Analysis

The new EU tax disclosure rules: practical challenges

Speed read

The recently published EU 'DAC 6' directive imposes obligations on intermediaries and, in some cases, taxpayers to disclose cross-border arrangements with particular characteristics to the tax authorities. The new rules raise numerous practical challenges; in particular, their potential application to entities that might have thought they could safely ignore these rules on the basis that they are not engaged in any 'aggressive tax planning'. Another significant concern is that although the first notifications are not due until August 2020, it is likely (depending on domestic implementation) that they will have to cover the period from 25 June 2018 onwards. Taxpayers and intermediaries therefore have to consider now how they will track relevant arrangements to enable them to file these notifications. This may prove challenging in the absence of national implementing legislation.

Brin Rajathurai
Freshfields Bruckhaus Deringer
Brin Rajathurai is a knowledge lawyer at Freshfields Bruckhaus Deringer covering all aspects of corporate taxation, with a particular focus on the tax aspects of domestic and international finance transactions. Email: brin.rajathurai@freshfields.com; tel: 020 7785 2161.

Helen Gunson
Freshfields Bruckhaus Deringer
Helen Gunson is a senior associate in the tax department. She advises both corporate groups and financial institutions on the tax aspects of a wide range of transactions. These include private and public M&A, joint ventures, restructurings, tax structured finance, debt issuances and tax disputes. Email: helen.gunson@freshfields.com; tel: 020 7427 3794.

The new rules in a nutshell

The new directive (2018/882/EU) amends the 2011 Directive on Administrative Cooperation (2011/16/EU) and is commonly referred to as 'DAC 6'. Inspired by Action 12 of the OECD's base erosion and profit shifting (BEPS) project and, to some extent, the UK's disclosure rules (DOTAS), the directive provides for the mandatory disclosure of information on 'potentially aggressive tax planning arrangements' by intermediaries; or, if there is no intermediary or the intermediary is protected by privilege, the disclosure obligation falls to the taxpayer.

The rules only apply to 'cross-border arrangements' which affect two member states or a member state and a third country. A cross-border arrangement is to be disclosed if it meets at least one of the 'hallmarks' set out in the directive. These hallmarks are intended to represent typical elements of potentially aggressive tax planning but, as highlighted below, there may be commercial transactions with no tax benefit that still fall within a hallmark.

What are the practical issues?

The definition of 'intermediary' is wider than you might think

'Intermediaries' is very broadly drafted. It is defined as any person that 'designs, markets, organises, manages or makes available for implementation a cross-border arrangement' and, in addition, any person that knows or could be reasonably expected to know that they have provided, directly or indirectly, 'aid, assistance or advice' in relation to a reportable cross-border arrangement.

The UK's DOTAS rules have some important exemptions that apply to group companies and employees, preventing most in-house advisers from being treated as promoters (the UK's equivalent to the intermediary concept). The EU rules have no equivalent to these, which means that an in-house legal team that advises a group company on a cross-border arrangement could be an 'intermediary' for these purposes. Furthermore, there is no need to have an intermediary at all to have a disclosure obligation under the directive. Taxpayers may find they have to grapple with these rules themselves.

Many commercial transactions with no tax motivation may have to be tracked and disclosed

The rules are intentionally very broad and will require disclosure of a wide range of arrangements; some of these may involve tax schemes, while others may have no tax motivation at all.

Many of the 'hallmarks' only apply where one of the main benefits of the arrangement is the avoidance of tax. In the UK, this 'main benefit' test is seen as quite a low bar, but guidance acknowledges that some products which carry a tax benefit may be entered into for commercial reasons. Examples are quoted eurobonds or discounted notes which, although having a tax benefit, are not treated as disclosable unless they form part of some wider tax scheme. In the absence of similar guidance, it is unclear whether such products will have to be disclosed under the EU rules or, alternatively, whether the 'main benefit' test will be seen as a higher hurdle under these rules.

Other hallmarks apply where certain features are present, regardless of whether one of the main benefits is the avoidance of tax. Examples include the hallmarks relating to the intra-group cross-border transfer of functions, risks or assets; and intra-group transfers of hard-to-value intangibles. An intra-group restructuring involving the transfer of such items may be disclosable where there is no beneficial tax effect, let alone tax motive. As such, the rules may well capture Brexit planning.

There is no de minimis

The rules appear to apply regardless of the amounts involved (although this may be dealt with when the rules are transposed into domestic law). For example, given the UK's inclusion plus credit regime for permanent establishments, the hallmark requiring disclosure where there is depreciation on an asset in more than one jurisdiction could potentially require a UK bank to disclose every time a non-UK branch buys a computer.

The rules have retroactive effect

One of the most concerning aspects of the new rules is the requirement to report on transactions implemented from 25 June 2018, while domestic legislation has yet to be implemented setting out the precise scope of the requirements and/or any safe harbours that might apply to reduce the compliance burden. As a practical matter, given the potential breadth of the rules, putting systems in place to track relevant arrangements will be challenging. It is also worth noting that some jurisdictions, such as Germany and Spain, may regard the retroactive aspect as unconstitutional. France has previously attempted to introduce a mandatory disclosure obligation comparable to the one proposed by the Directive, which was found by the French courts to be unconstitutional as it infringed the freedom of enterprise of tax advisers. The exception for privilege under the directive may mean that this particular issue does not arise here, but it remains to be seen whether the retroactive aspect of the rules will be subject to challenge in the national courts.

Privilege may not remove the disclosure obligation

Member states do have the right to waive the reporting obligation where this would breach legal professional privilege under national law. However, it is unclear exactly how member states will implement this waiver and in certain jurisdictions privilege is interpreted narrowly so may not assist. In any case, even where privilege does apply, the obligation falls back onto the taxpayer so the arrangements will still have to be disclosed, albeit by the taxpayer rather than the intermediary.

How will this apply to professional partnerships?

There is a pecking order for where intermediaries will have to file information, and they only have to file in the member state that features first in the list. If an intermediary is resident in a member state, then it has to file there. If not, it has to file in the member state where it has a permanent establishment; if none, the member state where it is incorporated; and finally the member state where it is registered with a professional association.

How will this apply to tax transparent partnerships where the concept of residence is not relevant? It is hoped that agreement can be reached on an EU or a national level that, notwithstanding the pecking order above, the disclosure can be made to the member state where the partnership is registered, rather than having to conclude that there are multiple permanent establishments, each of which might be subject to different domestic rules on privilege or be in jurisdictions which take different views on the constitutionality of the retroactive aspect of the rules.

What is the effect of making a disclosure?

US companies may observe similarities to the US tax shelter reporting rules, which subject taxpayers and material advisors to a highly onerous compliance regime, including significant penalties that are payable for participating in a transaction involving tax strategies or positions with certain specifically identified features. There is no suggestion that there will be penalties for entering into arrangements that are disclosed under the EU rules; however, the EU (or any of the individual member states) may adopt the UK's approach in using disclosures as an indicator of recalcitrant behaviour. For instance, in the UK, entities that have made a disclosure under DOTAS can be prevented from bidding for (entirely unrelated) government contracts if their tax return has been found to be incorrect as a result of the failure of the disclosed arrangement.

Will the UK, which is expected to implement these rules notwithstanding Brexit, extend the DOTAS regime and all its penal consequences to all matters that are disclosable under the directive? It is unclear at this stage whether the UK's safe harbours and main benefit tests would cease to apply to situations where these are not included in the directive. Could EU or other national bodies include similar conditions as part of their procurement processes? Given the width of the hallmarks, some of which do not require any tax motivation, it would seem draconian for disclosure under these rules to carry such consequences, but nevertheless this cannot yet be ruled out as a possibility.

What will happen to other domestic proposals?

The EU rules will not be operating in a vacuum. How will they interact with other proposals currently being discussed in different jurisdictions? For example, the French government has recently proposed a bill to Parliament aimed at strengthening the fight against tax fraud. This proposes the introduction of specific sanctions applicable to tax advisers or intermediaries who intentionally provide services to a taxpayer leading the latter to commit tax fraud. This provision is still being debated before Parliament, but if adopted, the sanction would take the form of a fine amounting to €10,000, or 50% of the fees received from the taxpayer, if higher.

In Germany, two German federal states have proposed German domestic disclosure rules in addition to the directive. The draft German rules are not limited to domestic arrangements and may, therefore, apply to any cross-border arrangement not covered by the directive. If the German rules are enacted in their current draft form, this could potentially require a two-step approach for cross-border arrangements, considering first the EU disclosure obligations and then the (broader) domestic German rules.

How did we get here?

The directive is further evidence that we are in an era of heavy regulation of corporate tax at an EU level, and with huge political support for such regulation. The directive took just eight months to be enacted. Previously, that would have been unheard of: historically, it has taken years to get full unanimity for direct tax directives, some of which have been blocked indefinitely. Even jurisdictions that are traditionally opposed to these kinds of measures did not use their veto, given that member states cannot be seen to be against such measures in the current political climate. Similar issues seem to have prevented taxpayers and intermediaries from being able to publicly oppose the measure, other than some (mostly futile) attempts to resolve some of the practical issues with the new rules.

What now?

Taxpayers and potential intermediaries should be considering now what systems they need to put in place to track relevant arrangements to enable them to comply with these new rules. We would also recommend getting in touch with key advisers to make sure there is an understanding of the approach that advisers are planning to take to disclosing their clients' affairs. ■

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- The EU reportable arrangement rules for intermediaries (Geoff Hippert, 3.5.18)
- News: Council approves new EU reporting rules for tax planning intermediaries (14.3.18)
- DOTAS: when do the rules apply? (2.2.17)