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DAC6 implementation into Luxembourg law: Who has to report what to whom, how and when?

What's DAC 6?

DAC6 is the name commonly given to Directive 2018/822 of May 25, 2018 amending Directive 2011/16/EU regarding the mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, which entered into force on June 25, 2018, and must be implemented by EU member states before December 31, 2019, to be applied as of July 1, 2020 (hereafter referred to as the **Directive** or **DAC6**).

In a nutshell, DAC6 introduces a new set of transparency measures by requiring intermediaries or, in the absence of an intermediary, the relevant taxpayer, to report on potentially aggressive cross-border tax-planning arrangements they are involved in to their relevant tax authorities and by setting out rules for the subsequent exchange of this information between tax administrations.

Consistent with Action 12 of the Base Erosion and Profit Shifting (BEPS) initiative proposed by the Organization for Economic Co-operation and Development (OECD), DAC6's objective is to tackle tax avoidance and evasion. DAC6 aims to enable tax authorities to deter harmful practices or to detect potential risks of avoidance or loopholes early and address them through effective audits or adequate reforms.

On August 8, 2019, the Luxembourg government submitted to the Luxembourg parliament a draft law implementing DAC6 into the national law. The Luxembourg draft law mirrors the text of DAC6 and does not extend the reporting obligation to domestic arrangements. The arrangements concerning "indirect" taxes (i.e. value added tax, custom duties, excise duties and compulsory social security contributions) remain out of the scope of this mandatory disclosure regime.

Why this paper?

The purpose of this paper is twofold: (i) outline the Luxembourg legislative proposal and (ii) shed light on how this new disclosure regime will affect intermediaries and taxpayers in Luxembourg.

Answering the different pieces of the following question should help explain DAC6 and its implications: Who has to report what to whom, how and when?

Who?

The disclosure obligation is on intermediaries in the first instance.

An intermediary is broadly defined under DAC6 as "any person that designs, markets, organises or makes available for implementation or manages the implementation of a reportable cross-border arrangement".

Intermediary 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".

Banks, insurers, consulting firms, accountants, law firms, tax advisors, family offices as well as public notaries would qualify as intermediaries who will have to disclose information that is within their knowledge, possession and control.

Given the nature of the business activities carried out in or originated from Luxembourg, many financial institutions will have to comply with the DAC6 mandatory disclosure obligations on a daily basis.

A waiver for legal professional privilege will be available to lawyers admitted to practice in Luxembourg and subject to the Luxembourg law of August 10, 1991: Should the obligation to report constitute a breach of their legal professional privilege, the lawyers must notify within 10 days any other intermediary involved in the transaction or the relevant taxpayer of their reporting obligations. The reporting obligations would then shift to any other involved intermediary or the taxpayer benefiting from the cross-border arrangement (in case no other intermediary is involved) so that the lawyer's legal professional privilege would not hamper the timely and mandatory disclosure of the relevant reportable cross-border arrangement(s).

In addition, notwithstanding the waiver of reporting obligations linked to their professional privilege, lawyers will remain liable for reporting anonymous information of a general nature on the cross-border arrangements.

Where no intermediary is involved in the transaction, the reporting obligation will lie with the relevant taxpayer.

A "relevant taxpayer" is defined as "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."

It should be noted that the Luxembourg lawmakers have (for now) opted not to extend the waiver for legal professional privilege to other professions apart from lawyers, such as for instance bankers, insurers, auditors and public notaries.

A client, being as taxpayer subject to reporting obligations, may still entrust the fulfillment of their reporting obligations to their lawyer, acting as their proxy.

What?

- **What arrangement should be reported?**

What is an arrangement?

There is no definition of "arrangement" as such in DAC6 nor in the draft law. "Arrangement" is meant to be a flexible concept defined by its outcome, which must be of cross-border magnitude and gives rise to material tax consequences. An arrangement may therefore encompass any scheme, plan or undertaking - either construed as a one-shot transaction or a series of transactions or related transactions - mature enough so as tangible steps towards the desired outcome mentioned above may be identified.

What is a reportable arrangement?

To qualify as reportable an arrangement or a series of arrangements must:

- have a cross-border dimension: it must concern (i) more than one member state or (ii) a member state and a third country – pure Luxembourg only transactions are therefore excluded from the scope of DAC6; and

- contain certain features known as hallmarks: i.e. characteristics of cross-border arrangements that might give an indication of a potential risk of tax avoidance.

The draft law transposes the five categories of hallmarks from DAC6 literally. The hallmarks are divided into generic and specific hallmarks. The so-called generic hallmarks and some of the specific hallmarks only apply if the main benefit test is satisfied.

In case the hallmark is not subject to the main benefit test, the cross-border arrangement becomes automatically reportable.

In case the hallmark is subject to the main benefit test, the arrangement will only be reportable should the main benefit test be met.

What is the main benefit test? When is it satisfied?

This test is met if it can be established that "the main benefit or one of the main benefits which, taking into account all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage".

The main benefit test aims at filtering down which arrangements must be reported. The test does not examine subjective intentions, but rather builds a reference to objective facts and circumstances.

According to the OECD BEPS Action 12 Report, "such a [main benefit] test compares the value of the expected tax advantage with any other benefits likely to be obtained from the transaction and has the advantage of requiring an objective assessment of the tax benefits" and "a number of countries consider this to be effective at filtering out all but the most relevant schemes".

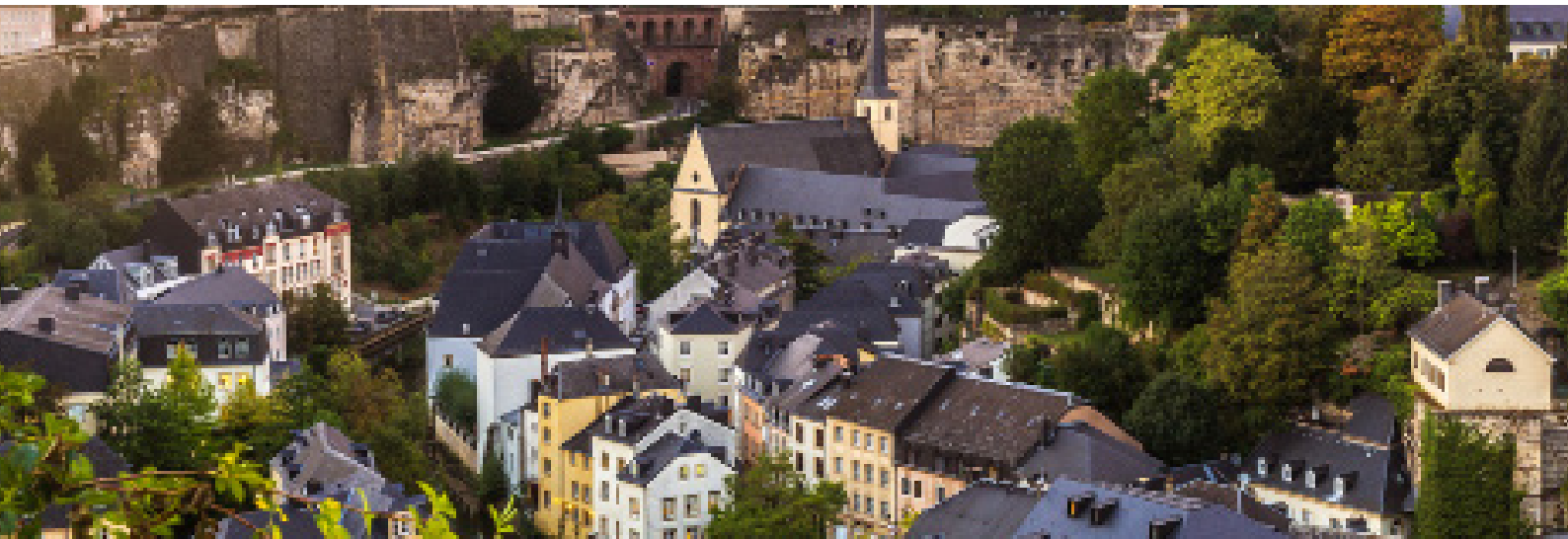
As per the Commission Recommendation of December 6, 2012 on aggressive tax planning, to determine whether an arrangement or series of arrangements has led to a tax benefit, the "national authorities are invited to compare the amount of tax due by a taxpayer, having regard to those arrangement(s), with the amount that the same taxpayer would owe under the same circumstances in the absence of arrangement(s). In that context, it is useful to consider whether one or more of the following situations occur: (a) an amount is not included in the tax base; (b) the taxpayer benefits from a deduction; (c) a loss for tax purposes is incurred; (d) no withholding tax is due; (e) foreign tax is offset".

Based on the foregoing, in the following scenarios the main benefit test may not be satisfied:

- Arrangements designed to fit the commercial, technical and financial aspects which allow for some tax savings;
- Arrangements simply taking advantage of a relief or exemption prescribed by the law of the country in which the taxpayer resides. The benefit does not derive from the arrangement but from the relevant government policy.

In any event, it is extremely important for market players to be able to subject arrangements to an objective test where all the benefits, tax and non-tax, are measured and compared and to draw an overall conclusion on the main benefit of an arrangement.

In practice, however, the application of the main benefit test is likely to raise significant difficulties and the subsequent uncertainty may lead to over reporting. Further clarifications from the legislator and the tax authorities on the practical implications would be welcomed by the local industry.



What are the generic and specific hallmarks?

These hallmarks serve as the key element defining whether a cross-border arrangement qualifies as a reportable cross-border arrangement. The following five categories of hallmarks have been transposed from DAC6 literally.

1. The generic hallmarks mainly relate to the engagement between the intermediary and the taxpayers and comprise:
    - an agreement regarding confidentiality provisions based on which it is not allowed to disclose to other intermediaries or to the tax authorities how the arrangement could secure a tax advantage;
    - an entitlement for the intermediary to receive a fee based on the amount of the tax advantage derived from the arrangement; or
    - an arrangement based on substantial standardized documentation and/or structure and available to more than one relevant taxpayer without the need to be substantially customized for implementation.
2. The specific hallmarks covered by the main benefit test refer to:
    - the acquisition of a loss-making company, discontinuing its main activities and using the losses to reduce its tax liability, including a transfer of losses or by the acceleration of the use of the losses;
    - the conversion of income into gifts, capital or other categories of revenue which are taxed at a lower level or exempt from tax; or
    - circular transactions resulting in the round-tripping of funds.
3. The specific hallmarks that relate to certain cross-border transactions comprise:
    - an arrangement that involves deductible cross-border payments between associated enterprises and at least one of the following conditions is met:
        a. the recipient of the payment is not tax resident in any tax jurisdiction;
        b. the recipient of the payment is tax resident in (i) a jurisdiction that impose a zero or almost zero corporate tax rate or (ii) the jurisdiction is included in a list of non-cooperative jurisdictions by the EU or the OECD;
        c. the payment benefits from a full exemption from tax in the recipient's tax jurisdiction; or
        d. the payment benefits from a preferential tax regime in the recipient's tax jurisdiction.

    It has, however, been clarified that the mere presence of the following conditions does not imply that the main benefit test is satisfied.

    - a deduction for the same depreciation in more than one jurisdiction;
    - a relief from double taxation in respect of the same item of income or capital in more than one jurisdiction; or
    - a transfer of assets with a material difference valuation.
4. Specific hallmarks further relate to (i) the automatic exchange of financial information under the Common Reporting Standard (CRS) as implemented in the member states and (ii) the determination of the ultimate beneficial ownership. These hallmarks include arrangements that may have the effect of undermining the reporting obligation under CRS as well as arrangements trying to hide beneficial owners.
5. The fifth and last category of hallmarks relates to transfer pricing. These include:
    - arrangements involving the use of unilateral safe harbour rules;
    - arrangements involving the transfer of hard-to-value intangibles;
    - arrangements involving intragroup cross-border transfers 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(s), are less than 50% of the projected annual EBIT of such transferor(s) if the transfer had not been made.

The rules are intentionally very broad and may require disclosure of a wide range of arrangements.

This may however result in a mass reporting that would hinder the tax authorities to address the effective tax avoidance. This will be assessed as the full application of DAC6 progresses.

What information should be reported?

- In the presence of a reportable arrangement, the following information must be provided to the Luxembourg tax authorities:
- identification of the intermediary(ies) involved and taxpayers;
- hallmarks that generated the reporting obligation;
- a summary of the arrangement;
- details of the relevant Luxembourg tax rules;
- date on which the first step of implementation has been or will be made;
- value of the arrangement;
- identification of any other person or member state likely to be affected by the arrangement.

All arrangements made after June 25, 2018 and meeting DAC6's criteria will have to be reported.

To whom?

The intermediary or the relevant taxpayer, as the case may be, must report the relevant cross-border arrangement to the Luxembourg tax authorities if it has some connection with Luxembourg.

The intermediary must report to the Luxembourg tax authorities if it:

- is resident for tax purposes in Luxembourg;
- has a permanent establishment in Luxembourg through which the services with respect to the arrangement are provided;
- is incorporated in, or governed by the laws of Luxembourg;
- is registered with a professional association related to legal, taxation or consultancy services in Luxembourg.

The relevant taxpayer must report to the Luxembourg tax authorities if it:

- is resident for tax purposes in Luxembourg;
- has a permanent establishment in Luxembourg benefiting from the arrangement;
- receives income or generates profits in Luxembourg, although it is not tax resident for tax purposes and has no permanent establishment in Luxembourg;
- carries on an activity in Luxembourg, although it is not tax resident for tax purposes and has no permanent establishment in Luxembourg.

How?

The intermediary or taxpayer will have to fill a standard form to be developed and made available by the Luxembourg tax authorities to file their reporting information.

To ensure effectiveness of the exchange of information, especially where more than one intermediary or relevant taxpayer is liable to file information, the Commission Implementing Regulation (EU) 2019/532 (as regards the standard forms for the mandatory automatic exchange of information on reportable cross-border arrangements) has pointed out that the form must include a field containing a reference number of the reportable cross-border arrangement. If more than one intermediary or relevant taxpayer is obliged to file information, one single reference number should feature on all exchanges of the same arrangement so that these exchanges can be linked to a single arrangement on the central directory.

When?

As from **July 1, 2020**, information on the cross-border arrangement treated as reportable must be filed **within 30 days** beginning on:

a. the day after it is ready/available for implementation; or

   when its implementation has started, whichever occurs first.

b. the day after the intermediary(ies) provided, directly or by means of other persons, aid, assistance or advice.

For a cross-border arrangement designed, marketed, ready for implementation or made available for implementation without a need to be substantially customized (so-called marketable arrangement), the intermediaries will be required to provide **every three months** as from **July 1, 2020**, a report providing an update containing new reportable relevant information since the last report was filed.

By **August 31, 2020** at the latest, information on the cross-border arrangement treated as reportable initiated during the period starting on June 25, 2018 and ending on June 30, 2020 must be reported.

Each relevant taxpayer is also required to file information about their use of the arrangement to the tax authorities in each of the years for which they use it. In practice, the taxpayers will disclose such information in their **annual tax return**.

.... We can help you start monitoring your transactions now in Luxembourg, across Europe and beyond, adjust or implement bespoke tracking and reporting solutions into your internal processes, build up adequate documentation from 2018 onwards and coordinate your reporting obligations.

What are the sanctions in case of non-compliance?

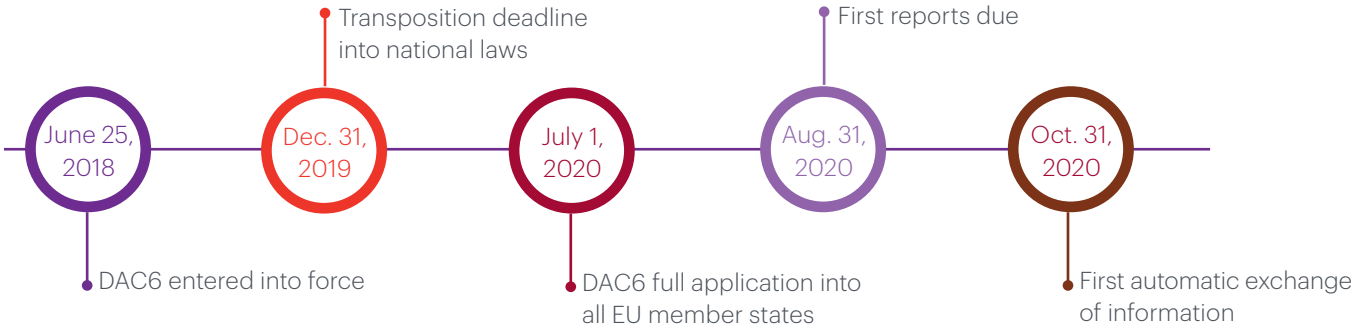
In response to the Directive's requirement for the member states to provide "effective, proportionate and dissuasive penalties", the Luxembourg lawmakers have set the penalty at a maximum of **€ 250,000 per breach**.

In accordance with the commentaries to the draft law, the amount of the fine determined by the Luxembourg tax authorities on a case-by-case basis may vary depending on how **intentional** the infringement was.

The intermediary or the taxpayer will have the possibility to challenge the amount of the fine by filing a recourse before the administrative court.

Reputational risks may arise for those businesses, individuals and intermediaries which fail to comply with these new disclosure obligations.

Timeline



What's next?

By December 31, 2019: adoption of the Luxembourg law transposing the Directive

The final vote of the draft law is expected to occur before December 31, 2019 as member states are to adopt and publish national laws required to comply with the Directive by the end of December 2019.

National laws need to take full effect from **July 1, 2020**, following an interim period to last from June 25, 2018 to June 30, 2020.

By August 31, 2020: first filings of reportable cross-border arrangements

All arrangements which qualify as reportable from June 25, 2018 to June 30, 2020 included will be reported on August 31, 2020, the first filing date.

By October 31, 2020: first automatic exchange of information between local tax authorities within the EU

The reported information will be automatically exchanged on a quarterly basis with all other member states through a secured centralised database, the common communication network developed by the European Union.

As the exchange of information should take place within one month following the end of the quarter in which the information was filed, the first information is thus to be exchanged by October 31, 2020.

How can we assist you?

As an intermediary ourselves, we are closely monitoring the ongoing legislative process and we will provide our clients with insights on any interpretative comments and significant amendments to the proposed draft law as well as on any further considerations and/or practical guidance we are expecting from the Luxembourg market players and tax authorities.

We can help you meet DAC6's disclosures rules in assisting you to proactively capture, identify and monitor the existence of a mandatory disclosure obligation for each of your transactions and to report them within the statutory deadlines.

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