Executive summary

On 22 July 2019, the United Kingdom (UK) Government published draft secondary legislation, the International Tax Enforcement (Disclosable Arrangements) Regulations 2019, which is intended to implement the European Union (EU) Directive on the mandatory disclosure and exchange of cross-border tax arrangements (referred to as DAC6 or the Directive). Under DAC6, taxpayers and intermediaries are required to report cross-border reportable arrangements from 1 July 2020. However, reports will retrospectively cover arrangements where the first step is implemented between 25 June 2018 and 1 July 2020. The draft legislation is subject to public consultation and comments on the proposals are requested by 11 October 2019. In addition to the draft legislation, a consultation paper was released on 22 July 2019 by HM Revenue and Customs (HMRC) which sets out HMRC’s policy intentions in relation to the draft legislation and its interpretation on the various elements of DAC6; it also invites comments from the public to assist in refining its current views. The draft legislation will be subject to the usual legislative process for Statutory Instruments and may well be amended before the final version is laid before Parliament, which is due to happen by 31 December 2019. The consultation document commits the UK Government to producing guidance relating to the application of the final legislation.

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The consultation document includes a comment to the effect that leaving the EU will not reduce the UK’s resolve to tackle international tax avoidance and evasion and that the UK will remain an active and influential member of the Organisation for Economic Co-operation and Development (OECD) and the G20.

If implemented as currently proposed in the draft legislation, the UK Mandatory Disclosure Rules (MDR) will be broadly aligned to the requirements of the Directive, though the draft legislation is more specific than the underlying Directive in certain areas.

The key highlights of the UK draft legislation and consultation paper are summarized below.

Key highlights

Scope and definitions

- The scope of taxes covered follows those covered by the Directive.
- Key definitions including “reportable cross-border arrangement,” “intermediary” and “relevant taxpayer” also broadly follow those of the Directive.

Reporting protocol

- There is a proposed limitation placed on legal professional privilege such that it is unlikely to provide a blanket “get out” for law firms from reporting obligations where they may be intermediaries.
- There is a suggested process for determining which intermediary should file a report and with which tax authority, based on the assumption that only one report should be required for any particular arrangement.
- Time limits for filing reports are aligned to those in the Directive and there are detailed comments on what triggers the time frame for making a report.
- There is detail on the likely process for filing a report including the comment that HMRC anticipates that there will be a standard template for filing reports.
- It is clarified that employees of an intermediary which is under an obligation to report are not personally subject to the reporting obligations.
- An annual reporting requirement on the reportable cross-border arrangement(s) is imposed on the relevant taxpayer (but not for an intermediary) if it is a UK tax resident.

- An evidential burden is imposed on intermediaries or relevant taxpayers wishing to claim exemption from the requirement to report to HMRC based on reporting made to other tax authorities implementing DAC6 or on reporting made to HMRC by another intermediary or relevant taxpayer.
- To determine whether the reporting obligations have been complied with, HMRC has the power to require the provision of information or documents and may require an intermediary or relevant taxpayer to provide information within 14 days of its request.

Hallmarks

- The main benefit test (MBT), which applies to a number of the hallmarks, is described as an “objective” test not requiring consideration of motives or intentions but of tax outcomes in relation to the policy objectives of the Directive.
- “Tax advantage” for the purposes of the MBT is defined specifically under regulation 12 of the draft legislation and applies to taxes covered by the Directive and any equivalent tax in a non-EU Member State. The tax advantage derived from an arrangement does not have to be realized in the EU for an arrangement to be reportable.
- Commentary on each of the hallmarks is provided which is generally consistent with the Directive but more detail is provided regarding how to apply the hallmarks than is generally present in the Directive.
- For example, regarding hallmark A1 (confidentiality), the definition of a confidential arrangement is widely drafted to include inter alia prohibitions on responding to HMRC information requests unless the request is made under statutory notice.
- Regarding hallmark B(2) (income into capital), there is a comment to the effect that the provision to employees of routine share options is unlikely by itself to trigger this hallmark.
- Regarding hallmark C(1)(b)(i) (deductible cross border payments), HMRC’s view is that a tax rate is “almost zero” if it is less than 1%.
- Regarding hallmark E (concerning transfer pricing), reporting is not required if the relevant taxpayer and any associated enterprise are exempted from the basic transfer pricing rule by Chapter 3 of Part 4 to the Taxation (International and Other Provisions) Act 2010.
Although there is generally more detail regarding each of the hallmarks than is present in the Directive, there are still areas where there is a lack of clarity. For example, there is no definitive list of what constitutes a “preferential tax regime” for the purposes of hallmark C1(d) and HMRC comments that this “could include patent box regimes or special economic zones which provide certain tax incentives.” “Unilateral safe harbors” are not further defined except that the comment is made that advanced pricing agreements (APAs) are not unilateral safe harbors.

On the transfer pricing specific hallmarks relating to Hard-To-Value Intangibles and Cross-Border Transfers, the concept of a “hypothetical informed observer” is proposed who would be considered to assess whether the hallmarks were present, and with regard to Cross-Border Transfers, HMRC invites comments on whether the reduction in EBIT (earnings before interest and tax) required to trigger the hallmark should be at the entity or UK sub-group level.

Penalties

The draft legislation contains detailed penalty provisions including for failures by intermediaries and relevant taxpayers to make returns of reportable information and to respond to requirements to provide information. For failures under these headings there is a maximum penalty of £600 per day and for certain other failures a flat rate penalty of up to £5000. A relevant taxpayer who fails to comply with the requirement to make an annual report is liable to a penalty of up to £5000 and up to £10,000 where there have been previous such failures. Penalties may be determined by the First Tier Tribunal which can determine a penalty for failures to make returns of up to £1 million if the penalty as otherwise calculated appears to them inappropriately low. They may also be determined by HMRC. The draft legislation includes a right of appeal against a penalty determination as well as time limits for penalty proceedings and provides that no liability to a penalty will arise where a person has a reasonable excuse for failure to comply. The consultation document states that the penalty provisions are intended to encourage compliance and act as an appropriate and proportionate deterrent even for wealthy individuals and large businesses.

Next steps

Responses to the public consultation are due by 11 October 2019, after which the legislation will be reviewed and amended as necessary. Guidance will be published at that point. The Government intends to lay the regulations, which are in the form of a Statutory Instrument, before Parliament in advance of 31 December 2019. EY expects to be engaging with HMRC throughout the process providing input and seeking further clarification on the draft legislation and consultation document.

Determining if there is a reportable cross-border arrangement under the draft legislation raises complex technical and procedural issues for both taxpayers and intermediaries. Taxpayers and intermediaries who have operations in UK should therefore design and implement policies for analyzing and, if necessary, reporting potentially reportable arrangements so that they are fully prepared for meeting both the UK and other local country obligations.

A detailed Global Tax Alert is forthcoming.
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