

Bird & Bird & DAC6 Briefings: Investment funds



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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)

Bird & Bird

“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 financial institutions) – or in certain circumstances the taxpayers themselves (such as the leasing companies) – 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 financial institution 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 investment funds.

Key hallmarks for investment funds

B.3.
Round-tripping
of
funds

C.1.
Cross-border
payments (to non-
residents, tax havens..)

D.2.
Non-transparent legal
or beneficial
ownership

Hallmark B.3. targets arrangements whereby **funds are being circulated** through various steps with no economic benefit.

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 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 D.2. targets arrangements involving **non-transparent legal or beneficial ownership** chains.

There are three main conditions:

- the use of persons/structures not carrying on substantive economic activity;
- they are established in another jurisdiction than that of the UBO; and
- the UBO is made unidentifiable

Even though standard practice and not motivated by tax reasons, these conditions are quite often met when using trusts in a jurisdiction which has not implemented a UBO register for such type of entities.

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



How does this translate to investment funds?

Investment funds can be organized in many ways and in a different context. Hence, there is no one-size-fits-all DAC6 approach. However, intermediaries (such as asset managers, fund administrators, financial institutions or advisors) should be wary of certain hallmarks that may be relevant in the funds industry. Intermediaries also do not have to be active in the arrangement as such. It suffices to be reasonably expected to know, from professional experience, that one assisted or advised the fund with respect to a reportable arrangement.

The setup of an investment fund, as such, with foreign investors should not *per se* be a reportable arrangement, even if it is clear that the investment fund benefits from an advantageous tax regime. However, if the fund would be interposed in way to take advantage of a mismatch in legislation between the fund's jurisdiction and the jurisdiction of either its foreign investors or its foreign 'targets', the place or form of the investment fund could be key in the arrangement, making it potentially a reportable arrangement.

And that relevance or mismatch could exist in the following scenarios, just to name a few:

- Financial income (dividends, interest, ...) is routed through a foreign investment fund, despite having a domestic origin, in order to benefit from preferential tax treaty terms or other similar benefits (hallmark B.3.). The round tripping of the funds serves little to no commercial purpose and is done primarily to achieve the beneficial treatment;
- The design or implementation of an investment fund arrangement is dictated by the residence of the fund partners in order to take advantage of tax benefits. This could for instance be to shelter tax deductible payments from EU in an offshore fund (hallmark C.1.);
- a fund set up in the form of a US LLC is typically treated as transparent from a US tax perspective and not resident in any jurisdiction. If a fund holds at least a 25% interest, tax deductible payments to such fund could trigger a reporting obligation (hallmark C.1.). A similar concern arises for funds that would be set up in a non-cooperative jurisdiction;
- An investment fund structure could potentially make use of a non-transparent vehicle that does not carry on a substantial economic activity and which conceals the identity of the ultimate beneficial owners (hallmark D.2.). An investment fund is likely to carry out an economic activity, but in the event of a multi-tier structure, it cannot be excluded that the structure falls into this category.

Several of these hallmarks would require the "main benefit test". However, it should be considered that – if the tax authorities can reasonably identify a tax benefit – it is up to the taxpayer or intermediary to be able to prove that it was not the intention to obtain such tax benefit. And this may be difficult to evidence for more complex structures.

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.

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