Euro Tax Flash from KPMG's EU Tax Centre

CJEU decision on the validity of DAC6 and on the notification obligations of non-lawyers

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Key Summary:

On July 29, 2024, the CJEU gave its decision in case C-623/22 concerning the validity of several provisions of Directive 2018/822/EU on automatic exchange of reportable cross border arrangements (DAC6).

The main findings of the CJEU are summarized below:

- whilst several key concepts introduced by DAC6 are broad, they are nevertheless "determined in a sufficiently clear and precise manner" and do not call into question the validity of the Directive;
- the solution adopted in the judgement in case C-694/20 as regards the notification obligations of lawyers can only be extended to professionals practicing under one of the titles listed in Directive 98/5/EC.

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CJEU – DAC6 – Belgium – Principle of equality – Legal certainty – Proportionality – Legal professional privilege

On July 29, 2024, the Court of Justice of the European Union (CJEU or the Court) gave its decision in case C-623/22. The case concerns the validity of Council Directive 2018/822 (DAC6) amending Directive 2011/16/EU on administrative cooperation (the DAC), as transposed into Belgian legislation, in light of rights guaranteed by European Union law and the European Convention on Human Rights.

The CJEU concluded that none of the concerns raised by the referring court could impact the validity of DAC6. The Court also held that, whilst several key concepts introduced by DAC6 are broad, they are nevertheless "determined in a sufficiently clear and precise manner" and do not constitute a breach of the Charter of Fundamental Rights of the EU (the Charter).

Regarding the CJEU's judgment of December 8, 2022 in case C-694/20 *Orde van Vlaamse Balies and Others*, the CJEU clarified that its decision applies only to persons that pursue their professional activities under one of the professional titles referred to in Article 1(2)(a) of the Directive to facilitate practice of the profession of lawyer[1]. In the Court's view, this solution, i.e. notification only to the client if that client is an intermediary or, where there is no such intermediary, that client is the relevant taxpayer, does not extend to other professionals who might also be authorized to provide legal representation.

Background

On December 21, 2020, the Belgian Constitutional Court made a request for a preliminary ruling in case C-694/20 regarding the compatibility with EU law of the requirement for intermediaries, who are subject to legal professional privilege (LPP), to notify other intermediaries of their reporting obligations under DAC6. The referral stemmed from proceedings initiated by the Flemish Bar Council, which argued that fulfilling this notification obligation would breach professional secrecy rules.

Under DAC6, intermediaries are required to file information on reportable cross-border arrangements if certain criteria are met. The version of Article 8ab(5) in effect at that time provided an exemption from this reporting obligation where doing so would breach LPP under the national law of that Member State. However, intermediaries benefiting from this exemption were still required to notify other intermediaries (or the taxpayer, if there were no other intermediaries) that a reportable cross-border arrangement exists and that a reporting obligation has arisen.

On December 8, 2022, the CJEU held that the notification obligation is invalid in light of the fundamental rights guaranteed by the Charter – specifically the right to respect for communications between a lawyer and his or her client (Article 7) – see Euro Tax Flash Issue 497. In light of this decision, the seventh amendment to the DAC (DAC8) modified Article 8ab(5) to require Member States that give intermediaries the right to a waiver from the reporting requirement (where that obligation would breach legal professional privilege) to require those intermediaries to notify their client, which could be another intermediary or the relevant taxpayer, of that client's reporting obligations.

In parallel to the above, in 2020, several Belgian legal and tax professional bodies[2] initiated proceedings before the Belgian Constitutional Court, seeking the annulment of the local implementation of DAC6. The plaintiffs argued that the Directive itself was unlawful, either in whole or in part. In September 2022, the Constitutional Court raised several additional questions to the CJEU, including whether:

- the DAC6 reporting obligations, covering all taxes falling in the scope of the DAC and not only corporate income taxes, infringe the principle of equality and non-discrimination protected under Article 6(3) of the Treaty on the European Union (TEU) and Articles 20 and 21 of the Charter, respectively;
- the use of key terms and deadlines, that allegedly are not sufficiently clear and precise, infringe the principle of legality in criminal cases and the general principle of legal certainty and the right to respect for private life, protected under Article 49(1) and Article 7 of the Charter and Article 8 of the ECHR. These terms include "arrangement", "intermediary", "participant", "associated enterprise", the

[1] Directive 98/5/EC to facilitate practice of the profession of lawyer on a permanent basis in a Member State other than that in which the qualification was obtained, as subsequently amended.

[2] The Belgian Association of Tax Lawyers, Ordre des barreaux francophones et germanophone, Orde van Vlaamse Balies and Others, Institut des conseillers fiscaux et des experts-comptables.

qualification of “cross-border”, the different “hallmarks”, the “main benefit test” and the trigger date for the 30 days reporting period;
- the requirement for intermediaries to notify any other intermediary or, if there is no such intermediary, the relevant taxpayer, of their reporting obligations, infringes the right to respect for private life as guaranteed by the Charter, in so far as the effect of that requirement is to oblige an intermediary bound by legal professional privilege subject to criminal sanctions under national law to share with another intermediary, not being their client, information which they obtain in the course of the essential activities of their profession;
- the reporting obligations interfere with the right to respect for private life (Article 7 of the Charter and Article 8 of the ECHR).

AG's opinion

Earlier this year, on February 29, 2024, Advocate General (AG) Nicholas Emiliou of the CJEU rendered his opinion in the case. The AG recommended the CJEU to find that none of the concerns raised by the referring court could impact the validity of DAC6. The AG also held that, whilst several key concepts within DAC6 are broad and general, they are nevertheless “reasonably clear” and do not constitute a breach of the Charter. Regarding the notification waiver enshrined in DAC6, the AG argued for a restrictive interpretation of the legal professional privilege and held that it only applies to lawyers and other professionals which are, in exceptional circumstances, treated in the same way as lawyers. For more information on the opinion, please refer to Euro Tax Flash Issue 539.

The CJEU Decision

Scope of the reporting obligation under DAC6

DAC6 Scope

The Court started by analyzing the wide scope of the reporting requirement under DAC6 in light of the principles of equality and non-discrimination, and of Articles 20 and 21 of the Charter of Fundamental Rights. The Court noted that the reporting requirement under the EU Mandatory Disclosure Rules extends beyond corporate taxes and applies to a variety of taxes, with the exception of VAT, customs duties and excises duties, which are specifically excluded. In the particular case of Belgium, the local bill implementing DAC6 extended the scope of reporting to other taxes such as registration fees.

The Court recalled that assessing a potential breach of these principles involves determining whether comparable situations are treated differently or whether different situations are treated the same, and whether such treatment is justified. The Court had previously held that the EU is granted broad discretion, particularly in areas involving political, economic, and social decisions that necessitate complex assessments. Consequently, based on this settled case-law, the legality of a measure can only be challenged if it is manifestly inappropriate in relation to its intended objectives.

The Court noted that the purpose of DAC6 is to combat aggressive tax planning and to prevent tax evasion and fraud. The Court found no evidence to suggest that aggressive tax planning is confined to corporate tax, excluding other direct taxes such as income tax for individuals, or certain indirect taxes. This conclusion was supported by the AG's analysis of the impact assessment prepared by the Commission and the OECD's BEPS Project Action 12 on mandatory disclosure rules, referenced in the DAC6 recitals as the source of inspiration for the EU rules. The Court recalled that the reason why VAT, custom duties and excise duties were excluded from DAC6 is because they are subject to specific EU legislation, which was considered to better achieve the purpose of fighting aggressive tax planning in their field.

Based on these considerations, the Court concluded that the wide scope of the reporting obligations under DAC6 is not manifestly inappropriate, given the objectives of DAC6 and the EU legislator's broad discretion in these matters. Consequently, the Court determined that this scope does not affect the validity of DAC6.

Clarity and precision of DAC6

The Court then focused on the plaintiffs' plea that the lack of precision or clarity in certain key concepts of DAC6 breaches the principle of legal certainty and the principle of legality in criminal cases protected under Article 49, paragraph 1 of the Charter and the right to respect for private life guaranteed in Article 7 of the Charter.

The Court recalled its settled case-law under which the principle of legal certainty requires that laws are clear and precise, and that their application is predictable, particularly when they may have adverse consequences. This principle ensures that interested parties can understand the scope of their rights and obligations and plan accordingly. However, this does not preclude the EU legislature from using abstract legal concepts in its legislation, nor does it require laws to cover every possible scenario, as not all situations can be anticipated by

lawmakers.

The Court also recalled that, with respect to the principle of legality in criminal cases, the jurisprudence of the European Court of Human Rights (ECHR) is also relevant. In this context, the ECHR had previously held that, due to their necessarily general nature, legislative acts cannot be absolutely precise. In the ECHR's view, the use of legislative techniques that involve resorting to general categories in legislation may create some gray areas, but this alone does not make a provision incompatible with the European Convention on Human Rights, as long as the provision is sufficiently clear in the vast majority of cases. Additionally, based on settled CJEU case-law, the gradual clarification of rules of criminal liability through judicial interpretation is not prohibited, provided that these interpretations are reasonably foreseeable. Where certain terms appear vague or ambiguous, they could be interpreted by using the ordinary methods of interpreting law, as well as by referring to relevant international conventions and practices.

Finally, the Court recalled its settled case-law, emphasizing that the required degree of foreseeability largely depends on the content and subject matter of the legislative act, as well as the number and quality of its intended recipients. Affected stakeholders are not precluded from seeking informed advice. In the particular case of persons carrying on a professional activity, the Court noted that they can be expected to take special care in evaluating the risk that such an activity entails.

The Court then examined the various terms and deadlines highlighted by the referring court in light of the aforementioned case-law and principles. In each instance, the CJEU determined that the provisions met the requirements of clarity and precision as outlined by these principles. To support this conclusion, the Court referenced the definitions provided in DAC6 and suggested interpretations based on the common usage of the terms, internationally accepted practices, or the OECD's Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures (2018) ('the OECD Model Rules'), drawn up on the basis of the best practices recommended by the BEPS Action 12, on which the EU MDRs was based. The key guidance provided by the Court is summarized below.

DAC6 Terms

'Arrangement'

Whilst acknowledging that the term 'arrangement' is not specifically defined in DAC6, the CJEU noted the various instances in which the term was used in the Directive. In this context, the Court clarified that the term should be understood in its "usual sense of mechanism, operation, structure or set-up, the purpose of which, in the context of DAC6, is to carry out tax planning".

The Court further elaborated on the reporting obligations under DAC6, particularly in situations where a 'reportable arrangement' consists of multiple sub-arrangements. If these sub-arrangements individually meet the criteria for being reportable (i.e., they independently pose a potential risk of tax avoidance), each one must be reported, in addition to the overall arrangement. Conversely, if the sub-arrangements do not individually meet these criteria, the reporting obligation applies only to the overarching arrangement, once it satisfies the temporal conditions set forth in DAC6.

'Cross-border arrangement', 'marketable arrangement, 'bespoke arrangement', 'intermediary' and 'associated enterprise'

The CJEU noted that several other key concepts – 'cross-border arrangement,' 'marketable arrangement,' 'bespoke arrangement', 'intermediary' and 'associated enterprise' are already defined in the DAC[3].

The Court also addressed the term 'participant in the arrangement.' Although not explicitly defined in DAC6, the Court clarified that this term should be understood to include the 'relevant taxpayer,' as outlined in point 22 of Article 3. However, in the Court's view, 'intermediaries,' are generally not considered participants unless they actively engage in the arrangement as relevant taxpayers.

Hallmarks

The Court held that the DAC6 hallmarks[4] are not drafted in such a way as to make the application of the reporting obligation unforeseeable for the persons subject to that obligation. The Court also addressed the plaintiffs' concerns about the subjectivity of the main benefit test[5]. In this context, the CJEU referenced the BEPS Action 12 Report, which clarifies that the main benefit test involves comparing the expected tax advantage with other potential benefits of the transaction.

Reporting deadline

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[3] Points 18, 24, 25, 21 and 23 of Article 3 of DAC6, respectively.

[4] DAC6 aims to capture potentially aggressive tax-planning arrangements by establishing a list of features and elements that are 'hallmarks' of those arrangements.

[5] Hallmarks in heading A and B listed in Annex IV of DAC6 can only be taken into account if a 'main benefit' test is also satisfied, i.e. the main benefit of an arrangement or series of arrangements is to obtain a tax advantage.

The Court emphasized the importance of early reporting to tax authorities, preferably before an arrangement is implemented. However, the CJEU upheld the AG's comments with respect to the need to minimize the risk of reporting on arrangements that may not be implemented, particularly for auxiliary intermediaries who are less directly involved and consequently less likely to specifically understand the progress of the arrangement concerned.

The Court clarified that the reporting obligation for auxiliary intermediaries begins after they have provided aid, assistance, or advice, and at the latest by the general deadline specified in DAC6. Auxiliary intermediaries can also choose to fulfill their reporting obligations before the start of the 30-day period allowed for such reporting.

Conclusion

Based on the above, the Court found that the degree of precision and clarity of the terminology used in DAC6 does not undermine its validity concerning the principles of legal certainty and legality in criminal matters. The Court also concluded that the interference with the private life of the intermediary and the relevant taxpayer entailed by the reporting obligation is defined in a sufficiently precise manner in view of the information which that reporting must contain.

Applicability of the solution in case C-694/20 to non-lawyers authorized to ensure legal representation for clients

Although not part of the questions raised before the CJEU, the Court then clarified the scope of the powers granted to Member States under the initial text of the Directive to substitute the reporting obligation with an obligation to notify other intermediaries or, in the absence of such intermediary the relevant taxpayer, of their reporting obligation.

Notification waiver

The CJEU noted the European Commission's and the Council's observations during the proceedings in the present case that the intention of the EU legislature was not to give Member States the option to allow the waiver to all professionals subject to legal professional privilege under national law. Instead, the intention was to allow the application of the waiver only to those professionals comparable to lawyers, who are authorized under national law to represent parties in legal proceedings.

The Court then reiterated its settled case-law on the interpretation of EU law[6] and concluded that this approach was supported by the objectives of DAC6[7]. The Court also upheld the AG's views that, by interpreting Article 8ab(5) as allowing the extension of the reporting waiver to all intermediaries merely because they are subject to legal professional privilege under national law, could undermine the effectiveness of the reporting mechanism. This restriction has however not been included in the DAC Directives. It can also be retained that it belongs to the EU Member States to define and confirm, based on their domestic laws and regulations, which intermediaries are covered by the Legal Professional Privilege.

The Court also referred to the equivalent provisions under the OECD's Model Rules (Rule 2.4), under which the reporting waiver, based on professional secrecy rules laid down by domestic law, applies 'only to the extent the disclosure would reveal confidential information held by an attorney, solicitor or other admitted legal representative with respect to a client'. The Court therefore concluded that the work which inspired the wording of DAC6 in this respect aims to protect professional secrecy only for lawyers and other professionals who, like lawyers, are legally authorized to ensure legal representation.

The Court also acknowledged that it is justified for Member States to be granted a measure of discretion in the exercise of their power to substitute the obligation to notify for the reporting obligation and noted that certain Member States have extended this waiver beyond lawyers.

The Court concluded, however, that this discretion is not intended to allow those Member States to extend the benefit of that substitution of obligations to professions which do not ensure legal representation. Moreover, in the Court's view, a conclusion to the contrary could create disparities between Member States – i.e., if some countries broadly apply the waiver to professions bound by legal professional privilege but not providing legal representation, it could encourage potentially aggressive tax-planning activities to move to those jurisdictions. The actual question remained however, whether the requirement for intermediaries to notify third parties – i.e. other intermediaries who were not their clients, was lawful. The Court's decision in Orde van Vlaamse Balies and Others (C 694/20) had already addressed this question in the context of lawyers, but that decision did not

[6] Under CJEU settled case-law, when interpreting a provision of EU law, the courts must consider not only the wording of the provision but also its context and the objectives of the legislation as a whole. In the case at hand, as the various language versions of that provision under dispute diverge, the literal interpretation of the wording was found to be inconclusive in determining which professions are likely to be affected.

[7] Enabling Member States to protect their national tax bases from erosion due to sophisticated tax-planning structures, which the EU legislature deemed necessary to address through mandatory disclosure by intermediaries.

cover the case of professionals that are not lawyers, but were authorized to ensure legal representation for their clients.

In addressing this question, the Court referred to its judgment in that case and reiterated that, based on the ECHR's case-law, Article 8(1) of the European Convention of Human Rights protects the confidentiality of all correspondence between individuals, but grants enhanced protection only to exchanges between lawyers and their clients. Article 7 of the Charter also guarantees the secrecy of legal consultations. In the CJEU's view, these protections are justified by the fundamental role that lawyers play in a democratic society, particularly in defending litigants.

In light of the above, and highlighting the unique position granted to the profession of lawyer, the Court took the view that the solution adopted in the judgement in case C-694/20 as regards lawyers can only be extended to professionals practicing under one of the titles listed in Article 1(2)(a) of Directive 98/5/EC (which primarily includes lawyers). The invalidity, in light of the Charter, of the obligation to notify another intermediary (and thus disclose the relationship with their client to a third party) does not extend to other professionals that are authorized by the Member States to ensure legal representation but that do not pursue their activities under one of the professional titles specified in that Directive.

Impact of the reporting obligation on the right to privacy for intermediaries and taxpayers

Interference with the right to privacy

The CJEU then proceeded to analyze how the reporting obligation imposed on intermediaries not entitled to a waiver due to legal professional privilege, affects the right to respect for private life for both intermediaries and relevant taxpayers. The Court acknowledged that the reporting requirement could concern lawful, genuine, and non-abusive cross-border arrangements, where the main advantage is not necessarily tax-related. Such an obligation could potentially restrict a taxpayer's choice and an intermediary's ability to design and advise on the least taxed route.

In this respect, the Court acknowledged that this constitutes a limitation on the right to private life, defined as the right of individuals to organize their personal affairs. However, in the CJEU's view, this interference does not violate the essence of the right to private life and is deemed as proportionate and justified in light of the public interest of combating aggressive tax planning and preventing tax avoidance and evasion. Consequently, the Court concluded that the reporting obligation does not infringe on the right to respect for private life, as protected by Article 7 of the Charter.

ETC Comment:

- Historically, the Court has been hesitant to conduct a substantive review of secondary Union law, especially when the legislation was unanimously adopted by Member States. A notable recent exception was the invalidation of Article 8ab(5) of DAC6 in case C-694/20, which the current judgment has now clarified should be interpreted narrowly, limiting the scope of the notification obligations exclusively to lawyers as defined in Directive 98/5/EC.
- The Court also adopted a restrictive interpretation regarding Member States' powers to substitute the reporting requirement for professionals bound by legal professional privilege with a notification requirement. This interpretation raises questions on the level playing field between different categories of intermediaries that, although subject to legal professional privilege under national law, are subject to different obligations under DAC6.
- It will be particularly interesting to observe Poland's response to this ruling, given the Polish Constitutional Court's decision on July 23, 2024, which invalidated certain provisions of DAC6 implementation in Poland. The Polish ruling was based on the argument that the provisions required tax advisors to disclose information on certain arrangements, even when such information is protected by legal professional privilege. The Constitutional Court also highlighted that the Polish Tax Code lacked clear conditions and procedures for exempting tax advisors from this privilege in specific circumstances. It should be underlined that the application of the Polish ruling application is limited to certified tax advisors only (i.e., members of the Certified Tax Advisors Association). More detailed information on the exact implications of this ruling in Poland should be known once the justification to the ruling is published. The Court provided some useful clarifications with regard to interpretation of certain DAC6 provisions, including the application of the main benefit test and the reporting obligation for auxiliary intermediaries.
- Feedback on the public consultation from KPMG member firms in the EU is available on the consultation website and focuses on DAC6. KPMG supports the EC's initiative to analyze whether the functioning of DAC6 is fit for purpose, and to consider the outcome and the experiences from the first years of DAC6 application. Such analysis should balance the advantages provided by DAC6 with the potential risk of putting the EU at a significant competitive disadvantage internationally, considering the compliance costs that relate to tax reporting obligations within the EU. KPMG recommends that:
    - the EC should assess how DAC6 disclosure information is being processed and used by local tax administrations. We would welcome a review in this respect by the European Court of Auditors and the use of the resulting conclusions for the purpose of narrowing the scope of the Directive to those provisions and data points that are proven to materially assist tax authorities;
    - the EC should re-evaluate whether the current framework provides for proportionate reporting obligations, i.e., whether the scope of reportable arrangements is sufficiently targeted and well defined. Based on our experience, taxpayers and intermediaries are required to make a significant number of disclosures of purely commercial transactions or arrangements that are not associated with any tax considerations, as well as disclosures of arrangements that are already known to the tax authorities;
    - the EC should consider establishing a whitelist of arrangements that would not fall in scope of DAC6 reporting requirements and extending the main benefit test to all applicable hallmarks with a view to ensuring that only arrangements that are primarily designed to obtain a fiscally unintended tax advantage are reported;
    - the EC should streamline local data collection under the DAC.

KPMG's EU Tax Centre team

Raluca Enache
Associate Partner
Head of KPMG's EU Tax Centre

Ana Pușcaș
Senior Manager
KPMG's EU Tax Centre

Elena Moro Fajardo
Assistant Manager
KPMG's EU Tax Centre

Kris Lievens
Partner, Corporate Tax
KPMG in Belgium

Gyöngyi Végh
Head of Knowledge & Research, Tax Services
KPMG in Belgium

Key EMA Country contacts

Ulf Zehetner
Partner
KPMG in Austria
E: UZehetner@kpmg.at

Margarita Liasi
Principal
KPMG in Cyprus
E: Margarita.Liasi@kpmg.com.cy

Jussi Järvinen
Partner
KPMG in Finland
E: jussi.jarvinen@kpmg.fi

Gábor Beer
Partner
KPMG in Hungary
E: Gabor.Beer@kpmg.hu

Vita Sumskaite
Partner
KPMG in Lithuania
E: vsumskaite@kpmg.com

Kris Lievens
Partner
KPMG in Belgium
E: klievens@kpmg.com

Ladislav Malusek
Partner
KPMG in Czechia
E: lmalusek@kpmg.cz

Patrick Seroin Joly
Partner
KPMG in France
E: pseroinjoly@kpmgavocats.fr

Colm Rogers
Partner
KPMG in Ireland
E: colm.rogers@kpmg.ie

Olivier Schneider
Partner
KPMG in Luxembourg
E: olivier.schneider@kpmg.lu

Alexander Hadjidimov
Director
KPMG in Bulgaria
E: ahadjidimov@kpmg.com

Stine Andersen
Partner
KPMG in Denmark
E: stine.andersen@Kpmglaw.Com

Gerrit Adrian
Partner
KPMG in Germany
E: gadrian@kpmg.com

Lorenzo Bellavite
Associate Partner
KPMG in Italy
E: lbellavite@kpmg.it

John Ellul Sullivan
Partner
KPMG in Malta
E: johnellulsullivan@kpmg.com

Maja Maksimovic
Partner
KPMG in Croatia
E: mmaksimovic@kpmg.com

Joel Zernask
Partner
KPMG in Estonia
E: jzernask@kpmg.com

Antonia Ariel Manika
Director
KPMG in Greece
E: amanika@cpalaw.gr

Steve Austwick
Partner
KPMG in Latvia
E: saustwick@kpmg.com

Robert van der Jagt
Partner
KPMG in the Netherlands
E: vanderjagt.robert@kpmg.com

Michał Niznik
Partner
KPMG in Poland
E: mniznik@kpmg.pl

António Coelho
Partner
KPMG in Portugal
E: antoniocoelho@kpmg.com

Ionut Mastacaneanu
Director
KPMG in Romania
E: imastacaneanu@kpmg.com

Zuzana Blazejova
Executive Director
KPMG in Slovakia
E: zblazejova@kpmg.sk

Marko Mehle
Senior Partner
KPMG in Slovenia
E: marko.mehle@kpmg.si

Julio Cesar García
Partner
KPMG in Spain
E: juliocesargarcia@kpmg.es

Caroline Valjemark
Partner
KPMG in Sweden
E: caroline.valjemark@kpmg.se

Stephan Kuhn
Partner
KPMG in Switzerland
E: stefankuhn@kpmg.com

Matthew Herrington
Partner
KPMG in the UK
E:Matthew.Herrington@kpmg.co.uk

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