EU Mandatory Disclosure Rules

Full regime now in force but reporting deadlines deferred

EU MDR entered into force on 1 July 2020. Taxpayers or their intermediaries must report cross border arrangements which fall within certain broadly defined hallmarks to EU tax authorities.

Reportable arrangements must be disclosed to tax authorities within 30 days of certain reporting trigger events, although EU member states have the option to defer the first reporting deadlines for six months due to the COVID-19 pandemic. The UK will defer reporting deadlines.

Despite Brexit, under transitional arrangements provided for in the Withdrawal Agreement, the rules will continue to apply until the end of 2020 as if the UK were still an EU member state. Thereafter the position will depend on the negotiation of the future economic partnership between the UK and the EU.

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Summary

EU Mandatory Disclosure Rules (EU MDR) were introduced by EU Directive 2018/822 (also known as DAC6) and have been implemented in the UK through regulations (SI 2020 No.25).

The UK regulations 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 are within the scope of the rules.

The regulations entered into force on 1 July 2020, with transitional rules applying to transactions implemented between 25 June 2018 and 30 June 2020.

Reportable arrangements must be disclosed to HMRC within 30 days of certain trigger events, with longer reporting deadlines for transitional arrangements. However, the reporting deadlines for all reportable arrangements with a trigger event occurring on or before 31 December 2020 have been deferred due to the COVID-19 pandemic - see further details on the next page.

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. HMRC also consider that, in certain circumstances, taxpayer entities can be intermediaries in their own right. There are penalties for non-compliance with the rules. HMRC has now published final guidance on its interpretation and application of EU MDR. Further detail on how the rules work is provided in Appendix 1.

Taxpayers need a strategy for complying with the rules, both in the UK and other EU territories, in particular noting that some EU territories (including Germany, Austria and Finland) have chosen not to defer reporting. Appendix 2 sets out our recommended approach to EU MDR compliance.

EU Mandatory Disclosure Rules

What's new?

Deferral of reporting deadlines

On 24 June 2020, ECOFIN agreed to amend DAC6 to give EU member states the option to defer the first reporting deadlines for six months due to the COVID-19 pandemic.

The UK will defer reporting deadlines in accordance with this decision. Amending regulations (SI 2020/713) will enter into force on 30 July 2020. Although the necessary legislative changes were not in force at 1 July 2020, no action will be taken by HMRC for non-reporting during any period between then and the date that the amended regulations come into force.

The revised deadlines are:

- For transitional arrangements (where implementation started between 25 June 2018 and 30 June 2020) reporting will be deferred until **28 February 2021** (originally 31 August 2020).
- For arrangements where the reporting trigger occurs between 1 July 2020 and 31 December 2020, the 30 day reporting window will not start until 1 January 2021 (i.e. **30 January 2021** filing deadline).
- For arrangements where the reporting trigger occurs after 31 December 2020, reports will continue to be due within **30 days** of the triggering event.
- For marketable arrangements, intermediaries must make their first periodic reports by **30 April 2021**.
- The first automatic exchange of information between Member States will take place by **30 April 2021**.

What does this mean for you?

What you need to do

While the temporary deferral of reporting deadlines is helpful, it remains important that businesses continue to prepare for accurate and timely reporting, particularly as some other EU member states may not exercise their option to defer.

How we can help you

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.

EU Mandatory Disclosure Rules

Appendix 1 - How do the rules work?

Which arrangements are reportable?

The UK regulations apply to **cross-border arrangements** concerning **at least one EU member state** (purely domestic arrangements are excluded). In order for an arrangement to 'concern' multiple jurisdictions, those jurisdictions must be of some material relevance to the arrangement. HMRC has clarified what this means and provided examples in its guidance.

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 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. Only **UK intermediaries** (i.e. intermediaries which are UK resident or have other UK nexus) are required to report in the UK, although non-UK intermediaries may have obligations in other EU Member States.

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**).

The guidance clarifies that a limited liability partnership (LLP) can be an intermediary in its own right and may therefore have an obligation to report. In this case, members of an LLP should be able to rely on reports made by the LLP.

In relation to corporate groups, HMRC consider that a group company which provides relevant services to other group companies may be an intermediary, and would therefore have a primary reporting obligation as an intermediary.

In relation to what an intermediary is 'reasonably expected to know', HMRC recognise that intermediaries who are service providers may not know all details of an arrangement and are not required to do additional due diligence or even read all documents which they may be provided with, beyond what they need to do to perform their services. A service provider in this situation would not need to make a disclosure.

HMRC notes that an intermediary may seek to obtain further information (e.g. from other intermediaries or relevant taxpayers) in order to minimise duplicate reporting. The guidance also makes it clear that where a promoter has reported an arrangement, a service provider should be able to rely on that report, although they accept that determining who is a promoter can be difficult.

Where information relating to an arrangement is covered by **legal professional privilege** (LPP), the intermediary is not required to report that information to HMRC, although they are obliged to notify other intermediaries or relevant taxpayers. The obligation to disclose would then be transferred to other intermediaries (or, if there are none, the taxpayer). Lawyers promoting marketable arrangements cannot however rely on 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**, unless they or another relevant taxpayer have already reported in another country.

It's important to remember that intermediaries and relevant taxpayers 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 intermediaries and UK relevant taxpayers may also have reporting obligations in other EU Member States (e.g. Poland).

EU Mandatory Disclosure Rules

Appendix 1 - How do the rules work?

Reporting triggers and timings

Where the first step in the implementation of a reportable cross-border arrangement was made between 25 June 2018 and 30 June 2020 (transitional arrangements), the person with the reporting obligation must file the report with HMRC by 28 February 2021.

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.

However, if the reporting trigger occurs between 1 July 2020 and 31 December 2020, the 30 day reporting window will not start until 1 January 2021 (i.e. 30 January 2021 filing deadline).

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 has provided guidance on how these trigger points should be interpreted. According to the guidance, an arrangement cannot be 'made available for implementation' until the design of the arrangement is final. Thus if an intermediary works with a client on the design of an arrangement, but there are material factors which remain subject to change, then it has not been made available. Once the design has been finalised, it is made available, even if there may still be some minor tweaks.

HMRC also acknowledges that the 30 day timeline for reporting is potentially challenging. The guidance includes 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. Reporting is required in the first year, and in any year where there is a direct tax advantage.

The disclosures will be made electronically. The reporting system is not yet available, although HMRC are building a system which will allow the uploading of files in XML format.

Penalties for non-compliance

There are **financial penalties** for failure to make a report. There is a **one-off penalty of up to £5,000**, with scope for reduction where there are mitigating factors.

Daily penalties of up to £600 only apply in more serious cases, including where the behaviour leading to the failure was deliberate, where the failure has "serious consequences" and where there are repeated failures. These are subject to the determination of the first tier tax tribunal.

The first tier tribunal may 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. Where a person has reasonable procedures in place to secure compliance, this is taken into account in determining whether they have a reasonable excuse for a failure.

EU Mandatory Disclosure Rules

Appendix 1 - How do the rules work?

The Main Benefit Test

The main benefit, or one of the main benefits a person may reasonably expect to derive from an arrangement is the obtaining of a tax benefit.

The definition of "tax advantage" is 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.

The definition of "tax advantage" is also limited to situations where "the obtaining of the tax advantage cannot reasonably be regarded as consistent with the principles on which the relevant provisions that are relevant to the cross-border arrangement are based and the policy objectives of those provisions". In applying this definition, HMRC indicates that it is necessary to consider whether the whole arrangement is consistent with the principles and policy objectives of the applicable legislation.

The hallmarks

Category A - General hallmarks linked to the Main Benefit Test	Subject to Main Benefit Test?
A1. An arrangement where participation is subject to conditions of confidentiality	✓
A2. An arrangement where the intermediary is entitled to receive remuneration related to a tax advantage	✓
A3. An arrangement that has substantially standardised documentation/structure In the guidance, HMRC has confirmed that the use of industry standard framework agreements should not normally satisfy this hallmark, as they are usually subject to significant contract-specific customisation.	✓

Category B - Specific hallmarks linked to the Main Benefit Test	Subject to Main Benefit Test?
B1. An arrangement which involves loss buying	✓
B2. An arrangement which has the effect of converting taxable income into capital gains or exempt/lower-taxed income The guidance includes examples of situations where HMRC would consider that there had or had not been a 'conversion' of income into capital or other non-taxable forms of revenue.	✓
B3. An arrangement which includes circular transactions	✓

EU Mandatory Disclosure Rules

Appendix 1 - How do the rules work?

The hallmarks (continued)

Category C - Specific hallmarks related to cross-border transactions	Subject to Main Benefit Test?
C1. An arrangement that involves deductible cross-border payments between two or more associated enterprises where: HMRC has confirmed that the recipient for the purposes of these hallmarks will generally be the person/people who is/are taxable on the receipt. In the case of transparent vehicles such as general partnerships, it will be the partners, rather than the partnership, who are taxable on the receipt, and so it will be the partners who are the recipients for the purposes of judging whether the hallmark is met. In the guidance, HMRC has clarified whether payments to entities incorporated in territories without the concept of corporate tax should fall within C1(a) or either of the C1(b) hallmarks. An entity incorporated in a jurisdiction without corporate tax should be considered under either C1(b)(i) or C1(b)(ii). HMRC indicates that it considers that C1(a) is targeted on situations where the non-residence arises due to mismatch of taxing criteria between territories.	N/A
(a) the recipient is not resident for tax purposes in any jurisdiction HMRC guidance clarifies that this should not apply to companies incorporated in jurisdictions that do not have a concept of tax residence.	✗
(b)(i) the recipient is tax resident in a jurisdiction whose corporate tax rate is zero or almost zero	✓
(b)(ii) the recipient is tax resident in a jurisdiction which is included in an EU or OECD list of uncooperative tax jurisdictions Guidance clarifies that, for transitional arrangements, it is necessary to consider whether the territory was on either of the lists **both** at the time of the first step of implementation and 1 July 2020 to determine if an arrangement is disclosable under this hallmark.	✗
(c) the payment benefits from a full exemption from tax in the jurisdiction where the recipient is tax resident	✓
(d) the payment benefits from a preferential tax regime in the jurisdiction where the recipient is tax resident Guidance clarifies that a preferential regime is one which is listed as harmful in accordance with the criteria of the OECD Forum on Harmful Tax Practices or by the EU Code of Conduct Group.	✓
C2. Deductions for the same depreciation on the asset are claimed in more than one jurisdiction. HMRC does not consider that arrangements will be reportable where there is a corresponding taxation of profits from the asset in the same jurisdictions in which the depreciation/amortisation is available.	✗
C3. Double tax relief in respect of the same item is claimed in more than one jurisdiction Guidance clarifies that this hallmark is intended to apply where income or capital is taxed only once but double taxation relief is given twice. It will not apply where two or more territories give double taxation relief in respect of the same item of income or capital, and that income or capital is taxed in each of those territories.	✗
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. According to the guidance, 'material' in this hallmark refers to a difference in consideration which does not result from the normal operation of the tax legislation, such that it would be reasonable to conclude that the tax authorities would want to understand more about the arrangement and its operation.	✗

EU Mandatory Disclosure Rules

Appendix 1 - How do the rules work?

The hallmarks (continued)

Category D - Specific hallmarks concerning the automatic exchange of information and beneficial ownership	Subject to Main Benefit Test?
D1. An arrangement which may have the effect of undermining reporting obligations under the Common Reporting Standard (CRS) HMRC indicates that, where the D hallmarks and the OECD's MDR rules cover the same ground, then HMRC will interpret the D hallmarks in line with the OECD's rules. Accordingly, the OECD's guidance on MDR can be used to help interpret the D hallmarks. HMRC has clarified that, just because an arrangement results in no CRS report being made, if this is in line with the policy objective of the CRS rules, this should not be disclosable under D1.	×
D2. An arrangement that is structured such that the beneficial owners cannot be identified The test is whether beneficial owners can reasonably be identified by relevant tax authorities. The identity of the beneficial owners does not have to be publicly available.	×

Category E - Specific hallmarks concerning transfer pricing	Subject to Main Benefit Test?
E1. An arrangement which involves the use of unilateral safe harbour rules	×
E2. An arrangement involving the transfer of hard-to-value intangibles	×
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. In the guidance, HMRC indicates that, when seeking to determine if hallmark E3 is satisfied, it is necessary to consider it from the point of view of a hypothetical informed observer. More specifically, based on all the facts and circumstances, would a reasonable person consider that, on the balance of probabilities, the expected EBIT of the transferor should decrease by at least 50% in the following three years? HMRC does not consider that it would be appropriate to carve out Brexit-related reorganisations from the legislation. Neither the regulations nor the guidance address the question of whether this hallmark should apply to a cross-border transfer of shares.	×

EU Mandatory Disclosure Rules

Appendix 2 - Approach to compliance

Taxpayers 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 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 reportable 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. Our **DAC6 Compare Tool** enables you to compare the way DAC6 has been implemented in each of the Member States.

Further information

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