

Another step towards corporate transparency

2/47/20



PwC tax manager
Viktorija Lavrova



PwC tax director
Vita Sakne

Globalisation is seeing a constant increase in cross-border business, something that encourages entrepreneurs to look for a suitable corporate structure within and outside their base country. Choosing a particular structure is often based not only on business interests in a certain market but also on favourable administrative and tax rules.

In recent years, countries as well as international and EU organisations have been working on legislation to prevent tax fraud and ensure that taxes are paid in the country where profits are made, by eliminating opportunities for creating artificial structures that allow profits to be shifted to other jurisdictions often with lower taxes. A key weapon in the fight against aggressive tax planning is the EU directive of 25 June 2018 (“DAC6”), which requires consultants to provide the Latvian State Revenue Service (“SRS”) with information on potentially aggressive tax arrangements created with the direct or indirect assistance of a consultant.

DAC6 requirements can apply to a new business wishing to expand into another market and to large enterprise groups with complex cross-border arrangements. How can a taxpayer figure out whether DAC6 requires him to report on his transactions, structures or arrangements? Who is liable to report and when? Let us look at a practical example.

Example

A Latvian software development company wins a procurement contract for services it has to carry out in another member state. A lack of skilled workers in Latvia prevents the company from rapidly boosting its capacity to be able to fill the order on time. The shareholders think of setting up a company in the Czech Republic, Poland or Hungary, as these countries have more professionals available than Latvia. The management decides to engage consultants in order to evaluate the three tax systems and choose an arrangement...

based on the level of a tax advantage.

Risk
area

The consultancy agreement –

- contains a confidentiality clause preventing the consultants from disclosing information on tax advantages to tax authorities;
- expresses the service fee as a percentage of the tax advantage.

Risk
area
Risk
area

The company owner discusses his expansion plans with a business partner and learns about tax advantages offered by Cyprus and about opportunities for setting up a holding company there. At the partner’s suggestion, the owner decides that the Cyprus company will only function as a holding company that does not need an office or skilled staff in Cyprus.

External service providers will take care of the presence in Cyprus and the holding company’s operations.

Risk
area

Since the company is a large one, its owner receives an investment offer from a venture fund in exchange for a 30% stake in the Cyprus holding company. The venture fund will hold shares in the Cyprus company indirectly through a general partnership registered in Scotland. The owner accepts this offer even though he knows that...

according to public registers the Scottish partnership is owned by a trust, but no information is available about its owner and ultimate beneficial owner. Risk area

In the circumstances, this cross-border arrangement is likely to meet DAC6 hallmarks, which means that the taxpayer is planning to implement or has already implemented an aggressive tax arrangement that is subject to the reporting obligation.

How does it work?

Any arrangement should be assessed from a cross-border perspective, i.e. we need to establish whether the arrangement covers two or more member states, or a member state and a third country. What we also need to establish is whether the arrangement meets one of 14 DAC6 hallmarks, which are now split into five categories under the rules issued by the Latvian Cabinet of Ministers. We might also need to run the main benefit test, as some of the hallmarks do not come into play unless this test is satisfied, i.e. if we find that the main benefit or one of the main benefits the taxpayer can reasonably expect from the arrangement is a tax advantage.

The arrangement in our example satisfies two hallmarks:

Category	Hallmark	Example
A	General hallmarks related to the main benefit test	An arrangement in which the taxpayer, or a party to the arrangement, undertakes to be bound by a confidentiality clause that prevents them from providing other intermediaries or tax authorities with information on how the arrangement can provide a tax advantage An arrangement where the intermediary is entitled to a fee set according to the level of a tax advantage created by the arrangement, or based on the successful creation of such a tax advantage
D	Special hallmarks related to automatic information exchange and actual ownership	An arrangement with a non-transparent chain of legal title or actual ownership, using legal entities, arrangements or structures that do not carry on any real business based on adequate staffing, equipment, assets and premises

Who is required to disclose and what information needs disclosing?

DAC6 places the responsibility for giving information about a cross-border arrangement primarily on the intermediary involved in planning that arrangement and then on the taxpayer who benefits from the arrangement. Any professional such as a tax consultant, a lawyer or an external accountant can become an intermediary. The reporting obligation will lie with anyone who designs, markets, organises or makes available for implementation or manages the implementation of a reportable cross-border arrangement.

It is important to emphasise that the reporting obligation primarily lies with the intermediary. If there is no intermediary, or if the intermediary is outside the EU and escapes DAC6 requirements or is protected by a “professional secret” under local legislation (e.g. a law firm), the reporting obligation lies with the taxpayer who benefits from the cross-border arrangement.

In our example, the consultants are liable to report the intention of setting up a company in the Czech Republic, Poland or Hungary, while the plans to incorporate a Cyprus holding company must be reported by the taxpayer, an individual.

DAC6 implementation status and penalties for non-disclosure in Latvia and elsewhere in Europe

DAC6 has already been passed into the national legislation of every member state. The first reporting round for the period from 25 June 2018 to 1 July 2020 was scheduled to take place by 31 August 2020. However, the EU decided to allow member states to extend the reporting deadline because of the Covid-19 pandemic, so information on reportable cross-border arrangements must be filed with the SRS by 31 January or 28 February 2021, depending on when the first stage of the arrangement was implemented.

Non-compliance with DAC6 disclosure requirements can lead to substantial fines set by each member state separately. The maximum fine in Latvia is EUR 3,200 but taxpayers need to be aware that the reporting obligation can lie with an intermediary or a taxpayer (group company) in another jurisdiction, and several member states impose much larger fines than Latvia. For example, a fine for failure to report one reportable arrangement is up to EUR 250,000 in Luxembourg, up to EUR 870,000 in the Netherlands, and up to GBP 1 million in the UK.

How to react?

As mentioned above, DAC6 can affect groups having companies in several jurisdictions, so taxpayers are advised to evaluate each structural change and each cross-border arrangement in the light of DAC6, provide the SRS with information on reportable arrangements early, and remember that non-compliance can have consequences and that the reporting obligation lies with consultants or other intermediaries, but in the absence of intermediaries, the taxpayer is required to do the reporting.

The transposition of DAC6 requirements into national legislation varies from country to country, so handling these tasks requires adequate experience as well as analysis of local legislation and practice. PwC's team of professionals has devised technological solutions to help taxpayers identify DAC6 disclosure risks. For example, our DAC6 comparison tool allows users to compare domestic laws and their interpretation with DAC6 requirements and rules enacted by other member states.