However, as was made clear in *Credit Suisse*, should HMRC wish to shift the discussion from informal enquiries to a formal enquiry, they must go further. This is consistent with the emphasis given by David Richards LJ in *Raftopoulou* (para 34) to the point that it must be *clear* from the notice that HMRC intends to enquire into the claim. (It's a little unfortunate that the court in *Raftopoulou* referred to both the formal and informal processes as 'enquiries' but this doesn't change the substance of the decision.) Judge Brannan confirmed in *Credit Suisse* that it therefore follows 'that a notice of the intention to enquire into a return cannot be regarded as validly given to a taxpayer by inference or implication'. Rather, the reasonable taxpayer with the subjective knowledge of the taxpayer in question needs to understand clearly, and not be left guessing, that HMRC is giving notice of enquiry at a particular point in time because of the important consequences flowing from a shift to a formal enquiry.

Given the important consequences that flow from such a shift, the best method for HMRC to adopt to ensure there is no ambiguity or misunderstanding is to expressly state to the taxpayer that HMRC is opening, or intends to open, an enquiry into a taxpayer's return, and (even if just for evidential purposes) to record that statement in writing. For the same reason, the importance of contemporaneous record-keeping by taxpayers should be self-evident. In that regard, reserving the position on a procedural point does not prevent continuing a constructive and open dialogue with HMRC; it simply preserves the balance of powers prescribed by Parliament. In our experience, taxpayers should reserve the position expressly on procedural points as soon as they are identified (even while continuing the substantive debate), rather than only challenging the procedural position in a tribunal appeal, so as to mitigate the risk of an estoppel challenge to the (potentially determinative) procedural arguments from HMRC.

Conclusion

Credit Suisse confirms that an important distinction exists between 'informal enquiries' made by HMRC into self-assessed returns (or indeed ongoing transactions or arrangements) and those which are 'formal enquiries'. In both scenarios, it is possible to have 'intermediate and possibly time-consuming scrutiny' of taxpayers' returns (per *Langham* at para 32); however, it is incumbent on HMRC to make clear if it intends to shift the discussion from informal enquiries to a formal enquiry. In order for HMRC to do so, it must actually give notice of its intention to enquire to the taxpayer. *Raftopoulou* confirms (and *Credit Suisse* applies) the objective, legal test that must be met in order for notice of enquiry to be effective: the notice must be understood by a reasonable person in the position of the intended recipient (usually, the taxpayer), having that person's knowledge of any relevant context, as giving notice of an intention to enquire into the return. If it doesn't, the balance of power established by Parliament prevents HMRC imposing any additional tax liabilities. ■

The authors' firm acted for the taxpayer in this case.

For related reading visit www.taxjournal.com

- Cases: *Credit Suisse Securities (Europe) Ltd and others v HMRC* (3.3.20)
- How to handle tax appeals (Adam Craggs & Constantine Christofi, 25.2.20)

Analysis

Local variations in DAC 6 implementation

Speed read

The local implementation of the EU's 'DAC 6' Directive by EU member states differs in several key aspects, including: the operation of legal and professional privilege; the application of the tax main benefit test; inclusion of domestic transactions and additional taxes in scope; and the level and type of penalties awarded. These differences are compounded by differing interpretations of the basic DAC 6 provisions between member states. Taxpayers and intermediaries alike therefore need to be aware of how these differences will practically impact the disclosure report and how they meet their DAC 6 reporting requirements.

EU member states were required to implement EU Directive 2018/822 (DAC 6, also referred to herein as 'the Directive') by 31 December 2019. The Directive is EU wide but the implementation of the Directive into local laws is left to each member state. The Directive is a minimum standard, with member states permitted to add additional elements into local laws. Furthermore, local tax authorities may interpret key definitions differently. We expand on some of these

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differences throughout the remainder of this article, although please note that in many cases we do not yet have final law or guidance and hence this is subject to further change.

By way of reminder, under DAC6, 'intermediaries' and in some instances, taxpayers are required to report on cross-border transactions possessing one or more 'hallmarks.' We are now within a transitional period where transactions occurring from 25 June 2018 need to be reported to the relevant tax authority/authorities by 31 August 2020. The Directive comes in force on 1 July 2020 across the EU and in the UK and any transactions occurring from this date have a 30-day window in which they need to be reported. The disclosures will then be shared between the tax authorities of member states on a quarterly basis.

Where are the territories in their implementation of DAC 6?

The UK's implementing regulations – the International Tax Enforcement (Disclosable Arrangements) Regulations, SI 2020/25 – were laid before Parliament in January.

Other territories are at various stages of implementation; some have released final legislation, while others did not meet the 31 December deadline.

The European Commission has recently issued letters of formal notice requesting further information on the implementation of DAC 6 to the following territories: Belgium, Cyprus, Czech Republic, Estonia, France, Greece, Italy, Latvia, Luxembourg, Portugal, Poland, Romania, Spain, Sweden and the UK. (We assume the UK's letter relates to the slightly late enactment of the regulations.) Those counties must now respond to the letters. If the Commission does not accept that response, it will set out its reasoning and give the territory concerned two months to comply.

Key differences in implementation

There are some significant differences in how the different territories have implemented, or intend to implement, DAC 6. These concern:

- the interpretation and operation of key terms (for example, the 'main benefit test' and operation of legal professional privilege/professional secrecy);
- the taxes and hallmarks in scope, and the application of the rules to domestic transactions; and
- administrative aspects (namely, reporting requirements and level and type of penalties imposed for non-compliance).

Differences in the local implementation of DAC 6 lead to significant implications for both taxpayers and intermediaries alike. This includes, but is not limited to, who is the reporting party, whether it is sufficient to report in one territory alone, and whether the local tax administrations involved may agree with the application of the tax main benefit test to any particular case.

One very significant difference in approach, which we do not consider further below as it is a one-off outlier, relates to Poland. Whereas all other territories have accepted that they should only seek to apply their rules to intermediaries and taxpayers with material nexus with their territory, Poland has enacted its rules to have extra-territorial effect. Accordingly, the Polish obligations potentially apply to persons anywhere around the world, not only within the EU.

Tax main benefit test: key observations

- **UK:** There will be no 'tax advantage' if the consequences of the arrangement are in line with the principles and policy objectives of the legislation the arrangement relies on. In the July draft regulations, HMRC referred to worldwide taxes being in scope of this consideration, however, in the final regulations this has been limited to EU taxes and also only to taxes within the scope of the DAC.
- **Germany:** The tax main benefit test will not be satisfied if the tax advantage is not a significant advantage of the arrangement, i.e. the tax advantage fades into the background when viewed against the arrangement as a whole. Additionally, a tax advantage will not be considered to arise where the arrangement only has an effect domestically and if it is legally provided for in German domestic law.
- **Netherlands:** The latest guidance from the Dutch Tax Authority aligns the interpretation of 'tax advantage' with the UK position, therefore tax advantages intended by the Dutch Tax Authority are unlikely to be caught within these rules. It is worthwhile noting that in the Netherlands, tax advantages realised in non-EU member states are in scope of the tax main benefit test.
- **Poland:** The Polish main benefit test has three-prongs:
  - the tax arrangement results in a tax benefit;
  - the tax benefit is the main or one of the main benefits of the arrangement; and
  - there was no alternative course of action which a person, acting reasonably and driven by legitimate non-tax reasons, could sensibly have chosen that would not result in achieving the tax benefit.

  Note that 'tax advantage' only relates to Polish taxes, and it is understood broadly as any reduction in tax liability or postponement in its creation.
- **Spain:** The Spanish draft legislation clarifies that 'tax advantage' means a reduction in the taxable base or tax due, including a deferral of the tax due, as well as generating net operating losses.
- **Ireland:** 'Tax advantage' is defined as relief, reduction, avoidance or deferral of charge to tax, a refund or repayment of tax and the avoidance of any obligation to deduct or account for tax.

Legal professional privilege

Across Europe, there are many different forms of legal professional privilege (LPP) and similar rights to professional secrecy, which differ significantly in source, scope and effect. The Directive permits that a territory may permit intermediaries a waiver from disclosing should such a disclosure breach such obligations. This variation in domestic law and latitude in enacting the Directive leads to a significant variety in outcome.

- **Austria:** Where LPP applies and the reporting obligation is shifted from the intermediary to the taxpayer, the taxpayer can waive the intermediary's confidentiality obligation to shift the reporting obligation back to the intermediary.
- **Estonia:** LPP applies to law firms and a taxpayer's auditors.
- **Germany:** Germany has implemented a two-stage process to accommodate professional secrecy. Namely, the intermediary discloses non-confidential information and then the taxpayer must disclose the confidential information.
- **Italy:** LPP applies to law firms. Advisers and taxpayers are exempt from their reporting obligation where reporting could give rise to 'self-incrimination'.
- **Luxembourg:** LPP is expected to apply to law firms registered with the Luxembourg Bar, although at the date of writing, there are rumours that this could be extended to other professions. Intermediaries falling under the reporting exemption are still required to inform other

intermediaries or relevant taxpayers of their obligations to report within a determined deadline.

- **Portugal:** There are no exemptions for reporting under LPP.
- **Slovakia:** LPP applies to law firms, tax advisers, auditors and banks.
- **Slovenia:** LPP applies to law firms. Intermediaries falling under this reporting exemption must immediately inform another intermediary if applicable otherwise the taxpayer, of the reporting duty. If the intermediary fails to inform another responsible person, they cannot utilise the waiver.
- **Spain:** LPP applies to law firms; however, taxpayers can elect for intermediaries to renounce privilege and thereby maintain their reporting obligation.
- **UK:** The release of the draft July regulations and consultation document caused much uncertainty regarding the operation of LPP, with many lawyers questioning how LPP would not be breached under the rules, as drafted. In the original consultation, HMRC accepted that intermediaries who can rely on LPP do not need to disclose, but only to the extent that the information is privileged. The legal profession made it clear it viewed this as undermining LPP. HMRC has since acknowledged these points and adjusted the rules accordingly, and it has indicated that it intends to work with representatives from the legal sector to provide further guidance setting out what is considered privileged in this context.

The different interpretations of DAC 6 by EU tax authorities have created unintentional 'bear traps' for intermediaries and taxpayers

The taxes in scope

Under the Directive, most indirect taxes are excluded from the scope of reporting. In some territories, such as Poland and Portugal, the local disclosure rules cover a wider range of taxes than required by the Directive, such as VAT and excise and customs duties.

Application of rules to domestic transactions

The disclosure requirements under DAC 6 apply only to cross-border transactions. Some territories – namely Poland, Portugal, Germany and Sweden have to date expanded this requirement to include the reporting of domestic transactions. Obviously, the UK has operated its DOTAS regime covering domestic and international transactions for many years.

Penalties for non-compliance

The level of penalties ranges significantly between territories from €1,200 to c.€4.8m (the highest being in Poland).

In Germany, Estonia and Poland, the local tax authorities may apply penalties to individuals in addition to legal entities. However typically more significant penalties are reserved for cases where there is intentional non-compliance. Additionally, for Poland, the sanctions are criminal in nature.

The UK's penalty regime set out in the final regulations differs from those in the earlier draft regulations. The default position is that there will be a one-off penalty of up to £5,000, with scope for reduction where there are mitigating factors. Daily penalties of up to £600 will only apply in more serious cases and will be subject to the determination of the First-tier Tribunal. The tribunal can increase any daily penalties up to £1m if the penalty would otherwise be 'inappropriately low.'

Additional or extended hallmarks

Under DAC 6, cross-border transactions possessing one or more of the hallmarks will be reportable to the relevant tax authority(ies). In Poland and Portugal, additional and extended hallmarks have been included in local rules.

In Poland, the additional four hallmarks have no tax main benefit test override, and they can apply mechanically to purely commercial cross-border payments out of Poland of c.€5m or more. Therefore, any arrangements involving Poland should be considered carefully not only due to the wide and mechanical application of hallmarks, the significant penalties and their extra-territorial effect, but also given the rules came into force from 1 January 2019.

Administrative reporting requirements

A practical consideration worth noting is that certain tax administrations, such as Poland, require additional information to be reported above and beyond the requirements under DAC 6 when an arrangement is actually disclosable. If a transaction occurs between Poland and the UK which met one of the hallmarks, it would not be sufficient to report this only in the UK, as the Polish rules require additional disclosures to be made.

Even where territories require the disclosure of similar data, intermediaries will, in practice, often not be able to rely on another's disclosures, because of as differences in the knowledge of an arrangement, LPP limiting disclosures and differences in timing of disclosure obligations.

In Belgium, UK and Luxembourg, taxpayers are required to refer to any reportable arrangements in their income tax returns.

Final thoughts

The different interpretations of DAC 6 by EU tax authorities have created unintentional 'bear traps' for intermediaries and taxpayers. Arrangements should be assessed on a cross-territorial basis, as the discrepancies in implementation could create unidentified reporting obligations. Each jurisdiction involved in a transaction should therefore be considered and consulted where appropriate.

Relevant tax authority administrative guidance in several territories will probably only be issued close to, or even after, 1 July 2020, which means that some grey areas will remain outstanding until then.

Clients should have an awareness of the local implementation of DAC 6 in all territories in which they have operations or intend to in the future.

Advisers should consider the transitional period and assess whether there are any reporting obligations, in good time, as there may be a significant number of assessments for some industries.

Finally, advisers should ensure that clients understand the penalty exposure both on organisations and, in some cases individuals, for non-compliance with the new disclosure requirements. ■

For related reading visit www.taxjournal.com

- The UK DAC 6 regulations: the good, the bad and the unknown (Brin Rajathurai, 5.2.20)
- The new EU tax disclosure rules: practical challenges (Brin Rajathurai & Helen Gunson, 28.6.18)
- The EU reportable arrangement rules for intermediaries (Geoff Hippert, 3.5.18)