EU mandatory disclosure rules

UK final regulations published

On 13 January 2020, final regulations to implement EU Directive 2018/822 (also known as DAC6) on the mandatory disclosure and exchange of cross-border arrangements were laid before Parliament. They are expected to become law within a few weeks.

The final regulations incorporate a number of changes made following consultation on the draft regulations which were published last year. HMRC has also published a summary of responses to that consultation, and following further consultation it will publish final guidance before the regulations come into force in July 2020.

If the UK leaves the EU on 31 January 2020 as expected, under the transitional arrangement provided for in the Withdrawal Agreement these rules will continue to apply at least until the future economic partnership between the UK and the EU is determined.

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Summary

The International Tax Enforcement (Discloseable Arrangements) Regulations 2020 (SI 2020 No.25) follow DAC6 closely and require **disclosure to HMRC** of **cross-border arrangements** entered into by taxpayers which fall within certain **hallmarks**. These hallmarks are very broadly defined and **many common transactions will be within the scope of the rules.**

The regulations enter into force on **1 July 2020** and require reportable arrangements to be disclosed to HMRC within **30 days** of certain trigger events. However, **transitional rules** apply to transactions implemented between **25 June 2018** and 30 June 2020, and these must be disclosed to HMRC before **31 August 2020**.

The **obligation to disclose** to HMRC falls on **UK intermediaries** (unless or to the extent to which legal professional privilege applies). Where there are no UK intermediaries with a reporting obligation, the obligation to disclose may fall to **UK taxpayers**. There are **penalties for non-compliance** with the rules.Further detail on how the rules work is provided in Appendix 1.

Following consultation, **the final regulations include a number of changes to more clearly define the scope of the rules and the obligations of those who are required to disclose arrangements to HMRC**. HMRC is developing guidance to clarify when and how the rules apply and this will be published in HMRC's International Exchange of Information Manual.

It's important to note that many features of the draft regulations have been retained. In particular, the limitation of **tax advantage** to one not consistent with the **principles and policy objectives** of the relevant tax law, which should ensure that those hallmarks subject to the **main benefit test** are more targeted.

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What's new?

Key changes to regulations

Differences between the final regulations and the draft regulations which were published on 22 July 2019 include:

- Amendments to the penalty regime - normally penalties will be limited to £5,000.
- Limiting 'tax advantage' for the purposes of the main benefit test to (broadly) EU direct taxes.
- Ensuring that an intermediary does not have an obligation to report in multiple jurisdictions.
- Restricting reporting obligations to intermediaries and relevant taxpayers with a UK connection.

Matters to be addressed in guidance

Particular areas of concern that will be addressed in guidance include:

- Definition of cross-border arrangement – when does an arrangement 'concern' more than one jurisdiction.
- Who is an intermediary, and what is expected of intermediaries in different situations.
- Clarification of reporting triggers (for example, when an arrangement is "made available").
- How the hallmarks apply to transparent entities.
- Application of the rules to those subject to Legal Professional Privilege (LLP).
- Scenarios where taxpayers and intermediaries should not face penalties for late reports.
- Clarification of interpretation and examples on the application of the hallmarks and the main benefit test.

What does this mean for you?

The regulations are now final, and will come into force on 1 July 2020.

There isn't long to go before 1 July 2020, so businesses need to understand their obligations and ensure that they have the systems and processes in place to comply.

See Appendix 2 for our recommended approach to compliance and how PwC can help you.

Although there is some welcome clarification of several issues, there a number of areas where uncertainty remains, so you should continue to monitor developments pending final guidance from HMRC.

Further details are included in Appendix 1.

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Appendix 1 - How do the rules work?

Which arrangements are reportable?

The regulations apply to **cross-border arrangements** concerning **at least one EU member state** (purely domestic arrangements are excluded). HMRC has previously expressed the view that in order for an arrangement to 'concern' multiple jurisdictions, those jurisdictions must be of some material relevance to the arrangement. HMRC is developing further guidance to clarify what this means and provide examples.

Cross-border arrangements are reportable if they fall within one or more of the **hallmarks**, some of which only apply where a "**main benefit test**" is met - i.e. where a tax advantage is one of the main benefits which someone could expect to derive from the arrangement. We have summarised the hallmarks, and commented on differences between the draft and final regulations later in this Appendix.

Who needs to make the disclosure?

Intermediaries

Intermediaries who are involved in the reportable arrangement are required to report information in their knowledge, possession or control about the arrangement to HMRC, unless they have the relevant (UK or non-UK) arrangement number obtained by another intermediary and proof that the required information has already been filed. The final regulations make it explicit that this reporting obligation is restricted to **UK intermediaries** (i.e. intermediaries which are UK resident or have other UK nexus).

An **intermediary** is anyone who helps to design, market or implement a reportable cross-border arrangement (**promoter**), or who provides aid, assistance or advice in relation to the design, marketing, organisation or implementation of a reportable cross-border arrangement (**service provider**). However, a service provider will not be an intermediary if they did not know, or could not reasonably be expected to know, that they were involved in a reportable arrangement. HMRC will develop guidance to address practical questions such as where to draw the line between a promoter and a service provider, what an intermediary is "reasonably expected to know", and how the rules apply to partners and partnerships, employees on secondment or on loan to other jurisdictions, and groups of companies (we understand that HMRC considers that group companies can be intermediaries).

HMRC has acknowledged that there is a risk that more than one intermediary may report the same arrangement, and so will provide guidance setting out what level of evidence an intermediary will need in order to be exempt from reporting themselves.

Guidance should also make it clear that where a promoter has reported an arrangement, a service provider will be able to rely on that report.

Where information relating to an arrangement is covered by **legal professional privilege** (LPP), the intermediary is not required to report that information to HMRC. Where an intermediary does not report information to HMRC because of LPP, the reporting obligation in relation to that information may pass to other UK-based intermediaries or, if there are none, to the relevant taxpayer (see below). The regulations have been amended to clarify that complying with the rules does not breach LPP, and HMRC is developing further guidance on the application of the rules to those subject to LPP.

Relevant taxpayers

A **relevant taxpayer** is any person to whom a reportable arrangement is made available for implementation, or who is ready to implement or has implemented the first step of a reportable arrangement. If no UK intermediaries are required to report the transaction (e.g. because there is no UK intermediary, or because a UK intermediary is not required to report due to LPP), the obligation to report to HMRC passes to **UK relevant taxpayers** (also now explicit in the final regulations), unless they or another relevant taxpayer have already reported in another country.

It's important to remember that intermediaries based in other EU Member States may have an obligation to report to their local tax authorities under their local implementation of DAC6. Similarly, UK-based intermediaries and taxpayers may also have reporting obligations in other EU Member States (e.g. Poland).

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Appendix 1 - How do the rules work?

Reporting triggers and timings

Where the first step in the implementation of a reportable cross-border arrangement is made between 25 June 2018 and 30 June 2020, the person with the reporting obligation must file the report with HMRC by 31 August 2020.

Otherwise, the person with the reporting obligation must file a report with HMRC within 30 days of the earliest of:

- When the arrangement is made available for implementation;
- When the arrangement is ready for implementation;
- When the first step in the implementation of the arrangement is made; or
- For UK intermediaries who are service providers, when they provided advice on the arrangement.

Where a UK intermediary is exempt from reporting information subject to LPP, then the person to whom the reporting obligation passes must file a report with HMRC within 30 days of receiving notification from the exempt intermediary.

HMRC acknowledges that terms such as 'made available' and 'first step' are potentially ambiguous and will provide guidance on how these trigger points should be interpreted.

HMRC also acknowledges that the 30 day timeline for reporting is potentially challenging. Guidance will include examples of scenarios where taxpayers and their intermediaries will not face penalties for late reports, for example if there was a reasonable excuse for the failure.

What information must be disclosed?

The information which must be disclosed includes:

- Taxpayer names, place and date of birth (for individuals), tax residence
- Taxpayer identification numbers
- Details of relevant associated persons
- A description of the arrangements
- The date on which the first step was, or will be, made available
- The value of the transaction

In addition to the initial disclosure under the MDR rules, there is also an **annual requirement** for relevant taxpayers to disclose details of reportable arrangements in their tax returns. The final regulations have been amended such that reporting is only required in the first year, and in any year where there is a direct tax advantage.

The disclosures will be made electronically. No details have yet been given of the reporting system to be used, although it is expected to be in XML format.

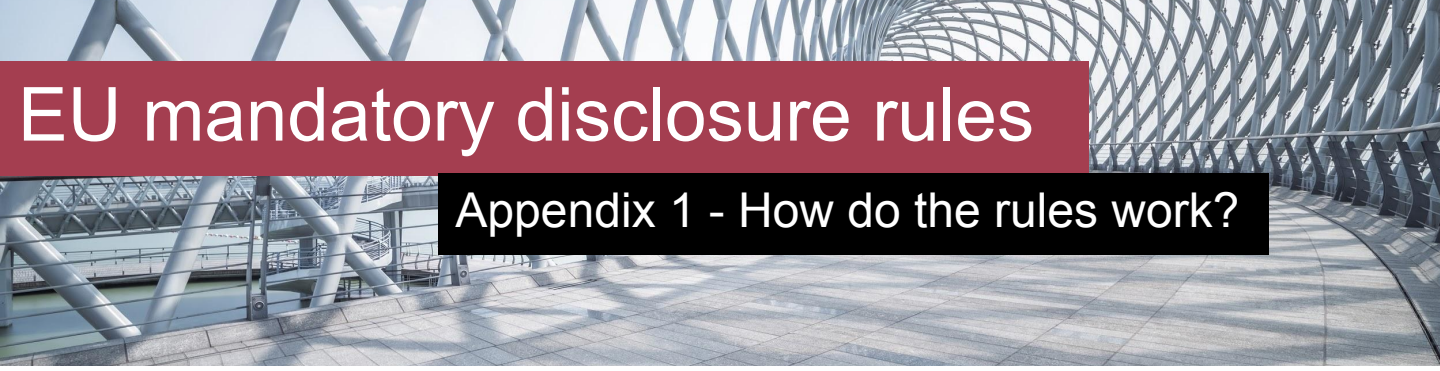
Penalties for non-compliance

There are **financial penalties** for failure to make a report, and for other failures to comply. Under the draft regulations, most penalties were calculated on a daily basis. The final regulations have been amended such that the default position will be a **one-off penalty of up to £5,000**, with scope for reduction where there are mitigating factors.

Daily penalties of up to £600 will only apply in more serious cases, including where the behaviour leading to the failure was deliberate, and will be subject to the determination of the first tier tax tribunal. The final regulations retain the ability for the first tier tribunal to increase any daily penalties up to £1.0 million if the penalty would otherwise be "inappropriately low". Further penalties of up to £600 per day may be imposed if the failure continues after the initial penalty was imposed.

Penalties will not be charged where a person has a reasonable excuse for failure to comply. The final regulations have been amended to clarify that where a person has reasonable procedures in place to secure compliance, this will be taken into account in determining whether they have a reasonable excuse for a failure.

Guidance will provide more detail on how the penalty regime will operate in practice and will provide examples of the situations where different levels of penalty will apply. In particular, intermediaries and taxpayers will not be penalised where failures in the transitional period occurred due to a lack of clarity over the application of the rules, this is due to legislation and / or guidance not having been finalised at the time and the meaning could not reasonably have been surmised from DAC6 itself or from previous publications or statements, including draft legislation and guidance.



EU mandatory disclosure rules

Appendix 1 - How do the rules work?

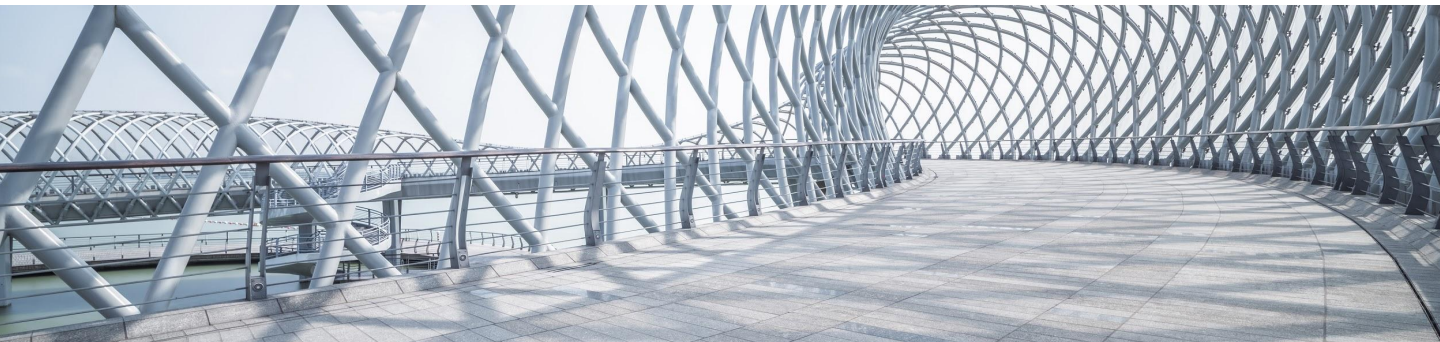
The hallmarks and Main Benefit Test

The Main Benefit Test

The main benefit, or one of the main benefits a person may reasonably expect to derive from an arrangement in the obtaining of a tax benefit.
The definition of "tax advantage" has been restricted to taxes to which DAC6 applies, i.e. EU direct taxes. This may reduce the number of arrangements discloseable under hallmarks subject to the main benefit test. HMRC will provide guidance and examples to illustrate where a tax advantage will and will not be consistent with the policy intent of the underlying legislation (UK or overseas).

Category A	General hallmarks linked to the main benefit test	
A1. An arrangement where participation is subject to conditions of confidentiality		Subject to main benefit test.
A2. An arrangement where the intermediary is entitled to receive remuneration related to a tax advantage		Subject to main benefit test.
A3. An arrangement that has substantially standardised documentation/structure *Guidance will clarify what 'substantially standardised' documentation means, and which kinds of documents HMRC would not consider to be substantially standardised.*		Subject to main benefit test.

Category B	Specific hallmarks linked to the main benefit test	
B1. An arrangement which involves loss buying		Subject to main benefit test.
B2. An arrangement which has the effect of converting taxable income into capital gains or exempt/lower-taxed income *Guidance will include examples of situations of where HMRC would consider that there had or had not been a 'conversion' of income into capital or other non-taxable forms of revenue.*		Subject to main benefit test.
B3. An arrangement which includes circular transactions		Subject to main benefit test.

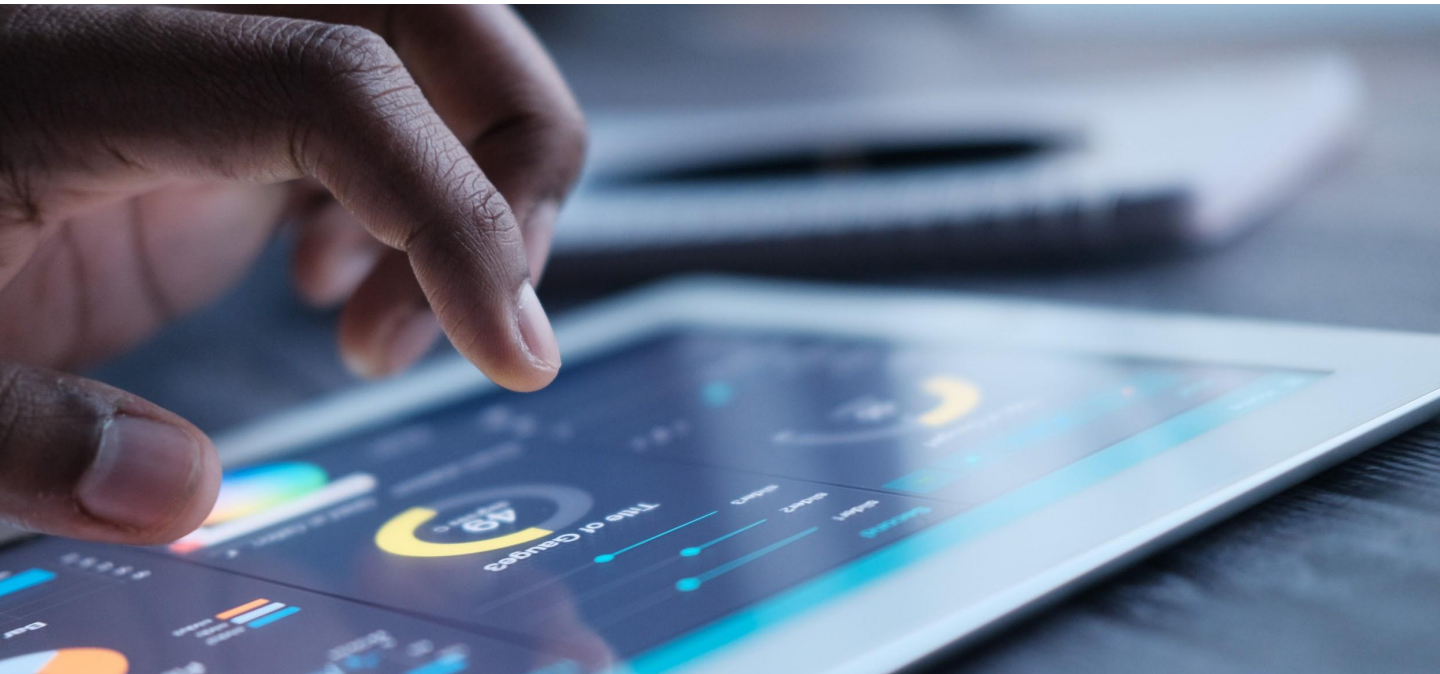


The hallmarks…..continued

Category C	Specific hallmarks related to cross-border transactions	
C1. An arrangement that involves deductible cross-border payments between two or more associated enterprises where: *HMRC will consult further on issues arising from the definition of 'associated enterprise' in DAC6. Guidance will provide more clarity and examples on the application of the C1 hallmarks. HMRC recognises that there is some uncertainty as to what an intermediary needs to do to establish whether a payment is deductible, and has indicated that it does not expect an intermediary to do additional due diligence beyond what it normally does in order to carry out its role.* *There are particular issues in applying these rules to asset managers and collective investment vehicles and the Government will work with the sector to provide guidance.*		N/A
(a) the recipient is not resident for tax purposes in any jurisdiction *The definition of "resident for tax purposes" has been limited so that this no longer applies to the hallmarks. Guidance will clarify the application of this hallmark in jurisdictions that do not have a concept of tax residence.*		Not subject to main benefit test
(b)(i) the recipient is tax resident in a jurisdiction whose corporate tax rate is zero or almost zero		Subject to main benefit test.
(b)(ii) the recipient is tax resident in a jurisdiction which is included in an EU or OECD list of uncooperative tax jurisdictions *Guidance will clarify the time at which an assessment should be made in respect of whether a country was on a list of uncooperative tax jurisdictions, particularly during the transitional period.*		Not subject to main benefit test
(c) the payment benefits from a full exemption from tax in the jurisdiction where the recipient is tax resident		Subject to main benefit test.
(d) the payment benefits from a preferential tax regime in the jurisdiction where the recipient is tax resident *Guidance will clarify what would constitute a preferential regime.*		Subject to main benefit test.
C2. Deductions for the same depreciation on the asset are claimed in more than one jurisdiction. Double tax relief in respect of the same item is claimed in more than one jurisdiction		Not subject to main benefit test
C3. Double tax relief in respect of the same item is claimed in more than one jurisdiction *Guidance will set out situations which would and would not need to be reported.*		Not subject to main benefit test
C4. The arrangement includes a transfer of assets where there is a material difference in the amount being treated as payable in consideration for the assets in the jurisdictions involved. *Guidance will clarify what is meant by "material difference", and examples of when an arrangement will be reportable (addressing how the hallmark applies in situations where differences arise as a result of the proper functioning of tax law in different jurisdictions, or where there are exemptions from tax).*		Not subject to main benefit test

The hallmarks…..continued

Category D	Specific hallmarks concerning automatic exchange of information and beneficial ownership	
	D1. An arrangement which may have the effect of undermining reporting obligations under the Common Reporting Standard (CRS) *Guidance will clarify the interaction between Category D hallmarks and the OECD's Mandatory Disclosure Rules. An arrangement will not be reportable simply because it involves the transfer or money or assets to jurisdictions which have not yet implemented the CRS. There will also be guidance on potential indicators that an arrangement could undermine the automatic exchange of information.*	Not subject to main benefit test
	D2. An arrangement that is structured such that the beneficial owners cannot be identified	Not subject to main benefit test
Category E	**Specific hallmarks concerning transfer pricing**	
	E1. An arrangement which involves the use of unilateral safe harbour rules	Not subject to main benefit test
	E2. An arrangement involving the transfer of hard-to-value intangibles	Not subject to main benefit test
	E3. An arrangement involving an intragroup cross-border transfer of functions, risks or assets which result in the EBIT of the transferor falling to less than 50% of what it would have been if the transfer had not been made. *The Government does not consider that it would be appropriate to carve out Brexit-related reorganisations from the legislation. Neither the regulations nor the responses to the consultation address the question of whether this hallmark should apply to the transfer of shares. However, HMRC will explore whether steps can be taken to minimise over-reporting of benign transactions through guidance. Guidance will also address sector specific issues such as the application of the EBIT test to financial sector entities and funds, and the liquidation of a subsidiary with a foreign parent.*	Not subject to main benefit test



Approach to compliance

Appendix 2

Taxpayers will need a strategy for managing their compliance with the rules, both in the UK and in other EU territories in which they operate. We recommend a **systematic five step approach** to identify how the rules might impact transactions and what processes there should be in place to identify, analyse and report relevant arrangements.

1 **Risk and impact assessment**	2 **Governance framework**	3 **Education and training**	4 **Assessment, Recording and Reporting**	5 **Testing and compliance**
Suggested approach				
Understand the type of transactions which could be in scope. Identify and risk assess which parts of the business are likely to undertake reportable transactions.	Ensure that all your advisers are aware of their responsibilities. Understand what is being reported about your business throughout the EU.	Educate senior management on the new rules. Develop training for business units/teams that need to identify notifiable transactions.	Develop an approach to assess, record and report arrangements within deadlines.	Demonstrate good ongoing controls and procedures to ensure compliance.
How can PwC help?				
Assessment of key risk areas and readiness to comply	Development of a governance framework to identify and manage risks, define roles and responsibilities, and monitor compliance.	Writing and delivery of training materials. Our **Learning Lab** app has a module on these rules which can be tailored to your specific requirements.	**DAC6 Smart Reporting** is a PwC developed online reporting tool that provides a central digital record of discloseable transactions with data visualisation.	Development of testing plans and key control analysis. Specialist support for internal audit or external review.

PwC can also help you to comply by analysing the impact of arrangements which you have implemented, especially where there is no UK-based intermediary. Please look out for our **DAC6 Compare Tool** which will enable you to compare the way the Directive is being implemented in each of the Member States.

Further information

For further information, please speak Rob Gooding, Kate Cornelius, or your usual PwC contact.