UPDATE ON SPANISH MANDATORY DISCLOSURE REGIME – D.A.C.6

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INTRODUCTION

After the implementation of European Union Council Directive n. 2018/822 ("the Directive"), enacting the sixth amendment of the Directive of Administrative Cooperation, known as D.A.C.6, all Member States of the European Union were obliged to transpose the contents of the Directive into national law. This means that each Member State was required to establish a regime of mandatory disclosure of cross-border arrangements, establish a procedure for the automatic exchange of information among Member States by December 31, 2019, and make the transposition enforceable by July 1, 2020. This established a transitory regime for reportable arrangements where the first step was taken between June 25, 2018, and July 1, 2020.

BACKGROUND

The contents of the Directive include the mandatory disclosure by intermediaries or taxpayers of certain cross-border arrangements ("C.B.A.'s") and structures that (i) could be used for aggressive tax planning and (ii) have the potential to be used as tax avoidance or evasion techniques. Mandatory automatic exchanges of C.B.A.. information among E.U. Member States would then occur.

In Spain, the exchanges of information are authorized by Law number 10/2020 ("the Spanish Law"), which modifies the Spanish General Taxation Act and was approved on December 29, 2020. The regulations that further develop the procedures have been issued in draft form ("the Draft Spanish Regulation"). In addition, a draft order issued by the Spanish Tax Authorities still must approve different forms to report the C.B.A.'s affected by the mandatory disclosure regime (the so-called, Forms 234, 235 and 236). However, this draft order has not been approved as of the date of publication of this article.

The transposition of the Directive into Spanish Law followed a bare approach, using the wording of the Directive without elaboration. This approach has raised questions surrounding interpretation of both the Spanish Law and the Draft Spanish Regulation, which will be explored in this article, following a brief comparison of the wording of the Directive and the Spanish legislation implementing the D.A.C.6.

The Spanish Law establishes general references to the Directive for many definitions and terms. In addition, it provides even more references to the Draft Spanish Regulation that is meant to develop the Spanish Law. Consequently, the Draft Spanish Regulation establishes the terms of the disclosure, the determination of the way to calculate the value of the "tax effect" of the C.B.A., and the terms of the obligation to communicate the disclosure or waiver by one intermediary to other intermediaries or to the taxpayer.

As previously mentioned, the Draft Spanish Regulation has not yet been approved. This creates uncertainty regarding the specific terms of the obligations contained in the Spanish Law. The Draft Spanish Regulation published in 2019 helps shed some light on these matters, but also raises questions on the interpretation of certain aspects of the reporting regime. Indeed, the delay in publication and approval of both the Spanish Regulation and the Order issued by the Spanish Tax Authorities establishing the forms to be used, means that, currently, neither intermediaries nor taxpayers have final guidance on the required way to comply with reporting obligations. Beyond the internal complications that this may present, failing to establish a proper procedure for the disclosure in due time puts Spain at risk of an infringement proceeding by the European Commission.

Given the lack of definitions in the Spanish Law and the provisional status of the Spanish Regulation, there is neither administrative doctrine nor jurisprudence that may shed light on the correct interpretation of the D.A.C.6 as implemented by Spain.

This article addresses the opinion of Spanish scholars in relation to the foreseeable issues that may derive from the implementation of the D.A.C.6 in Spain, considering the current wording of the Spanish Law and the Draft Spanish Regulation.

MAIN ISSUES SURROUNDING THE IMPLEMENTATION OF THE D.A.C.6 IN SPAIN

Lack of Definition of Certain Terms

Significant definitional problems have arisen in Spain because terms used in the E.U. Directive are not further explained in the Spanish Law. A similar issue arises in the Draft Spanish Regulation.

The main issues relate to scope of the Directive, which is the disclosure of C.B.A.'s. Different language versions of the Directive may have introduced differences in interpretation and transposition to domestic law. Such is the case of the translation of "cross-border arrangement" into Spanish. In Spanish, the word used is "mechanism" (*mecanismo*), which is not defined in the Directive nor the Spanish Law. The Draft Spanish Regulation defines a tax planning mechanism as an "agreement, legal transaction, scheme or operation," but some of these concepts have no recognized technical definition in Spanish tax law.

Comparing the use of the terms mechanism and arrangement, and noting the definition provided for in the Draft Spanish Regulation, questions arise regarding whether the definition of an "arrangement" (mechanism in Spanish) for purposes of the Directive and the Spanish Law implies the participation of more than one party. The uncertainty stems from the fact that unilateral decisions seem to be excluded from the definition and thus of the disclosure obligation. For example, it is unclear whether a change in tax residence, while complying with exit tax obligations, would comprise an arrangement under the terms of the Directive, considering there is only one party involved.

Regarding the cross-border characteristic of the arrangements, it is defined by the Directive as an arrangement that concerns (the Spanish word for "affects" is used in the Spanish Law) more than one Member State. While this characteristic is essential for determining the scope of the reporting obligation on an intermediary, there is no

clarification in the Draft Spanish Regulation or the Spanish Law as to what exactly the term comprises. This may prove to be problematic when the intermediary's knowledge of the scope and reach of the arrangement is limited. It is not unlikely in this type of pattern for the intermediary to have no knowledge of the client's involvement with another Member State. Moreover, if there is only one intermediary or the client has separate dealings with all intermediaries, there may be no notification by one intermediary to a second intermediary where neither has knowledge of the other.

The Draft Spanish Regulation contemplates that the Tax Authorities will publish lists of relevant cross-border arrangements that have been disclosed, including the relevant legal regime, qualification, and classification in tax terms. If and when published, the list will assist intermediaries to better understand the scope of the reporting obligation. It may be somewhat less helpful if the list is not updated on a regular basis when and as new arrangements are encountered.

The Directive's recitals and the Spanish Law's preamble give importance to the goal of D.A.C.6 in relation to clamping down on aggressive tax planning designed to achieve tax avoidance or evasion. The use of the term "tax planning" raises the question of whether commercial arrangements that are not carried out for tax reasons are automatically excluded from the scope of the obligations.

In principle, a balance exists between pure cross-border business transactions and transactions containing identified Hallmarks. The balance may fall one way or the other depending upon whether the main benefit test ("M.B.T.") applies to the Hallmark. Currently, it is unclear whether an intermediary must consider the effects of the arrangement (as provided in the Spanish Law) and if they result in tax savings (as provided in the Draft Spanish Regulation) without considering the main purpose or aim of the arrangement. Another question left unanswered is whether a transaction is reportable if it reflects a tax incentive enacted under Spanish law, where without the incentive, the operation would not have been carried out. An example is the formation and use of an E.T.V.E. formed under Spanish law for purposes of holding shares of companies often based in South America. Some tax advisors have suggested that a test based on valid business motives should be applied for special tax regimes formed under Spanish law, provided the rules are followed by the taxpayer as contemplated in the legislation. Other commentators have suggested the opposite.

The approach of the Spanish Government to simply refer to the Directive can create many gaps in legislation, even if the approach is a valid legislative exercise that saves both time and resources at the time of transposition into law. These gaps could be addressed when the Draft Spanish Regulation is adopted in final form, but only if the Spanish Tax Authorities put in the time and effort to apply D.A.C.6 rationally.

Concept of "Intermediaries" and Its Scope

The Directive defines an intermediary as any person that designs, markets, organizes, or makes available for implementation or manages the implementation of a reportable cross-border arrangement. It also states that an intermediary will be any person that, having regard to the relevant facts and circumstances and based on available information and the relevant expertise and understanding required to provide such services, knows, or could be reasonably expected to know, that they have

undertaken obligations to provide, directly or by means of other persons, aid, assistance or advice with respect to designing, marketing, organizing, making available for implementation or managing the implementation of a reportable C.B.A. After defining who could potentially be an intermediary, the Directive follows with a clarification that in order to be considered an intermediary, one must perform at least one of the identified acts within a Member State. Neither the Spanish Law nor the Draft Regulation clarify this 151 word sentence and many questions remain unanswered.

The first is whether in-house advisors fit into this description. It is common for larger companies to have an internal department that provides internal tax advice to the company or to companies falling within a single group. In this sense, a question arises as to whether these in-house advisors are considered to be intermediaries for the purpose of the Directive or are merely representatives of the taxpayers. This may affect whether a C.B.A. is reportable by the internal group of advisors.

The second question surrounds the fact that the Directive's definition establishes two kinds of intermediaries. The first is a primary intermediary that creates a plan leading to the C.B.A. or implements the C.B.A. The second is an auxiliary intermediary, who knows or could be expected to know that they have participated in the creation or implementation of an C.B.A.

Regarding primary intermediaries, some degree of uncertainty exists in Spain as to the degree of participation required in order to have a primary obligation to report a C.B.A. when many different advisors are involved. Phrased differently, when an arrangement is tailored for a specific taxpayer by many advisors, it is not clear which advisor should be considered the intermediary with the primary or the initial obligation to file a report. Is the advisor that aids in the creation of the plan but is unaware of its implementation, the intermediary with the primary obligation? In connection with a bespoke arrangement that proposes variations to an ordinary business transaction, is the entire transaction a reportable C.B.A. and is the party that proposes the variation the intermediary with the primary obligation to report? If there is no report, are all advisors exposed to penalties for nonfiling?

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As for secondary intermediaries, their determination can be excluded by way of the "did not know" test, but the scope of the definition can be interpreted as either wide or restricted depending on the facts and the view taken. Some commentators argue that a wide interpretation can give rise to many involuntary violations of the obligation to disclose. It is not uncommon for several advisors to cooperate in the implementation of a plan. In those circumstances, it is common for most not to know the full set of steps of an arrangement and its tax implications. Do those secondary persons face liability for filing an incomplete disclosure under Spanish Law if they report all they know but less than the entire transaction? Further clarity is required when the Draft Spanish Regulation is adopted in final form.

Where a client uses several advisors with each focusing on a particular aspect of a plan based on its area of expertise, no single intermediary has knowledge of the full picture of the C.B.A. In this context, should an advisor on corporate law be able to claim it was unaware that the transaction turned out to be a reportable C.B.A.? Is the answer different if the advisor is a law firm with a tax department and a corporate law department, but only the latter is retained to provide services? No answer is given to this in the Spanish Law or the Draft Spanish Regulation.

Finally, regarding relations between primary and secondary intermediaries, clashes may occur in their respective obligations to disclose. If the secondary intermediary's services regarding tailored arrangements end before the first step of implementation begins, when does it face a reporting obligation? Does the secondary intermediary have an obligation to report a C.B.A. within 30 days after rendering its service but prior to the period for the primary intermediary's obligation to disclose begins to run? What is included in the report if its assignment is theoretical, without values assigned to the transaction?

While the Spanish Law establishes the obligation of the intermediaries to communicate to other intermediaries and the taxpayer that they have disclosed the relevant information, thus exempting the others from disclosure obligations, the exemption may not be operative if the first reporter does not disclose all of the required information.

These issues were identified by the Spanish Association of Tax Advisors ("A.E.D.A.F.") in a request for a tax ruling filed with the Spanish General Directorate for Taxes. However, as of the date of publication of this article, no response has been received, leaving intermediaries with uncertainty.

Legal Professional Privilege, Waiver of Report, and Conditions of the Waiver

The Directive allows Member States to provide intermediaries with a waiver of the reporting obligation for C.B.A.'s where reporting comprises a breach of legal professional privilege under the national law of that Member State.

The Spanish Government decided to include this waiver in the transposition of the Directive, but it did so "regardless of the economic activity" carried out by the intermediary and provided that it acted as a passive advisor. The Spanish Law also goes a step further than the Directive and provides that the taxpayer may expressly authorize its legal advisor to report on the arrangement. This must be done by means of a written communication to the intermediary.

While professional privilege is provided for under the Spanish Constitution, there is no substantive legal regulation developing the scope and terms of this privilege. This means that while most professional sectors have developed a privilege concept in their codes of conduct, professional privilege is recognized only for certain professionals, including lawyers, and the scope of the privilege is quite general.

This raises issues of inconsistency between the wording of the Directive and the wording of the Spanish transposition. The Directive allows for Member States to provide for a waiver if it is in accordance with national law, which can be interpreted to mean that only legally recognized professional privilege may be covered by the waiver. On the other hand, the Spanish Law establishes the waiver regardless of economic activity, which can be interpreted as a recognition of the waiver to all advisors and intermediaries, even if their professional privilege is not covered by the Spanish Law. This may be understood as a breach of the Directive, but the main issue it raises is of uncertainty for tax advisors that are not lawyers. Can those advisors access the reporting waiver because "tax advisory" services are given, even though that is not a recognized independent profession with a specific code of conduct in Spain?

Another inconsistency between the Spanish transposition and the Directive is the requirement under Spanish law that intermediaries wishing to access the waiver must have acted in a passive way regarding the arrangement. The exact terms of the Spanish Law for the recognition of the waiver to intermediaries include a specific condition precedent to the waiver. Translated into English, the intermediary must have

> * * * provided advice on the designing, marketing, organizing, making available for implementation or for the managing of the implementation of a reportable cross-border arrangement, with the sole objective of evaluating its compliance with the applicable legal standards and without providing or ensuring its implementation.

This provision is much clearer than the simple reference to "neutral advisory" included in the terms of the Draft Law, but the determination of its limits may prove to be difficult in practice.

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Finally, the waiver of the obligation in the Directive or in the Spanish Law does not imply an exemption from disclosure. Rather, it shifts the reporting obligation to the taxpayer or other intermediaries by requiring the professional to notify the other intermediaries or the client. Regrettably, as of the date of publication of this article, no mechanism has been devised for intermediaries benefitting from waivers to communicate with intermediaries linked to another Member State.

Main Benefit Test

The whole purpose of D.A.C.6 is to communicate information relating to C.B.A.'s that include the presence of certain tax avoidance Hallmarks. The Spanish Law makes a direct reference to the Hallmarks established in the Directive, without any sort of clarification as to their meaning. The Draft Spanish Regulation adopts the principle of the M.B.T. as explained in the O.E.C.D. provisions on reporting, but does so in an enhanced way. In any event, the mere reference in the Spanish Law to the Hallmarks of the Directive leaves many gaps in the meaning of the Spanish Law, notwithstanding the Draft Spanish Regulation.

Regarding the M.B.T., the Directive's annex establishes that the M.B.T. will be satisfied if one of the main benefits which a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage, having regard to all relevant facts and circumstances. It then establishes generic and specific Hallmarks that are linked to the M.B.T., meaning that no reporting is due if the M.B.T. is not met.

As mentioned earlier, the Draft Spanish Regulation defines the term "tax advantage" by reference to "tax savings," thus redefining when the M.B.T. will be met and broadening its scope. Tax savings include any reduction in the taxable base or the tax liability, including the deferral of tax that would otherwise be due in the absence of the arrangement. In addition, the term includes deferred tax savings that arise from liabilities, deductions, or credits that may be realized in following years.

Tax saving is not the same as tax advantage as used in the Directive. Tax advantages are defined in the directive as tax benefits derived from defeating the purpose of the applicable law. Tax savings, on the other hand, are defined so as to include cases where the applicable law's purpose is met and where the entities or persons involved in the arrangement are simply making use of tax incentives or special tax regimes that have been provided for by the legislator. It is difficult to reconcile the

purpose of D.A.C.6, which is to combat aggressive tax planning, with entering into transactions that are consistent with applicable law and that would not be aggressive but for the implementation of D.A.C.6.

The circumstances where tax reduction is a main characteristic of a transaction are not well defined. This raises the question of whether the value of the tax benefits must be measured against the reasonably expected economic value of the operation, if conducted as planned.

The Hallmarks related to cross-border payments raise serious questions as to the expectations that an intermediary will be able to identify expected tax benefits when there is limited knowledge of the entire transaction. It is unreasonable to expect that a secondary intermediary can collect all relevant information to know of its obligation and to file a required report in a full and complete way.

No clarifications are made regarding the specific Hallmarks related to the M.B.T. Consequently, some degree of uncertainty remains as to the circumstances in which the conversion of income into capital has as a main benefit the reduction of tax. Similar uncertainty exists when considering when a circular transaction, a lower taxed form of completing a transaction, or merely entering a transaction that ends with a complete tax exemption can ever reflect a valuable business purpose that defeats the M.B.T.

The Draft Spanish Regulation provides that a transaction entered into with a jurisdiction that is noncooperative will be will be measured with Spanish list of noncooperative jurisdictions that is revised infrequently in comparison to the latest O.E.C.D. or E.U. list. This is contrary to the wording of the Directive, which determines noncooperative jurisdictions according to the O.E.C.D. or the E.U. standard, and moreover it is broadening the Hallmark's scope by determining that some third party jurisdictions included in the list according to a provision of national law are noncooperative when they are cooperative in the eyes of the E.U. or the O.E.C.D. In this regard, draft legislation has been proposed to update the tax regulations regarding noncooperative jurisdictions so that it is in line with O.E.C.D. and E.U. principles.

Useful clarifications have been made regarding Hallmarks concerning the automatic exchange of information, beneficial ownership, and transfer pricing, but it remains to be seen whether the final version of the Spanish Regulation will be identical to the Draft Spanish Regulation.

Again, the Draft Spanish Regulation has not yet been approved, which may mean that modifications should be anticipated.

Obligation to File Information

As mentioned above, the transposition of D.A.C.6 into the Spanish Law includes the obligation imposed on intermediaries to file reports disclosing certain C.B.A.'s and the obligation to communicate among themselves and with taxpayers. It also includes the imposition of penalties for the violations of those obligations.

The Draft Spanish Regulation generally is based on the Directive when proposing the conditions triggering the obligation to report and the person who must report. However, the actual content of the report is somewhat broader than the Directive. For example, the Draft Spanish Regulation requires information on both national and international activities. The data that is gathered may prove useful to the

Spanish Tax Authorities when communicating with other Member States, but may also impose undue obligations on intermediaries and taxpayers. For example, an intermediary that is a tax law expert in Spain will need to understand provisions contained in the law of other Member States, even if that intermediary is not an expert in that law. This begs the following question – how does a Spanish tax advisor measure the value of the tax effects of the arrangement in another member state? Is it acceptable to provide that the value is unknown? Even if acceptable, is it prudent to provide that the value is unknown? Is a guess at value acceptable? Whichever path is taken, the risk is that none of these responses is comprehensive enough for Spanish Tax Authorities.

Regarding which intermediary has the primary obligation to file a report and the scope of the relevant information in the report, no clarification is provided by the Draft Spanish Regulation. Past experience suggests that it is not uncommon for one advisor to design an arrangement for a taxpayer without ever knowing whether the taxpayer implements the arrangement. It may also be possible that one advisor has an initial obligation as an intermediary, but due to the limited scope of its role, another person would be considered the reporting intermediary because of substantially greater assistance in bringing the arrangement into fruition. Between the two intermediaries, there seems to be no answer in the Draft Spanish Regulation as to which intermediary is actually obligated to file what information.

Another question exists regarding proportionality. When balancing the value of reporting to the Spanish Tax Authorities with the burden to intermediaries, is it fair to impose burdens at the time of implementation when the Spanish Tax Authorities already have knowledge of the arrangement from a prior filing of a tax ruling request? For example, when a party submits a request for a tax ruling with the Spanish Directorate for Taxes, the Public Administration is usually provided with all relevant information on the transaction. If we follow the interpretation that information must be filed no matter what, the reporting obligation does not appear to be proportional as both Spain and the other Member State are aware of the particulars of the transaction.

The issues raised above could be addressed in a comprehensive and complete final version of the Spanish Regulation that develops rules for the disclosure of certain cross-border arrangements, but limits the obligations of intermediaries when tax rulings covering cross-border arrangements involving Spain and a Member State have been obtained from Spanish Tax Authorities by a Spanish taxpayer and those authorities have communicated the ruling to affected Member States.

Violations and Penalty Regime

As mentioned above, the transposition of the Directive into the Spanish Law includes a penalties regime to deal with violations of six separate duties related to the two main obligations of filing information and of communication among intermediaries and the taxpayer. The duties include (i) timely filing, (ii) containing complete, exact and true information, (iii) made through the proper means. Where an intermediary is exempt from reporting, an obligation is imposed on that intermediary to share information with other intermediaries or the taxpayer.

Violations of the foregoing obligations are punishable by fines. The Spanish Law establishes minimum and maximum fines, and the amount of the maximum fine may depend on the fee charged by the recalcitrant intermediary or the value of the tax saving derived from the C.B.A. It is up to the intermediary or taxpayer to prove the value that sets the maximum limits.

The determination of these values presents certain difficulties. The first difficulty is that an intermediary may have provided advice over a period of time without knowing initially that the transaction is a C.B.A. How does that intermediary apportion its fee between (i) advice in general and (ii) advice as to a C.B.A.?

Another difficulty relates to the fact that there is no provision that applies to the information that should be disclosed for a C.B.A. in which the first step is taken between the date of entry into force of the Directive (June 15, 2018) and its entry into application (July 1, 2020). Imposing a penalty that is determined retroactively to an act during that period violates several cardinal principles of Spanish law, *viz.*, the rule of law, legal certainty, and non-retroactivity of unfavorable provisions. Regrettably, any action to limit penalties is not likely to be accepted by Spanish Tax Authorities and may be viewed by the European Commission to be an infringement by Spain.

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While the transposition of the Directive should have been fully completed by July 2020, the Spanish Law was not approved until the end of December 2020. In addition, no final version of the Draft Spanish Regulation has been adopted as of the date of publication of this article. This delay affects the implementation of D.A.C.6, because while the obligation to disclose exists in Spain from late 2020, the means of filing reports are nonexistent as of the date of publication of this article as the draft order mandating the use of certain forms has not been finalized, forcing taxpayers and intermediaries into a situation of involuntary violation. While it is anticipated that the Spanish Tax Authorities will not punish intermediaries for noncompliance with reporting obligations resulting from the failure of the Spanish Government to implement the reporting regime on a timely basis, the lack of answers in this area remains worrisome.

CONCLUSION

The current situation in Spain in connection with D.A.C.6 is that of an orphaned obligation: while the D.A.C.6 has been transposed into the Spanish Law and reporting obligations now exist, there are no means to comply with the reporting obligations, as the Spanish Regulation has not yet been approved. Much uncertainty exists as to the scope of the reporting obligations and the consequences of noncompliance.

It is imperative for the Spanish Government to approve the Spanish Regulation developing D.A.C.6 obligations under Spanish law in way that is more comprehensive than the draft that has been proposed.