DAC 6: International Tax Enforcement: disclosable arrangements

Management of taxes

01 December 2019

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

The draft regulations make provision for implementing EU Directive 2018/822 amending Directive 2011/16/EU (otherwise known as DAC 6) into UK law. The consultation document set out HMRC's current thinking and approach to interpreting DAC 6, and sought comments on the technical application of the rules.

Background

DAC 6 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 DAC 6.

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.

Key points

Our main concern with the measure is that there could be a very large number of transactions requiring disclosure, with many being trivial and/or benign, creating additional burdens on businesses and taxpayers, and on HMRC which will have to process the information. Additionally, there may be unnecessary disclosures where intermediaries and taxpayers take a very precautionary approach in order to avoid the risk of penalties. We recognise that the government is constrained by what is legally required by the Directive, but we encourage HMRC to take a pragmatic approach to implementing the rules, where possible.

With the uncertainty continuing around Brexit, we asked HMRC to provide clarification as soon as possible with regard to the implementation of DAC 6 in the UK. The previous government had consistently said that implementation would go ahead regardless of Brexit, and on the assumption of there being a withdrawal agreement and a transitional period, but the position is now less clear. Advisers potentially affected by the measure want certainty.

We also make some specific points regarding Brexit's effect on the implementation of the Directive, such as how it might impact the UK's access to the shared central EU database.

The approach set out in the consultation document will provide the basis for the guidance, which HMRC will provide alongside the finalised regulations. We support HMRC's proposals to update their guidance iteratively after it is introduced and note that it will be helpful in understanding the scope of the rules and reducing uncertainty around whether or not a disclosure is required. We also welcome HMRC's intention to share a draft of their guidance with stakeholders by the end of 2019.

Intermediaries

The definition of an intermediary envisages two types of intermediaries: 'promoters' and 'service providers'. Promoters design and implement the arrangements, whilst service providers 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.

HMRC expect a service provider to carry out the ‘normal’ due diligence it would for the type of transaction and the client(s) in question, and do not expect service providers to undertake ‘significant extra’ due diligence to establish whether there is a reportable arrangement.

We say that it would be helpful if the guidance included some examples teasing out the potential dividing lines between promoters and service providers, as well as what is considered to be normal and significant extra due diligence, as we are not sure that the distinctions are as clear as the consultation document suggests.

We also ask HMRC to confirm that a service provider, such as a tax adviser or accountant, would not fall within the definition of intermediary if they only become aware of a reportable cross-border arrangement after it has been implemented, for example whilst preparing a tax return for a client (similar to the ‘auditor’ example in paragraph 3.9 of the consultation document).

The regulations appear to require an individual that is registered with a professional association (which will include the CIOT) to consider whether they are an intermediary and required to make a report in the UK, even if they are not resident for tax purposes in the UK, nor have a permanent establishment in the UK, through which they provide the services in respect of the arrangement. We do not know how common such a scenario will be in practice, or indeed whether the individual would have enough information to know what to report. To be reportable by an intermediary, information must be in its knowledge, possession or control. We are intending to update our guidance for members once the Regulations come into force.

There is a requirement for intermediaries 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.

We note that it seems probable that intermediaries will be less likely to try to satisfy themselves that a report has been made by another intermediary and that the information they would have to report has already been reported, and will be more likely to make their own report. Partly this will be because of their own risk management procedures, but also because the tight reporting deadlines could mean there is insufficient time for another intermediary to provide a reference number.

It is also likely that there will be many examples of service providers only being aware of their own (possibly small) part in a reportable arrangement. We ask HMRC to confirm whether they expect partial disclosure reports to be made.

Legal professional privilege

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. We are concerned that the consultation document makes some statements that show a misunderstanding about LPP and ask that this be corrected in the guidance.

Reporting requirements

It is intended that the information provided by reporters will be shared by HMRC with other EU member states. There will be a standard schema or template on which reports will need to be made. We ask that HMRC share the technical specifications with interested parties as soon as possible, so they have time to develop their systems to ensure they are compatible.

Under the regulations, HMRC can ask for information and documents ‘reasonably required’ but we note that there does not appear to be any provision for appeal against an HMRC officer’s decision to ask for such information or documents. There should be a right of appeal here. In addition, in our view, the requirement to provide the information and documents requested within ‘no less than 14 days’ is too tight. This is only 10 working days. It will be extremely difficult to meet this deadline in practice. We think that at least 56 days (that is 40 working days) is a more reasonable timescale.

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 to 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.

One key point to note is 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.

We ask HMRC to confirm that ‘normal commercial’ transactions involving employees do not give rise to a tax advantage because they are not inconsistent with the policy intent. We give some examples in our response of such transactions involving employees.

In the context of applying the rules to transactions involving UK land, we would expect that the criteria regarding whether or not there is a tax advantage arising from a cross-border arrangement can be applied with certainty in most cases. However, as there are a number of hallmarks which do not have a main benefit test, we provide some examples in our response of typical commercially driven arrangements involving UK land, where the position may be less clear.

We also make some specific comments on the approach set out for each of the hallmarks.

Penalties

Daily penalties of £600 per day will be imposed for failures to comply with certain provisions. In our view, the penalty should be a one-off charge, subject to mitigation. Daily penalties seem inappropriate in this context because the failure might be a consequence of an active decision by an intermediary not to make a return, rather than an ongoing failure.

Also, in view of the high level of uncertainty around the application of the rules, and the fact that benign transactions are likely to be caught, the level of penalties appears disproportionate, given that daily penalties can quickly add up. We encourage HMRC to take a light touch approach to penalties, particularly in the early days of the regime.

The CIOT’s full response can be read on the CIOT website.