

## France publishes additional official tax guidelines on Mandatory Disclosure Rules

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### Executive summary

In October 2019, the French Tax Code (FTC) was supplemented with Articles 1649 AD to 1649 AH, implementing the European Union (EU) Directive 2018/822 of 25 May 2018 on the mandatory disclosure and automatic exchange of cross-border tax arrangements (referred to as DAC6 or the Directive).<sup>1</sup>

On 9 March 2020, the French Tax Authorities (FTA) published official detailed draft guidance regarding the definitions of the terms and the reporting process under the French Mandatory Disclosure Rules (MDR).<sup>2</sup>

Following the March guidance, the FTA published on 29 April additional official detailed draft guidance (referred to herein as the official tax guidelines or draft guidance) dedicated to hallmarks. The draft guidance is subject to a public consultation until 31 May 2020 but may be relied upon until the final guidance is issued. The draft guidance provides some clarity on the definition and scope of the hallmarks. It also provides some examples of arrangements that meet the criteria set out in the hallmarks.

The key differences between the official tax guidelines and the Directive are summarized below. This Alert also highlights any clarifications provided by the draft guidance.

## Detailed discussion

Most elements of the hallmarks included in DAC6 are not expressly defined. The French draft guidance provides some clarification on these elements.

### Hallmark A.1

Hallmark A.1 refers to an arrangement where the relevant taxpayer or a participant in the arrangement undertakes to comply with a condition of confidentiality which may require them not to disclose how the arrangement could secure a tax advantage vis-à-vis other intermediaries or the tax authorities.

The French official tax guidelines indicate that this hallmark concerns an arrangement that is offered to the relevant taxpayer by an intermediary on condition of confidentiality, which implies that the relevant taxpayer may not disclose to third-parties information considered confidential which relates to the fiscal engineering of the arrangement enabling the user to obtain a tax advantage.

The French draft guidance indicates that the condition of confidentiality is met in particular in the following circumstances:

- ▶ Signing a confidentiality agreement
- ▶ Written correspondence (such as a letter or e-mail) that contains an explicit or implicit obligation not to disclose or share the features of the arrangement
- ▶ If proof is provided that a verbal or written agreement has been given on an obligation of confidentiality

The French draft guidance also indicates that the following are not covered by hallmark A.1:

- ▶ A confidentiality clause to protect a commercial, industrial or professional secret
- ▶ The legal and ethical obligations that may apply with respect to confidentiality

### Hallmark A.3

Hallmark A.3 refers to an arrangement that has substantially standardized documentation and/or structure and is available to more than one relevant taxpayer without a need to be substantially customized for implementation.

The French official tax guidelines provide an example of a cross-border arrangement that includes a share savings plan (*Plan d'Épargne en Actions*) and an employee shareholding agreement that meets the criteria for both hallmarks A.3 and B.2:

- ▶ The share savings plan and the employee shareholding agreement have the characteristics of hallmark A.3 because of their standardized documentation.
- ▶ The employee shareholding agreement has also the characteristics of hallmark B.2 as it has the effect of converting a salary taxed at the progressive scale of income tax into a capital gain taxed at a lower level (flat rate or even exemption).

The draft guidance also addresses the specific case of certain banking and financial products that rely on standardized documentation. It specifies that many products, instruments and banking transactions are offered to a wide number of people using standardized documentation and therefore meet the criteria set out in hallmark A.3. This will also be the case for regulated savings products (*Livret A*, *Livret de développement durable et solidaire* (LDDS), *Plan épargne logement* (PEL), *Compte épargne logement* (CEL), etc.). However, the draft guidance suggests that in the absence of meeting the criteria of other hallmarks and provided that the tax advantage derived is provided for by the French law and that the use of such products is in accordance with the legislator's intention, the arrangements which would include such products, instruments and banking transactions do not need to be reported.

### Hallmark B.2

Hallmark B.2 refers to an arrangement that has the effect of converting income into capital, gifts or other categories of revenue which are taxed at a lower level or exempt from tax.

The French draft guidance provides some further examples of arrangements that fulfill the criteria for hallmark B.2:

- ▶ The first example is the conversion of fees to be received by an independent consulting services company into dividends distributed by the company that uses the services.
- ▶ The second example is the use of a life insurance mechanism in order to transform the income of financial investments into income exempt from tax through the subscription of a life insurance policy. In this example, the taxpayer retains the management and control of the amounts invested in the life insurance policy to subscribe to bonds of a company that he controls.
- ▶ The third example involves the issuance of a convertible bond by a 100 % subsidiary to its parent company. This arrangement entails the partial conversion of the interest which would have been due on ordinary bonds into a premium exempt from tax in France at the level of the parent company.

### Hallmark B.3

Hallmark B.3 refers to an arrangement which includes circular transactions resulting in the round-tripping of funds, namely through involving interposed entities without other primary commercial function or transactions that offset or cancel each other or that have other similar features.

The French draft guidance provides for an interesting example of an arrangement that meets the criteria for hallmark B3 as it does not deal with purely financial transactions but refers to transactions that are standard commercial practice for manufacturing arrangements. The following example is provided: Company A established in France develops a manufacturing process which it patents. Company A sets up a license agreement relating to this technology with Company C established in another Member State. Due to the non-exclusive and time-limited nature of the license contract, the amount of the royalty paid by Company C to Company A, determined under the applicable transfer pricing rules, is rather low.

Company C uses the manufacturing process to make a product and resells the product to Company A at a high market price. Company A then resells the finished product with a trading margin that is heavily impacted by royalty transactions. The taxable trading margin thus realized by Company A was reduced by the intervention of Company C in the manufacturing process, due to the offsetting transactions.

### Hallmark C.1

Hallmark C.1 refers to an arrangement that involves deductible cross-border payments made between two or more associated enterprises where at least one of the following conditions occurs:

- (a) The recipient is not resident for tax purposes in any tax jurisdiction.
- (b) Although the recipient is resident for tax purposes in a jurisdiction, that jurisdiction either:
  - (i) does not impose any corporate tax or imposes corporate tax at the rate of zero or almost zero; or
  - (ii) is included in a list of third-country jurisdictions which have been assessed by Member States collectively or within the framework of the Organisation for Economic Cooperation and Development (OECD) as being non-cooperative.

- (c) The payment benefits from a full exemption from tax in the jurisdiction where the recipient is resident for tax purposes.
- (d) The payment benefits from a preferential tax regime in the jurisdiction where the recipient is resident for tax purposes.

In the context of hallmark C1, the French tax authorities clarify that “residence is determined by applying the bilateral tax conventions, in the absence of bilateral conventions, residence is assessed in accordance with the criteria set out in Article 4 of the OECD Model Tax Convention.”

In the context of hallmark C.1 (b)(i), the French official tax guidelines specify that an effective tax rate of less than 2% is considered to be an “almost zero” corporate tax rate.

In the context of hallmark C.1 (c), the draft guidance also indicates that payments which would not give rise to taxation by reason of set-off, deduction of losses or other deductible charges, deduction or imputation of taxes paid abroad, or notional tax credits are deemed to benefit from a full exemption from tax.

The draft guidance defines the term “recipient” as the person liable to pay tax on the payment. Thus, in the case of transparent companies, the recipient will be the partner(s) of the transparent company.

Pursuant to the French official tax guidelines, the non-cooperative jurisdictions that are covered by hallmark C.1 are those:

- ▶ Which are included in the list published in the *Official Journal of the European Union*. The EU list can be found at [https://ec.europa.eu/taxation\\_customs/tax-common-eu-list\\_en](https://ec.europa.eu/taxation_customs/tax-common-eu-list_en).
- ▶ That are assessed as “non-compliant” or “partially compliant” jurisdictions by the OECD under the Global Forum on Transparency in Tax Matters. The OECD list can be found at <http://www.oecd.org/tax/transparency/>.

The French draft guidance specifies that the non-cooperative jurisdictions concerned are those appearing on one or both of the two lists (EU and OECD) at the date of the triggering event of the reporting requirement.

The French official tax guidelines indicate that a regime must be preferential in comparison with the general principles of taxation in the relevant country, and not in comparison with principles applied in other countries.

### Hallmark C.3

Hallmark C.3 refers to the case where relief from double taxation in respect of the same item of income or capital is claimed in more than one jurisdiction.

The French official tax guidelines indicate that when relief from double taxation in respect of the same item of income or capital is claimed in more than one jurisdiction, the arrangement at the origin of the tax relief must be reported, provided that this tax relief does not result from the will of the French or Community legislator. This is the case in particular for arrangements based on treaty shopping.

The French draft guidance also specifies that this hallmark does not concern the provisions of bilateral tax treaties aimed at eliminating double taxation, provided that the use of such provisions is not contrary to the will of the French or Community legislator.

The French draft guidance provides an example of an arrangement that fulfills the criteria for hallmark C.3.

Company A, a tax resident in State V, has entered into a securities lending agreement with the French bank B for the shares of company C, a tax resident in State W: Company A is the lender and French bank B is the borrower.

The loan covers a period during which Company C pays a dividend. Bank B, to which the securities have been lent, collects this dividend net of the withholding tax that has been levied in State W, and remits the amount to Company A as an “offset payment” or “manufactured dividend.”

Company A sets off against the income tax it owes in State V a tax credit equal to the withholding tax levied in State W.

Bank B sets off against the corporation tax it owes in France the entire tax credit equal to the withholding tax levied in State W.

The draft guidance considers that the effect of this arrangement is to obtain tax relief in several jurisdictions (France and State V) for the same item of income: the dividend arising from State W.

### Hallmark C.4

Hallmark C.4 refers to an arrangement that includes transfers of assets where there is a material difference in the amount being treated as payable in consideration for the assets in those jurisdictions involved.

The French official tax guidelines specify that the transfer of assets may take place within the same legal entity. This is the case when assets are transferred between a head office and its permanent establishment.

However, the draft guidance does not clarify the term “material difference.”

### Hallmark D.1

Hallmark D.1 refers to an arrangement which may have the effect of undermining the reporting obligation under the laws implementing EU legislation or any equivalent agreements on the automatic exchange of Financial Account information, including agreements with third countries, or which takes advantage of the absence of such legislation or agreements.

The French draft guidance indicates that this hallmark refers to the regulation known as DAC2/Common Reporting Standard (CRS), to Article 1649 AC of the FTC (which also includes FATCA, *Foreign Account Tax Compliance Act*) and Decree No. 2016-1683 of 5 December 2016, which only includes the DAC2/CRS provisions.

The French official tax guidelines specify that the absence of reporting under CRS does not have the effect of circumventing CRS provided that such absence does not undermine the objectives followed by such legislation.

#### Hallmark D.1 (a)

Hallmark D.1 (a) refers to the use of an account, product or investment that is not, or purports not to be, a Financial Account, but has features that are substantially similar to those of a Financial Account.

For this hallmark, the concept of “financial account” is defined by the French draft guidance on the basis of DAC2/CRS.

The draft guidance provides two examples of arrangements that fulfill the criteria for hallmark D.1 (a):

- ▶ The use of certain types of electronic currency as an alternative of deposit accounts
- ▶ The use of certain types of derivative contracts that are out of the scope of DAC2/CRS but have the characteristics of the underlying financial assets covered by DAC2/CRS

#### Hallmark D.1 (b)

Hallmark D.1 (b) refers to the transfer of Financial Accounts or assets to, or the use of jurisdictions that are not bound by the automatic exchange of Financial Account information with the State of residence of the relevant taxpayer.

The draft guidance provides an example of an arrangement that does not meet the criteria for hallmark D.1 (b): the regular transfers from a deposit account in a CRS jurisdiction to a non-CRS jurisdiction provided that this does not constitute a transfer of the account or financial assets as it is mentioned that cash (*numéraire*) is not a financial asset.

The French official tax guidelines also provide an example of an arrangement that meets the hallmark D.1 (b) criteria: the closure with transfer of all funds to a non-CRS jurisdiction (the jurisdiction mentioned in the example as a non-CRS jurisdiction is Algeria).

#### Hallmark D.1 (d)

Hallmark D.1 (d) refers to the transfer or conversion of a Financial Institution or a Financial Account or the assets therein into a Financial Institution or a Financial Account or assets not subject to reporting under the automatic exchange of Financial Account information.

The French tax official guidelines provide an example of an arrangement that does not meet the criteria for hallmark D.1 (d).

A German tax resident employed by a French company repurchases its capitalization contract held with a French insurance company to open a retirement savings plan with another French intermediary (account excluded from the scope of CRS). The French guidance refers to the *OECD's Model Rules for Mandatory Reporting of Information on Circumvention of the CRS and Opaque Offshore Structures* to justify this point, which presents this type of transaction in a "normal situation" as not having the effect of circumventing the legislation implementing the CRS.

The draft guidance also provides two examples of arrangements that fulfill the criteria for hallmark D.1 (d):

- ▶ A French tax resident holding an account in an EU Member State who uses his assets held in this account to acquire a real estate property to be rented in a non-CRS jurisdiction or which does not exchange information for tax purposes with France because of: (i) the conversion of a reportable asset into a non-reportable asset; and (ii) in a jurisdiction that does not exchange information for tax purposes.
- ▶ The use of funds held through a foreign structure in an irrevocable and discretionary trust whose beneficiary is apparently a foundation, but which can be analyzed as a non-discretionary and revocable trust whose beneficiary is the settlor of the trust (use for personal purposes by the

settlor of the assets invested in trust, sums distributed to the settlor designated as beneficiary for the purposes of the distribution).

#### Hallmark D.1 (e)

Hallmark D.1 (e) refers to the use of legal entities, arrangements or structures that eliminate or purport to eliminate reporting of one or more Account Holders or Controlling Persons under the automatic exchange of Financial Account information.

The French draft guidance refers to three categories of risks identified as:

- ▶ The acquisition of a company stating that it automatically qualifies for Active non-financial entity (NFE) status in the jurisdiction in which it is incorporated.
- ▶ The establishment, through an NFE, of successive investment arrangements aimed at avoiding the need for an investor to disclose his identity.
- ▶ Investments structured within a Passive NFE so to lead a shareholder to fall outside the definition of a controlling person.

#### Hallmark D.1 (f)

Hallmark D.1 (f) refers to arrangements that undermine, or exploit weaknesses in, the due diligence procedures used by Financial Institutions to comply with their obligations to report Financial Account information, including the use of jurisdictions with inadequate or weak regimes of enforcement of anti-money-laundering legislation or with weak transparency requirements for legal persons or legal arrangements.

The French tax official guidelines provide an example of an arrangement that meets the criteria for hallmark D.1 (f): the situation of an individual resident for tax purposes in the United Kingdom who makes investments in Malta in order to obtain a certificate of tax residence in Malta and opens an account mentioning only his tax residence in Malta in his self-certification.

#### Hallmark D.2

Hallmark D.2 refers to an arrangement involving a non-transparent legal or beneficial ownership chain with the use of persons, legal arrangements or structures: (a) that do not carry on a substantive economic activity supported by adequate staff, equipment, assets and premises; and (b) that are incorporated, managed, resident, controlled or

established in any jurisdiction other than the jurisdiction of residence of one or more of the beneficial owners of the assets held by such persons, legal arrangements or structures; and (c) where the beneficial owners of such persons, legal arrangements or structures, as defined in Directive (EU) 2015/849, are made unidentifiable.

The French draft guidance specifies that the notion of beneficial owner must be understood in accordance with the recommendations of the EU Financial Action Task Force.

The French official tax guidelines also indicate that a “treuhand” or a “fideicomiso” is considered as a legal arrangement.

### Hallmark E.1

Hallmark E.1 refers to an arrangement which involves the use of unilateral safe harbor rules.

The French draft guidance indicates that the definition of unilateral safe harbor rules is the same as the one provided by the *OECD Transfer Pricing Guidelines* in Chapter IV, Section E.

A safe harbor is a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations otherwise imposed by a country’s general transfer pricing rules. A safe harbor substitutes simpler obligations for those under the general transfer pricing regime.

Such a provision could, for example, allow taxpayers to establish transfer prices in a specific way, e.g., by applying a simplified transfer pricing approach provided by the tax administration. Alternatively, a safe harbor could exempt a defined category of taxpayers or transactions from the application of all or part of the general transfer pricing rules.

Safe harbors do not include:

- ▶ Administrative simplification measures which do not directly involve determination of arm’s-length prices, e.g., simplified, or exemption from, documentation requirements (in the absence of a pricing determination), and procedures whereby a tax administration and a taxpayer agree on transfer pricing in advance of the controlled transactions (advance pricing arrangements).
- ▶ Tax provisions designed to prevent “excessive” debt in a foreign subsidiary (thin capitalization rules).

### Hallmark E.3

Hallmark E.3 refers to an arrangement involving an intragroup cross-border transfer of functions and/or risks and/or assets, 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.

The French draft guidance indicates that the annual EBIT is defined as the operating income.

### Next steps

Determining if there is a reportable cross-border arrangement raises complex technical and procedural issues for taxpayers and intermediaries. Due to the scale and significance of the regime enacted in the legislation and official tax guidelines, taxpayers and intermediaries who have operations in France should review their policies and strategies for logging and reporting tax arrangements so that they are fully prepared for meeting their obligations.

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## Endnotes

1. See EY Global Tax Alert, [France publishes legislation on Mandatory Disclosure Rules](#), dated 23 October 2019.
2. See EY Global Tax Alert, [France publishes official tax guidelines on Mandatory Disclosure Rules](#), dated 17 March 2020.

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1508-1600216 NY  
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