

HOW DOES **DAC 6** AND THE **LEGAL PROFESSIONAL PRIVILEGE** IN **CYPRUS** INTERTWINE?

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The implementation of DAC 6 into Cyprus law

On 18 March 2021, the Cyprus Parliament in order to harmonise EU Directive 2018/822 (referred as 'DAC6' or the 'Directive') with Cyprus domestic law, enacted the **Law N. 41(I)/2021**, (the '**Law**' or '**Mandatory Disclosure Rules - MDR**') amending the Law on Administrative Cooperation in the Field of Taxation (**Law N. 205(I)/2012**). The law entered into force on 31 March 2021 with effect as of 1 January 2021.

The Law provides for a retroactive effect on reportable cross-border arrangements that took place on or after the 25th of June 2018, with a prerequisite that a **triggering event / hallmark** is satisfied. It goes without saying that taxpayers and intermediaries are under the obligation to review arrangements made on or after that date in order to fully comply with the Law.

The Directive - and consequently the Law - aim to increase transparency and minimise the gap between Tax Authorities and taxpayers, with a view of taking early action against aggressive tax planning schemes and tax evasion arrangements.

In essence, the Directive introduces a new mandatory reporting regime for intermediaries (such as banks, fiduciary service providers, law firms and insurance companies) and in some cases taxpayers, involved in designing, marketing, organising reportable cross-border arrangements or providing aid and assistance for their

implementation. DAC 6 is also applicable to intermediaries who could reasonably be expected to know that a transaction involves a reportable cross-border arrangement.

It is noteworthy that while Cyprus domestic Law has been enacted with minor deviations to broadly reflect and embrace the objectives of DAC6, key terms of the Law remain undefined. To that end,

MDR imposes significant reporting and compliance obligations to lawyers who advise or are somehow involved in reportable cross-border arrangements.

on 29 October 2021 the Ministry of Finance in coordination with the Cyprus Tax Department issued further guidelines, in the form of a Ministerial decree **N. 438/2021** providing clarity over interpretational and procedural matters.

How will MDR affect lawyers?

MDR imposes significant reporting and compliance obligations to lawyers who advise or are somehow involved in reportable cross-border arrangements. Law firms and individual legal practitioners involved in such arrangements, will invariably be within the scope of the definition of intermediaries.

Exemptions from the reporting obligation

MDR provides for two situations where intermediaries and taxpayers are exempted from their reporting obligations. The first exemption falls under the situation where there is sufficient proof of reporting of the same information already reported by other Intermediaries or taxpayers in relation to a reportable cross-border arrangement.

The second exemption, concerns reporting from intermediaries who are bound by the so-called legal professional privilege ('LPP'). The exemption is applicable provided that the reporting of information would constitute a breach of the intermediaries' duty under the legal professional privilege.

The MDR clarifies that LPP is only granted to lawyers and law firms that practice law in accordance with Cap. 2 Advocates Law. Nonetheless, legal practitioners who are bound by LPP may be exempted from reporting to the local tax authorities, but they still have the obligation to provide a heads-up or even warn other intermediaries involved, of their reporting obligations, provided that such warning does not itself breach LPP.

Such warnings to other intermediaries shall be made within ten calendar (10) days from the date when the reporting obligation occurred. If there are no other qualifying intermediaries or other intermediaries with an EU nexus effect, the reporting obligation is shifted to the taxpayer.

What is Legal Professional Privilege (LPP)?

Under the Advocates' Law (Cap. 2) and the Advocates Code of Conduct Regulations of 2002, Legal Professional Privilege constitutes a fundamental client's right and advocate's duty.

In a nutshell, LPP protects confidential communications and documents exchanged between clients and their lawyers from being disclosed or used in various proceedings. In certain circumstances it also extends to cover communications exchanged between clients, lawyers and third parties.

The advocate's duty is not only a duty of confidentiality, but also a duty to always act and promote the client's best interests. LPP plays a vital role in the legal system as it makes the legal practice effective and underpins the rule of law.

LPP and MDR Reporting

Under the LPP exemption, lawyers need to consider whether any information - that they would otherwise be expected to disclose to the Local Tax Authorities - is privileged.

In doing so, lawyers should ask the primary questions of whether such information forms part of confidential communications that have passed between them and their clients in the course of giving legal advice. If that is the case, then the information provided by the client is protected by LPP, meaning that it cannot be disclosed.

In addition, equally important is the case where a client discloses non-privileged information to his lawyer. In such a case, non-privileged information provided for the dominant purpose of obtaining legal advice becomes privileged in the lawyer's hands. Thus, the disclosure of such information becomes LPP protected, despite the fact that such information might be publicly available or is not considered to be privileged in the hands of the client.

Moreover, lawyers may receive information that does not qualify as privileged from a counterparty, other than the client. For instance, a law firm may receive information in relation to an arrangement from an audit or consulting firm.

Such information is not privileged as it came to the lawyer's hands under non-privileged circumstances. Nevertheless, a lawyer by disclosing such information in the context of MDR is likely to reveal the fact that an advice has been given in relation to a reportable cross-border arrangement or even reveal the lawyer's judgement that MDR are applicable to the arrangement.

In that context, the vast majority of reportable information are likely to be privileged; even though law firms will need to examine on a case-by-case basis that both LPP and MDR are being followed.

Nonetheless, there are still circumstances where law firms might be under the obligation to file a report to the local tax authorities. For example, if they were to structure and promote arrangements or schemes to potential clients that fall under the definition of the reportable cross-border arrangements, such information would not be privileged and therefore would be reportable under MDR.

It is generally suggested that law firms and individual legal practitioners shall always balance their professional duties in line with the Law by establishing policies and barriers in order to manage and avoid conflicts in relation to such arrangements.

Is communication of potential disclosure with the Client prohibited?

As it is previously mentioned, LPP indeed is a client's right and a lawyer's duty, therefore lawyers can communicate potential disclosure with their clients where there is a reportable arrangement in question. In some cases, lawyers might be obliged to notify their clients if they qualify as 'relevant taxpayers' and there are no other intermediaries involved.

Is LPP exemption applicable to the 'lack of knowledge' defence?

Intermediaries and consequently, lawyers are under no obligation to disclose information if they can prove that they did not know and/or could not reasonably be expected to know that they were involved in a reportable cross-border arrangement. In case where such evidence is qualified as privileged information, LPP prevents lawyers from making such evidence available without the prior consent of their client.

Waiving LPP

The LPP belongs to the client and it is the lawyer's duty to uphold it until an expressed waiver is issued. Such waiver can take the form of a clause in an engagement letter or as a separate waiver letter authorising lawyers to make the necessary disclosures. This could be done at any stage of the retainer period. A formal waiver of LPP would extricate lawyers from the inconvenience of contacting clients every time a disclosure issue arises.

The purpose of this article is to provide a general guideline on the subject and not to be considered, in any way, as legal advice. It is advisable to seek professional and legal advice on this subject before proceeding with any general information provided to you. For further clarifications and advice please contact us at legal@economideslegal.com.

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