With effect from 1 July 2020, new mandatory disclosure obligations to tax authorities of certain cross-border arrangements have come into force in Germany. The new rules are based on the 6th EU Directive on Administrative Cooperation ("DAC6").

Even though the underlying updated EU rules would have allowed for a deferral in reaction the Covid-19 pandemic, Germany has now opted - at short notice and in contrast to almost all other EU Member States - to not defer the start of the reporting regime.

As a consequence, a comprehensive range of market participants in lending transactions are now required to fully understand, comply with and monitor these new disclosure obligations.
Crucially, this does not only include borrowers, lenders and other parties actually entering into the transaction and its documentation, but also their advisors, including M&A / debt advisories, law firms and accounting firms. As certain intra-group transactions will also trigger the new regime, likewise private equity forms need to keep a close eye on their portfolio companies as well as in particular CEOs, treasurers, board members and managing directors of corporates need to be aware of their statutory responsibilities and consequences of any breaches.

This briefing provides an overview as to the “must-know” background features of DAC6 in light of the specific key issues to be considered in lending transactions (see Section IX below).

**I. DAC6 - WHAT’S THIS AND WHERE DOES IT COME FROM?**

Once initially suggested by the OECD, the EU Commission and the EU Member States have decided to further promote tax transparency in the European Union by specifically tackling aggressive cross-border tax planning and structuring.

The existing Directive on Administration Cooperation dated 15 February 2011 (Directive 2011/16/EU) was therefore amended by the Council Directive dated 25 May 2018 (2018/822/EU), requiring the EU Member States to introduce respective national law rules by the end of 2019 and to start applying the new disclosing regime latest from 1 July 2020 onwards.

Germany has enacted DAC6 into national German law by the Act on the Introduction of an Obligation to Notify Cross-Border Tax Arrangements dated 21 December 2019 (Federal Law Gazette Part I 2019 No. 52) (the “German DAC Act”). Consequently, relevant provisions have been added to the German Fiscal Code (Abgabenordnung).

**II. WHAT IS THE SCOPE OF DAC6?**

With only limited exceptions, DAC6 generally applies to all types of taxes imposed by an EU Member State. and requires the mandatory reporting of cross-border arrangements (“Arrangements”) which fulfil certain criteria called hallmarks (“Hallmarks”).
However, it is crucial to note that the rather broad language of DAC6, which has been mirrored by the German DAC Act, not only captures rather obvious aggressive tax strategies but also other cross-border arrangements which do not appear to specifically relate to tax structures at first sight. Each limb of the DAC6-test therefore requires careful and thoughtful assessment as to its potential scope and the resulting impact on resulting reporting obligations.

III. WHICH ARE THE RELEVANT HALLMARKS UNDER DAC6?

Hallmarks by which Arrangements are only caught if they fulfil the so-called Main Benefit Test ("MBT"). The MBT is fulfilled if an informed third party may reasonably expect, taking into account all material facts and circumstances, the main benefit, or one of several main benefits, of the arrangement to be a tax advantage.

Hallmarks by which Arrangements are caught irrespective of the MBT.

<table>
<thead>
<tr>
<th>Hallmarks linked to MBT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Confidentiality undertakings; fees linked to tax savings; usage of standardised transaction documentation or structures.</td>
</tr>
<tr>
<td>Acquisition of loss-making entities; income-to-capital-conversion; circular transactions; certain deductible cross-border payments where the recipient of the payment or the payment as such are subject to no or almost no tax or a specific preferential tax regime.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Hallmarks not linked to MBT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cross-border payments where the recipient is tax resident in no jurisdiction or a non-cooperation jurisdiction; the same business expenses deducted in more than one jurisdiction; double non-taxation due to tax exemptions in two jurisdictions; cross border transfers of assets where the valuation of the same asset deviated between jurisdictions.</td>
</tr>
<tr>
<td>Arrangements which intend to effect the undermining of applicable tax reporting standards and/or the obscuring of the beneficial ownership chain.</td>
</tr>
<tr>
<td>Transfer pricing by involving unilateral safe harbours rules; involvement of hard-to-value intangibles; certain intra-group transfers which result in a 50% or more reduction in projected annual earnings of the transferor in the next three years.</td>
</tr>
</tbody>
</table>

IV. WHO DOES REPORT UNDER DAC6?

The reporting obligations require action first and foremost from everyone qualifying as a so-called intermediary ("Intermediary"). This includes any person (natural or legal) that designs, markets, organises, makes available, implements or manages the implementation of a reportable Arrangement and is tax resident in, or otherwise connected to, an EU Member State.

Examples include sponsors of a private equity / investment fund, fund managers, group treasuries, holding companies, parent companies, borrowers, lenders, agents, trustees, mandated lead arrangers, lawyers (including both external law firm and internal in house counsel, subject to legal privilege, depending on jurisdiction and applicable regime), M&A advisors, debt advisors, tax advisors, auditors, providers of other consultancy services, insurance companies, family offices.
If two or more persons qualify as Intermediary, the reporting by one Intermediary will generally be sufficient to satisfy the legal DAC6 requirements (subject to certain formal requirements).

If and to the extent a transaction does not involve an Intermediary, or any suitable Intermediary is subject to legal privilege, the actual taxpayer (“Taxpayer”) will be obliged to report itself. Such Taxpayer reporting obligations will in particular arise in purely intra-group transactions which do not involve third parties outside the group.

V. TO WHOM?

Reports in Germany are to be made to the German Federal Central Tax Office (Bundeszentralamt für Steuern) web-based using a specific online interface. The German Federal Central Tax Office has published step-by-step guidelines and video tutorials to assist with the implementation and usage of the reporting scheme.

Reporting in relation to a particular Arrangement however may require reporting in more than just one EU Member State if an Intermediary has a connection to several EU Member States or the Arrangement involves different persons with varying connections to several EU Member States.

VI. WHICH DEADLINES HAVE TO BE MET?

Due to the COVID-19 pandemic, the EU Council has, based on a proposal of the EU Commission dated 8 May 2020, approved certain amendments to the initial Directive 2011/16/EU on 19 June 2020 allowing the EU Member States to opt to postpone the initially set deadlines by up to six months. However, Germany has opted to not postpone the deadlines in a rather surprising last-minute move and in contrast to the vast majority of the other EU Member States.

Consequently, reports in respect of any Arrangement conducted from 1 July 2020 onwards have to be submitted within 30 days after the earlier of the Arrangement being ready for implementation and the first of several steps of implementation having been completed / the Arrangement having been fully implemented.

However, reports will also have to be made for any historic Arrangements dating back up to 25 June 2018. The reports in respect of those historic Arrangements are due by 31 August 2020.

VII. WHICH INFORMATION NEEDS TO BE REPORTED?

The German Federal Central Tax Office requests, in particular, the following information to be provided:
• Identity of Intermediary and Taxpayer (including name, address, birth date/place, country of residence and tax identification number as well as persons related to the Taxpayers, if relevant)

• Description of the Arrangement (including business activities and underlying legal provisions)

• Value and timing of implementation of the Arrangement

• Applicable Hallmark

• Involved EU Member States and any other EU Member State likely to be affected by the Arrangement

Each submission will be assigned a registration number (“Arrangement ID”) as well as a separate disclosure number (“Disclosure ID”).

If an Intermediary reports, it has to pass on the obtained Arrangement ID and Disclosure ID to the Taxpayer, inter alia, to allow it to include such numbers in its tax returns.

VIII. BREACHES AND THEIR CONSEQUENCES

In Germany, the authorities may award monetary fines up to EUR 25,000 per case if the relevant failure has been committed intentionally or recklessly.

Notably, the EU Member States have taken different approaches as to the scope and nature of penalties for breaches which consequently materially vary across the EU.

IX. WHAT SPECIFIC IMPACT DOES DAC6 HAVE ON LENDING TRANSACTIONS?

Reportable Arrangements may capture a wide range of planning, structuring and transactions. This may include all types of lending transactions, in particular in an acquisition financing context, but also in more general syndicated, club or bilateral leveraged or investment grade (corporate loan) transactions.
More generally, banks and other financial institutions provide a wide range of ancillary services and functions, from the simple maintaining of bank accounts and the wiring of money for borrowers, guarantors and other group companies party to, or indirectly involved with, a financing up to more sophisticated structuring of financings and the providing of cross-selling products, including private banking for wealthy individuals, succession planning and real estate. Many, if not almost all of them, rather not specifically see the financial institution providing direct tax advice but could nevertheless indirectly relate, or otherwise affect, their customers’ tax affairs and thereby potentially trigger disclosure obligations.

As to the documentation of lending transactions based on the LMA recommended forms of documentation, the Loan Market Association has issued a guidance paper as to the immediate impacts of DAC6 on its template documentation (accessible for subscribed members on the LMA website). In addition, please see the paper “Application of DAC6 to Financial Products and Services” dated June 2020 issued by the ISDA for further guidance as to the impact of DAC6 on a wider range of financial products and services.

As many transactions and financial institutions will act in a cross-border context and the definition of an Arrangement is generally broad, the crucial test to be passed is exactly which role a financial institution plays and whether or not a Hallmark is actually triggered.

It is questionable whether a financial institution, in particular when lending, provides “aid, assistance or advice...with regards to making the arrangement available for facilitation” at all. Often, a financial institution may not be aware of, or aim at, any particular tax-driven aspects nor be involved in the planning, structuring or implementation thereof. In addition, it usually rather does not directly or indirectly intend to facilitate or benefit from any tax evasion by a customer.

These are strong arguments to demonstrate that a financial institution which merely lends to a customer should not qualify as Intermediary. However, as such definition allows for a broad interpretation as well as the function of a financial institution may reach beyond any rather plain services. For example, the role as an arranger, including marketing the loan in a primary syndication, or more sophisticated deal activities, such as the review and approval of tax structure memorandums in acquisition financings, may cross the line.

Financial institutions who offer and conduct such services are assumed to fully understand the characteristics and impacts of the underlying transactions, including their tax-specific aspects, and may therefore not argue not having actual knowledge of, or not having investigated as to, the actual facts of a particular transaction.

It is therefore crucial to carefully assess the exact role and scope of activities undertaken in relation to a customer and the business mandate. This also comes with the burden to complete such assessment in each relevant jurisdiction as the exact scope of “Intermediary” might differ across EU Member States. To illustrate, the United Kingdom has introduced a concept of “Service Provider” which has no equivalent in Germany.
The financial institution may also acquire knowledge, or reasonably be expected to have an adequate level of knowledge, about the existing status of the borrower’s affairs and relevant past transactions, for example which may come to light as part of a due diligence, as well as, looking forward, the borrower’s lending purpose and any relevant underlying structures. This also applies to any planned or potentially arising intra-group arrangements, such as cash pooling systems, disposals, mergers, and other transfers the loan agreement may allow for.

As to the Hallmarks, the following examples may serve to demonstrate areas of particular concern:

- **Confidentiality clauses** are a standard feature of the LMA recommended documentation for lending transactions, including for loan agreements, reliance letters, commitment letters and others. In the current form, they might prevent the required disclosure to the relevant tax authorities as they do not expressly allow for it. The LMA has therefore provided sample language which parties might consider to add to their documentation to address such issue.

- As the usage of standardised transaction documentation, such as the LMA recommended documentation, together with market precedents, very often forms the basis of transactions, Category A might be triggered also related thereto. Also, financial institutions should carefully check as to any in-house standard / template documentation regularly used for customer transactions. Business / Loan Terms and Conditions (Allgemeine Geschäftsbedingungen / Allgemeine Darlehensbedingungen) to govern the civil rights and duties as well as investment conditions (Anlagebedingungen) or investment prospectuses (Anlageprospekte) are more likely to benefit from exceptions.

- Borrower-related transactions relating to, for example, the acquisition of loss-making entities, would typically not be actively arranged by financial institutions; to be on the safe side, any lender might nevertheless wish to capture any qualifying transactions by disclosure obligations prior to committing to the transaction and afterwards by way of representations and undertakings in the loan documentation providing comfort that the borrower, and if applicable, its group, are not close to passing the MBT for such limbs. Any such confirmation could be repeated on an ongoing basis and/or even be included in one of the regular certifications to be submitted as part of the general reporting package.

- The same may be true, for example, for cases of double non-taxation in two jurisdictions. While such transactions are usually not expressly permitted in the loan documentation, the relevant lenders could rather easily reach comfort by demanding related ongoing safeguard provisions in the loan documentation.

- In addition to intra-group disposals or other ways of transfer of assets, common intra-group treasury instruments such as cash pooling or zero balancing might cross the line in multi-national groups. Again, any loan documentation should ideally capture any
risk relating therefrom by adequate representations, undertakings and event of defaults.

- Generally, any kind of transactions linked to certain blacklisted jurisdictions, such as the Cayman Islands or Panama, should raise immediate concerns now also in relation to DAC6.

- The verification of a party’s beneficial ownership chain has already become a standard feature of know-your-customer checks in financing transactions in recent years, including due to legislation such as the English law PSC register and German banking law requirements pursuant to the German Banking Act (Kreditwesengesetz). It is crucial that financing institutions, as well as legal and other advisers, maintain and apply highest standards to also tackle any potential inconsistencies from a DAC6 perspective. This is even more true as the nature of beneficial ownership for tax purposes may not necessarily be identical to that for German Bank Act purposes.

In addition to the sophisticated testing of Hallmarks, parties should not underestimate the administrative burden of facing multi-jurisdictional parties on one or even both sides of a financing transaction, with various finance parties and borrowers / other relevant group members potentially being exposed to different reporting obligations in different jurisdictions.

It is therefore key to adopt a standard process at an early transaction stage to agree and communicate who will have the primary obligation to report, which information will be disclosed and whether the disclosure documentation will have to be agreed with, signed off by, or just provided for information purposes to all other parties.

The reporting party may also be asked to undertake to share the Arrangement ID and Disclosure ID to all other parties to allow them to then merely pass on such IDs to the authorities to satisfy their very own obligations. Any such set-up needs to carefully factor in that in the very same transaction e.g. one lender might not be required to disclose due to not being an EU bank or not being sufficiently closely involved whereas others might well qualify as Intermediaries or being the beneficiary of the transaction.

Consequently, all parties involved not only need to familiarise themselves with the underlying legal requirements, maintain internal structures to identify, collect, analyse, document and disclose Arrangements as well as implement internal training, supervision and reporting systems, but also introduce an adequate and clear external responsibility and communication strategy as a tick-the-box exercise at a very early stage of each lending or other finance transaction.

**X. AND WHAT ABOUT JURISDICTIONS OTHER THAN GERMANY?**

As many of the scenarios and transactions affected are likely to relate to more than one EU Member State, it is crucial to assess right from the onset any potentially involved jurisdictions and its specific requirements.
Even though DAC6 forms the joint basis of all national laws and regulations, the national lawmakers have enjoyed, and made use of, a certain extent of flexibility, in particular the scope of legal or other professional privilege will vary due to deviating legal traditions and laws already in place and different countries are taking different views about the severity of breaches.

Notably, DAC6 has also been transferred into national law in the United Kingdom and as of now, it is widely expected that the United Kingdom will continue to apply DAC6 after the end of the EU withdrawing period on 31 December 2020. Updates should however be closely watched.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

DR STEFFEN C. HÖRNER
PARTNER, GERMANY

+49 69 2222 82462
steffen.hoerner@hsf.com

DR KATJA LEHR,
LL.M. (UCL)
COUNSEL, GERMANY

+49 69 2222 82567
katja.leaner@hsf.com

LEGAL NOTICE

The contents of this publication are for reference purposes only and may not be current as at the date of accessing this publication. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.

© Herbert Smith Freehills 2020