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The DAC6 Intermediary: multiplying compliance-costs and creating loopholes

Martijn Weijers (Pelinck Nijssen Weijers) · Wednesday, November 20th, 2019

In June 2017, the European Commission published its proposal on transparency rules for tax planning by intermediaries and certain taxpayers (the Commission proposal). The Commission proposal was amended multiple times, before it was formally adopted as Directive 2018/822 (DAC6) on 25 May 2018. DAC6 requires Member States to put in place, by 31 December 2019, a mandatory disclosure regime for reportable cross-border arrangements and exchange the collected information amongst other Member States. In most cases, this regime will apply from 1 July 2020. It aims to provide the Member States with information on potentially aggressive tax practices at an early stage and enable them to react promptly against harmful tax practices by closing loopholes, undertaking adequate risk assessments, carrying out tax audits and scaring off such tax practices. The scope of DAC6, however, is considered to be extremely broad. Especially with regards to the hallmarks and intermediary definition. This blog focusses on the intermediary definition.

The intermediary

Under DAC6, the primary disclosure requirement lies with the intermediary, being any person with EU-nexus that 'designs, markets, organises or makes available for implementation or manages the implementation of a reportable cross-border arrangement' or '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 such activities. This includes, but is not limited to, tax advisors, lawyers, trust officers, consultants, and bankers. Except where national legislation gives the right to a waiver from filing information because of legal professional privilege (LPP waiver), *all* of those intermediaries are required to file information that is within their knowledge, possession or control to the tax authorities. In case of identical disclosures an exemption may be claimed if an intermediary has proof that the same information was already filed by another intermediary. Only where no (reporting) intermediary is involved, the disclosure requirement is shifted to the Relevant Taxpayer.

The intermediary definition differs from the one adopted in the Commission proposal. In short, in that proposal the intermediary was considered 'any person that carries the responsibility vis-a?-vis the taxpayer for designing, marketing, organising or managing the implementation of the tax aspects of a reportable cross-border arrangement, or series of such arrangements, in the course of providing services relating to taxation' and any such person that undertakes to provide 'material aid, assistance or advice with respect to designing, marketing, organising or managing the tax aspects of a reportable cross-border arrangement.' It thus focused on persons performing activities relating to the tax aspects of a reportable cross-border arrangement. This limitation was in line with the recommended Intermediary definition in the BEPS Action 12 Report (p. 35). In addition, where more than one intermediary was involved, only the intermediary carrying the responsibility vis-a?-vis the taxpayer for designing and implementing the arrangement (the promotor) was required to file the information. Such line of priority limits the disclosure obligation for the same arrangement to the person most likely to have all the relevant information readily available. For this reason, compliance costs for intermediaries were considered to be limited (Explanatory Memorandum to the Commission proposal dated 21 June 2017, p. 10). Where the intermediaries were located outside of the EU or the promotor was able to claim an LPP waiver the reporting obligation would shift to the Relevant Taxpayer.

Multiplying compliance costs…

When comparing DAC6 and the Commission proposal, it is clear that the personal scope of DAC6 is much broader: it also captures persons performing supporting activities and/or that have no relation to the tax aspects of the arrangement. Other than fear that the disclosure rules might otherwise be circumvented, there is not much to say for such a radical change in scope. When combining the fact that DAC6 puts the disclosure obligation on all of these persons simultaneously, compliance costs multiplied when compared to the Commission proposal; not only for the intermediaries, but also for the authorities who will have to deal with a much larger number of disclosures. In addition, the large number of expected disclosures – even when taking into account the possibility of big data – may also pose a serious threat to the effectiveness of DAC6.

…unintended consequences…

Apart from the risk of over-disclosure, the broad personal scope of DAC6 also, somewhat paradoxically, creates the risk of relevant information being left undisclosed. This may be illustrated by the following example:

US promotor A designs and implements a cross-border arrangement for German Taxpayer X. The arrangement concerns the purchase and sale of a hard-to-value intangible between X and associated enterprise Y while the purchase price remains outstanding. The interest on the outstanding amount is deductible in Germany but remains untaxed because Y is not resident for tax purposes in any tax jurisdiction. The only other person involved in the implementation of the Arrangement is German consultant B, who is in charge of the valuation of the intangible.

This cross-border arrangement is reportable under Hallmark E(2) and C(1)(a). The tax authorities will be interested in both the transfer of the intangible and the existence of a mismatch in the interest payment between X and Y. Promotor A has all relevant information in his possession but is located outside of the EU and thus not considered an Intermediary under DAC6. Consultant B is not a promotor but qualifies as Intermediary if he knows or could be reasonably expected to know that he has undertaken to provide advice with respect to the implementation of a reportable cross-border arrangement. Consultant B is aware that he is advising on the transfer of a hard-to-value intangible between associated enterprises X and Y, which triggers Hallmark E(2). He is therefore considered an intermediary and has to provide the information within his knowledge, possession or control. Because he has no knowledge of the tax aspects of the transaction, that information will most likely be limited to the identification of A, X and Y and some information on Hallmark E(2). German Taxpayer X is not required to disclose any (additional) information because a reporting Intermediary is involved (Consultant B). As a result, the relevant information on Hallmark C(1)(a) goes unreported. Taking into account the large number of expected (and more detailed) disclosures in other cases, the chances of the tax authorities carrying out a tax audit based on this disclosure may be considered small.

I must note that one could, however, argue that the sale and purchase on the one hand, and the fact that the purchase price is left outstanding on the other are considered different arrangements. That would shift the reporting requirement for Hallmark C(1)(a) to German Taxpayer X. Article 3(18), however, explicitly provides that an arrangement also includes a series of arrangements and may comprise more than one step or part. In addition, article 3(19) defines a reportable cross-border arrangement as any cross-border arrangement that contains *at least* one of the hallmarks.

… and creating a loophole

The effect of under-disclosure may also be engineered to intentionally undermine the DAC6, not only by having persons without EU-Nexus design and implement a reportable cross-Border arrangement and involve an EU intermediary with little knowledge on the tax aspects, but also by having the scheme designed and implemented by a person who can rely on an LPP-waiver and involving an EU intermediary with little knowledge on the tax aspects. As observed: one single qualifying intermediary, however ignorant of the tax aspects of the arrangement, is enough to prevent the reporting obligation from shifting to the taxpayer. Apparently, these loopholes were not spotted during the legislative process of DAC6. Recently, however, the Dutch legislator adopted a motion to take up this matter with the European Commission (13 November 2019, 35.302, nr. 46).

Conclusion

It goes without saying that under- and over-disclosure undermine the effectiveness of DAC6. The personal scope of DAC6 should therefore be limited to the persons who most likely have the (tax) information sought. One way to do so, is by limiting the (nature of the) Intermediary activities to those involving the tax aspects of a Reportable Cross-Border Arrangement. That would also lower the compliance costs for a large number of professionals who only have limited (to none) relevant information. In addition, the number of disclosures may be reduced by creating a line of priority. Both limitations were included in the Commission proposal but were deleted during the legislative process. In order to prevent circumvention, the disclosure obligation could be shifted to the taxpayer not only where no reporting EU intermediary can be identified, but also where an EU intermediary is a mere red herring put in place to avoid a reporting obligation of the taxpayer. Without these amendments, DAC6 may turn out to be mainly a compliance cost multiplier for both Intermediaries and tax authorities, rather than an effective and efficient early warning system to curb aggressive cross-border tax avoidance schemes.

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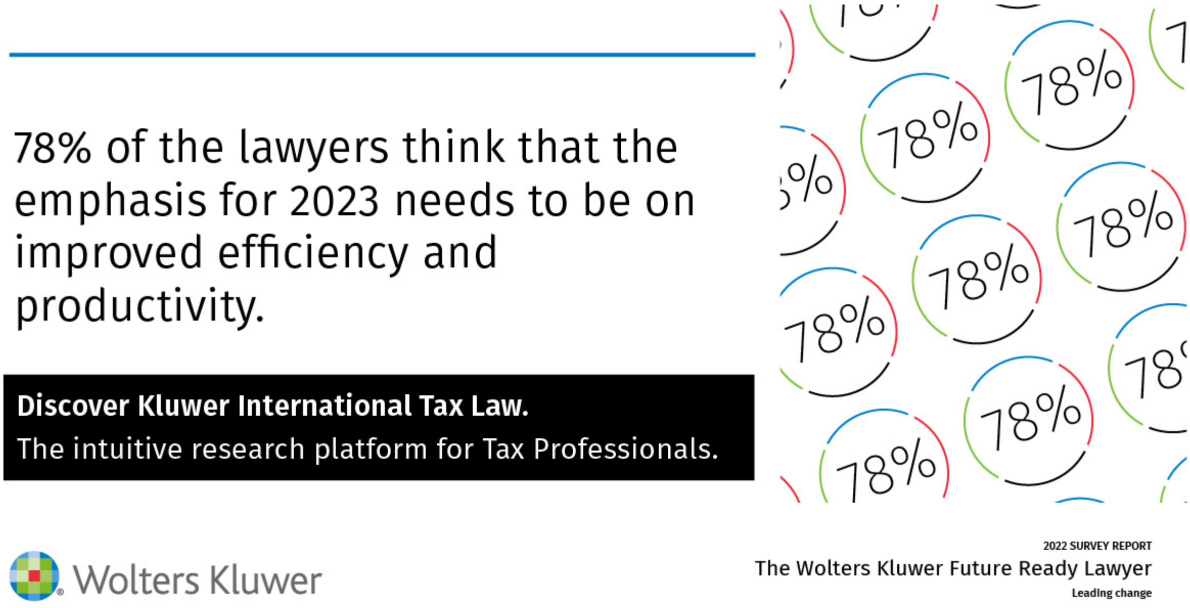

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