DAC6 Pulse

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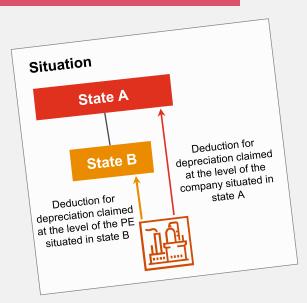
Special issue featuring C2 as the "Hallmark of the month"

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.

Hallmark C2

An arrangement is reportable under C2 if deductions for the same depreciation on the asset are claimed in more than one jurisdiction.

Example 1 – Company with a Permanent Establishment (PE)



Link to the Main Benefit Test (MBT)

Hallmark C2 is not linked to the MBT.

As a consequence, it leads to a reporting obligation irrespective of whether a tax advantage is the main benefit or one of the main benefits to be expected from the arrangement.

Therefore, all such arrangements are reportable.

A company, which is situated in state A, has a PE in state B. At least one of the jurisdictions is an EU Member State. The company acquires an asset which is attributed to the PE.

The profit of the PE is taxed in state B by taking into account the depreciation of the attributed asset.

The worldwide profit of the company is reported and taxed in state A and double taxation of the profits attributable to the PE is eliminated by using the credit method. The worldwide profit of the company, taxed in state A, also takes into account the depreciation on the asset attributed to the PE.

Could the deductibility of the depreciation be within the scope of Hallmark C2?

Assessment questions

- 1. Is there an arrangement? Yes
- 2. Is there a cross-border element? Yes
- 3. Is there EU-nexus? Yes
- 4. Are deductions for the same depreciation on an asset claimed in more than one jurisdiction? No
- 5. Is the MBT satisfied? Hallmark C2 is not connected to the MBT.

Conclusion

Hallmark C2 is not met. The European Commission has clarified that Hallmark C2 does not apply where "deduction for the same depreciation on an asset" is claimed both in the state of the PE and the Head Office, which taxes the PE profits and gives relief for double taxation by credit.

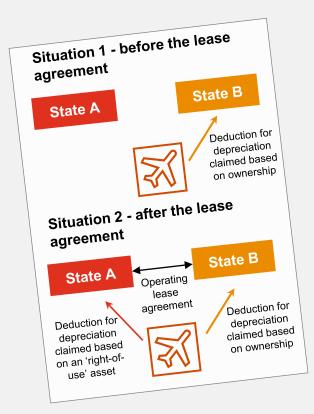
Further remarks

On 24 September 2018, EU Member States dedicated the entire meeting of the European Commission (EC)'s Working Party IV to seeking more clarity from the EC concerning the interpretation of Council Directive 2018/822/EU (commonly referred to as DAC6).

The EC confirmed that the views expressed during the meeting cannot be regarded as a legally binding interpretation of the Directive. However, they provide

valuable feedback on some key provisions of the Directive. From the <u>summary record of that meeting</u>, which was later published, it was clarified that Hallmark C2 does not apply where the deduction is claimed in both the PE and its Head Office and the latter taxes the profits of such PE and gives a credit as a relief from double taxation. Furthermore the summary record references other circumstances of a similar nature including, for example, where controlled foreign corporation (CFC) rules apply.

Example 2 – Operating lease



A company located in state B is in the possession of an aircraft. The company leases the asset to a (related or unrelated) company located in state A under an operating lease agreement for a period of 10 years. At least one of the jurisdictions is an EU Member State.

The companies apply IFRS accounting principles. The lessee company thus recognises a 'right of use' asset and a lease liability on its balance sheet and depreciates this 'right of use' asset. The lessor company recognises the leased asset on its balance sheet and claims depreciation on the asset.

Could the operating lease arrangement be within the scope of Hallmark C2?

Assessment questions

- 1. Is there an arrangement? Yes
- 2. Is there a cross-border element? Yes
- 3. Is there EU-nexus? Yes
- 4. Are deductions for the same depreciation on an asset claimed in more than one jurisdiction? No
- 5. Is the MBT satisfied? Hallmark C2 is not connected to the MBT.

Conclusion

Both parties may be entitled to tax relief on the lease arrangement. However, this relief is not based on the same depreciation on the asset. The asset which is recognised by the lessee company pertains solely to the terms of the lease agreement and not to the underlying asset. In essence, the deduction that is claimed by the lessee company is in respect of lease rentals and not capital expenditure incurred on the asset.

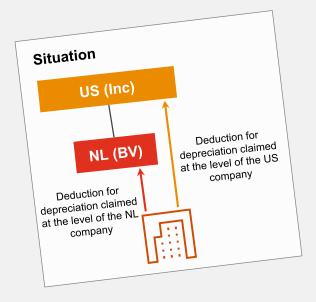
Further remarks

On 27 September 2017, a meeting of the EC's Working Party was held on DAC6. In advance of this meeting, the EU Commission Services prepared a document, which was later published, setting out the origin of the hallmarks together with examples of each. While the examples cited cannot be regarded as a legally binding interpretation of the Directive, they do provide valuable guidance on the intended scope of the hallmarks.

The following example was cited in relation to Hallmark C2:

"Two jurisdictions operate different rules on who has the right to depreciate leased assets: in one jurisdiction, the right to depreciate is with the legal owner whilst in the other, with the economic owner. In such situations, the same asset may turn out to be depreciated in both jurisdictions (i.e. by both the legal and economic owner)." In our view, this pertains to a finance lease arrangement whereby the lessor retains legal ownership of the asset and the lessee essentially has the benefits and the risks of economic ownership of that asset. This is completely different to an operating lease arrangement whereby the lessor generally retains legal and economic ownership of the assets.

As a result, finance lease arrangements may give rise to a reporting obligation where tax depreciation is in fact claimed in both jurisdictions. However, this will clearly be dependent on the facts of a particular case i.e. whether the lessor and lessee jurisdictions would allow tax depreciation to be claimed in respect of such assets and whether or not such depreciation will actually be claimed by both participants to the arrangement.



A US Inc holds real estate all over the world, including in the Netherlands.

The real estate in the Netherlands is held by a Dutch BV. For tax purposes, the BV is elected as a transparent entity under the law of the United States of America (on the basis of the 'check the box-election' it is a disregarded entity).

As a result of this qualification, the real estate can be depreciated both in the United States of America and in the Netherlands. The property is included for US taxation purposes as if it were the property of the US Inc directly.

Could the US check the box regime be within the scope of Hallmark B2?

Assessment questions

- 1. Is there an arrangement? Yes
- 2. Is there a cross-border element? Yes
- 3. Is there EU-nexus? Yes
- 4. Are deductions for the same depreciation on an asset claimed in more than one jurisdiction? No
- 5. Is the MBT satisfied? Hallmark C2 is not connected to the MBT.

Conclusion

Hallmark C2 is not met. Similar to Example 1, the profits of the Dutch BV are subject to tax in both jurisdictions with credit allowed in the US for tax paid in the Netherlands. It is understood that the EC's view is that Hallmark C2 does not apply in these types of circumstances (see 'Further Remarks' under Example 1).

Further remarks

We are of the view that the circumstances are similar to that in Example 1 as the profits of the Dutch BV are subject to tax in both jurisdictions with credit allowed in the US for tax paid in the Netherlands. It is understood that the EC's view is that Hallmark C2 does not apply in such circumstances. However, in light of the broad wording of the Hallmark it would be hoped that Member States will clarify these principles in local guidance, particularly in the context of the application of CFC rules and check the box elections.

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 <u>here</u>.

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