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## Global Tax Alert

# UK HMRC issues draft guidance on Mandatory Disclosure Regime regulations

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### Executive summary

The United Kingdom (UK) tax authority, Her Majesty's Revenue and Customs (HMRC) has circulated draft guidance on the application of the UK's implementing legislation for the European Union (EU) Directive 2018/822 on the mandatory disclosure and exchange of cross-border tax arrangements (referred to as DAC6 or the Directive). The International Tax Enforcement (Disclosable Arrangements) Regulations 2020 (the UK Regulations), which implements the Directive in the UK, was laid before Parliament on 13 January 2020 and will come into force on 1 July 2020. HMRC is inviting comments on this draft guidance from interested parties to be made by **15 May 2020**, following which HMRC will update and finalize this guidance.

HMRC's initial commentary on the EU Directive was contained in its consultation document published in July 2019 alongside the UK's draft legislation.<sup>1</sup> HMRC published the comments received in response to the consultation in January 2020 alongside the UK's enacted legislation. The current draft guidance incorporates much of the content that was contained in the consultation and the responses to the consultation document but also includes additional material including a number of key changes on specific points.

HMRC has acknowledged that work on the guidance is on-going as many of the comments submitted to HMRC from industry groups have not been reflected in the current update and specifically that it intends to develop the content on the "Penalties" section of the guidance.

## Detailed discussion

### Background

The Council of the European Union Directive 2018/822 of 25 May 2018 amending Directive 2011/16/EU regarding the mandatory automatic exchange of information in the field of taxation (the Directive or DAC6), entered into force on 25 June 2018.<sup>2</sup>

The Directive requires intermediaries (including EU-based tax consultants, banks and lawyers) and in some situations, taxpayers, to report certain cross-border arrangements (reportable arrangements) to the relevant EU member state tax authority. This disclosure regime applies to all taxes except value-added tax (VAT), customs duties, excise duties and compulsory social security contributions.<sup>3</sup> Cross-border arrangements will be reportable if they contain certain features (known as hallmarks). The hallmarks cover a broad range of structures and transactions. For more background, see EY Global Tax Alert, [Council of the EU reaches an agreement on new mandatory transparency rules for intermediaries and taxpayers](#), dated 14 March 2018.

As discussed in EY Global Tax Alert, [UK mandatory disclosure rules come before Parliament; HMRC releases consultation responses](#), dated 4 February 2020 addressing the UK Mandatory Disclosure Regime (MDR) legislation, the UK legislation is broadly aligned with the Directive. Some of the key areas where the current draft guidance has expanded on the consultation document published in July 2019 are set out below. In general, HMRC's guidance is consistent with DAC6 but provides additional detail and insight beyond the text of the Directive. In discussions, HMRC has consistently indicated that it is in discussions with EU Member States, and that the interpretations it has included in the guidance are consistent with the wider understanding of the intent of the Directive.

### Draft Guidance overview

The draft guidance is organized as follows:

- ▶ Introduction (IEIM610000)
- ▶ Who has to report? (IEIM620000)
- ▶ Reportable Cross-Border Arrangements (IEIM630000)

- ▶ Hallmarks (IEIM640000)
- ▶ Reporting Obligations and Triggers (IEIM650000)
- ▶ Penalties (IEIM660000)
- ▶ Commencement (IEIM6700000)

### Key provisions of the Draft Guidance

#### Reportable arrangements (IEIM630000)

Under the Directive, an arrangement is reportable if:

- ▶ The arrangement meets the definition of a cross-border arrangement; and
- ▶ The arrangement meets at least one of the hallmarks A-E specified in Annex IV of the Directive.

Under DAC6, cross-border arrangements are defined as arrangements concerning more than one Member State or a Member State and a third country. The hallmarks can be distinguished as hallmarks which are subject to the main benefit test (MBT), and those which by themselves trigger a reporting obligation without being subject to the MBT.

In the UK Regulations, the definition of the term "arrangement" follows the EU Directive and the HMRC guidance adds that an arrangement should be looked at holistically, not as a series of small steps or separate transactions. This could be helpful especially in relation to arrangements which comprise several steps and where the first step of implementation of the arrangement was prior to 25 June 2018. However, no examples have been provided and this is a key point in the context of the temporal scope of the Regulations.

There are however a number of examples of the meaning of "concerning" multiple jurisdictions which provide additional clarity on the scope of this term.

#### Hallmarks (IEIM640000)

##### *Main benefit test*

Some of the hallmarks require consideration of an MBT. HMRC's comments on the application of the test include the need to consider whether a "tax advantage" is consistent with the policy intention of the relevant legislation and the need to look at the arrangement as a whole when considering whether the tax advantage is consistent with the policy intention of legislation. Additional detail is provided which indicates that consistent with policy should be viewed widely as to whether the overall outcome is not what is intended within the tax regime as a whole, rather than narrowly, such as a specific law which permits a deduction. The guidance

also makes clear that in assessing whether an arrangement confers a tax advantage, the meaning of tax is the same as that in the Directive: "all taxes levied by or on behalf of a Member State other than VAT, customs and excise duties and social security contributions."

### **Associated enterprises**

The guidance also emphasizes that a number of the hallmarks apply to arrangements involving associated enterprises and that the definition of "associated enterprises" in the Directive and the UK Regulations is wider than in UK domestic law, including for example a 25% shareholding which will be an important point where there are minority shareholdings or joint venture structures are in place.

### **Hallmarks A-E of the Directive**

- ▶ **Hallmark A1 - Use of confidentiality clauses (IEIM642010):** The guidance has been expanded to provide further examples of clauses which may trigger reporting and those which may not and also to include the comment that confidentiality agreements will not necessarily be contractually evidenced.
- ▶ **Hallmark A2 - Remuneration related to tax advantage (IEIM642020):** There is no additional commentary for example to clarify whether remunerating an intermediary for assisting with claims to reliefs to which a taxpayer is entitled under law would trigger this hallmark. However, this hallmark is subject to the MBT.
- ▶ **Hallmark A3 - Standardized documentation and structures (IEIM642030):** the guidance notes that standardized documentation and structures are widely used, including in respect of many financial products. However, the existence of such documentation and structures should not trigger reporting unless one of the main benefits of the arrangements was the obtaining of a tax advantage which is inconsistent with the purpose of the legislation.
- ▶ **Hallmark B1 - Loss buying (IEIM643010):** There is no additional commentary on this hallmark.
- ▶ **Hallmark B2 - Conversion of Income to Capital (IEIM643020):** The guidance has been expanded to include an example which states that conversion of income would include conversion from employment income into dividend income, which indicates a potentially wider scope for this hallmark in the UK than many had previously assumed.
- ▶ **Hallmark B3 - Circular Transactions (IEIM643030):** HMRC adds that there is a need to consider whether entities have primary commercial function and that not to be caught by this hallmark the commercial function must be a primary one so that even if there is a minor or subsidiary commercial purpose the arrangement would still be reportable.
- ▶ **Hallmark C1 (IEIM644030):** The guidance clarifies that the recipient of a payment for these purposes is the person(s) who are taxable on the receipt. In the case of transparent vehicles such as partnerships, that will mean looking to the partners to determine whether this hallmark applies. Additional guidance is provided for both promoters and service providers who do not know the identity of the partners in question.
- ▶ **Hallmark C1(a) (IEIM644040):** A jurisdiction that does not have a concept of residency within their tax regime would not be treated as an entity without a tax residence and would not meet hallmark C1(a). This addresses an issue previously identified for the Cayman Islands, which will no longer trigger this hallmark. For the time being, transactions with the Cayman Islands will still be reportable without considering the MBT as the Cayman Islands was added to the EU blacklist on 20 February 2020.
- ▶ **Hallmark C1(b)(ii) (IEIM644010):** The guidance clarifies that for retrospective reporting a country must be both on the EU blacklist at the time when the first step of the arrangement takes place and on 1 July 2020 for the country to be relevant. This means unless countries such as the United Arab Emirates and Bermuda are re-added to the EU blacklist (or other relevant list) before 1 July 2020, they should not be in scope for this particular hallmark. This will make identifying retrospective arrangements for this hallmark simpler in a number of cases.
- ▶ **Hallmark C2 - Depreciation (IEIM644060):** The guidance makes clear that HMRC does not consider this hallmark to apply where there is a corresponding taxation of profits from the asset in the same jurisdiction. Therefore, a deduction for depreciation in a permanent establishment and at head office level would not be in scope provided the associated profits were also taxed in both jurisdictions.
- ▶ **Hallmark C3 - Relief from Double Taxation (IEIM644070):** There is no additional commentary on this hallmark.
- ▶ **Hallmark C4 - meaning of material (IEIM644090):** HMRC would consider a material difference to be one which the tax authorities would wish to know more about such as the exploitation of mismatches in the tax system to give an unintended outcome. HMRC specifically notes that where there is a difference in value of assets as a result

of the normal operation of tax law, for example if shares transferred from the UK are exempted from that under the substantial shareholding exemption, this would not be caught within the hallmark.

- ▶ *Hallmark D1 - Undermining Reporting Obligations (IEIM645010)*: HMRC has further clarified that where a bank transfers money to another country outside of Common Reporting Standard (CRS), but has no knowledge as to the underlying reason for the transfer and if an arrangement exists, it would not expect it to be reportable. HMRC has also added a number of "red flags" which may indicate that the hallmark is met.
- ▶ *Hallmark D2 - Obscuring Beneficial Ownership (IEIM645020)*: HMRC's guidance largely follows the Organisation for Economic Co-operation and Development MDR guidance.
- ▶ *Hallmark E1 - Unilateral Safe Harbors (IEIM646020)*: HMRC has not substantially added to the earlier guidance except to add that Advance Thin Capitalization Agreements are not caught by this hallmark.
- ▶ *Hallmark E2 - Hard-to-value intangibles (IEIM464030)*: There are no additional comments.
- ▶ *Hallmark E3 - Cross-border transfers (IEIM646040)*: HMRC has confirmed that the 50% EBIT (earnings before interest and taxes) test must be considered at the level of the individual company rather than at the level of the sub-group that is located in the same jurisdiction.

### Intermediaries (IEIM621000)

Under the Directive, intermediaries with EU nexus have the primary obligation to report arrangements to the tax authority. The Directive gives Member States the option to exempt intermediaries from the obligation to report where the reporting obligation would breach legal professional privilege (LPP). If there are no intermediaries which can report, the obligation will shift to the taxpayers.

DAC6 defines two categories of intermediaries: promoters and service providers. The UK legislation and draft guidance define intermediaries by reference to the same two categories.

The distinction will be important in practice because HMRC regards "promoters" as being likely to have full information about a reportable arrangement and therefore to be in a position to report. Conversely, HMRC envisages that service providers may not have full knowledge and may not have to report if they did not know or could not reasonably be

expected to know that they were providing aid, assistance or advice in relation to the implementation of a reportable arrangement.

However, the guidance also indicates that a wide range of activities may be caught within the definition of service provider, giving the example that a bank providing finance to a company that was carrying out an arrangement being implemented by a third-party promoter is providing aid in relation to the managing of the implementation of the arrangement, and is therefore a service provider.

Hence it will be important for advisers and their clients to understand whether they are service providers and if so whether they have such knowledge.

HMRC does not expect service providers to do additional external due diligence to establish whether there is a reportable arrangement. It also clarifies that a service provider who receives documents that might indicate a transaction is reportable but is not required to, and does not, read those documents will not have reason to know, provided there has not been a deliberate attempt to avoid becoming aware of the facts.

The guidance clarifies the level of knowledge aggregation that is expected at an intermediary level by providing an example. The position remains that all knowledge held by individuals does not have to be aggregated into a "hive mind," provided there is no attempt to deliberately fragment knowledge. However, the example indicates that two teams who are working alongside each other would be considered as a whole for knowledge purposes, while someone within the same organization who has no knowledge of the work of those two teams would not be covered.

HMRC confirms that a company within a group of companies can be an intermediary. An example is provided of a group treasury company which provides advice to fellow group companies. An employee working for an employer which is an intermediary cannot however be an intermediary. Partners in a partnership can however fall within the definition.

- ▶ The guidance makes clear that the definition of an intermediary does not extend to a person who has not been involved in the implementation of a reportable arrangement but who subsequently becomes aware of such an arrangement. Examples are provided of an auditor and of an adviser completing a tax return. The guidance adds that providing an opinion on whether an arrangement is reportable will not in itself make the provider an intermediary.

- ▶ *Limited liability partnerships (IEIM621100)*: a limited liability partnership can be an intermediary in its own right and therefore may have an obligation to report. HMRC would not expect members of the partnership to report separately. The partnership can determine whether to report and the members of a limited liability partnership would not have to re-evaluate that decision. Penalties applied to the members of a limited liability partnership will be applied based on policies and procedures which the partnership had in place.
- ▶ *Practical application of rules for overseas intermediaries (IEIM621110)*: HMRC has added some clarifying examples on the application of the rules outside of the EU:
  - For a non-EU firm which has a permanent establishment in the UK, advice provided by the overseas firm that was not connected with the business of the UK branch would not bring the rest of the firm into scope as an intermediary. However, this would not apply if there was an attempt to circumvent the regulations for example through channeling the provision of advice from the UK branch through the overseas firm.
  - If a secondment of a UK resident takes them outside of the EU, they may only be an intermediary through the registration with a professional association. If this is the case the UK branch can report on behalf of the secondee. No reporting would be required however, if the individual is living and working outside of the UK and the EU, and that reporting would result in a breach of data protection legislation.
- ▶ *Legal Professional Privilege (IEIM621130)*: HMRC has included guidance on the application of privilege. The guidance notes that lawyers with LPP may still have to report where the information is not covered by privilege. Where LPP prevents reporting and is not waived by a client, the firm must notify another intermediary or relevant taxpayer of the obligation to report in accordance with the UK Regulations (section 7(2)) as soon as is reasonably practicable. The guidance makes clear that a client may waive privilege only to the extent necessary to enable the lawyer to make a report (i.e., that they have not waived privilege for any other purposes). LPP cannot be asserted in respect of marketable arrangements.
- ▶ *Registration with a professional association (IEIM621140)*: To be considered registered, the association must have: governance or supervision in respect of the person's work, the ability to prevent the person from carrying out the

professional activity, or the ability to impose monetary sanctions. For overseas firms and individuals, where the registration does not result in the person falling under the governance and oversight of the professional body, they will not be treated as a UK intermediary.

## Reporting

Under DAC6, for intermediaries (and relevant taxpayers), the trigger events for reporting under the Directive (from 1 July 2020) are when the reportable arrangement is "made available for implementation"; or when the reportable arrangement is "ready for implementation"; or when "the first step of implementation has been made."

HMRC has provided a number of examples of when an arrangement is "made available" for implementation. This includes the comment that unsolicited advice received by a taxpayer will not fall within this definition. The guidance also includes comments on the term "ready for implementation" and "first step of implementation."

Under the Directive, reporting starts from 1 July 2020 and exchanges between jurisdictions from 31 October 2020. However, reports will retroactively cover arrangements where the first step is implemented between 25 June 2018 and 1 July 2020.

The corresponding UK reporting deadlines fully align with DAC6.

*Additional obligations for relevant taxpayers (IEIM655000)*: HMRC has confirmed that taxpayers should include Arrangement Reference Numbers (ARN) on their tax returns, both for the period in which they enter into the transaction and any subsequent period in which they obtain a tax advantage.

*Information to be reported (IEIM657000)*: HMRC has provided some additional guidance on the fields required for reporting, including:

- ▶ The value to be reported is the amount paid, or market value, if it is not an arm's-length transaction. The value is not the tax advantage. Where guidance has been issued by other Member States, there has been the same interpretation.
- ▶ The guidance clarifies that the national provisions that form the basis of the reportable arrangement may not always be relevant for reporting, for example for the D hallmarks.

HMRC has also added some commentary recognizing the difficulties which may arise where there are multiple intermediaries and the need to liaise to ensure that duplicate reports are not filed wherever possible. The guidance is particularly helpful for service providers as it streamlines the process by which they may rely on the reporting of another intermediary and allows all intermediaries to rely on a statement by another intermediary that they will report within the 30-day period, provided that if they do not receive confirmation at the end of the 30-day window they report without unreasonable delay.

HMRC has confirmed that work is on-going to create its on-line portal for reporting.

### Penalties

The HMRC guidance currently comprises a list of failures which could lead to penalties. It reiterates that HMRC will not charge penalties where a person has a reasonable excuse for failure.

HMRC is to provide further guidance on its intended application of the UK penalty regime in its updated guidance.

### Commencement (IEIM670000)

This section of the guidance contains useful commentary including the recognition by HMRC that the new reporting requirements pose certain challenges for intermediaries and relevant taxpayers and particularly so where the first step of implementation of an arrangement was taken prior to the publication of the UK Regulations and guidance.

HMRC acknowledges that intermediaries will need to look back at arrangements since 25 June 2018 to determine whether they are reportable under the final UK Regulations and that this will need to be done on a "best efforts" basis using information available at the time of review.

The guidance adds that where a failure to report relates to an arrangement where the first step of implementation predates the publication of the final UK Regulations, and the failure was due to lack of clarity around the obligations or interpretation of the rules, which could not reasonably have been inferred from DAC6 itself or HMRC's draft Regulations and consultation document, it is likely that the person will have a reasonable excuse for the failure and that no penalty will therefore be due.

### 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 final UK Regulations, taxpayers and intermediaries who have operations in the UK should review their policies and strategies for logging and reporting tax arrangements so that they are fully prepared for meeting their reporting obligations according to the deadlines.

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## Endnotes

1. See EY Global Tax Alert, [UK publishes draft legislation and consultation paper on EU Mandatory Disclosure Regime](#), dated 24 July 2019.
2. For background on MDR, see EY Global Tax Alert, [EU publishes Directive on new mandatory transparency rules for intermediaries and taxpayers](#), dated 5 June 2018.
3. DAC6 sets out a minimum standard. Member States can take further measures; for example, (i) introduce reporting obligations for purely domestic arrangements; (ii) extend the scope of taxes covered; (iii) bring forward the start date for reporting.

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