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Interpreting the Mandatory Disclosure Rules for Tax Intermediaries

22 October 2020

This Position Paper sets out the MIT's views on the interpretation and practical application of the provisions of the Cooperation With Other Jurisdiction On Tax Matters Regulations (S.L. 123.127) implementing Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, the "Mandatory Disclosure Rules for Tax Intermediaries."

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This paper sets out the views of the MIT on the subject-matter addressed and is intended to assist MIT members in their application of the Mandatory Disclosure Rules for Tax Intermediaries. However, any views expressed herein may, ultimately, not necessarily be consistent with guidance which may be issued by the Commissioner for Revenue in connection with the Mandatory Disclosure Rules for Tax Intermediaries subsequent to the date of publication hereof. MIT Members are, of course, encouraged to consider the contents of this paper in light of any such guidance once it is issued and in light of any other pertinent materials which may be published in respect of the Mandatory Disclosure Rules for Tax Intermediaries.

Any comments or queries concerning the contents of this paper should be addressed to the Chief Technical Officer on CTO@maintax.org or MIT@maintax.org

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1. Introduction

The Legislation

The Cooperation with Other Jurisdictions on Tax Matters Regulations (S.L. 123.127) (hereinafter the "**Regulations**"), inter alia, transpose the provisions of Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (hereinafter "**DAC6**").

References to the Regulations herein are to be construed limitedly as referring to the provisions of the Regulations which transpose the requirements of DAC6 into domestic law.

The Regulations establish an obligation incumbent upon so-called 'intermediaries' to file information with the Commissioner for Revenue on 'reportable cross-border arrangements' (as defined), that is within their knowledge, possession or control. Where there is no intermediary, or where the filing of information by the intermediary would constitute a breach of professional secrecy,[1] the obligation to file information on a reportable cross-border arrangement would lie with the taxpayer.

The Regulations, which apply as of 1 July, 2020[2], require intermediaries and/or taxpayers to collect relevant information in connection with reportable cross-border arrangements the first step of which was implemented on or after 25 June, 2018. This information must be reported by 28 February 2021.[3]

Applying the Regulations in practice

The application of the legislation in practice invariably requires the interpretation of the relevant provisions and an understanding of the scope of application of the terms as defined therein. For

[1] In terms of Regulation 13(7)(e) of the Regulations, an intermediary whose profession is referred to in Article 3 of the Professional Secrecy Act (Chapter 377 of the laws of Malta) would be entitled to a waiver from the obligation to file information on a reportable cross-border arrangement where the reporting of such information would constitute an offence under article 257 of the Criminal Code. The scope of the said waiver raises several issues (not least insofar as intermediaries may only be entitled to the waiver to the extent that they operate within the limits of the relevant national laws which define their professions) which are currently being considered by the MIT (together with other representative organisations) and will form the subject of a separate paper.

[2] LN 315 of 2020 implementing Directive 2020/876 of 24 June 2020, extended the relevant reporting deadlines. The period of 30 days for filing information shall begin by 1 January 2021 where: (a) a reportable cross-border arrangement is made available for implementation, or is ready for implementation, or where the first step in its implementation has been made between 1 July 2020 and 31 December 2020; or (b) intermediaries provided, directly or by means of other persons, aid, assistance or advice between 1 July 2020 and 31 December 2020.

[3] The original deadline of 31 August 2020 was extended by LN 315 of 2020 implementing Directive 2020/876 of 24 June 2020.

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professionals, the key questions arising from the Regulations in respect of a given arrangement would be – in the following order:

(1) Does an arrangement represent a reportable cross-border arrangement?
(2) Am I an intermediary with respect to the arrangement?
(3) Would the (professional secrecy) waiver apply?
(4) When does the 30-day reporting time-frame start to run?

The members of the Direct Tax Committee and the Council of the Malta Institute of Taxation discussed the Regulations at a think-tank session. This paper sets out the views considered and conclusions drawn during the session and, in turn, the resulting views of the MIT on the specific issues addressed.

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2. Who is a Tax Intermediary for the purposes of the Regulations?

The respective definitions in the Regulations (Reg 13(9)) and DAC6 (article 3(21)) essentially provide that there are, in effect, two types of intermediaries:

(1) The intermediary who designs, markets, organises, makes available for implementation or manages the implementation of reportable cross-border arrangements; and

(2) The intermediary who provides (directly or by means of other persons) aid, assistance or advice with respect to designing, marketing, organising, making available for implementation or managing the implementation of a reportable cross-border arrangement and who knows or could reasonably be expected to know that he has undertaken to provide such aid, assistance or advice in light of relevant facts and circumstances and based on available information and the intermediary's relevant expertise and understanding required for the purposes.

The broad scope of the definition is such that it captures not only professionals who have the technical expertise and understanding of the tax implications, the benefit derived by a cross-border arrangement, the legislation it is based on and/or the criteria which need to be met to achieve the outcome (such as tax, legal and/or accounting professionals), but also other service providers who may promote or otherwise provide assistance in the implementation of arrangements, such as corporate services providers, trustees, real estate agents, banks and financial advisors.

The determination as to whether a person is to be regarded as an intermediary should be made not on the basis of the categorisation of the professional activity of the individual or company concerned, but on the basis of the individual's or company's involvement in a cross-border arrangement.

In our view, in terms of the Regulations, the following would be regarded as an 'intermediary':

- A tax advisor (including a lawyer, accountant, tax practitioner, notary) providing services in connection with a cross-border arrangement, including the provision of a second opinion in connection with a reportable cross-border arrangement.
- Other professionals operating in non-tax fields (including corporate services providers and financial advisors) providing advice or information on or assistance in connection with a cross-border arrangement (such as an auditor issuing a report under Article 73 of the Companies Act (Chapter 386 of the Laws of Malta) in the course of the implementation of a reportable cross-border arrangement);

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- Other persons who may be involved in a cross-border arrangement such as real estate agents and bankers.

It is our view that where a service provider is not involved in the design, marketing or implementation of a cross-border arrangement in terms of point (1) or (2) above, but subsequently becomes aware of the said cross-border arrangement, that service provider should not be regarded as an intermediary for the purposes of the Regulations. For example:

- An Auditor who becomes aware of a reportable cross-border arrangement in the course of a statutory audit being carried out in respect of the company which implemented the arrangement;
- A professional who becomes aware of a reportable cross-border arrangement in the course of a review/audit of advice provided by another unrelated advisor/firm of advisors;
- A practitioner who becomes aware of a reportable cross-border arrangement whilst assisting with the completion of a tax return.

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3. The 30-day reporting window – when is a reportable cross-border arrangement to be regarded as "made available for implementation"?

Regulation 13(7)(a) requires Intermediaries to file information that is within their knowledge, possession or control on reportable cross-border arrangements with the Commissioner for Revenue within 30 days beginning on the earliest of the following:

(i) on the day after the reportable cross-border arrangement is made available for implementation;
(ii) on the day after the reportable cross-border arrangement is ready for implementation; or
(iii) when the first step in the implementation of the reportable cross-border arrangement has been made.

There are a number of ways in which information on a prospective cross-border arrangement may be transmitted by a person to a taxpayer, whether upon specific request, or acting unilaterally pursuant to a marketing or information campaign. The key question is, at what point is the arrangement to be said to have been made available for implementation? Is the provision of information or advice during a physical, virtual or telephonic meeting with a client concerning a potential cross-border arrangement making that arrangement available for implementation? What if the taxpayer is not an existing client? What if the discussion is not held in the context of a formal meeting but an informal one? What if information is shared during the course of a seminar or other public event?

It is, in our view, indisputable that a deliverable in connection with a reportable cross-border arrangement which is in written format (i.e. written advice), and which has been formally signed off, should definitely be regarded as having been made available for implementation. The knowledge of, or the involvement of the intermediary in, the actual implementation of the advice is not relevant.

However, it is recognised that an arrangement may still be regarded as having been made available for implementation even where the advice has not been completed and formally delivered in its final format. In our view, where a person provides advice concerning a cross-border arrangement, whether actual or potential, whether the advice is given in writing or verbally, that person may be regarded as having made the arrangement available for implementation. Submitting written advice on a specific arrangement in 'draft' does not of itself necessarily imply that the arrangement has not yet been made available for implementation. Similarly, the advice should be considered to have been made available for implementation, even in the event of the inclusion of language in the advice (written or verbal), cautioning the taxpayer against the actual implementation of an arrangement, whether on the basis of specific legislative provisions, anti-abuse principles, and/or undesirable commercial and/or practical consequences of or resulting from the proposed arrangement.

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Furthermore, it is our view that an arrangement may be considered to be made available for implementation whether the recipient of the advice (written or verbal) is an existing client, a prospective client, a target client or otherwise. Whether the information or advice is or will be billed for is not relevant.

On the other hand, in our view, the following scenarios should not be regarded as making an arrangement available for implementation:

- An introductory discussion between an advisor and a taxpayer, where the advisor does not have sufficient information about the fact-pattern to establish whether or not the arrangement is in line with tax policy (see discussion below on main benefit test);
- The mere provision of information in respect of one or more provisions of law made outside the context of a specific fact-pattern;
- The provision of information which is generic in scope and which constitutes a statement of the requirements or effects of any rules but which does not amount to a statement on the outcome of the application of the said rules to a specific set of facts and circumstances[4].

[4] Facts and circumstances may be specific even when they are formulated as hypotheticals and do not refer to the facts and circumstances pertaining to a particular person/s.

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4. The Hallmarks

4.1 The Main Benefit Test

In terms of the Regulations, a cross-border arrangement would be reportable if it meets at least one of the prescribed Hallmarks – reproduced in Annex IV of the Regulations. Certain hallmarks are also subject to the so-called Main Benefit Test.

The 'main benefit' test is satisfied to the extent that it can be established that the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement, is the obtaining of a tax advantage.

In turn, when interpreting the manner in which the main benefit test should be applied, it would, in our view, not be unreasonable to limit the application of the test to arrangements which result in the obtaining of a tax advantage which is inconsistent with tax policy objectives.

As a result, when considering whether a cross-border arrangement may yield a tax advantage in Malta, we are of the view that it would not be unreasonable to conclude that a tax advantage which results from the application of the provisions of the Income Tax Acts in a manner which is consistent with domestic tax policy, should not be considered a 'tax advantage' for the purposes of the main benefit test.

When considering whether a tax advantage would be consistent with domestic tax policy, an assessment must be made as to whether the arrangement is likely to fall within the scope of application of:

(i) Article 51 of the Income Tax Act (Chapter 123 of the Laws of Malta);
(ii) Regulation 6 of the European Union Anti-Tax Avoidance Directives Implementation Regulations (Subsidiary Legislation 123.187); and/or
(iii) an anti-abuse rule in any other pertinent domestic legislation, including a relevant double taxation treaty concluded by Malta.

In our view, insofar as an arrangement is not likely to be captured by the provisions referred to in (i), (ii) and/or (iii), then such an arrangement should be considered to be in line with the policy intent of Maltese tax legislation, and as a result should not be seen to meet the requirements of the main benefit test. Similarly, where the declared tax policy position supports the enjoyment of the tax advantage notwithstanding the outcome of the above assessment, our view remains that the arrangement should likewise not be seen to meet the requirements of the 'main benefit' test.

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Notwithstanding the aforesaid, it is recognised that the object and purpose of DAC6 and the Hallmarks which are subject to the main benefit test, as transposed into Maltese law, is to protect against the enjoyment of a tax advantage resulting from the wholly artificial cross-border shifting of profits.

As a result, in our view, an intermediary cannot merely consider whether a relevant cross-border arrangement meets the requirements of the main benefits test in light of domestic tax policy. Rather, in the application of the main benefit test, an intermediary would also be required to consider whether the arrangement as a whole may reasonably be deemed to give rise to a tax advantage accruing in another EU Member State[5] and resulting from the wholly artificial cross-border shifting of profits. To the extent that the arrangement as a whole gives rise to such an advantage, then the arrangement should be seen to meet the requirements of the 'main benefit test'.

When considering whether a cross-border arrangement may yield a tax advantage outside Malta as a result of a wholly artificial cross-border shifting of profits, we believe that it would not be unreasonable to assess the arrangement in light of the arm's length principle, the then current OECD transfer pricing guidelines and pertinent pronouncements in respect of EU law – in particular, judgments of the Court of Justice of the European Union in respect of the arm's length principle and the EU freedom of establishment. As such, should an arrangement be deemed to yield returns which are commensurate with risks, functions and assets, any resulting tax advantage may, in our view, reasonably be considered to be consistent with tax policy and should, therefore, fall outside the scope of the main benefits test. In turn, an arrangement which does not allocate returns amongst participants on an arm's length basis but which is commercially justifiable may likewise fall outside the scope of the main benefits test.

We believe that an assessment of a cross-border arrangement (which meets any of the hallmarks which are subject to the main benefits test) in light of domestic tax policy and such EU tax policy and proportionality standards should properly achieve the object and purpose of the Regulations.

4.2 Hallmarks E: Specific hallmarks concerning transfer pricing

Hallmarks E concern transfer pricing and aim to address arrangements that are contrary to the arm's length principle as reflected in the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2017 ('TP Guidelines'). Insofar as Malta has not yet promulgated or otherwise introduced specific transfer pricing rules, the MIT believes that practitioners should refer to the TP Guidelines in their application of Hallmarks E.

[5] In our view, a tax advantage accruing in a third country (but not in any EU member State – including Malta) should fall outside the scope of the Regulations.

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Hallmarks E are not subject to the main benefit test. Therefore, arrangements meeting the relevant requirements of any of the Hallmarks E are reportable, regardless as to whether such arrangements may give rise to a tax advantage or otherwise.

Hallmark E2 – Hard-to-value intangibles ('HTVI')

Hallmark E2 applies to arrangements involving a transfer of HTVI. The definition of the term 'hard-to-value intangibles' in Hallmark E2 is aligned with the definition contained in paragraph 6.189 of Chapter IV of the TP Guidelines. The TP Guidelines set out features of transactions involving the transfer of HTVI – including the following:

- the intangible is only partially developed at the time of the transfer;
- the intangible is not expected to be exploited commercially until several years following the transaction;
- the intangible is expected to be exploited in a manner that is novel at the time of the transfer and the absence of a track record of development or exploitation of similar intangibles make projections highly uncertain.

It is our view that, for the purposes of the determination as to whether an intangible constitutes HTVI, an assessment should be carried out at the time of the transfer. Where, based on the aforementioned assessment, it is determined that Hallmark E2 is not met at the time of the transfer, this assessment should not be impacted by any event or information which subsequently occurs or becomes subsequently available.

Hallmark E3 – Cross-border transfers

Hallmark E3 applies to arrangements which involve an intragroup cross-border transfer of functions and/or risks and/or assets, if the projected annual earnings before interest and taxes (EBIT), during the three-year period after the transfer, of the transferor or transferors, are less than 50% of the projected annual EBIT of such transferor or transferors if the transfer had not been made. This test looks at projected earnings (EBIT) over a three-year period after the transfer, and the projection over the same period if the transfer had not gone ahead. In our view, such alternative projected earnings should be calculated by reference to the average projected EBIT over the three-year period, starting from the year in which the transfer takes place.

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