustee, with Italian resident beneficiaries, for legitimate family and succession planning purposes? Most likely, such transaction is reportable.

Specific Hallmarks Concerning Transfer Pricing (E)

- 1. An arrangement which involves the use of unilateral safe-harbour rules.
- 2. An arrangement involving the transfer of hard-to-value intangibles. The term “hard-to-value intangibles” covers intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises:
 - (a) no reliable comparables exist; and
 - (b) at the time the transaction was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain, making it difficult to predict the level of ultimate success of the intangible at the time of the transfer.
- 3. An arrangement involving an intragroup cross-border transfer of functions and/or risks and/or assets, if the projected annual earnings before interest and taxes (EBIT), during the three-year period after the transfer, of the transferor or transferors, are less than 50% of the projected annual EBIT of such transferor or transferors if the transfer had not been made.

Who Is Obligated to Report

- Each Member State shall take the necessary measures to require intermediaries to file information that is within their knowledge, possession or control on reportable cross-border arrangements ...
- **“Intermediary”:**
 - Any person that that designs, markets, organizes or makes available for implementation or manages the implementation of a reportable cross-border arrangement.
 - It also means any person that, having regard to the relevant facts and circumstances and based on available information and the relevant expertise and understanding required to provide such services, knows or could be reasonably expected to know that they have undertaken to provide, directly or by means of other persons, aid, assistance or advice with respect to designing, marketing, organizing, making available for implementation or managing the implementation of a reportable cross-border arrangement. Client’s counsel and tax lawyers are obliged to report.
 - Any person shall have the right to provide evidence that such person did not know and could not reasonably be expected to know that that person was involved in a reportable cross-border arrangement. For this purpose, that person may refer to all relevant facts and circumstances as well as available information and their relevant expertise and understanding.

Who Is Obligated to Report

- **Nexus with the EU:** in order to be an intermediary, a person shall meet at least one of the following additional conditions: (a) be resident for tax purposes in a Member State; (b) have a permanent establishment in a Member State through which the services with respect to the arrangement are provided; (c) be incorporated in, or governed by the laws of, a Member State; (d) be registered with a professional association related to legal, taxation or consultancy services in a Member State (that is me, even though I operate through an office base in the US).
- **Multiple Intermediaries (par. 9):**
 - Each Member State shall take the necessary measures to require that, where there is more than one intermediary, the obligation to file information on the reportable cross-border arrangement lie with all intermediaries involved in the same reportable cross-border arrangement.
 - An intermediary shall be exempt from filing the information only to the extent that it has proof, in accordance with national law, that the same information referred to in paragraph 14 has already been filed by another intermediary.
- **Waiver (par. 5):**
 - Each Member State may take the necessary measures to give intermediaries the right to a waiver from filing information on a reportable cross-border arrangement where the reporting obligation would breach the legal professional privilege under the national law of that Member State.
 - In such circumstances, each Member State shall take the necessary measures to require intermediaries to notify, without delay, any other intermediary or, if there is no such intermediary, the relevant taxpayer of their reporting obligations under paragraph 6.

Who Is Obligated to Report

- **No intermediary or waiver (par. 6):** each Member State shall take the necessary measures to require that, where there is no intermediary or the intermediary notifies the relevant taxpayer or another intermediary of the application of a waiver under paragraph 5, the obligation to file information on a reportable cross-border arrangement lie with the other notified intermediary, or, if there is no such intermediary, with the relevant taxpayer.
- **“Relevant Taxpayer”:**
 - means any person to whom a reportable cross-border arrangement is made available for implementation, or who is ready to implement a reportable cross-border arrangement or has implemented the first step of such an arrangement.
 - Each Member State may take the necessary measures to require that each relevant taxpayer file information about their use of the arrangement to the tax administration in each of the years for which they use it.
- **Multiples relevant taxpayers (par. 10):** Each Member State shall take the necessary measures to require that, where the reporting obligation lies with the relevant taxpayer and where there is more than one relevant taxpayer, the relevant taxpayer that is to file information in accordance with paragraph 6 be the one that features first in the list below: (a) the relevant taxpayer that agreed the reportable cross-border arrangement with the intermediary; (b) the relevant taxpayer that manages the implementation of the arrangement.
- Any relevant taxpayer shall only be exempt from filing the information to the extent that it has proof, in accordance with national law, that the same information referred to in paragraph 14 has already been filed by another relevant taxpayer.

Comments

- Tax lawyers, corporate lawyers, contract lawyers, non-legal consultants who (know or could be reasonably expected to know that they have undertaken to) advise a client on a reportable cross-border arrangements are “intermediaries” obliged to report, to the extent that they have their residence or permanent establishment in an EU Member State or are licensed as lawyers, accountants or consultants with a professional body in an EU Member State.
- If exempt through a waiver, the duty to report shifts to the taxpayer.

Where Reporting Is Made

- By intermediary (par. 3): filing is done in the Member State that features first in the list below:
 - (a) the Member State where the intermediary is resident for tax purposes;
 - (b) the Member State where the intermediary has a permanent establishment through which the services with respect to the arrangement are provided;
 - (c) the Member State which the intermediary is incorporated in or governed by the laws of;
 - (d) the Member State where the intermediary is registered with a professional association related to legal, taxation or consultancy services.
- Where, pursuant to paragraph 3, there is a multiple reporting obligation, the intermediary shall be exempt from filing the information if it has proof, in accordance with national law, that the same information has been filed in another Member State.

Where Reporting Is Made

- By relevant taxpayer (par. 7):
- Where the relevant taxpayer has an obligation to file information on the reportable cross-border arrangement with the competent authorities of more than one Member State, such information shall be filed only with the competent authorities of the Member State that features first in the list below:
- (a) the Member State where the relevant taxpayer is resident for tax purposes;
- (b) the Member State where the relevant taxpayer has a permanent establishment benefiting from the arrangement;
- (c) the Member State where the relevant taxpayer receives income or generates profits, although the relevant taxpayer is not resident for tax purposes and has no permanent establishment in any Member State;
- (d) the Member State where the relevant taxpayer carries on an activity, although the relevant taxpayer is not resident for tax purposes and has no permanent establishment in any Member State.
- Any relevant taxpayer shall only be exempt from filing the information to the extent that it has proof, in accordance with national law, that the same information referred to in paragraph 14 has already been filed by another relevant taxpayer.

What Is Reported

- (par. 14): the information to be communicated by the competent authority of a Member State under paragraph 13 shall contain the following, as applicable:
 - (a) the identification of intermediaries and relevant taxpayers, including their name, date and place of birth (in the case of an individual), residence for tax purposes, TIN and, where appropriate, the persons that are associated enterprises to the relevant taxpayer;
 - (b) details of the hallmarks set out in Annex IV that make the cross-border arrangement reportable;
 - (c) a summary of the content of the reportable cross-border arrangement, including a reference to the name by which it is commonly known, if any, and a description in abstract terms of the relevant business activities or arrangements, without leading to the disclosure of a commercial, industrial or professional secret or of a commercial process, or of information the disclosure of which would be contrary to public policy;
 - (d) the date on which the first step in implementing the reportable cross-border arrangement has been made or will be made;
 - (e) details of the national provisions that form the basis of the reportable cross-border arrangement;
 - (f) the value of the reportable cross-border arrangement;
 - (g) the identification of the Member State of the relevant taxpayer(s) and any other Member States which are likely to be concerned by the reportable cross-border arrangement;
 - (h) the identification of any other person in a Member State likely to be affected by the reportable cross-border arrangement, indicating to which Member States such person is linked.

What Is Reported

- “*Marketable agreements*”: a cross-border arrangement that is designed, marketed, ready for implementation or made available for implementation without a need to be substantially customized.
- (par. 2): In the case of marketable arrangements, Member States shall take the necessary measures to require that a periodic report be made by the intermediary every 3 months providing an update which contains new reportable information as referred to in points (a), (d), (g) and (h) of paragraph 14 that has become available since the last report was filed.

Comments

- The extent of information to be included in the report to be filed with the tax administration is extremely vast.
- More precisely, it requires a description of the applicable “hallmark”, meaning, a description of the strategy used to potentially achieve an MTB for the taxpayer (which in turn requires to assume the perspective and point of view of the tax administration).
- Is this tantamount to requiring the confession of “wrongdoing”?

Penalties

- *Failure-to-report monetary penalty (in Italy, euro 3,000-31,500).*
- *Insufficient or incorrect reporting monetary penalty (in Italy), euro 1,000-10,500).*
- *Non-monetary penalties:*
 - *Removal from office of director, officer or auditor of a company or entity in case of multiple violations?*
 - *Professional sanctions?*
- Potential professional sanctions, if enforced, might be a strong incentive to report,

Final Observations

- DAC6 is very far reaching and wide in scope, cumbersome, and challenging.
- DAC6 will affect directly the practice of consultants, legal advisors and tax counsel, and the way in which they advise their clients, on cross-border transactions, in and outside of the EU.
- DAC6 will generate inefficiencies, require costly compliance, put more pressure on taxpayers, tax administration and international tax practitioners, and create potential obstacles to free flow of business and investments on a global basis, to the detriment of global growth.
- At the same time, DAC6 will put a reward to sound and smart international tax planning and advice, by exposing harmful tax evasion or abusive tax avoidance practices, and the smartest and brightest will emerge victorious one more time.