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DAC 6 and Middle East based companies

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In the Middle East
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In 2018, the Council of the European Union (EU) issued the Directive 2018 /822 (Directive), commonly known as DAC 6 or Mandatory Disclosure Rules (MDR), for the exchange of information in relation to cross-border arrangements that meet certain criteria. The implementation of this Directive allows the EU Member States (i) to identify potentially aggressive tax planning that could erode their taxable basis and (ii) to react properly in cases of tax avoidance or abuse. This Directive will be subject to an evaluation process every two years by the European Commission and the Member States. It may also be subject to further amendments if necessary (the first review will take place in 2022).

In order to implement the Directive, EU Member States have already transposed it into its domestic legislation. As a result, the application of some rules may vary due to different approaches or interpretations adopted by each country, which could lead to different results in the reporting obligation depending on the jurisdiction. For example, the same arrangement could fall within the scope of DAC 6 in one country while it could be out of the scope in another one.

Consequently, every transaction involving arrangements with one or more EU Member States should be carefully assessed to determine whether it triggers a reporting obligation and in which jurisdiction, especially taking into account the high penalty amounts, e.g. Cyprus up to EUR 20.000, Germany up to EUR 25.000, Belgium up to EUR 100.000, Luxembourg up to EUR 250.000 or The Netherlands up to EUR 870.000, among others.

This tax alert is intended to remind businesses of the reporting obligations.

Implications of the implementation of DAC 6 rules for Middle East based companies

Although the Directive establishes the reporting obligations for EU intermediaries or EU tax residents, it is strongly recommended that Middle East (ME) based companies monitor whether their arrangements could have a nexus with the EU and whether they trigger the reporting obligation.

For this purpose, it is considered that a ME company could have such nexus when the arrangement involves its EU subsidiaries, EU Permanent Establishments, real estate located in EU, or other similar presence.

Special attention should be given to any sort of intercompany transactions between the EU and group companies in no or low tax countries such as the United Arab Emirates (UAE) including the transfer of assets, risks and functions.

Key aspects of DAC 6

In accordance with the Directive, below are the key issues to be considered in determining whether the transaction falls within the scope of DAC 6 and if further analysis is required:

- **Does the arrangement have any EU nexus?**

  It is important to point out that due to the broad definition of “arrangement” given by the Directive, it could include more than one step or part of a series of arrangements; therefore, it covers any scheme, plan or understanding, and persons who are part of or affected by it.

  Transactions concerning third countries, such as the UAE and any EU Member State are considered cross-border arrangements when:

  - One of the participants is a tax resident in an EU Member State (it also includes dual-resident participants);
  - It involves a participant and its permanent establishment (PE);
  - At least one participant carries on an activity in another jurisdiction without being a tax resident or constituting a PE.

  Please note that the definition of “participant” is also broad, and may include companies, individuals, partnerships, investment funds, foundations, among others.

- **Does the transaction concern at least one of the covered taxes?**

  The transaction may only be reportable when it covers the taxes indicated by the EU Member State in the law transposing the Directive. Therefore, taxes of non-EU Member States are not covered by the report.

  Consequently, a country-by-country analysis should be performed to determine whether this condition is met considering the different approaches adopted by each jurisdiction. For instance, most of the countries have excluded indirect taxes and domestic transactions from the scope of DAC 6, while Poland has included them.

- **Does the arrangement fall in the scope of any Hallmark?**

  A “Hallmark” is defined by the Directive as “a characteristic or feature of a cross-border arrangement that presents an indication of a potential risk of tax avoidance”, which means that the Hallmark itself does not constitute a finding of tax avoidance.

  The Directive established the following five categories of Hallmarks:

<table>
<tr><th colspan="3">Hallmarks</th></tr>
<tr><td colspan="2">A - Generic Hallmarks: confidentiality, premium fee and standardized tax arrangement Hallmarks.</td><td rowspan="3">Hallmarks A, B and some of C only apply when the main benefit or one of the main benefits of the arrangement is a tax advantage in the EU territory or outside of it. Therefore, a Main Benefit Test (MBT) re the covered taxes should be performed to determine if this condition is met.</td></tr>
<tr><td colspan="2">B - Specific Hallmarks: acquiring a loss-making company, converting taxable income into capital gains or exempt income, and circular or offsetting transactions.</td></tr>
<tr><td rowspan="2">C - Specific Hallmarks related to intragroup cross border transactions</td><td>Deductible cross-border payments, where the recipient is resident in a state whose corporate tax rate is zero or almost zero, or the receipt is exempt or
the payment benefits from a preferential tax regime (such as free zones).</td></tr>
<tr><td colspan="2">Deductible cross-border payments, where the recipient is resident nowhere; deductions for depreciation on the same asset are claimed in more than one jurisdiction; double tax relief is claimed in more than one jurisdiction; or there is a transfer of assets and there is a material difference between the consideration in
the two jurisdictions.</td></tr>
<tr><td colspan="3">D - Hallmarks related to automatic exchange of information and beneficial ownership: structures involving holding companies and trusts, whereby the identity of the beneficial owners is made “unidentifiable”.</td></tr>
<tr><td colspan="3">E - Specific transfer pricing hallmarks: 1) arrangements involving unilateral safe harbor rules; 2) arrangements involving the transfer of hard-to-value intangibles; and 3) intragroup cross-border transfer of functions / risks /assets which result in the EBIT of the transferor to fall by more than a specified amount.</td></tr>
</table>

However, in addition to the categories indicated above, some countries have also included additional Hallmarks such as Poland. Moreover, following the implementation of the Directive, the EU Member States have also issued decrees, guidelines, circulars, and other regulations for the interpretation of the DAC 6 rules given the broad and general approach of the Directive, so some Hallmarks may apply differently depending on the position taken by each jurisdiction.

For instance, Hallmark E3 applies in case of intra-group transfers of assets, risks and/or functions which result in a 50% reduction of the projected earnings before interest and taxes (EBIT) of the transfer or in the three-year period following the transfer; however, depending on the interpretation of the conditions of this Hallmark, a transfer could fall within or out of scope in different jurisdictions. Please see below an example of some of the differences:

- **Mergers**: For Luxembourg DAC 6 purposes the term 'transfer' has a broad meaning, and therefore, mergers or liquidations could fall within the scope of this Hallmark, whereas France has indicated that it does not apply to mergers and similar operations.

- **Definition of EBIT**: EU countries do not have an aligned definition of EBIT, some of them refer to accounting profit and others have adopted a financial approach. In consequence, depending on the interpretation applied by each country, dividends should be included for the calculation of the projected EBIT or not, which may result in a different outcome for the reporting obligation.

Accordingly, all facts and circumstances surrounding the arrangement should be carefully assessed along with the particularities of the DAC 6 rules implemented by each jurisdiction involved in the transaction to establish whether a Hallmark is met.

- **Report responsibility**

As a general rule, any EU intermediary involved in the transaction, such as a bank, accounting firm, law firm or other service provider, is responsible for reporting arrangements falling within the scope of DAC 6. However, where the intermediary is covered by legal professional privilege, it is only obliged to notify the reporting obligations to other EU intermediaries and the relevant taxpayers, and in such a case, the latter will be obliged to report the transaction.

Therefore, depending on the service provider and the exemptions established in each country, the taxpayer will have the obligation to report the arrangement, and if the reporting is incorrect or is not filed within the deadline, it will be subject to penalties.

- **Triggering date for the reporting**

According to the Directive, the triggering date for the reporting should be the earliest of the following dates:

- On the day after the reportable cross-border arrangement is made available for implementation;
- On the day after the reportable cross-border arrangement is ready for implementation; or
- When the first step in the implementation of the reportable cross-border arrangement has been taken.

To this end, it is highly recommended to verify whether the countries involved in the transaction have issued any guidelines to assess the criteria of “made available for implementation”, since it does not necessarily require the actual implementation of the transaction by the taxpayer, and therefore, the arrangement could be considered reportable from the perspective of the intermediary, but not from the perspective of the relevant taxpayer leading to a different result in the reporting, which could be challenged by the respective tax authorities.

Deloitte’s view

Considering the wide scope of the Directive and the continuous evolution of the EU legislation due to the new guidance and clarifications issued by each EU Member State for the application of the DAC 6 rules and further amendments of the Directive by the European Commission due to the bi-annual evaluation process, it is recommended to monitor the arrangements of the ME based companies that may have a nexus with an EU country to assess whether it gives place to any reporting obligation.

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