# FRENCH ADMINISTRATIVE PRONOUNCEMENTS ON D.A.C.6

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## INTRODUCTION

Before the European Directive was enacted and then transposed into domestic law, France adopted rules to tackle tax fraud, starting with measures aimed at residents holding undisclosed funds through foreign bank accounts.

In December 2012, the Cahuzacgate[1] was the trigger for the law of 6 December 2013.[2] M. Cahuzac was a former Minister of Economy and Finance. While in charge of leading his government's fight against tax fraud, he was found to have concealed bank accounts abroad for two decades. Hidden funds in Switzerland and Singapore amounted to at least €3.5 million.

Since 2013, France enacted a variety of measures to tackle tax fraud. A dedicated regularization unit was set up to allow French taxpayers to voluntarily disclose foreign bank accounts, income, and assets with the promise of lower penalties. Once the automatic exchange of information became effective among many countries by the end of 2017, the regularization unit was closed. By 2019, information on foreign bank accounts was gathered by this automatic exchange.

The law of October 23, 2018, authorized the Government to legislate by way of Ordinance the transposition into French law of the European Directive of 25 May 2018,[3] called D.A.C.6. The Ordinance[4] finally entered into force on July 1, 2020 and is codified under articles 1649 AD et seq. of the French Tax Code ("F.T.C."). And since, the French tax authorities have issued detailed guidelines.[5]

The French regularization unit and the automatic exchange of information were directly inspired by the Actions of the B.E.P.S. project. Similarly, D.A.C.6 is the European translation of the set of recommendations for the design of mandatory disclosure rules when aggressive tax planning arrangements appear (B.E.P.S. Action 12).

D.A.C.6 goes further than the B.E.P.S. recommendations since it fits into a more global framework of transparency to combat fraud and tax evasion. All Member States of the European Union ("E.U.") were required to transpose the Directive into their own legislation by December 31, 2019.

1. French Minister of Economy and Finance for 2012 and 2013.
2. Law related to the combat tax fraud and serious economic and financial crime.
3. E.U. directive 2018/822.
4. Ordinance no. 2019-1068, related to automatic and mandatory exchange of information in tax area in relation to reportable cross border arrangements dated October 21st, 2019.
5. B.O.F.I.P. dated November 25th, 2020.

After a delay in recognition of Covid, intermediaries and taxpayers have a 30-days following the triggering event to report cross border arrangements within the scope of D.A.C.6. This article describes the French legislation in the light of administrative guidelines and highlights areas of divergences between the French rules under D.A.C.6 and those adopted by other Member States.

## WHO SHOULD REPORT AND WHEN?

### Who Should Report?

According to D.A.C.6, intermediaries have a primary obligation to disclose cross border arrangements ("C.B.A.'s"). French regulations implement that obligation.[6] The reporting obligation switches to the taxpayer when reporting by intermediaries cannot be achieved. This situation occurs when

- there is no intermediary,
- the intermediary is outside of the jurisdiction of the E.U. Member State, and
- when the reporting obligation would breach the legal professional privilege of the intermediary under the law of France.

One should not underestimate the possible reach of these reporting obligations for taxpayers established or active in France. Taxpayers, such as French subsidiaries or permanent establishments ("P.E.'s") of multinational groups should be aware and attentive to the transactions having a tax impact in France. The French subsidiary or P.E. may be subject to the reporting obligations because no intermediary was involved in a reportable transaction or because an in-house department designed the transaction and qualifies as an intermediary, itself.

Under French law, the taxpayer means "any person to whom a reportable cross-border arrangement ("R.C.B.A.") is made available for implementation, or who is ready to establish an R.C.B.A. or has implemented any step or part of such an arrangement." The definition is broader in scope than the one provided by the Directive as it can apply to a taxpayer even when no first step has been taken.

The French guidelines add useful guidance regarding pass-through entities. For such entities, the partners or members who are liable to tax in France are "taxpayers" and not the pass-through entity itself, except if an election has been made by a pass-through entity to become subject to corporate income taxes ("C.I.T.") in its own right.

For example, one can easily imagine a US headquarter company designing a cross border arrangement ("C.B.A.") that is used by a French subsidiary. The French subsidiary is the taxpayer having the reporting obligation, unless an intermediary[7] has a nexus with France or a Member State without being exempt from reporting by reason of attorney-client privilege.

The concept of an intermediary is broadly interpreted and includes a natural person or a legal person whether acting in its professional capacity or otherwise.

6 F.T.C. Art 1649 AE.

7 A Promoter or a Service Provider that knows enough about the arrangement to assess its reportable nature.

Intermediaries are divided in two categories, “Promoters” and “Service Providers.” The time when Promoters and Service Providers must file a report differs from that of a taxpayer.

Promoters are any person that designs, markets, organizes, or makes available for implementation or manages the implementation of an R.C.B.A. Service Providers include persons who know or could reasonably be expected to know that they have undertaken to provide aid, assistance, or advice, directly or indirectly, in relation to the and R.C.B.A., based on available information and relevant expertise and understanding.

This is exactly the definition of the Directive and therefore, the definition of intermediary is very large and is not limited to certain professional categories. Promoters could be lawyers, tax advisors, bankers, and accountants. The term also includes an in-house department of a company that otherwise fulfills the definition of Promoter, such as an in-house tax team that designs a C.B.A. Accountants, auditors, insurance companies, wealth managers, asset managers of investment funds, lawyers specializing in company law or financial law, bankers, notaries, family offices, etc. might fall in the category of Service Providers if they participate in implementation rather than design of an R.C.B.A.

The French regulations however provide detailed definitions of the terms “design,” “market,” and “implementation” of such arrangements. Under the French legislation, the obligation to report is a simple presumption and Service Providers are entitled to demonstrate by all ways of proof that they did not know and could not reasonably have known that they provided aid, assistance, or advice in relation to an R.C.B.A.

Unlike some Member States, France did not expressly indicate that the Service Providers have no duty of investigation with respect to the facts and circumstances of any given transaction. Instead, the law states that the assessment to report must be made based on available information. This might imply an absence of additional due diligence obligation for the Service Provider.

The mere fact that the presumption can be countered by any elements of proof is a relief. Indeed, some Member State require the written proof in this respect. Unlike some other Member State, the French legislation and guidelines do not limit in any other ways the definition of Service Providers based on a sufficient involvement or an active involvement.

When a French lawyer provides advice containing general tax considerations, or if a taxpayer asks his accountant to prepare a general tax memorandum – for example, a comparison between the holding regimes in the Netherlands and in France – whether or not in a view to implementing a C.B.A., the lawyer or the accountant can be viewed as an intermediary at this early stage, without any further involvement.

The French guidelines provide an express exemption to reporting obligations for financial institutions in relation to ancillary banking services (*i.e.*, the granting of a loan, the opening of an account, the transfer of funds) – excluding exceptional banking operations. Indeed, financial institutions are rarely “actively” involved.

The only relief the French guidelines provide applies to Service Providers that are first involved in an R.C.B.A. after the arrangement has been implemented or after the advice has been provided. In that fact pattern, a Service Provider has no reporting obligation. To illustrate, a statutory auditor who first learns about an R.C.B.A.

during an audit that occurs at or after yearend or a tax advisor who merely provides a second opinion about an R.C.B.A. without suggesting any amendments to the existing arrangement is not a Service Provider.

## An Intermediary with Nexus in France

An intermediary must fulfill its reporting obligations in France where there is a territorial nexus between the intermediary and France. A territorial nexus is defined as (i) having a tax residence in France, (ii) having a P.E. in France through which the services with respect to the R.C.B.A. are provided, (iii) being incorporated in France, (iv) governed by the laws of France, or (v) being registered with or authorized by a professional association in France in relation with the legal, taxation or consultancy services. The last item of nexus likely draws U.S. law firms having an office in France into the D.A.C.6 rules in France when advising on a C.B.A. involving France.

For intermediaries that are liable to reporting obligations in more than one Member State regarding an R.C.B.A., reporting should be made with the competent authorities of only one Member State. Here, a priority rule applies. The foregoing list of contacts that comprise territorial nexus is applied to both Member States. The first time that nexus exists to only one Member State determines the Member State that receives the report. For example, if an intermediary has its head office in France and a P.E. that provided services in the Netherlands must file the reportable information in France as tax residence trumps the location of a P.E.

*"To be exempt, the French intermediary must prove that reporting has been made in another Member State."*

When the reporting has been filed by another intermediary in another Member State, French nexus fades away and the French intermediary is exempt from reporting obligation.

To be exempt, the French intermediary must prove that reporting has been made in another Member State. In France, the proof demonstrating that the R.C.B.A. has been filed in another Member State encompasses all means available. This is less burdensome than the rule in certain other Member States, which require written proof of reporting or even the "unique reference number" under which the R.C.B.A. was reported. Some countries even require a summary of the R.C.B.A.

This can be quite a challenge when within the E.U., multiple filing obligations arise. One intermediary should report the transaction unless the intermediary or the taxpayer is able to provide the proof the transactions has been filed with the tax authorities.

Because of the 30-day time period for reporting, an intermediary must promptly identify the transaction, other intermediaries, coordinate who will report, obtain the proof of reporting, and if necessary communicate its proof to the other intermediaries. No need to say that strong internal processes and procedures will be useful.

In addition, uncertainty remains where one Member State considers a C.B.A. to be reportable while the other does not require the arrangement to be reported. For example, an intermediary located in a foreign Member State through a P.E. in France, designs an arrangement that affects the tax base in France and the C.B.A. qualifies as reportable from a French perspective, but not from the other Member State's perspective. The priority rule for nexus requires the intermediary to report in the foreign Member State, so one should question if the R.C.B.A. will be reported.

## The Exemption of Intermediary Bound by the Legal Professional Privilege

When the intermediary is bound by legal professional privilege, reporting the R.C.B.A. is prevented. This exemption has raised many questions and critics from tax practitioners both in and outside the E.U.

In this situation, the intermediary must notify the other intermediaries, in writing, of the reason why he or she cannot perform the reporting obligation based on the professional-client privilege, which leads to a shift of the reporting duty to the other intermediaries. In the absence of other intermediaries, the intermediary should notify the taxpayer in writing, of the reason why reporting cannot be performed. This leads to a shift of the reporting obligation to the taxpayer. Of course, the taxpayer may waive its rights under the privilege, thereby allowing the intermediary to fulfill the reporting obligation. From the viewpoint of the attorney, the waiver must be in writing and must be unequivocal.

In France, this exemption applies only to members of the legal profession, as they can be sanctioned by the criminal code if in breach. For others, a confidentiality obligation based on contractual obligations[8] will not be sufficient to trigger an exemption.

The French concept of legal privilege is broad and is not limited to (i) litigators who represent a taxpayer before judicial courts or (ii) an intermediary that determines the legal position of the taxpayer.[9] Accordingly, lawyers, notaries, and certified public accountants ("*Experts-comptables*") are within the scope of the legal professional privilege.

The French guidelines provide a detailed procedure in order to inform other intermediaries or the taxpayer and the steps for an efficient and legal waiver of the professional privilege. The notification to the taxpayer should include all information the intermediary is aware of, or that is under its control or possession, in order for the taxpayer to be in a position to report the C.B.A.

The French legislation also allows a notified intermediary or the taxpayer to revise the initial assessment regarding the facts and circumstances of the reportable nature of the arrangement. Should either conclude that there is no obligation to report, the initial intermediary that is bound by the professional privilege cannot be held responsible if the C.B.A. is ultimately deemed reportable by the tax authorities.

## Timing and Information for Filing

Intermediaries generally must file information that is within their knowledge, possession, or control on an R.C.B.A. within 30 days, beginning at the earliest of the following times:

- On the day after the R.C.B.A. is made available for implementation
- On the day after the R.C.B.A. is ready for implementation
- When the first step in the implementation of the R.C.B.A. been made

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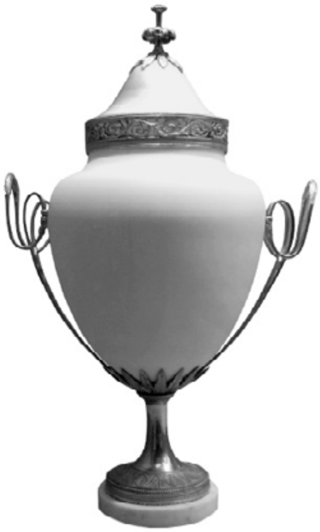
8 This is true for example in Portugal.

9 This approach, in line with the exemption from the reporting obligations laid down in the Anti-Money Laundering Directive (2015/849), has been chosen by Belgium.



For an intermediary that is a Service Provider, the 30-day window begins on the day the intermediary first provides aid, assistance, or advice in relation to designing, marketing, or making available the C.B.A.. When a French lawyer provides a detailed tax memorandum to a client with respect to a reportable C.B.A., the 30-day period likely begins at the moment the lawyer/advisor sends the tax advice to the client, even if the client fails to implement the arrangement. However, as of the date of this article, no final decision on point has been reached.

In computing the 30-day period, calendar days are used, not business days as used by the O.E.C.D. or other countries.

In practice, it is difficult to identify the date on which an intermediary makes an arrangement available to a taxpayer. Indeed, there are as many starting points and delays as there are situations. Much depends on whether the intermediary's obligation derives from its qualification as Promoter, Service Provider, taxpayer, Service Provider who receives notification from another intermediary bound by the legal privilege, or service provider receiving notice from a person resident in another E.U. Member State.

Regarding the content of a report, a wide range of data relating to the arrangement, the tax benefit, and the taxpayer concerned must be reported to the French tax administration. The report may be made in French or English. I should contain the following information:

- A summary note describing the arrangement and the Hallmarks, if possible, in English language, on which the scheme rests
- Legal information on the intermediaries and taxpayers
- An estimate of the valuation of the arrangement

The method of valuing the arrangement is an open question. When some countries have taken a more conservative approach and define the valuation as the estimation of the tax advantage, the French legislation indicates that the valuation of the arrangement relates to the amounts at stake in the transaction – reported at nominal value which depending on the facts of the transaction, might differ from the Fair Market Value ("F.M.V.").

The information to be reported is the same no matter which Hallmark triggers the reporting obligation. The mention of the Hallmark present in the transaction is the only specific information.

Filing should be done electronically on the French tax authorities' portal. According to French law,[10] insufficient or incomplete reporting of information or lack of notification to intermediaries or taxpayers is subject to a fine up to €10,000 (or €5,000 for a first offence every three years). The amount of the fine applied to a single intermediary or taxpayer may not exceed €100,000 per calendar year.

## REPORTABLE CROSS-BORDER ARRANGEMENT

Once it is understood who should be attentive to the reporting obligation, the challenge is to identify R.C.B.A.

[10] C.G.I. art. 1649 AD and following.

## Identification of Cross-border Arrangements

As the D.A.C.6 directive does not provide a definition, the French legislation[11] refers to the O.E.C.D. to provide a broad definition. Hence, the definition of the term "C.B.A." mirrors the definition of the term "arrangement or transaction" in article 29 of the O.E.C.D. Model Convention on Income and on Capital ("O.E.C.D. Model Treaty"). The guidelines provide a nonexhaustive but longer list of operations that could qualify as an arrangement, such as an agreement, understanding, scheme, transaction or a series of transactions whether or not legally enforceable.

Arrangements include the creation, assignment, acquisition or transfer of income itself, or the property or right in respect of which such the income accrues. These terms also encompass arrangements concerning the establishment, acquisition or the dissolution of a legal entity or the subscription to financial instruments.

The definition is so broad that, in the view of many commentators, an arrangement may include many subparts such that it is difficult to know if one should declare one arrangement or several arrangements, in particular when different Hallmarks are present.

The French guidelines provide examples from the O.E.C.D. Model Treaty. Included is an arrangement where steps are taken to ensure that meetings of the board of directors are held in a different country in order to claim that the company has changed its residence.

***"By itself, waiting cannot be considered to be an arrangement. This covers situations in which a taxpayer merely waits for a certain deadline to expire or a certain time period to end before it carries out a transaction in order to benefit from a tax exemption. . ."***

By itself, waiting cannot be considered to be an arrangement. This covers situations in which a taxpayer merely waits for a certain deadline to expire or a certain time period to end before it carries out a transaction in order to benefit from a tax exemption, such as waiting for the dividend distribution in order to dividend to benefit from the participation exemption.

Under the French legislation, to be an R.C.B.A., (i) the arrangement should concern France and another State, whether or not in the E.U. and (ii) one or more of the participants in the arrangement should be resident or have activities in more than one State.

The group of participants in an arrangement refers to the taxpayer, associated enterprises being active in the arrangement, and any other person active in the arrangement. The final version of the French guidelines exclude intermediaries from the definition of participants.[12] This is in accordance with the Directive, which does not count intermediaries as participants.

A participant may be defined as any entity participating in the arrangement that is affected or affects the legal or economic position of other entities (also participants) whose role leads to a potential tax avoidance outcome or meets a Hallmark requirement. Such a definition of participant involves the taxpayer and third parties.

As regards the notion of "cross-border" of C.B.A., French law is not perfectly aligned with the definition of D.A.C.6 and is narrower insofar as it only covers arrangements

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11 F.T.C. art. 1649 AD.

12 Unlike some M.S. that would include intermediaries when they directly and materially interfere with the arrangement or when their intervention gives rise to the application of a hallmark.

that concern France. As a result, for arrangements in which an intermediary, a taxpayer, or an associated enterprise is located in France but is involved with an arrangement that only relates to countries other than France, no report is required in France. In comparison, once an arrangement implicates France, the arrangement falls within the scope of R.C.B.A. even though none of the participants have a residence or an activity in France.  A potentially significant number of situations might be concerned.

To be reportable, a C.B.A. should be aggressive. In order to determine if a C.B.A. is "aggressive", the key issue is now to identify whether it contains at least one of the "Hallmarks."

## Identification of the Hallmarks of a Cross-Border Arrangement

A Hallmark is a characteristic of an arrangement that could indicate a potential risk of tax avoidance. The mere existence of a Hallmark is enough to be an indication of a potential risk of tax avoidance. The goal of the reporting mechanism is to identify the tax planning arrangements that the tax authorities may wish to review.

In general terms, French Hallmarks are the same as those set out in D.A.C.6 and are drafted in the same terms. There are generic and specific Hallmarks linked to the Main Benefit Test ("M.B.T.") and specific Hallmarks related to cross-border transactions .

## Generic and Specific Hallmarks Linked to the M.B.T.

Generic Hallmarks and some specific Hallmarks trigger a reportable obligation only when the M.B.T. is met, such as Hallmarks A, B and C1b(i), c, and d. The M.B.T. is met if the main benefit or one of the main benefits that can reasonably be expected from an arrangement is obtaining a tax advantage considering all the relevant facts and circumstances.

In France, this M.B.T. definition is similar to the French general anti-abuse rule ("G.A.A.R."),[13] which has been enriched with a new concept allowing the French tax authorities to challenge a transaction, namely the mini abuse of law concept ("*mini abus de droit*"). This new legal ground enables the French tax authorities to disregard acts implemented to obtain, as the main purpose or one of the main purposes, a tax benefit which is contrary to the aim or the purpose of the tax legislation. As a result, intermediaries and taxpayers could be torn between a willingness to comply with the reporting obligations under D.A.C.6 and a fear of pleading guilty to a mini abuse of law.

French case law decided many years ago holds that the choice of the most favorable tax solution does not, in itself, constitute an abuse of law.[14] Indeed, between two paths, the taxpayer is never forced to choose the one that is less advantageous from a tax point of view. One should wonder how this definition will be articulated with the case law that is bound to develop as compliance with D.A.C.6 will increase or be sanctioned.

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[13] F.T.C. art. L64 A.

[14] *Conseil d'Etat*, March 21, 1986, *Société Auriège*.

## Generic Hallmarks

The Hallmarks in Categories A will only give rise to a reporting obligation if the M.B.T. has been met.

*Hallmark A1 – Confidentiality Clause*

This first Hallmark is an arrangement where the relevant taxpayer or a participant in the arrangement undertakes to comply with a condition of confidentiality which may require them not to disclose how the arrangement could secure a tax advantage *vis-à-vis* other intermediaries or the tax authorities.

French tax authorities indicate that agreements with a nondisclosure clause regarding information on estate planning arrangements to other intermediaries or to the French tax authorities are within the scope of Hallmark A1. Consequently, a simple confidentiality clause to any third party in an agreement related to estate planning arrangements will meet Hallmark A1, even where there is no express mention to other intermediaries or to French tax authorities – if the M.B.T. is met.

France makes an exact transposition of the Directive, in comparison with other Member States whereby the confidentiality could be induced by circumstantial factual elements even when there was no confidentiality clause in the arrangements.

*"The Hallmarks in Categories A will only give rise to a reporting obligation if the M.B.T. has been met."*

*Hallmark A2 – Success Fees in Relation to a Tax Benefit*

The French legislation follows the Directive and adds the need for a direct link between the tax benefit achieved and the fees received by the intermediary.

*Hallmark A3 – Use of Substantially Standardized Documentation and/or Structures*

The last general Hallmark concerns any arrangement that has substantially standardized documentation and/or structure and is available to more than one taxpayer without a need to be substantially customized for implementation.

Following D.A.C.6, the French guidelines provides examples to illustrate its application:

- The French Equity Savings Plan (*Plan d'Epargne en Actions* or P.E.A.), for which documentation is standardized is outside the scope of Hallmark A3 as these saving plans and their tax benefits result from a national law rather than arrangements designed by intermediaries.
- On the contrary, employees' share-ownership arrangements which aim to convert salaries into capital gains will meet the definition of Hallmark A3 as soon as the capital gain is taxable at a lower rate than salaries, even if no standard model of employee's equity plan is used and each plan is different. Consequently, French guidelines consider that a cross-border management package available to some managers only will be in the scope of Hallmark A3.

French guidelines do not define "substantially standardized documentation and or/structure" in relation to groups of companies. Hence, this term can have broad scope. To illustrate, it seems to cover internal standard intercompany loan agreements or support services agreements within a group and standardized agreements for transactions with clients or suppliers  To limit an overbroad interpretation of this Hallmark, some Member States provide a detailed definition and expressly excluded intercompany services agreements, license agreements, loans agreement, and secondment agreements.

## Specific Hallmarks

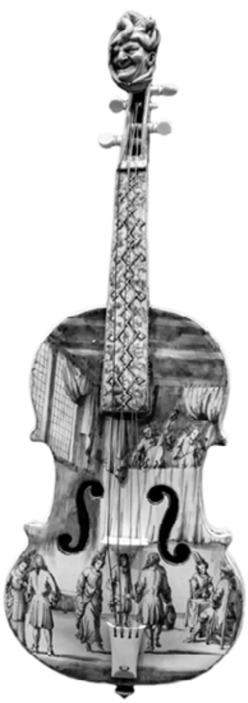
The Hallmarks of Category B (specific Hallmarks linked to the M.B.T.) only focus on income taxation. They mention three techniques developed to obtain tax benefits and include the acquisition of a loss making company (Hallmark B1), the conversion of income (Hallmark B2) and the round-tripping of funds (Hallmark B3).

As under Category B, the link with the M.B.T. applies, but functions in this context as evidence that the applied techniques are expected to obtain a tax benefit. However, if the tax benefit is not one of the main benefits, the arrangement does not need to be reported.

### *Hallmark B1- Exploiting Tax-Deductible Losses*

An arrangement meets Hallmark B1 if a participant[15] in the arrangement takes artificial steps in order to acquire a loss-making company, discontinue its main activity, and use its tax losses in order to reduce tax liability. The transfer of losses may be to another jurisdiction or to accompany that can accelerate the use of those losses.

The guidelines note that the acquisition of companies whose operations have already ceased at the time of acquisition or that are generating profits at the time of acquisition is also not covered by the Hallmark. However, this Hallmark is not clear as to whether a company with loss carry-forwards must generate profits for a minimum period of time to be excluded from Hallmark B1.



French guidelines implement the exact wording of the Directive and emphasize the fact that the three criteria are cumulative, which means that the intention when acquiring a loss-making company and implementing the arrangement is necessary for the arrangement to be within the scope of Hallmark B1.

### *Hallmark B2 – Conversion of Income to Reduce Taxes Due*

An arrangement meets Hallmark B2 if it has the effect of converting income into capital or gifts or other categories of revenue that are taxed at a lower effective rate or that are exempt from tax or not subject to taxation. Here again, the French guidelines follow the wording of the Directive.

The definition of a conversion and the determination of when it occurs are unresolved questions. Is the lower tax rate sufficient for Hallmark B2 to apply or must a real change in the nature income occur?

The French guidelines illustrate the application of the Hallmark with two examples. One involves a conversion of service remuneration into dividends and the other involves income derived from a life insurance contract.

Another unanswered question is whether a stream of income must exist at the time of the change in its character or whether Hallmark B2 is applicable merely when one makes a decision prior to the recognition of any income? In comparison to guidelines of other Member States, the French guidelines do not provide any indication that the absence of a pre-existing situation does not prevent the application of Hallmark B2.

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[15] See definition §16.

*Hallmark B3 – Circular Transactions Resulting in the Round-Tripping of Funds*

Hallmark B3 applies to arrangements that include circular transactions resulting in the round-tripping of funds, namely through interposed entities without another primary commercial function. It also applies to transactions that offset or cancel each other.

French guidelines specify that Hallmark B3 refers to arrangements involving transactions that result in a circular movement of funds that otherwise meet one or more of the following conditions:

- Presence of interposed entities without a primary business function in the arrangement
- Presence of transactions that offset or cancel each other
- Presence of other equivalent characteristics

The guidelines indicate further that this Hallmark targets arrangements in which funds originating in a Member State pass through one or more intermediary companies established in Member State or a state outside the E.U. in order to benefit from favorable tax treatment after which the funds return to the Member State of origin.

The guidelines, however, do not address the factual and temporal connection between two offsetting transactions. For instance, it is currently not clear whether offsetting transactions that occur after a significant period of time has passed would be considered as non-reportable.

## SPECIFIC HALLMARKS RELATED TO CROSS-BORDER TRANSACTIONS CONCERNING AUTOMATIC EXCHANGE OF INFORMATION AND ACTUAL BENEFICIARIES AND TRANSFER PRICING

### Specific Hallmarks – Cross-Border Transactions

*Hallmark C – Deductible Cross-Border Payments Between Associated Enterprises*

The first list of Hallmarks under Category C refers to arrangements that involve deductible cross-border payments made between two or more associated enterprises where one or more of the following conditions occur:

- The recipient is not resident for tax purposes in any tax jurisdiction.
- Although the recipient is resident for tax purposes in a jurisdiction, that jurisdiction
  - does not impose any corporate tax or imposes corporate tax at the rate of zero or almost zero, or
  - is included in a list of jurisdictions that are noncooperative, as determined collectively by E.U. Member States or are noncooperative within the framework of the O.E.C.D.

- The payment benefits from a full exemption from tax in the jurisdiction where the recipient is resident for tax purposes.
- The payment benefits from a preferential tax regime in the jurisdiction where the recipient is resident for tax purposes.

All four situations require deductible cross-border payments between associated enterprises, resulting in a favorable tax treatment at the level of the recipient.

Arrangements qualifying under Hallmark C1(a) and (b)(ii) are always reported. The M.B.T. is not a relevant consideration.

Under Hallmark C1(a), where the recipient not a resident in any tax jurisdiction, D.A.C.6 seems to presuppose that the payment will not be taxed. It does not address the treatment of a payment to a nonresident that has been subjected to withholding tax in the source State. It also fails to address income that is attributed to a P.E. of the nonresident recipient that is taxed in the State where the P.E. is located.

Hallmark C1(b)(ii) appears to be more logical. When a tax authority of the recipient entity is unwilling to exchange information, it becomes difficult for tax authorities of Member States to assess the main benefit.

French guidelines adopt the wording of the Directive and clarifies some elements of this Hallmark:

- The term "recipient" is defined as the person liable to pay tax on the payment. The French guidelines also provide for a specific identification of the recipient for pass-through entities.
- A corporate tax rate is considered to be "almost zero" when its effective tax rate is not more than 2%. France's choice of a 2% rate is within the average of Member States; some have chosen a lower rate, 1%, and some have chosen a higher rate, 4% or 5%.
- France's choice to take into account the effective tax rate, and not the statutory rate, has been made by very few countries.
- In connection with the term "payment," it is assumed that Hallmark C1 is intended to apply to deductible payments such as interest, royalties, or rents. Other Member States have clarified that the notion of payment encompasses all types of payments, whether or not income is ultimately realized.
- In connection the list of noncooperative jurisdictions, the definition used by the French guidelines are not identical to those of D.A.C.6, since it refers to the O.E.C.D. list. As this list is regularly updated, the applicable list is the one in force on the date of the triggering event for the reporting obligation.

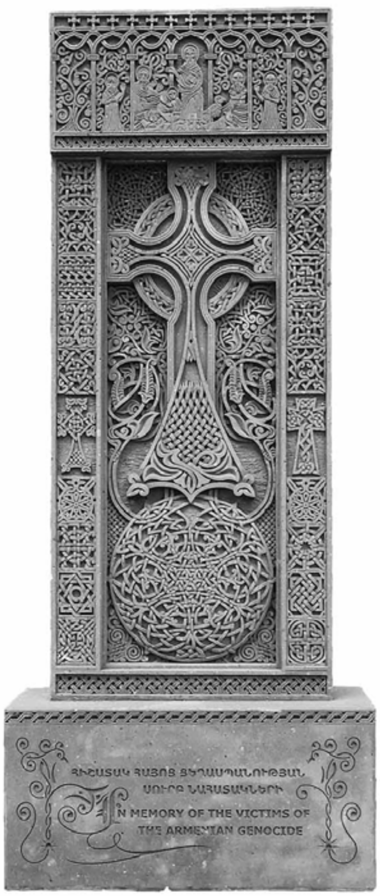
### *Hallmark C2 – Deductions for the Same Depreciation of an Asset That are Claimed in More Than One Jurisdiction*

Here again, French law and guidelines have used the same wording as the Directive. Hallmark C2 concerns only cases where the tax deduction for depreciation of the same asset is claimed in more than one jurisdiction without an accompanying double inclusion of income recognized for accounting and tax purposes.

*Hallmark C3 – Relief from Double Taxation in Respect of the Same Item of Income or Capital Claimed in More Than One Jurisdiction*

In such cases, the arrangement that gives rise to the tax relief must be reported, unless double relief is in accordance with the intention of the French or European legislator. Arrangements based on treaty shopping should be reported, which in principle, is consistent with Action 6 of B.E.P.S.

Here again, French law and guidelines have used the same wording as the Directive. The French tax authorities were careful to clarify that this Hallmark does not apply to provisions designed to eliminate double taxation under an existing bilateral tax treaty, provided that the use of the provision is not contrary to the legislator's intention.




Taxpayers located in countries with anti-hybrid rules, implemented under A.T.A.D. 2 and Action 2 of B.E.P.S., must report hybrid arrangements.

*Hallmark C4 – Transfers of Assets Where There is a Material Difference in the Amount Being Treated as Payable in Consideration for the Assets in the Jurisdictions Involved*

The definition used in the French Tax Code is similar to the one in the Directive. This Hallmark covers transfers of assets where the valuation methodology significantly differs by jurisdiction. As an example, one jurisdiction uses net book value in measuring the transaction and the second jurisdiction uses market value.

The French guidelines specify that merger and similar transactions realized in accordance with the E.U. Mergers Directive are excluded from the scope of this Hallmark.

This Hallmark makes no distinction between intra-group transfers, internal transfers between a legal entity and a P.E. in another country, and transfers to third parties.

Finally, questions exist as to which valuation differences are significant or material. For example, assume one Member State excludes from the scope of this Hallmark differences that are consistent with legislative intent. At the same time, a second Member State indicates that a difference in values used of up to 25% is not characterized as material difference.

## Specific Hallmarks – Automatic Exchange of Information on Ownership

Category D refers to the rules defined by the O.E.C.D. in 2018 in the *Model Mandatory Disclosure Rules for Common Reporting Standards ("C.R.S.") Avoidance Arrangements and Opaque Offshore Structures*. C.R.S. was developed by the O.E.C.D. in 2014. It calls on jurisdictions to obtain information from their financial institutions which will be exchanged automatically with other jurisdictions on an annual basis. C.R.S. has rules that set out the financial account information to be exchanged, the financial institutions required to report, the different types of accounts and taxpayers covered, and common due diligence procedures to be followed by financial institutions.

The C.R.S. rules were transcribed in D.A.C. 2. Hallmarks D1 and D2 reflect the new 2018 model established by the O.E.C.D. and reinforce the application of the C.R.S. in the E.U.

For the application of Category D, an arrangement is not considered to have the effect of avoiding C.R.S. merely because the reporting obligation has not been met, provided that the failure to report does not undermine the purposes of the legislation. D.A.C.6 and the French legislation and guidelines transcribe these rules without adding any comments or information.

## Specific Hallmarks – Transfer Pricing

The specific transfer pricing related Hallmarks under Category E cover safe harbor rules (Hallmark E1), hard-to-value intangibles (Hallmark E2), and intra-group transfers that result in profit shifting (Hallmark E3).

The transfer pricing Hallmarks have a very broad reach and apply without regard to the M.B.T. A purely business driven transaction cannot be reportable under these Hallmarks. That results from the divergence in the definition of associated enterprises for Category E and for transfer pricing purposes. For transfer pricing purposes, a 25% interest in an entity generally is not sufficient to constitute control over the transfer prices between related parties. But for D.A.C.6 purposes, a 25% ownership interest is sufficient to trigger the reporting obligation under Category E. Consequently, taxpayers must adopt a new set of transaction tracking rules to ensure compliance with Category E.

### *Hallmark E1 – Arrangement Which Involves the Use of Unilateral Safe Harbor Rules*

Hallmark E1 is met in respect of an arrangement that involves the use of unilateral safe harbor rules. However, neither the Directive nor the French legislation provide a definition of a "safe harbor rule." The O.E.C.D. recommendations provide for a definition that could be of used. They provide that a safe harbor rule is a provision applicable to a category of taxpayers or transactions that provides relief from certain obligations normally imposed under by the general transfer pricing rules of a State.

The French guidelines limit the unilateral safe harbors that are reportable to safe harbors in the transfer pricing area, and not to other possible safe harbor tax rules. One such safe harbor that should not be reportable when used is a thin-capitalization safe harbor.

Further, the French guidelines state that safe harbor rules that are accepted by the O.E.C.D. are not considered unilateral safe harbor rules within the meaning of this Hallmark. One example of an O.E.C.D. safe harbor is an administrative simplification measures that does not directly concern the determination of the arm's length price. Here, the tax authority and a taxpayer may agree in advance on the determination of transfer prices applicable to transactions with associated enterprises as part of an advance pricing arrangement. A second example is a 5% markup of costs for low value-added services.[16]

### *Hallmark E2 – Arrangement Involving the Transfer of Hard-to-Value Intangibles*

An arrangement involving a transfer of hard-to-value intangibles will meet the Hallmark E2 requirements. Again, the definition used in the French legislation and guidelines is similar to that of the D.A.C.6.

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[16] O.E.C.D. 2017 Guidelines, Ch. VII.

The guidelines define the term "hard-to-value intangibles" in line with the definition from D.A.C.6 and O.E.C.D. transfer pricing guidelines. This Hallmark covers situations where (i) the intangible is only partially developed at the time of the transfer, (ii) there will be a delay in achieving commercial exploitation, or (iii) there has never been commercial exploitation of the intangible prior to the transfer. In contrast, where market prices have already been established for patents or trademarks, no hard-to-value intangibles should be deemed to exist for purposes of Hallmark E2.

*"The Directive also does not specify what it means by reliable comparable transactions. The guidelines suggest that the comparability criteria set out by the O.E.C.D. for intangible assets should be used wherever possible."*

Where multiple intangible assets are transferred under a uniform economic process, the transfer is reported only once. The report must include all intangible assets concerned. The purpose of this treatment is administrative simplicity.

Neither the Directive, nor French law, nor the tax authorities have yet addressed whether Hallmark E2 applies to transfers between a headquarters in one Member State and branch located outside that State. In addition, neither the Directive nor French law addresses whether Hallmark E2 applies only to sales of intangible property or whether it applies also to transactions involving the transfer of use of intangible assets, such as licenses involving trademarks or patents.

To be considered hard-to-value, reliable comparable transactions of assumptions must not exist at the time the transaction is concluded so that projections of future cash flows and expected income from the transferred intangible are highly uncertain. The Directive also does not specify what it means by reliable comparable transactions. The guidelines suggest that the comparability criteria set out by the O.E.C.D. for intangible assets should be used wherever possible.

To understand the reach of this Hallmark, consider the transfer of intellectual property from Mexico to the U.S. for purely business reasons. This leads to new royalty arrangements or cost arrangements with entities resident in a Member State of the E.U. (not simply an assignment of existing arrangement). Query. Is this a transfer of use of a hard-to-value intangible? Because of its consequences in the E.U. for taxpayers, would the transfer trigger a reporting obligation and if so, by whom?

*Hallmark E3 – Transfer Halving the Transferor's E.B.I.T. During the Next Three Years*

An arrangement will meet Hallmark E3 if it involves an intra-group cross-border transfer of functions, risks, or assets, provided that the projected annual earnings before interest and taxes ("E.B.I.T.") of the transferor during the three-year period following the transfer are less than 50% of the projected annual E.B.I.T. of the transferor were the transfer not made. Even if realized at fair market conditions, a transfer of assets, a risk or a function may lead to reportable transaction because Hallmark E3 is not linked to the M.B.T.

The definitions used in France again similar to the one in the Directive. However, the following clarifications have been made by the French tax authorities:

- E.B.I.T. is defined by the French General Chart of Accounts – French G.A.A.P.
- The decline in earnings is assessed on the basis of the information available at the time of the transfer, and the decline must be inherent to the functions and/or risks and/or assets transferred.
- Mergers and similar transactions are excluded from this Hallmark.

The concept of E.B.I.T. does not include interest, dividends, and capital gains. Thus, the use of E.B.I.T. does not seem to be relevant for holding companies. This raises the question of whether holding companies are indirectly excluded from Hallmark E3. or whether a criterion other than E.B.I.T. should be substituted. Other Member State have chosen to use another aggregate for holding companies, since interest and dividends are not included in the operating result.

Here again, one can think of a very insignificant transaction like the transfer of a small sale function from a Dutch subsidiary to a French subsidiary that could come within the scope of Hallmark E3. Such a transfer of an intra-group function might result in the requirement to report R.C.B.A., although tax is not a driver in the transaction.

## CONCLUSION

As shown, the French legislation attempts to meet the basic requirements set by D.A.C.6. Nonetheless, several aspects of the law remain uncertain and require clarification.

In addition, Member States publish their local implementation legislation, it is becoming obvious that national implementation of D.A.C.6 could ultimately differ considerably across the E.U. For this reason, it is to be expected that compliance with the reporting obligations will be problematic in the absence of a detailed knowledge of the domestic legislation of each Member State. This need for actual knowledge affects intermediaries as well as taxpayers.