DAC6: International Tax Enforcement: disclosable arrangements

Management of taxes

01 September 2019

HMRC recently published a consultation document and draft regulations which require taxpayers and advisers to report certain cross-border tax arrangements to HMRC.

On 22 July 2019, HMRC published draft regulations implementing EU Directive 2018/822 amending Directive 2011/16/EU (otherwise known as DAC6) into UK law, alongside a consultation document which is seeking comments on the technical application of the rules and is aiming to clarify HMRC's approach.

Background

DAC6 provides for the mandatory disclosure by intermediaries, or individual or corporate taxpayers, to the tax authorities of certain cross-border arrangements and structures that could be used to avoid or evade tax and the mandatory automatic exchange of this information amongst EU member states. A cross-border arrangement is reportable if it meets one or more hallmarks set out in Annex IV of DAC6. Member states are required to implement the Directive into national law by 31 December 2019 and apply the provisions by 1 July 2020. Reportable cross-border arrangements where the first step is undertaken between 25 June 2018 and 1 July 2020 will need to be reported when legislation becomes effective in 2020. Intermediaries must file their first report by 31 August 2020.

The UK is working to implement these rules as a current EU member state, but the consultation does not explain what happens if the UK leaves the EU on 31 October 2019. There is only a general statement that 'leaving the EU will not reduce the UK's

resolve to tackle international tax avoidance and evasion’.

Terminology

The draft regulations refer to DAC6 for key definitions on terminology such as ‘cross-border arrangement’, ‘reportable cross-border arrangement’, ‘intermediary’, ‘relevant taxpayer’, ‘reportable information’, ‘hallmark’ and ‘main benefit test’.

The definition of an intermediary envisages two types of intermediaries: ‘promoters’ and ‘service providers’. Promoters are those who design and implement the arrangements, whilst service providers are those that provide assistance or advice in relation to the arrangements. The reporting obligation is fundamentally the same but there is a ‘knowledge’ defence available to service providers which, if applicable, means that they do not have an obligation to report. There is no equivalent defence for promoters.

Intermediaries

An intermediary must make a report to HMRC if it meets any of the following conditions:

- it is resident for tax purposes in the UK;
- it has a permanent establishment in the UK, through which it provides the services in respect of the arrangement;
- it is incorporated in the UK, or governed by the laws of the UK; or
- it is registered with a professional association relating to legal, taxation or consultancy services in the UK.

To be reportable by an intermediary, information must be in its knowledge, possession or control.

Where an individual employed by a firm takes actions on behalf of the firm, which falls within the definition of intermediary, it is the employing firm, and not the individual employee, who is the intermediary, and who is required to make the report as necessary. Individuals may still have to make reports if they are sole traders and are not employed by a firm.

Where information relating to a reportable arrangement is covered by legal professional privilege (LPP), the lawyer is not required to report that information to

HMRC. Where a lawyer does not disclose information because of LPP, the lawyer must inform other intermediaries or relevant taxpayers of their reporting obligations in respect of the legally privileged information, and the reporting obligation passes to the other intermediary or relevant taxpayer as the case may be.

Taxpayers

The relevant taxpayer (that is the person to whom a reportable cross-border arrangement is made available for implementation, or who is ready to implement a reportable cross-border arrangement or has implemented the first step of such an arrangement) must report an arrangement to HMRC if there is no intermediary who is required to report the required information in relation to the arrangement. This could be because there is no intermediary, or because the intermediary does not have to report certain information due to LPP.

There is a requirement for intermediaries (or relevant taxpayers, as appropriate) to make a report of a cross-border arrangement which meets one or more of the hallmarks within 30 days of the arrangement being ‘made available’ or ‘ready’ for implementation.

Once a report has been made, HMRC will allocate a reference number to the arrangements.

Relevant taxpayers who are resident or taxable in the UK have an obligation to report to HMRC for each accounting period or tax year that they participate in the reportable arrangement and supply the relevant arrangement reference number provided following the initial report. It is envisaged that the reference number will need to be provided in the white space on income and corporation tax returns. HMRC have not yet decided on the process where other taxes, such as inheritance tax, are involved, and would welcome views on the appropriate process.

What must be reported?

The information that reporters will need to provide is set out in the Directive. This is the information that will be shared by HMRC with other EU member states. They anticipate that there will be a standard schema or template on which reports will need to be made. The storage and use of data reported under these regulations will be done in accordance with GDPR.

The hallmarks

In order for a cross-border arrangement to be reportable, one or more of the hallmarks set out in Annex IV of DAC6 must apply to the arrangement. The hallmarks are grouped under five broad categories, A – E. The 'main benefit test' must be satisfied for any arrangement for hallmarks under categories A, B and subcategories 1(b)(i), 1(c) and 1(d) of category C to apply. It does not have to be satisfied for arrangements under any of the other hallmarks.

The main benefit test is an objective one. It will be satisfied if it can be established that the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage. 'Tax advantage' is defined in Regulation 12. Key points to note are that:

- the main benefit of an arrangement will not include the obtaining of a tax advantage if the tax consequences of the arrangement are entirely in line with the policy intent of the legislation upon which the arrangement relies; and
- tax does not only include taxes levied by EU member states, but also equivalent taxes levied in other jurisdictions. This means that the regulations can apply to a tax advantage realised in a non-EU member state.

The hallmarks are:

- Category A (1)-(3): the 'generic hallmarks' (confidentiality, remuneration related to a tax advantage and standardised documentation);
- Category B (1)-(3): loss buying, income into capital and circular transactions;
- Category C (1)-(4): deductible cross border payments, depreciation, relief from double taxation and transfer of assets;
- Category D (1)-(2): undermining reporting obligations and obscuring beneficial ownership; and
- Category E (1)-(3): unilateral safe harbours, hard-to-value intangibles and cross-border transfers.

Consultation

The consultation document seeks comments on the approach set out for each of the hallmarks.

The draft regulations specify the penalties for failure to make reports and other failures to comply with the regulations. These draw on concepts from the DOTAS regime. No penalties will be due where a person has a reasonable excuse for the failure.

The consultation document provides some examples to help clarify how HMRC will seek to apply the regulations but is seeking suggestions about how more clarity can be provided.

The approach set out in the consultation document will provide the basis for the guidance, which HMRC will provide alongside the finalised regulations.

The draft regulations and consultation document are on GOV.UK with a closing date for comments of 11 October 2019. The CIOT is intending to respond to the draft regulations and the questions posed in the consultation document. Please send any comments you may have to mcurran@ciot.org.uk.