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DAC6 in Luxembourg — Can a taxpayer also be an “intermediary” ?

The international tax landscape has substantially changed over the last decade, and the fifth amendment to the 2011/16/EU Directive on Administrative Cooperation (DAC6) has prompted yet another shift in reporting obligations.

DAC6 aims to collect information on reportable cross-border arrangements (RCBAs) in order for Member States to close tax legislation loopholes more rapidly and react against harmful tax practices. This data, which EU Member States collect and share between them, require arrangements to be analyzed based on cumulative criteria to determine whether they are RCBAs and, therefore, require reporting to the tax authorities.

Based on DAC6's transposition into Luxembourg law, “intermediaries” or “relevant taxpayers” must report RCBAs to the Luxembourg tax authorities from 1 January 2021 (i.e., opening date of the reporting obligations which was deferred by six months due to COVID-19).

The cumulative criteria of RCBAs are:

- i. A cross-border feature, i.e., the involvement of either two EU Member States or an EU Member State and a third jurisdiction;
- ii. Specific EU covered taxes (including corporate tax, individual tax and inheritance tax); and
- iii. Specific features known as “hallmarks”.

Hallmarks that may be triggered in a typical alternative investment fund industry framework are:

- *B2* - arrangements that have the effect of converting income into capital, gifts or other categories of revenue, which are taxed at a lower rate or exempt from tax;
- *C1* - arrangements with deductible cross-border payments between “associated enterprises” under certain conditions; and
- *E3* - arrangements involving the intra-group cross-border transfer of functions and/or risks and/or assets with an impact on earnings before interest and taxes (EBIT).

Some hallmarks - *A*, *B* and some subcategories of *C* - are also coupled with a “main benefit test”. This means that, for an arrangement to be reportable, the main benefit or one of the main benefits of the arrangement must be to obtain a tax advantage.

The obligation to report RCBAs lies primarily with EU intermediaries. If there is no EU intermediary involved, or all the EU intermediaries have legal professional privilege, the reporting obligation falls to the relevant taxpayer.

Intermediaries are divided into two categories. The first is defined as a person who designs, markets, organizes,

makes available for implementation, or manages the implementation of an RCBA. The second category is any person who knows or could be reasonably expected to know that they have undertaken to provide—directly or indirectly through other persons—aid, assistance, or advice regarding the activities mentioned above, based on all relevant facts and circumstances, available information and the relevant expertise and understanding required to provide these services. This definition is broad enough to not only include lawyers and advisers but also banks, trustees, insurance companies, asset managers and other service providers.

A relevant taxpayer is defined as *“any person to whom an RCBA is made available for implementation, or who is ready to implement an RCBA or has implemented the first step of such an arrangement.”* The notion of a relevant taxpayer (as for an intermediary) refers to the notion of a “person”. This is explicitly defined as (a) natural persons, (b) legal persons, (c) associations of persons recognized as having the capacity to perform legal acts but lacking the status of a legal person and (d) any other legal arrangement of whatever nature and form, regardless of whether it has legal personality, owning or managing assets, which are subject to any of the covered taxes.

Unlike an intermediary, the definition of a taxpayer does not refer to a nexus within the EU. However, as for intermediaries, taxpayers must have a presence in Luxembourg for a reporting obligation to arise in Luxembourg.

In certain cases, mainly in the alternative industry, a taxpayer could also be considered as an intermediary; for example, a management company or a dedicated entity with a tax function that assists the wider group. Special attention must be given to roles and responsibilities to determine if a taxpayer could also be considered as an intermediary, as their obligations can differ. A detailed, case-by-case analysis is recommended.

DAC6 requires that EU intermediaries report RCBA in a timely and efficient manner. However, due to legal professional privilege (which covers lawyers, auditors and accountants operating within the limits of their respective professions in Luxembourg), sometimes the obligation to report RCBA can pass to other intermediaries that did not assist with the design of the RCBA (e.g., banks and asset managers) or directly to taxpayers.

The reporting clock starts when (i) an RCBA is made available; (ii) an RCBA is ready for implementation; or (iii) the first step in the implementation of an RCBA has occurred. When one of these trigger events takes place on or after 1 January 2021, intermediaries and relevant taxpayers must:

- Report the RCBA to the Luxembourg tax authorities within 30 days; and
- Notify other intermediaries or taxpayers in cases of legal professional privilege within 10 days.

Failure to comply with DAC6 obligations may result in penalties of up to EUR250,000 per RCBA in Luxembourg.

Given the involvement of different persons, short reporting period and penalties, entities must anticipate and establish RCBA identification processes to avoid intermediaries assessing the same RCBA and to facilitate the reporting process. Taxpayers must pay careful attention to how intermediaries assess the hallmarks, as information gaps may lead to different undesired outcomes. Good governance is recommended, as is a coordination point where all assessments are received, compared, and eventually reported.

Compliance with DAC6 rules must be supported by documentary evidence in the case of tax audits. Therefore, it is essential that records of analyses and conclusions, whether internal or performed by external advisors, are properly documented.