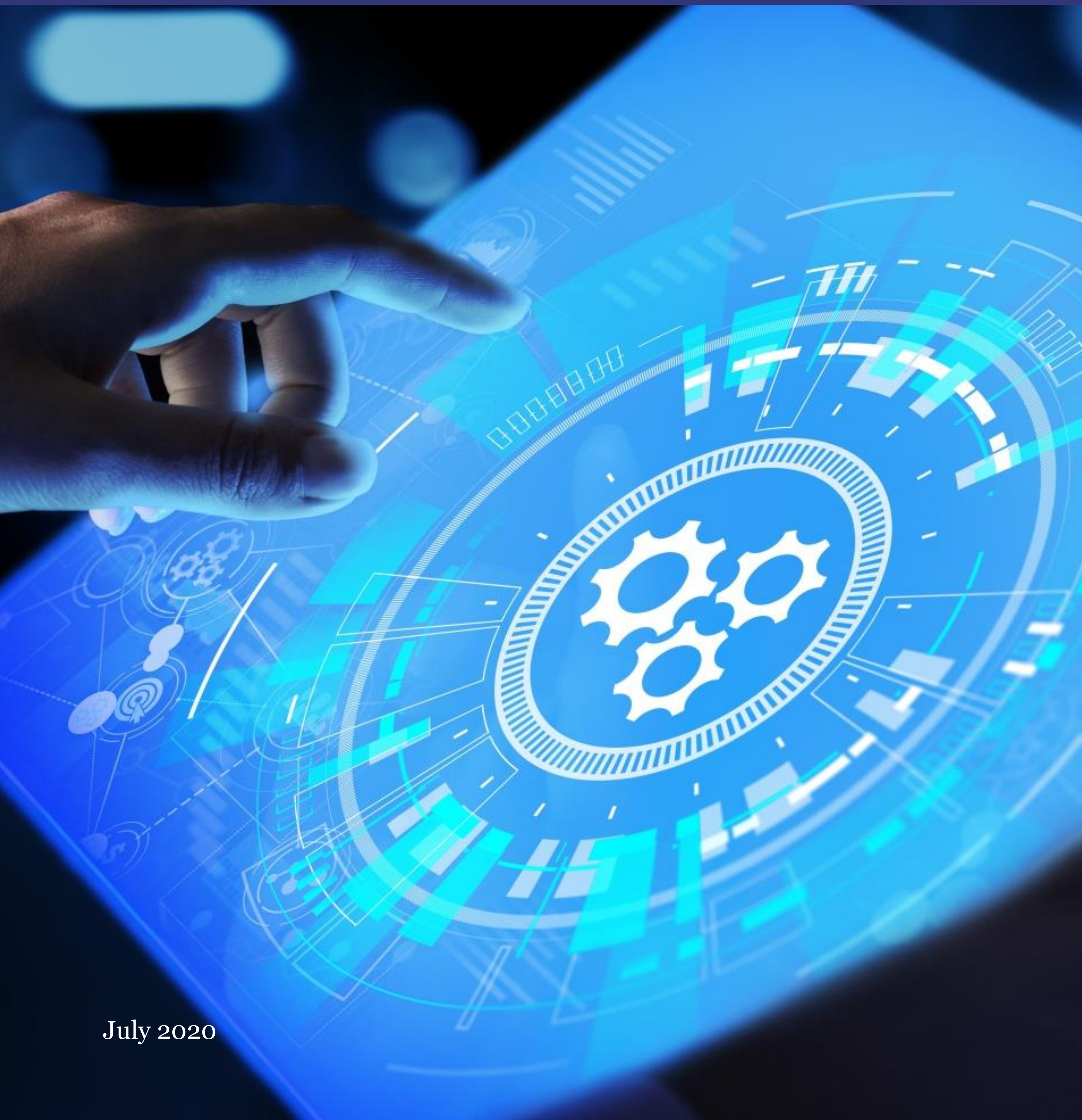
Bird & Bird

DAC6 Briefings: IP Transactions



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DAC6 in a nutshell

Cross-border arrangement...

- any transaction, scheme, action, operation, agreement, grant, understanding, promise, undertaking or event
- involving one EU Member State and another EU or third state (*but local implementation may include pure domestic arrangements, e.g. Portugal and Poland*)

&

... of (potentially) aggressive tax planning

Measured through "hallmarks" as indicators

A	B	C	D	E
Generic hallmarks	Specific hallmarks	Hallmarks related to cross-border transactions	Hallmarks related to automatic exchange of information and UBO	Hallmarks related to transfer pricing
With "main benefits test"		Without "main benefits test"		

&

... involving intermediaries and taxpayers (clients)

Intermediary *(promotor or service provider)*

AND

Taxpayer

Territorial link with EU

=

Reportable cross-border arrangement (RCBA)

"DAC6" or the 6th Directive on the Administrative Cooperation between EU Member States aims at improving the functioning of the internal market by discouraging the use of aggressive cross-border tax planning arrangements.

In a nutshell, the directive requires intermediaries (such as IP lawyers or patent attorneys) – or in certain circumstances the taxpayers themselves (such as the IP owners) – to report any advice and/or implementation of a cross-border arrangement of potentially aggressive tax planning to the local tax authorities. The presence of such aggressive tax planning is evaluated on the basis of certain objective indicators (called "hallmarks"). Some of these hallmarks only become relevant if one of the arrangement's primary motives is to obtain a tax advantage. Others will just be reportable based on specific indications that the taxpayer or intermediary is (supposed to be) aware of.

For further general information, please consult the first issue of our DAC6 Briefings ("Introduction of a Mandatory Disclosure Obligation") or visit the [DAC6 In Focus] page on our website. This Briefing builds on the general knowledge of previous issues, with a focus on what these rules mean for IP transactions.

Key hallmarks for IP related transactions

B.2. Conversion of income into less taxed item → **C.1.** Cross-border payments (low/no tax, ..) → **C.4.** Consideration mismatch → **E.2.** Transfer of hard-to-value intangibls → **E.3.** Transfer of substantial functions/assets

Hallmark B.2. targets arrangements whereby existing **revenue streams are converted into a more favourably taxed income** item. However, such arrangement would only be reportable if the main benefit of this conversion was to obtain this tax benefit.

It should normally not target the implementation of the least taxed arrangement if there was no prior existing arrangement (*i.e.* there is no 'conversion'). This might be caught by another hallmark however.

Hallmark C.1. targets a number of **cross-border payments**.

A **first category** represents payments to associated recipients that are resident in **tax favourable jurisdictions**, *i.e.* zero tax jurisdictions (or tax havens), jurisdictions with preferential tax regimes for specific type of income, or jurisdictions with a territorial tax system (exemption for foreign source income).

A **second category** represents payments to associated recipients that are (i) **not resident** for tax purposes in any tax jurisdiction, or (ii) resident in a **non-cooperative jurisdiction** (according to EU or OECD).

Hallmark C.4. targets arrangements that take advantage of a **consideration mismatch**, *i.e.* where two jurisdictions would assess the price for the transfer of an asset differently. In practice, this will be most relevant where a service is implicitly included in the asset transfer and the value of that service is valued differently or not at all in one of the jurisdictions. No apparent tax motive is required to trigger reporting.

Hallmark E.2. targets arrangements involving the transfer of **hard-to-value intangibles** between associated companies. The term "hard-to-value intangibles" covers intangibles or rights in intangibles for which, at the time of their transfer (i) there are no reliable comparables; and (ii) at the time the transaction was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain.

Hallmark E.3. targets intra-group arrangements involving the **transfer of functions, risks or assets** as a consequence of which the transferor's projected EBIT over a period of 3 years is going to be less than 50%, had he not transferred those functions, risks or assets. No apparent tax motive is required to trigger reporting.

Note: *The above list is certainly not exhaustive for IP transactions, but rather a list of what are likely the most common hallmarks that will have to be monitored.*

How does this translate to IP related activities?

In general, IP professionals and owners should generally **not be concerned** with any reporting obligation when dealing with **IP litigation** (but caution for out of court settlements – see below), **trademark registrations, searches or renewals**, or **IP transfers to third parties**.

However, DAC6 will typically impact IP related activities that imply the setup of a structure or arrangement which implicates an **intra-group revenue stream** and/or the **transfer of IP rights**.

More concretely, any implementation of an **intra-group transaction that involves royalty payments** to jurisdictions that enjoy a favourable tax regime for such royalties (*eg*. a patent box, no corporate income or only a territorial tax system) will be reportable if the primary motive was to benefit from such favourable tax regime. Also, payments to so-called stateless companies (pursuant to conflicting residence rules) or companies in non-cooperative jurisdictions will be reportable, even in the absence of any tax motive (Hallmark C.1.).

This rule may come into play in the context of an out of court settlement: it is not uncommon that in view to fiscally optimize settlement indemnification, ill-advised parties qualify the settlement indemnification as a royalty to have it enjoy the favourable tax regime (also Hallmark B.2.), or to divert a settlement royalty to another group entity that benefits from a favourable tax regime. This is the type of aggressive tax planning that DAC6 seeks to expose.

From a transfer pricing perspective, IP owners and IP professionals should also always closely monitor whether the IP rights that are being transferred do not fall within the scope of **"hard-to-value intangibles"** (HTVI) (Hallmark E.2.). "Hard-to-value" means that there are no reference prices with unrelated parties and no predictable future cashflows. Particularly patents which are transferred early stage and have not yet been commercialised with third parties, are prone to qualify as HTVI.

In the event that IP is registered in the name of an IP holding company and the group decides to move the IP portfolio to another jurisdiction in order to be (more) compliant with BEPS regulations, such transfer will likely trigger a reporting obligation as this will entail the transfer of substantial assets (Hallmark E.3.). A tax motive is not required.

Finally, IP owners should be attentive to a consistent reporting. Therefore, when they (plan to) carry out an intra-group IP restructuring, engagement terms with the various IP intermediaries should be coordinated. Even though intermediaries are not allowed to waive any reporting, they can adhere to a reporting framework that ensures a consistent approach on the data that are submitted to the tax authorities, which avoids confusion about potentially contradicting views or assessments by the relevant IP professionals.

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 the reporting, if multiple intermediaries (whether or not in various countries) are involved, through DAC6 frameworks. 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

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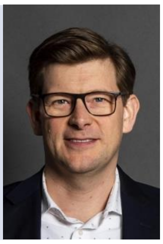

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