Tax & Bird & Bird

DAC6 – Will it fly?

A new EU Directive comes in force later this year, forcing intermediaries to report certain cross-border transactions. Many intermediaries in the aviation sector may not be aware of their obligations, or that they even are intermediaries. Looking to understand whether you are affected and ensure you are compliant? Read on to find out more.

DAC6 and what it means for you

New EU rules come into force later this year which require intermediaries - eg financial institutions, lawyers and accountants, and in certain circumstances taxpayers themselves – to report certain cross-border arrangements to their local tax authorities.

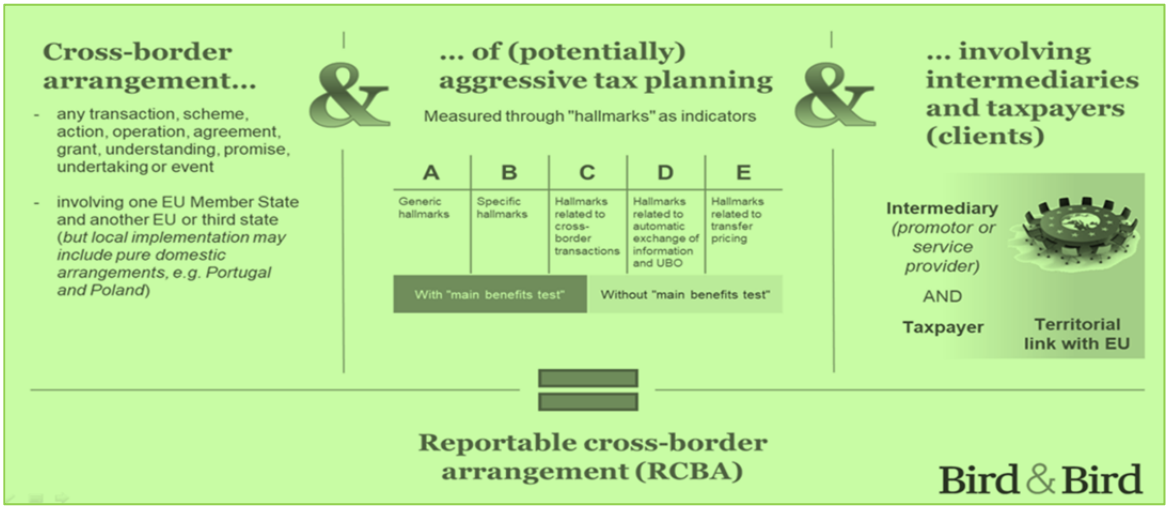
Known as DAC6, or more formally, the 6th Directive on Administrative Cooperation, the Directive aims to discourage the use of aggressive cross-border tax planning arrangements by asking those intermediaries either advising on or implementing them to report the arrangements.

If a cross-border arrangement has certain objective indicators or "hallmarks" then the intermediary is required to report it. In some cases, the hallmarks are only relevant if obtaining a tax advantage is a primary motive for entering into the arrangements. Others are simply reportable because of the presence of the specific hallmarks of which the intermediary is (supposed to be) aware.

Mandatory reporting is due to start on 1 July, 2020 (although this may be delayed by three months as a result of the Covid-19 pandemic), but reporting is also required on arrangements that happened during a transition period between 25 June 2018 until 30 June 2020 (or, potentially, three months later).

Therefore, intermediaries and taxpayers should be reviewing cross-border arrangements containing these hallmarks that they have implemented or advised on since 25 June 2018.

DAC6 in a nutshell



Who is an intermediary?

An intermediary is broadly defined in the Directive as a person who **designs, markets, organises or makes available or implements a reportable arrangement** ("*promotor*" or "*type 1 intermediary*"), or anyone who **directly or indirectly provides aid, assistance or advice** with regard thereto and knows or could reasonably be expected to know that he or she is providing such assistance ("*service provider*" or "*type 2 intermediary*").

The definition of a "service provider" is deliberately broad, and "advice, aid or assistance" could include providing finance, expertise or knowledge, sharing experience or offering accounting advice.The broad scope of the definition means that a large number of those involved in a standard aircraft financing transaction are potentially "intermediaries". It could include:

- consultants, accountants, financial advisers, lawyers (including in-house counsel);
- banks, trust companies, insurance intermediaries, etc.

Although most parties in the chain are unlikely to be treated as "promotors" because they do not provide tax advice and do not actively design aggressive tax arrangements, they will still be treated as "service providers". This would include financial institutions and may also include lessors where those lessors are effectively structuring the deal.

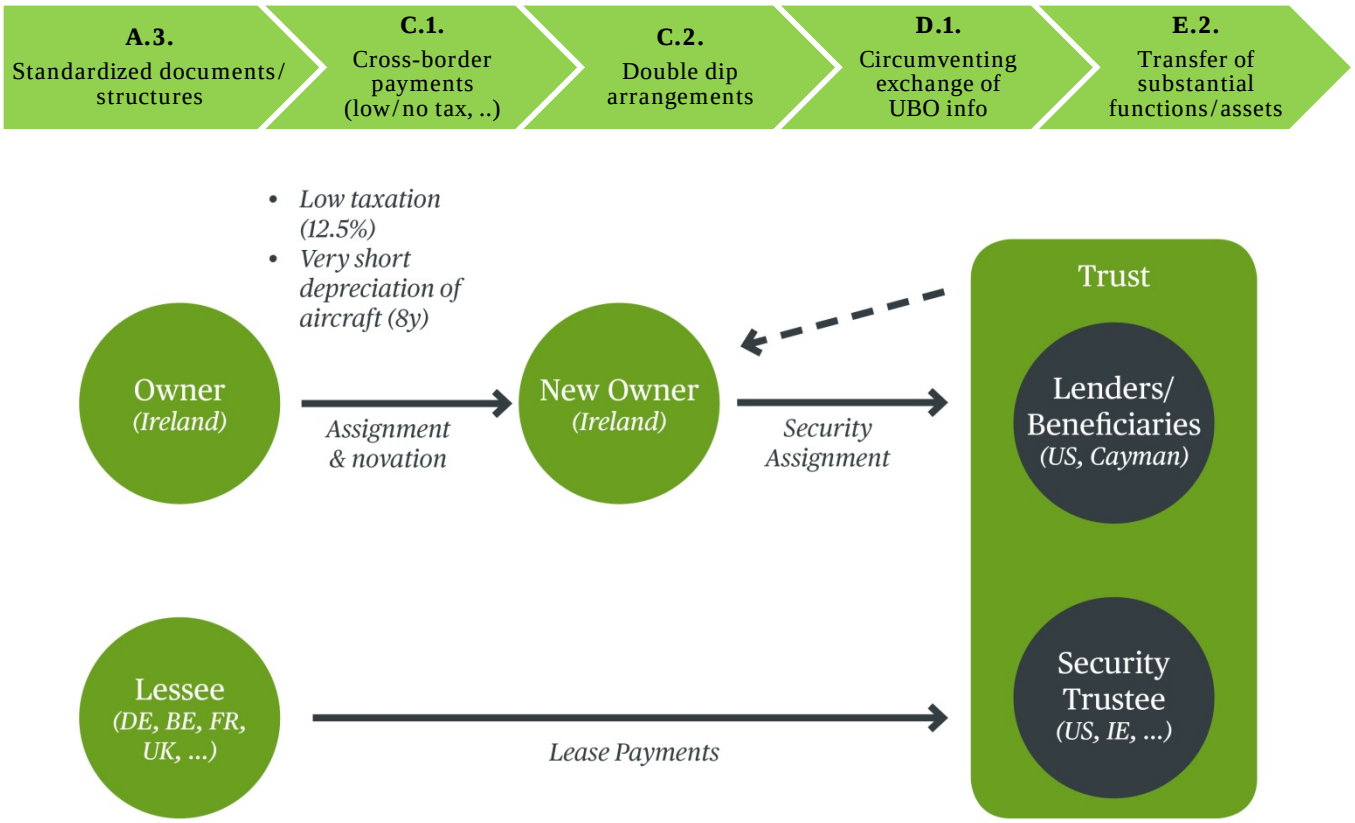
When a service provider is not aware or is not assumed to be aware of their participation in a reportable arrangement, they will not be required to make a report. Guidance is available on what a service provider should be aware of. The UK tax authorities will provide detailed guidance setting out what would be expected of intermediaries in different situations, but they have already stated that intermediaries will not be required to undertake additional customer due diligence beyond what they would normally do in the course of their business and in compliance with existing obligations. Tax authorities in each member state make take different views on this point.

Additionally, for an intermediary to be subject to these rules, there must be a connection to the EU. This means they must be:

- resident for tax purposes in an EU Member State/the UK;
- have a permanent establishment in an EU Member State/the UK through which the services with respect to the arrangement are provided;
- be incorporated in or governed by the laws of an EU Member State/the UK; or
- be registered with a professional association related to legal, taxation or consultancy services in an EU Member State/the UK.

What are the key hallmarks for aircraft finance transactions?

We set out below a typical aircraft financing transaction involving the assignment and novation of an existing lease, as well as the granting of new security. The diagram below shows some of the hallmarks which may be triggered. As set out above, some of these hallmarks also require there to be a tax advantage motive, so an intermediary would need to consider each of these factors to determine whether a report is required.



What kinds of transactions will need to be disclosed?

When reviewing historic transactions, intermediaries may need to report transactions which have no tax avoidance motive, but still fall within these rules. Therefore, reviews of all transactions implemented or advised upon since 25 June 2018 should be undertaken, as well as systems put in place for the review of all future transactions to ensure reports are made as required.

Assignment of aircraft or engines to an SPV for ringfencing purposes may trigger the hallmark regarding the transfer of substantial assets, particularly where the transfer occurs between single asset SPVs. This would result in 50% decline of EBIT and would therefore fall within the rules. There is no requirement for a tax avoidance motive where this hallmark applies.

Structures which result in an aircraft being eligible for amortisation in two jurisdictions at the same time, ie so called "double dip" arrangements may require disclosure.

Many aircraft finance arrangements use a market standard structure and standardised documents. This would fall within the first category of hallmarks, although also requires a tax avoidance motive.

Finally, any payments which are deductible in one jurisdiction and made to a recipient who either pays little or no tax on the receipt, or is tax resident in a "non-cooperative" jurisdiction would also need to be disclosed.

Payments from a lessee in an EU member state to a Cayman lessor, for example, would be included. The list of non-cooperative jurisdictions is relatively limited at the moment, and under constant review.

What are the penalties for non-disclosure?

The Directive requires member states to adopt effective, proportionate and dissuasive penalties. This has been implemented differently across the EU with Hungary and Slovenia imposing a maximum fine of €25,000, whereas the UK's maximum fine is £1 million and Poland's is €4.7 million.

How can Bird & Bird assist?

Our international tax team advises clients on whether they have disclosure obligations, and whether or not certain activities contain hallmarks.

We advise clients on how to manage and coordinate their reporting obligations, especially where multiple intermediaries (across a variety of countries) are involved.

Please get in touch to find out more about how we can help.

Your key contacts

Zoe Feller
Partner, London

Tel: +442030176950
zoe.feller@twobirds.com

Brent Springael
Partner, Brussels

Tel: +32 2 282 60 42
brent.springael@twobirds.com

twobirds.com

Abu Dhabi & Amsterdam & Beijing & Berlin & Bratislava & Brussels & Budapest & Copenhagen & Dubai & Dusseldorf & Frankfurt & The Hague & Hamburg & Helsinki & Hong Kong & London & Luxembourg & Lyon & Madrid & Milan & Munich & Paris & Prague & Rome & San Francisco & Shanghai & Singapore & Stockholm & Sydney & Warsaw