DAC6 reporting: Ten steps to streamlined compliance

WHITE PAPER

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DAC6 is here, but regulatory reporting requirements will be a moving target for companies as the underlying rules evolve and countries beyond Europe adopt similar initiatives.

The sixth version of the European Union's Directive on Administrative Cooperation — commonly referred to as DAC6 — is a mandatory disclosure regime (MDR) that affects all multinational corporations with business operations in the EU. It is intended to identify "aggressive" cross-border tax arrangements and thwart tax avoidance. Failure to comply can trigger stiff penalties and cause reputational damage for companies. Tax advisory firm Deloitte described[1] DAC6 as "one of the most significant changes for tax advisors, service providers, and taxpayers in recent years."

Compliance is complex and challenging: rules vary from one participating country to the next and reporting guidelines, deadlines, and penalties will inevitably change and diverge as policymakers and tax authorities refine or reshape the regime.

Meanwhile, more jurisdictions are expected to enact rules overseeing cross-border tax arrangements. DAC6 is the EU's response to the BEPS Action 12 initiative[2] spearheaded by the Organisation for Economic Co-Operation and Development (OECD). BEPS is a global initiative, however, so similar responses can be expected beyond the EU — starting with Mexico's MDR.

The challenges

Gratian Joseph, CEO of Orbitax, the international tax software company, recently described[3] challenges that multinational enterprises (MNEs) face as they strive to comply with DAC6 requirements:

- In the past, rules requiring the disclosure of aggressive tax planning activities have included a list of defined transactions that are considered suspect and, therefore, require reporting. DAC6 does not work that way. Instead, it uses "hallmarks" — characteristics that might require a transaction to be reported if it also has cross-border tax implications and involves at least one EU member state. Some of these hallmarks are common in agreements — confidentiality clauses and standardized documents, for example — and many require subjective interpretation. As a result, companies must assess a wide range of activities and determine which, if any, to report.

- DAC reports can be triggered by units throughout a company and they must be filed within 30 days, so MNEs need controls in place to ensure reportable transactions are identified promptly. Joseph recommends a customized survey tool. "Start out by casting a wide net in terms of the survey questions and the various respondents that you reach out to," he says. "And send out the survey as frequently as every three weeks to ensure that, if something is reportable, you can meet the 30-day timeline. With time, you can be more targeted with the questions in the survey, narrow the number of respondents, and even consider reducing the frequency."

- Disclosure obligations can diverge from one country to the next, because 20-plus EU states have enacted their own DAC6 rules and reporting deadlines. "You have to stay on top of the country legislation, including the implementation guidelines, and some countries are more active than others," Joseph notes. "The Netherlands, for example, puts out additional guidance on a regular basis. (MNEs need) a system that is constantly being updated with the rule changes and clarifications."

- MNE's DAC6 decisions — including decisions not to report particular arrangements — must be defensible. "You have to have a process to ensure that all of these arrangements are run through the same workflow as those that you end up reporting so you can document all the evidence as to why they were not considered a reportable cross-border arrangement," Joseph advises. "This way, you can refer to the documentation when there is an inquiry."

1 DAC6: EU Mandatory Disclosure Regime--New tax transparency initiative increases reporting requirements.
2 Action 12 Mandatory Disclosure Rules, OECD.
3 Hallmark Strategies to Stay Ahead of DAC6, a session conducted as part of Synergy 2020, Thomson Reuters' annual user conference.

- There are many hallmarks and their application is complicated. "The EU directive has listed a total of 15 hallmarks, but some have sub-categories, so the actual count is more like 29," Joseph explains. "Some hallmarks also require additional conditions like meeting a 'main benefit test' or the participation of associated or related parties." Joseph groups the hallmarks into five categories:
  - Category A hallmarks address how arrangements are implemented — do they utilize standardized documentation or a nondisclosure agreement, for example.
  - Category B hallmarks address the overall effect of the arrangement — did it, for example, convert high-tax income into low-taxed income.
  - Category C hallmarks can be divided into two subcategories — one is triggered by low-tax status and the other when a tax advantage is the impetus for a transaction.
  - Category D hallmarks target arrangements that bypass transparency initiatives so investors and owners are not identified to tax authorities.
  - Category E hallmarks focus on related-party transactions based on a 25% ownership threshold or management participation.

"I think the takeaway is that early on during DAC6 compliance you want to look at most cross-border arrangements involving an EU member country to see if they meet any of the 29 hallmarks, because the coverage is quite broad and even routine business transactions may have to be reported," Joseph notes. "With time you can start to narrow the scope of the transactions you review, because you'll develop a better sense for the type of arrangements in your organization that could trigger hallmarks and all countries will have provided more exact guidance."

Here's how one early-adopter made their DAC6 reporting protocols adaptable, scalable, and future-proof.

Putting all the pieces together

David Gassman is the director of tax operations at Cowen, Inc., a financial services firm with offices worldwide. When he and his team learned that DAC6 was coming they set out to build a tax reporting solution that would do more than comply with the current rules as written.

That's because they knew the guidelines would continue to change, Gassman explains.[4] "We really wanted to come up with a solution that allowed us to tackle both what needs to be done (now) and also what could be coming down the road," Gassman says. "We needed to future-proof."

This mindset led the Cowen tax team to forge an operational model built on three pillars: people, process, and technology. Here are their key steps and takeaways:

1. First, they evaluated how DAC6 rules might affect Cowen's business and concluded that a broad range of its transactions could be impacted because the hallmarks include potential triggers — such as non-disclosure tenets and standardized documentation — that are common in their agreements.
2. They engaged a wide range of internal stakeholders, educated them about DAC6 and its implications, and solicited their input regarding a technology solution and operating model. As a result, the stakeholders were equipped to explain DAC6 requirements and the need for a systemic solution to their stakeholders and the executives leading their business lines and divisions.
3. The tax team mapped a workflow relying on internal surveys to surface on a timely basis cross-border activities that might need to be disclosed under DAC6.

4 *Hallmark Strategies to Stay Ahead of DAC6*, a session conducted as part of Synergy 2020, Thomson Reuters' annual user conference.

4. Clear roles and responsibilities were essential. "We came up with action items for everybody — business units, leadership, and the people who need to provide the tax information and supporting documentation," Gassman says. "As part of that (effort), we also agreed to an operating model. It's managed by a core group of people because you need someone who's responsible and accountable to make sure you're getting feedback and sign-off on surveys and information from business lines."
5. Cowen wanted a single tool for managing DAC6 so nothing was missed inadvertently and all information was standardized, centralized, and traceable for internal and external audits. "We wanted traceability from the time that an entity starts pre-arrangements all the way to the filing," Gassman explains, "so that anybody can look at what the requirements are, what we're reporting, and be sure it's consistent with what's actually happening. . . If a tax authority comes back and says, 'You told us you did these three activities. Show me the evidence' — well, we have it in the tool already."
6. Data privacy controls were established so Cowen's system and processes were compliant with the European General Data Protection Regulation and similar standards.
7. Cowen needed a global tool that would support the company in all the regions it operates in and reflect regulations in each country participating in DAC6 now and likely to adopt MDRs in the future. "Germany is live. Finland's live. We see other markets coming on in Europe, and we're hearing things out of Asia," Gassman notes. "We're hearing things out of Latin America. We wanted one solution. We didn't want to have to go out and get separate solutions for each continent of country."
8. The solution needed to be scalable, so it would keep up with Cowen's growth and expanding, evolving rules and regulations. "We didn't want to put any limitations on our business," he says.
9. This need for repeatable processes and a single global, scalable tool required a technology solution designed for DAC6 compliance. "We wanted a system. We did not want to hire armies of people," Gassman says. "We wanted to get this out of the 'manual workflow' mindset. . . . The right solution is scalable and technology-driven, because (otherwise) complying with all the different rules can be very expensive." The Thomson Reuters® DAC6 & MDR Reporter powered by Orbitax fulfilled all of Cowen's requirements for a successful system today and a foundation for the future.
10. After implementing the solution, Cowen turned to training. "The Thomson Reuters team and the Orbitax team were phenomenal partners in training. They gave us overviews and details. They answered our questions and even took some of our feedback to help improve the system."

Cowen's first DAC6 filing, in Germany, was successful and has informed their data management, validation, and reporting in other jurisdictions. "That was great success," Gassman says. "I can't speak highly enough about the Orbitax workflow. It worked in a transparent way so people knew what obligations they had and what information was being submitted — and they know what's going on in almost real-time. That's a really priceless thing in this global environment that we work in."

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