

Special issue featuring E3 as the “Hallmark of the month”

A few words on “Hallmarks”

A hallmark is defined as a characteristic or feature of a cross-border arrangement that presents an indication of a potential risk of tax avoidance, as listed in Annex IV of the Directive. The legislative proposal imposes mandatory disclosure (reporting) requirements for arrangements with an EU cross-border element that meet one or more of the listed hallmarks.

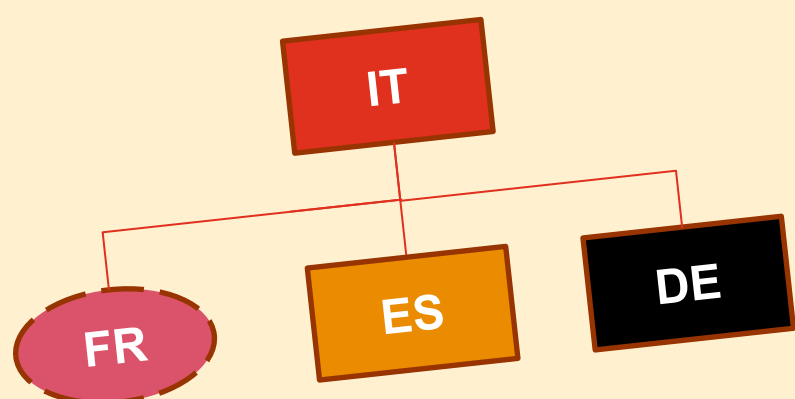
For certain hallmarks it is required that also the main benefit test (MBT) is met in order for the arrangement to be reportable.

Hallmark E3

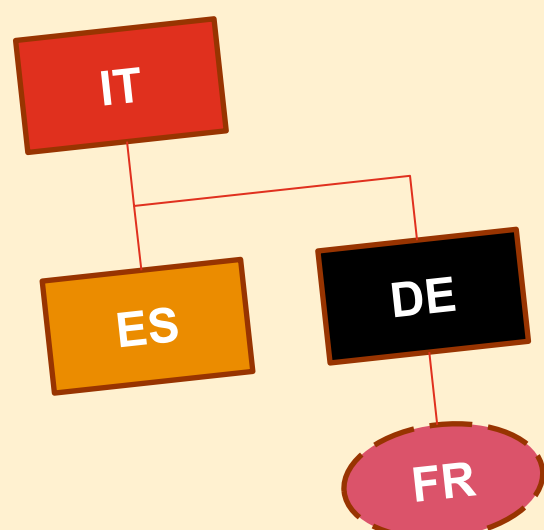
An arrangement is reportable under E3 if it involves an intragroup cross-border transfer of functions and/or assets and/or risks, but only if the projected annual earnings before interest and taxes (EBIT), during the three-year period after the transfer, of the transferor or transferors, are less than 50% of the projected annual EBIT of such transferor or transferors if the transfer had not been made. Hallmark E3 is not linked to the MBT.

Example 1 – Transfer of a permanent establishment

Situation 1 - before restructuring



Situation 2 - after restructuring



An Italian parent company currently has an active operating branch located in France. The Italian parent company decided to reallocate the branch under its German subsidiary.

Is the reallocation of the French branch a DAC6 reportable cross-border arrangement?

Assessment questions

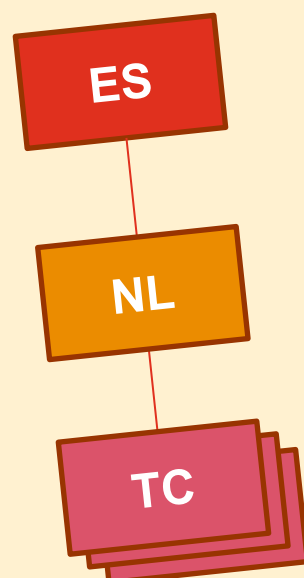
1. Is there an arrangement? **Yes**
2. Is there a cross-border element? **Yes**
3. Is there EU-nexus? **Yes**
4. Are any of the hallmarks met? **Hallmark E3 could be met.**
5. Is the MBT satisfied? **Hallmark E3 is not connected to the MBT.**
6. Does the French branch amount for more than 50% of the EBIT of the Italian parent company before transfer? **Further assessment needed.**

Conclusion

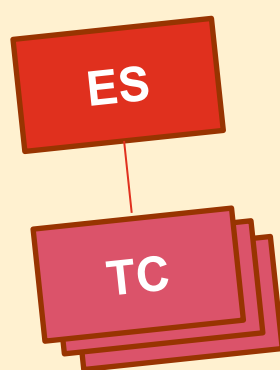
Hallmark E3 could be met leading to the transaction being reportable under DAC6 if the projected EBIT of the Italian parent company fall to less than 50% of what it would have been had the transfer not happened.

Example 2 – Transfer of shares

Situation 1 - before restructuring



Situation 2 - after restructuring



A Spanish-headed group currently includes a Dutch company, which owns some trading companies in third countries. The group wants to save ongoing costs by getting the Dutch company to transfer the shares in the trading companies to the Spanish company, and liquidating the Dutch company.

Is the transfer of shares a DAC6 reportable arrangement?

Assessment questions

1. Is there an arrangement? **Yes**
2. Is there a cross-border element? **Yes**
3. Is there EU-nexus? **Yes**
4. Are any of the hallmarks met? **Hallmark E3 could be met.**
5. Is the MBT satisfied? **Hallmark E3 is not connected to the MBT.**
6. Do the trading companies amount for more than 50% of the EBIT of the Dutch company before transfer? **Further assessment needed.**

Conclusion

Hallmark E3 could be met leading to the transaction being reportable under DAC6 if the projected EBIT of the Dutch company fall to less than 50% of what it would have been had the transfer not happened.

Countries however may take the position that the sale of shares in a subsidiary does not fall within the scope of E3 and/or that EBIT is not impacted upon the sale of shares.

The context of EBIT within E3

The term EBIT is not defined in the Directive, and the Directive doesn't say whether it relates to earnings for tax purposes. Normally the most sensible approach would be to look at the projected profits before interest and taxes in the financial statements, and this must be determined by the intermediary at the time the advice or other services is given.

What does EBIT mean in the context of a transfer of shares?

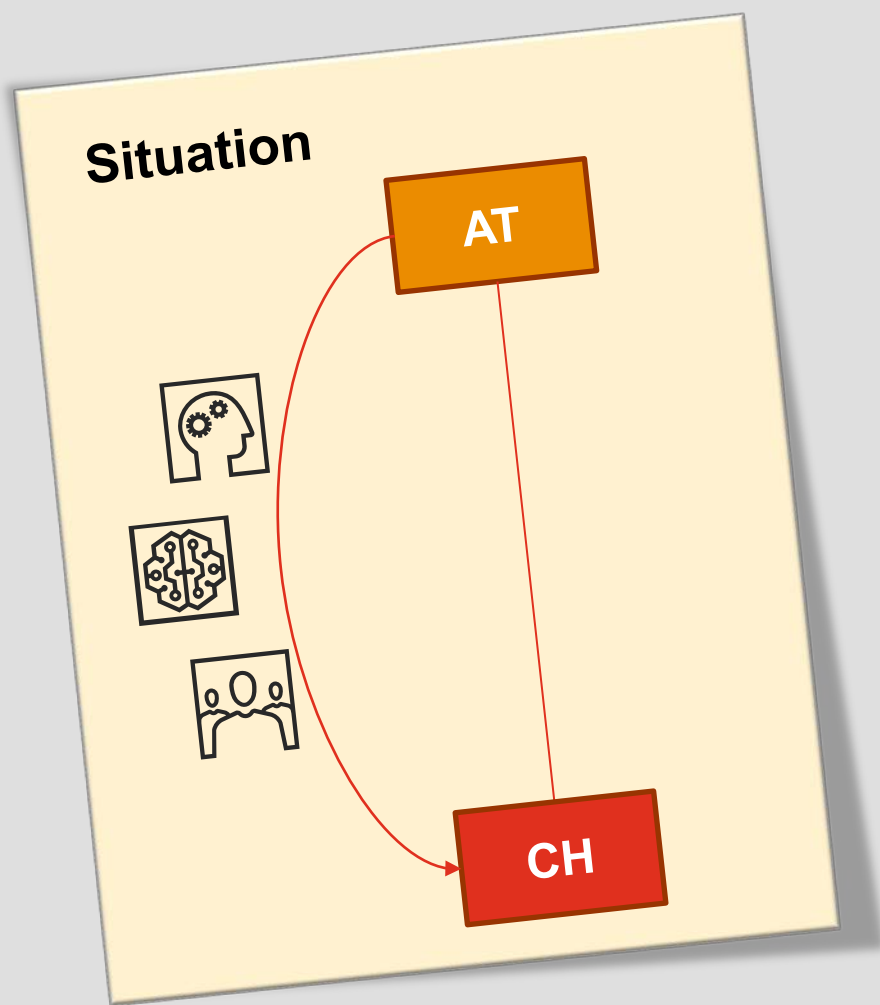
Possibly not all EU countries are aligned on the definition of EBIT for DAC6 purposes. Some countries argue that EBIT means accounting profits, and is reached by looking at the result in the accounts immediately before the interest and tax lines. This would include dividends received from associated companies.

However, it is arguable that the meaning of EBIT isn't fixed, and that it depends on the context. Hallmark E3 is included in a section headed "transfer pricing". Dividends receivable are generally not taxable; moreover dividends are never capable of being the subject of a transfer pricing adjustment, as timing and amount of dividends are at the discretion of the directors. Therefore there might be a justification for excluding dividends receivable from EBIT, which would mean that EBIT wasn't reduced by a transfer of shares.

How is the test of "projected" EBIT in the absence of the transfer to be applied?

In our experience, groups often do not forecast or budget the level of intra-group dividends, and it would be difficult to apply the "projected dividends" test. Does this depend on whether the group had projected dividends or not? How could an intermediary apply this test if the group didn't prepare projections?

Example 3 – Transfer of functions



An Austrian parent company carries out the central functions of the group and holds 100% of the shares in a Swiss subsidiary. Besides the Swiss subsidiary, the Austrian parent company holds many further subsidiaries in different EU countries, for which it performs the function of central purchasing.

Going forward, the Swiss subsidiary will perform this central purchasing function for the group. The Austrian parent company transfers a part of its staff members (with expertise in the purchasing function) as well as the needed IT systems and the purchasing handbook.

Is the transfer of the purchasing function a DAC6 reportable arrangement?

Assessment questions

1. Is there an arrangement? **Yes**
2. Is there a cross-border element? **Yes**
3. Is there EU-nexus? **Yes**
4. Are any of the hallmarks met? **Hallmark E3 could be met.**
5. Is the MBT satisfied? **Hallmark E3 is not connected to the MBT.**
6. Does the purchasing function amount for more than 50% of the EBIT of the Austrian company before transfer? **Further assessment needed.**

Conclusion

Hallmark E3 could be met leading to the transaction being reportable under DAC6 if the projected EBIT of the Austrian company fall to less than 50% of what it would have been had the transfer not happened.

However, since the Austrian company is a parent company of an internationally operational group, it seems unlikely that the purchasing function amounted for more than 50% of the EBIT of the Austrian company. Therefore, hallmark E3 is probably not met.

Further remarks

Intra-group definition

Hallmark E3 covers cases when functions and/or assets and/or risks are transferred "intragroup". In contrast to hallmarks C1 and E2, hallmark E3 does not refer to the term "associated enterprises" as defined in the Directive (Art. 3 Pt. 23).

According to the [Summary Record](#) of a meeting on 24 September 2018, between representatives of the Member States and the European Commission's Working Group on Direct Taxation, the Commission Services are of the opinion that the term "intra-group" should refer to "associated enterprises" in the meaning of Art. 3 Pt. 23. It should be noted, however, that this opinion has no binding effect with regard to the interpretation of the Directive. Also, the definition of a person in DAC in general may be relevant.

How can PwC help you

Our team combines experts in tax, people, processes, data and technology. By bringing these different skill sets together, we can help you and your organization understand DAC6, and the broader tax policy context, and implement effective controls and processes to ensure all reportable cross-border arrangements are proactively identified and managed.

Furthermore, we have developed a DAC6 Smart Reporting tool that makes use of technology to ensure DAC6 compliance, while keeping costs under control. Find out more [here](#).

Stay tuned for our next issue featuring all the latest news and insights!

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