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Global Tax Alert

UK Tax Authority publishes Mandatory Disclosure Regime Guidance

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Executive summary

On 1 July 2020, the United Kingdom (UK) Tax Authority, Her Majesty's Revenue and Customs (HMRC) published the UK Mandatory Disclosure Regime (MDR) Guidance (the Guidance) publicly for the first time. The content has been added to the International Exchange of Information Manual, and can be accessed at: https://www.gov.uk/hmrc-internal-manuals/international-exchange-of-information/ieim600000.

The Guidance had previously been circulated in draft to interested parties, and a previous Global Tax Alert, *UK HMRC issues draft guidance on Mandatory Disclosure Regime regulations*, dated 7 May 2020, provides an overview of that Guidance.

As with other automatic exchange regimes, HMRC has indicated that it will continue to develop the Guidance to address additional issues arising in practice, and it is expected that the guidance will continue to be expanded on until at least the end of 2020, with addition specific content continuing to be added as needed. However, from this point, it is also reasonable to assume that changes are likely to be clarifications and additional examples rather than changes which substantially amend the overall approach.

Building a better working world

In general, the changes made in this version of the Guidance are beneficial when compared to the March draft of the Guidance and help to clarify areas of uncertainty or to reinforce key assumptions being adopted by taxpayers.

The key highlights of the newly issued Guidance are summarized below.

Detailed discussion

Background

The Council of the European Union (EU) 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.

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.

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 our Global Tax Alert, *Council of the EU reaches an agreement on new mandatory transparency rules for intermediaries and taxpayers*, of 14 March 2018.

EU Member States were required to adopt and publish national laws required to comply with the Directive by 31 December 2019. The UK has introduced domestic legislation to give effect to the Directive, and has also confirmed that it will adopt the deferral of reporting deadlines of up to six months as permitted by Directive 2020/876 and allow intermediaries to report from 1 January 2021.[1]

Hallmarks A-E of the Directive

Most elements of the hallmarks included in DAC6 are not precisely defined. The UK MDR draft guidance already included extensive commentary on many of the hallmarks. The updated Guidance contains a number of further clarifications largely in response to comments that HMRC had received:

Hallmark A3: Confirms that using precedent documents will not fall into A3 "the use of precedent documents in the production of legal documentation would not normally trigger this hallmark as the documents are commonly subject to detailed consideration of the clients' circumstances and can be customised accordingly."

Hallmark B2:

- A number of examples have been included that focus on reorganizations and indicate that a commercial choice between different options is not conversion and that the Main Benefit Test (MBT) should be assessed by taking into account whether a tax advantage is in line with the policy intention of the relevant provisions.
- Specific reference to Excluded Indexed Securities as not reportable - "structuring of a security to qualify as an Excluded Indexed Security should not fall within hallmark B(2) provided that arrangement as a whole is consistent with the principles of the relevant tax provisions."

Hallmark B3: Confirms that certain normal commercial arrangements will not be considered circular – "Some common commercial structures may have some of the features listed in this hallmark. For example, it is common for certain investment structures to use intermediate holding companies, which could be viewed as interposed entities. However, in normal commercial arrangements investors could make commercial gains or losses and so the transactions would not normally be considered circular."

Hallmark C1:

- HMRC clarifies that C1(a) does not apply to permanent establishments
- The Guidance appears to exclude C1(a) which applies to payments to entities not resident anywhere. This condition is referred to in later Guidance and appears to have been excluded in error.
- For the purposes of hallmark C1(d), links to the Organisation on Economic Co-operation and Development Forum on Harmful Tax Practices and the EU Code of Conduct Group have been included, and HMRC note that regimes should be considered preferential where they are described as harmful by those groups.

Hallmark C3: HMRC has indicated that they are not seeking to capture scenarios in which there is double inclusion and double relief. The language included here appears to be wide enough to exclude scenarios where there is a Double Tax Relief claim by a branch, and scenarios in which Controlled Foreign Company (CFC) and similar regimes may include both income and tax relief in their calculation.

Hallmark D1: HMRC has added a note to say that although avoiding reporting under *Foreign Account Tax Compliance Act* (FATCA) is not caught, existing rules would be in point here. HMRC continues to treat the United States as a non-participating jurisdiction for Common Reporting Standard (CRS) purposes.

Hallmark D2: There is some helpful expansion on hallmark D2 to confirm that if a person has to identify a beneficial ownership under Anti Money Laundering (AML) legislation in accordance with Financial Action Task Force recommendations, and does so, hallmark D2 should not be triggered.

This will be particularly valuable to Financial Institutions (FI) under FATCA/CRS as it indicates that where an FI correctly performs AML and tax identification processes they should not have further obligations under hallmark D2 unless they specifically know that an account holder is seeking to avoid reporting. HMRC has also included clarification on the application to trusts where there are classes of beneficial owner.

Hallmark E3: Note that HMRC has not added any additional guidance for hallmark E3, which continues to be an area where a large number of transactions with no particular tax characteristics may be reported. HMRC indicated at a recent meeting that they were still considering this hallmark, although they consider that they are bound by the limitations of the Directive.

Intermediaries

HMRC has added the following clarifications to the guidance in respect of intermediaries:

Service Provider: Changes have been made to seek to clarify the scope of circumstances in which the service provider definition will apply:

- The example of a bank providing finance has been removed, although this does not appear to significantly alter the meaning of this section of the guidance.
- An additional paragraph has been added stating that a person may be too far removed from an arrangement to have sufficient knowledge to be a service provider:

  "A person may be sufficiently far-removed from the arrangement that they would not be a service provider. For example, a person may provide assistance in respect of the implementation of an arrangement but may have little knowledge of the detail of what the arrangement actually entails. They may therefore not be able to assess whether the arrangement is reportable or not. A person in this situation would not be a service provider."
- Note that HMRC continues to rely primarily on the lack of knowledge as the primary reason for an entity not becoming a service provider.

Meaning of arrangement: Includes a useful clarification that indicates that arrangements entered into before 25 June 2018 do not become new arrangements solely because they are extended, unless there is some material change.

Cross-border: Confirms that overseas territories and dependencies of the UK/EU Member States are considered to be separate jurisdictions for assessing if an arrangement is cross-border. Some additional examples are added to the Guidance to help define those circumstances which are not cross-border.

Policy objectives and principles of the relevant provisions: Now specifically references research and development relief, which is not considered to confer a tax advantage per MBT as claiming this relief is in line with policy intent as long as the arrangement does not attempt to "manufacture an entitlement to a relief artificially."

Reporting deadlines

Since the previous guidance, HMRC has circulated the UK draft XML schema and guidance. Although they have not provided any details about reporting, HMRC has confirmed that reports will be uploaded through the Government Gateway and HMRC continues to indicate that there will be the possibility of submitting either as an xml file or a manual upload.

The Government Gateway requires specific registration, but many intermediaries are likely to have already registered for other purposes. The Arrangement Reference Number and Disclosure ID will be provided back through the same portal.

The schema is largely consistent with the EU schema and with the schemas published by other Member States including Germany, Netherlands and Sweden, although there are a number of differences which indicate that there is some room for discretion in national adoption.

Further reporting obligation for service providers: HMRC has clarified that it expected most reports from service providers will be at the point services are provided as a service provider may not know the point at which the arrangement is made available for implementation, is ready for implementation or when the first step of the implementation is taken.

Arrangement Reference Numbers (ARN): Clarifies the difference between an ARN and a Disclosure ID (Disclosure ID not intended to be shared with the taxpayer and other intermediaries).

Meaning of evidence: Recognizes that it may not always be possible to tell if an intermediary is a promoter or a service provider. Where multiple intermediaries are involved, a reasonable judgment should be made.

Penalties

HMRC has added detailed additional guidance on the circumstances in which penalties will be levied and where they may not be.

Of particular interest will be the section related to Reasonable Procedures:

- HMRC introduces guidance on the meaning of reasonable procedures as a mitigation for penalties. This is not covered in the Directive, although the Directive does give wide discretion to Member States in determining an appropriate penalty regime.
- There is no requirement to establish reasonable procedures. However, HMRC notes that:

  "Failure to have such procedures in place will not automatically mean that a penalty is due, but simply that a person will not be able to rely on having procedures in place as part of their defence."

  HMRC also notes that whether procedures are reasonable will depend on the nature of the business, size and scale, profile of activities and whether it generally has involvement in "a lot" of cross-border work.
- Procedures do not have to be newly established and it is acceptable in principle to rely on existing procedures if they are considered appropriate to managing the risks under MDR.
- HMRC suggests that reasonable procedures might include training for staff, escalation routes for potentially reportable arrangements, and overall governance around reporting decisions. Businesses should also consider the practicalities of reporting, responsibilities and training and how to ensure that reports are made even where staff are absent.
- The principles apply equally to both intermediaries and taxpayers.
- It is worth noting that the tone of the Guidance on reasonable procedures is similar to the guidance provided by HMRC in relation to the Corporate Criminal Offence.

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 identifying, assessing and reporting relevant arrangements so that they are fully prepared for meeting their reporting obligations according to the applicable deadlines.

As HMRC's Guidance makes clear, organizations will be able to rely on the fact that they have established reasonable procedures to comply with the Directive potentially to mitigate any penalties where arrangements are not reported and HMRC believes that they should have been, or where any other aspects of the Regulations are not complied with.

For most UK intermediaries and taxpayers, that will mean designing and implementing procedures to allow for the identification, assessment and review of potentially reportable arrangements and the filing of any necessary reports in a timely fashion.

Endnote

1. See EY Global Tax Alert, *Council of the EU adopts amendments for deferral of MDR filing deadlines*, dated 24 June 2020.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP (United Kingdom), London

- Jo Myers jmyers@uk.ey.com
- Ariana Kosyan akosyan@uk.ey.com
- Helen Childers helen.childers@uk.ey.com

Ernst & Young LLP (United Kingdom), Financial Services, London

- James Guthrie jguthrie@uk.ey.com
- David Wren dwren@uk.ey.com
- Mark Persoff mpersoff@uk.ey.com

Ernst & Young LLP (United States), UK Tax Desk, New York

- Daniel W Rees daniel.w.rees1@ey.com
- Matthew Williams matthew.williams1@ey.com
- Pamela Collie pamela.collie1@ey.com
- Graham Shaw graham.shaw@ey.com

Ernst & Young LLP (United States), FSO Tax Desk, New York

- Michael Bolan michael.bolan@ey.com

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