

HOW TO ACHIEVE THE BALANCE OF TAX EFFICIENCY AND TAX COMPLIANCE AFTER DAC 6



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ABOUT THE AUTHOR

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A BALANCED APPROACH

One of the key challenges for wealth structuring in today's global tax environment of transparency is to achieve a balanced approach to tax planning for clients. Wealth structuring should seek to achieve tax mitigation for clients by claiming all available reliefs, deductions and lower rates of taxes in accordance with tax legislation and in line with the intent of the legislation. Achieving this balanced approach is fundamental to ensuring clients can benefit from tax efficiency but also prevent undue scrutiny from tax authorities, audits,

legal challenges, and elimination of the tax benefits plus large penalties and interest liabilities.

DAC 6

One of the recent developments in increased tax transparency in 2021 is the implementation by the EU Member States of EU Directive 2018/822, known as DAC 6. The purpose of DAC 6 is to enable EU Member States to react promptly against harmful tax practices by closing loopholes in legislation, undertaking risk assessments and carrying out tax audits.

It introduces an obligation on certain advisers and promoters to disclose potentially aggressive cross-border tax planning arrangements to their home country's tax authorities, who in turn will provide this information to the tax administration impacted by the transaction.

WHAT TRANSACTIONS ARE REPORTABLE UNDER DAC 6?

DAC 6 states that transactions are reportable if they have certain hallmarks, which are characteristics or features that are common in tax avoidance arrangements. However, the hallmarks are drafted very widely and can capture many routine and generally accepted financial transactions.

DAC 6 is a directive, which means each Member State has to implement it through their own legislation. Tax authorities in EU Member States have

produced detailed guidance notes to provide further clarity on the type of transactions that are reportable.

The hallmarks are grouped into five categories (A-E). Transactions that contain hallmarks under category A,B and some of category C will only be reportable if they also fulfil the main benefit test. The main benefit test will be satisfied if a tax advantage is the main benefit, or one of the main benefits, which a person may reasonably expect to obtain from the transaction.

In order to avoid satisfying the main benefit test on the sale of a unit linked life policy, Utmost PanEurope would need to be able to demonstrate that the policyholder would still buy the product without the tax advantage and the tax advantage would only be the 'icing on the cake'.

As Utmost PanEurope is an Irish tax resident life insurance company, the Irish legislation and Irish Revenue guidance notes outline what type of transactions are reportable. Unfortunately, there is no distinction between tax mitigation and tax avoidance in the definition of tax advantage or any reference to policy intent in the Irish Revenue guidance notes. Therefore, for the sale of unit linked life policies, it is likely that the main benefit test would be satisfied in most cases. Thus, it is necessary to demonstrate that the hallmarks themselves do not apply to avoid a DAC 6 reporting obligation.

WHICH HALLMARKS COULD POTENTIALLY APPLY TO THE SALE OF UNIT LINKED LIFE POLICIES?

There are 15 hallmarks in total but the two main hallmarks that could apply to the sale of unit linked life policies are Standardised Documentation (Hallmark A3) and Arrangements that convert Income into Capital (Hallmark B2).

STANDARDISED DOCUMENTATION

This hallmark covers cross-border arrangements using standardised documentation made available to more than one taxpayer. Utmost PanEurope does provide standardised documentation in relation to the sale of its products as this is required to ensure the products meet all of the EU and local country regulations that govern the sale of life insurance products.

The Irish Revenue guidance notes state that many types of documentation and structures can be substantially standardised and provide a list of examples. The examples include life assurance products.

The Revenue guidance notes define standardised documentation as documentation that is pre-prepared and requires little, if any, modification to suit an individual client.

However, a large number of Utmost PanEurope's sales involve some form of customisation for individual clients, which often takes the form of an endorsement to the standard policy terms and conditions. Such sales on "special terms" should not be regarded as involving standardised documentation.

In relation to sales that do not involve a bespoke legal endorsement to the terms and conditions or other customisation, it is necessary to consider the following comments in the guidance:

- › for this hallmark to be met, there must be a link between the documentation and/or structure in question and the tax advantage that was obtained or expected to be obtained;
- › the use of documentation in certain routine financial transactions, that is standardised for regulatory or other legal reasons and is not linked to a tax advantage, will not bring such transactions within this hallmark; and

› this hallmark is intended to capture what are often referred to as "mass-marketed" or "off-the shelf" schemes that are promoted by tax advisers.

The standard documentation associated with Utmost PanEurope's products is not linked to the tax advantage but is linked to the regulatory requirements associated with selling a financial product in a regulated industry. The tax advantage is linked to the intended legislation for insurance products specially provided for in the international territory of the customer and not to how the documentation or structure is standardised. The sales of Utmost PanEurope's products are routine financial transactions and can be clearly contrasted with mass-marketed or off-the-shelf schemes promoted by tax advisers. Therefore, the sale of an Utmost PanEurope unit linked life policy in 2021 will not satisfy this hallmark.

INCOME INTO CAPITAL

This hallmark covers cross-border arrangements that convert income to capital, which is then taxed at a lower rate or is exempt from tax.

The Revenue guidance notes state that this hallmark is satisfied if the transaction:

- › has the effect of converting an existing or prospective income stream into another category of revenue (including capital and gifts), and
- › the other category of revenue is taxed at a lower level or is exempt from tax, and
- › the lower level of tax or tax exemption is one of the main benefits that a person may reasonably expect to obtain from the arrangement.

The guidance notes also state that "in assessing whether an arrangement bears this hallmark, the key test to apply will be whether, viewed objectively, an amount that would normally be taxed as income is instead taxed in another category of revenue that attracts a lower rate of tax or is tax exempt. As such, normal commercial transactions are unlikely to be caught by this hallmark."

The sale of a life policy for cash premiums should not be regarded

as converting income to capital and, therefore, should be classified as a normal commercial transaction. However, the sale of life policies by Utmost PanEurope for premium-in-kind could potentially fall within this hallmark.

For example, if an individual has a portfolio of direct securities and transfers the securities into a life policy, the dividend income and capital gains will roll up and be taxed at later date by way of surrenders from the life policy. It is thus necessary to review Utmost PanEurope's premium-in-kind transactions against the three tests outlined above.

For the majority of Utmost PanEurope's sales markets (e.g. Italy, Spain), there is no reduction in the rate of tax applicable pre and post the acquisition of the premium-in-kind policy (i.e. dividend income and capital gains are subject to income tax at the same tax rates as surrenders from the life policy). There is clearly a deferral of taxation within the policy due to their gross roll up nature but the Irish Revenue guidance does not refer to the timing of taxation and is focused on whether the new income stream is taxable at a lower rate or is tax exempt. Therefore, gross roll up should not be relevant to the analysis and, for countries where there is no income being taxed at a lower rate, this hallmark would not be satisfied.

The Irish Revenue have also confirmed that premium-in-kind life policies should not be reportable under this DAC 6 hallmark if the transfer of the assets to the insurance company by the policyholder is a taxable disposal in the relevant EU country and where the assets transferred are not personalised assets. Therefore, even if there is a reduction in the tax rate applicable in the relevant EU country (e.g. some countries have reduced tax rates based on the length of time the policy is held), no DAC 6 reporting would be required if the above two conditions are satisfied, which should be the case for all Utmost PanEurope life policies.

Therefore, the sale of an Utmost PanEurope life policy in 2021 will not satisfy this hallmark.

BREXIT AND THE UK

The definition of tax advantage in the DAC 6 EU Directive is restricted to an EU tax advantage.

Therefore, as a result of Brexit, from 1 January 2021, any UK tax advantages accruing to UK tax resident policyholders will no longer meet the definition of EU tax advantage under DAC 6. This means Utmost PanEurope has no obligations to report any UK policies issued from 1 January 2021 under DAC 6 even if the above hallmarks were satisfied.

SUMMARY

In 2021, the taking out of an Utmost PanEurope unit linked life policy can offer clients a balanced approach to tax planning with a tax efficient and tax compliant wealth planning solution. Achieving this balanced approach to tax planning ensures clients avoid their transactions being reported under DAC 6 and the potential adverse consequences which could arise due to the increased scrutiny of the tax authorities into their affairs.



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