International Tax Enforcement: disclosable arrangements

Summary of Responses

January 2020

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1. Executive Summary

Tackling tax avoidance and evasion is a priority for the Government. The International Tax Enforcement (Disclosable Arrangements) Regulations 2020, which were published in draft in July 2019, and which implement EU Directive 2018/822, which amends Directive 2011/16/EU (*on Administrative Cooperation in the field of taxation*), more commonly known as 'DAC 6', will provide HMRC with early information about cross-border arrangements that could potentially be used to avoid or evade tax. This will allow HMRC to better target its compliance activity, and deter people from entering into abusive arrangements in the first place.

We have listened carefully to stakeholders' responses and the concerns they raised during the consultation phase. In particular, we recognise there are concerns about the penalty regime, the risk of over-reporting, and the interaction of the rules with legal professional privilege (LPP). Whilst we are limited by our legal obligations to implement the Directive faithfully, where possible we have made a number of changes to the draft legislation to make the rules more proportionate, including:

- amending the penalty regime to ensure it is proportionate and is flexible enough to deter non-compliance, while not unduly penalising those who make genuine mistakes.
- limiting the scope of 'tax advantage' to only taxes covered by the Directive, addressing a particular concern raised by a number of stakeholders around ensuring the rules are proportionate.
- amending the rules to ensure that the same intermediary does not have an obligation to report in multiple jurisdictions.
- ensuring that the scope of the rules is limited to UK intermediaries and does not apply to those without a UK connection, as intended by the Directive.
- ensuring that the rules are compatible with LPP. We will work with stakeholders on the guidance to ensure it does not inadvertently risk impacting on LPP.

We recognise that because the Directive is broad and this is a new regime, there are areas where business will be uncertain about the circumstances in which they need to report. We are very grateful for the examples provided during the consultation to highlight these issues.

We will use the examples provided during the consultation, and other evidence from the consultation itself to help inform the detailed additional guidance we are preparing. Our aim is to continue to minimise burdens for business as far as possible, whilst ensuring that the UK stays within the rules of the Directive, and HMRC gets the information it needs to tackle tax avoidance and evasion.

We will work closely with interested stakeholders to develop this guidance, and it will be published before the regulations come into force on 1 July 2020.

While the UK is an EU Member State, and during any implementation period, under the terms of the Withdrawal Agreement, the UK is obliged to implement this Directive. It is also important to note that leaving the EU will not diminish the UK's resolve to tackle tax avoidance and evasion, and we will continue to work internationally to improve tax transparency.

2. Introduction

Background to the Consultation

The Government announced at Budget 2018 that it would introduce new rules requiring taxpayers and intermediaries to disclose details of certain types of cross-border arrangement to HMRC. These rules will give effect to EU Directive 2018/822 on Administrative Cooperation in the field of direct taxation, commonly known as DAC 6. This Directive requires member states to collect and share information about cross-border arrangements which could be used to avoid or evade tax. It ensures there is a common framework to avoid creating multiple different regimes in different countries.

Arrangements will be reportable if they meet any of a number of distinctive features, referred to in the Directive as ‘hallmarks’ sometimes seen in arrangements used to avoid or evade tax. The information received from these reports will be shared with other tax authorities, who will in turn share the information they receive. The primary reporting obligation will fall on ‘intermediaries’, which includes those who design and market cross-border arrangements, and those who provide aid, assistance or advice in respect of such arrangements. The report will normally be made to the tax authorities of the country where the intermediary is resident for tax purposes. That tax authority will then share the report with tax authorities in other EU Member States so that they can identify any potential tax risks in their jurisdictions.

HMRC will use this information to better identify and challenge offshore non-compliance, as part of the Government’s strategy to bear down on tax avoidance and tax evasion[1].

Consultation Process

The Government published a draft version of the International Tax Enforcement (Disclosable Arrangements) regulations 2019 on 22 July 2019 alongside a consultation document setting out details of the Government’s proposed approach to implementation. The consultation closed on 11 October 2019. In total 59 written responses were received, primarily from medium and large businesses which are likely to be affected by the regulations, and from industry representative bodies. Some responses were also received from smaller businesses. Alongside the written responses, officials held a number of meetings with businesses and representative bodies to discuss the draft regulations.

[1] HMRC’s strategy for offshore tax compliance, No Safe Havens 2019, is at https://www.gov.uk/government/publications/no-safe-havens-2019

Summary of the responses

Many of the responses received provided general comments on the draft regulations and on the approach set out in the consultation document, before responding to the specific questions raised in the consultation. Some only provided responses to specific questions which dealt with areas of particular relevance to the respondent's business, while others addressed all or almost all of the questions.

A number of key themes emerged from the consultation meetings and written responses. These included:

- Whether the penalty regime strikes the right balance between being fair and proportionate on the one hand and providing a meaningful deterrent on the other.
- Whether it is appropriate for the regulations to refer back to the Directive, rather than setting out a UK version of the rules.
- Whether the regulations provide sufficient clarity on when an arrangement will be reportable, and whether there is an over-reliance on guidance instead of providing detail in the legislation.
- How certain key concepts in the Directive should be interpreted.
- How the rules will operate where information is subject to legal professional privilege.
- The need for as much consistency as possible between the UK rules and those in other jurisdictions.
- The need for clear guidance and examples to help intermediaries and taxpayers meet their obligations.
- What would happen in relation to these rules after the UK leaves the EU.

Government responses

The Government is grateful to all those who responded to the consultation both in writing and in meetings. As a result, we have made a number of changes to the regime to ensure that the rules are proportionate and to ensure that the Directive is implemented properly.

In response to comments on the penalty regime, the Government has made amendments to clarify that where a person has reasonable procedures in place to secure compliance with these rules, this will be taken into account in determining whether they have a reasonable excuse for a failure. The Government has also amended the rules so that the default position will be a one-off penalty of up to £5,000, with daily penalties only applying in more serious cases, and subject to the determination of the first tier tax tribunal.

It is important that the regulations deliver their policy objective by providing information to HMRC about potential offshore non-compliance. The scope of the legislation is set in the Directive, and deviation from this would risk failing to implement the Directive properly, meaning the UK would not meet its international obligations. It would also lead to potential differences in the approaches of the UK and other countries. The regulations will therefore implement the rules as set out in the Directive.

The Government is keen to provide as much certainty as possible to those who will be affected by the regulations, to minimise the burdens on business. To achieve this HMRC will provide detailed guidance on the application of the rules, working closely with interested stakeholders in drafting the guidance to ensure it is helpful in providing clarity to businesses and taxpayers. The guidance will also provide examples of how the rules will apply in different circumstances, recognising that the application of the rules will often depend on the facts of a particular arrangement. The Government is grateful for the numerous examples that were included in consultation responses, and will draw on those examples in developing the guidance. The consultation document set out the Government's intended approach to applying the rules and the guidance will build on this approach while taking into account the helpful comments and suggestions received during the consultation.

The Government acknowledges the points made around the interaction of these rules and legal professional privilege, and has made adjustments to the rules accordingly. This is set out in the response to question 5 in Section 3 of this document.

The UK is legally obliged to transpose this Directive before the UK leaves the European Union. That obligation will continue during the Implementation Period, under the terms of the Withdrawal Agreement.

The UK's commitment to tax transparency will not be weakened as a result of leaving the EU. The Government will continue to work with international partners to tackle offshore tax avoidance and evasion. As part of this collaboration, we will consider amending the rules further if necessary to ensure they work as planned.

The Government's responses to the specific questions asked in the consultation are set out below.

Timing

EU Directive 2018/822 requires legislation to be in place by 31 December 2019. Due to the dissolution of Parliament prior to the General Election on 12 December 2019, it has not been possible to lay the regulations by this deadline. The regulations were laid before Parliament on 13 January 2020.

The regulations come into force on 1 July 2020. Reports for arrangements entered into from 25 June 2018 to 30 June 2020 will be due by 31 August 2020. HMRC will publish guidance on the regulations before they come into force on 1 July 2020.

3. Responses

In this section we have set out each question asked in the consultation document and provided a summary of the responses and the common themes and issues that were raised, together with the Government's response to the points made.

Annex B sets out a list of the 'hallmarks' mentioned in the Directive for ease of reference.

Question 1.
Do you have any suggestions about how HMRC can provide more clarity about when an arrangement will concern multiple jurisdictions?

Summary of responses:

A number of responses welcomed the description and example in the consultation document of when an arrangement will concern multiple jurisdictions. However, most responses to this question felt that further clarity would be welcome. In particular, respondents questioned what it would mean for a jurisdiction to be of 'material relevance' to an arrangement. Some responses suggested that the legislation should include a definition of what is meant by the word 'concerns'. A number of responses provided examples of situations where an arrangement might be said to concern multiple jurisdictions and either offered a view on why the arrangement would or would not concern each jurisdiction, or invited HMRC to provide confirmation through guidance.

Government response:

The Government recognises the need to provide clarity on when an arrangement concerns multiple jurisdictions. This will often depend on the facts of a particular arrangement. It is therefore not appropriate to attempt to legislate what 'concerns' means. Instead, HMRC will include examples in guidance to illustrate when an arrangement concerns multiple jurisdictions, and the meaning of 'material relevance'. HMRC will work with stakeholders to ensure the guidance provides as much clarity as possible, drawing on helpful examples already provided during the consultation. The guidance will seek to strike a balance in ensuring that arrangements that could be used to avoid or evade tax are reported, while avoiding over-reporting of benign transactions.

Question 2.
Are there any people who might be caught by this approach to defining 'intermediary', who you think should not be caught?

Summary of responses:

Many respondents noted that the definition of intermediary was broad which would ensure that arrangements were reported. However, a number of risks around duplicate reporting where multiple intermediaries may report the same arrangement were also identified because the exemptions from reporting were tightly drawn and the timelines for reporting were short. Duplicate reporting could pose difficulties for HMRC in piecing together information from different reports, and would be potentially burdensome on business.

Many responses also raised practical questions about what an intermediary could ‘reasonably be expected to know’, how to draw the line between a ‘promoter’ and a ‘service provider’ under the rules, and whether a person could be both.

Several responses also queried how the intermediary rules would apply to partners and partnerships, to employees on secondment or on loan in other jurisdictions, and whether the territorial scope of the definition was limited to the UK. Several responses, particularly from larger organisations, queried whether it would be acceptable for one company in a group to do all the reporting for all the companies within that group, and whether one company in a group could be an intermediary for another company in the same group.

Government response:

The Government acknowledges that duplicate reporting could create additional burdens and is keen to minimise this where possible. However, the structure of the reporting obligations is set out in the Directive and changing that would increase the likelihood of there being substantial differences in obligations between jurisdictions. This in turn could increase burdens on business, as well as potentially creating loopholes in the rules. To balance these points HMRC will work with stakeholders to provide guidance to clarify situations where intermediaries can rely on another intermediary, whether in the UK or in another jurisdiction, to report without the risk of penalties.

Many of the practical questions around what an intermediary could ‘reasonably be expected to know’ and where to draw the line between a promoter and a service provider will depend on the facts of the arrangement in question. HMRC will provide guidance and examples to help intermediaries apply the rules in practice. The response to question 4 below addresses what would be expected from intermediaries in terms of due diligence.

Regarding the territorial scope of the draft rules, the Government agrees that in certain situations the scope was too wide. New definitions of UK intermediary and UK resident taxpayer have been introduced in the regulations to address this point. This will ensure that the regulations do not apply to intermediaries without a connection with the UK, minimising burdens on business as far as possible.

In relation to queries about whether it is partnerships or the partners themselves who have the obligation to make reports, the Directive is clear that an intermediary is any person who carries out any of the activities listed. Therefore, partners could be intermediaries, in the same way that self-employed individuals could be intermediaries. However, partnerships will be able to make relevant reports on behalf of partners who would otherwise have to report separately. HMRC will work with stakeholders to provide guidance on this. The Government also recognises that there may be challenges in applying the rules in situations where an intermediary is on loan or is seconded. How the reporting obligations will operate in these situations will depend on the particular circumstances, such as the location of the secondee. HMRC will work with industry to provide guidance to deal with these scenarios.

Question 3.

Does this definition of intermediary risk not catching certain types of intermediary who should be caught?

Summary of responses:

Respondents generally felt that the definition was sufficient to capture all those intermediaries who should be required to report. Some commented that if anything the definition was too broad rather than too narrow.

Government response:

The Government agrees that those who should have reporting obligations will be in scope in line with the definition of intermediary. The Government does not consider that it would be appropriate to reduce the scope of the term ‘intermediary’, as this would not properly implement the Directive.

<u>Question 4.</u>
Do you identify any particular practical challenges with regard to HMRC’s approach to identifying intermediaries, and what information they have in their knowledge, possession or control?

Summary of responses:

There were a number of potential challenges identified by respondents. A number of responses queried what additional work intermediaries would need to do to identify whether an arrangement was reportable, and in particular queried what HMRC envisaged by its use of the term “no significant extra due diligence” in the consultation document. Several responses highlighted the challenging timeline for reports to be made, and the practical difficulties, particularly in large organisations in identifying reportable arrangements and gathering the necessary information to report in time.

Numerous responses queried whether knowledge had to be vested in one individual, or whether it should be considered across the reporting entity. Several respondents highlighted practical difficulties in bringing information together where it was held by multiple people across an organisation, particularly where information was held separately to prevent conflicts of interest, or to ensure GDPR compliance.

Government response:

The Government recognises that there are potential practical challenges in operating the rules. We want the rules to be workable and so HMRC will provide guidance setting out what would be expected of intermediaries in different situations. This will confirm that intermediaries will not be required to do any additional customer due diligence beyond what they would normally do in the course of their business and in compliance with their existing obligations.

The Government acknowledges that there may be challenges in bringing information together across large organisations. At the same time there is a risk of deliberate and artificial separation of knowledge to try to avoid reporting obligations. The guidance will seek to ensure that the regime is workable while minimising the risk of anyone avoiding their obligations.

The Government acknowledges that the timeline for reporting is potentially challenging, but the 30 day period is set out in the requirements of the Directive. We will work with stakeholders to set out examples in guidance about the scenarios where taxpayers and intermediaries will not face penalties for late reports, for example if there was a reasonable excuse for the failure.

Question 5.
Do you have any other comments about the definition of intermediary and who will be caught under the proposed rules?

Summary of responses:

Many of the points highlighted in the responses to questions 2, 3 and 4 were also made in response to question 5. In particular, the points around duplicate reporting, and about whether an intermediary knows or could reasonably be expected to know that an arrangement was reportable. In addition, a number of responses to question 5 addressed the issue of legal professional privilege (LPP) and how it interacted with the reporting rules under these regulations. Amongst the responses that addressed LPP, there was a strong view that the structure of the rules at present would be difficult for lawyers to operate and risked threatening legal privilege, or putting lawyers in an impossible position where they would either have to fail to comply with the regulations or breach privilege. Some responses suggested potential changes to the legislation to deal with this, and a number of others expressed disagreement with examples in the consultation document about when material may or may not be privileged.

A significant number of respondents also commented that it would be difficult for intermediaries to know when a reporting trigger was met. This was because terms used in the regulations such as ‘made available’ and ‘first step’ were potentially ambiguous, and the commentary in the consultation document did not align with the approach used for DOTAS. Many respondents commented that there was a risk of over-reporting if more clarity was not provided, as intermediaries would take a risk-averse approach and report early iterations of potential arrangements which were never implemented.

Government response:

The Government agrees that the rules as originally drafted could cause difficulties in ensuring that LPP was not breached. Accordingly, the regulations have been modified to prevent this. HMRC will work with representatives from the legal sector to provide guidance on how the rules will operate.

HMRC will also work with stakeholders to provide guidance on how the trigger points should be interpreted, balancing the aim of avoiding unnecessary reporting with the need to ensure that reporting obligations are not avoided or delayed. We appreciate that intermediaries will need clarity on when a reporting trigger is reached and so the meaning of ‘made available’ and ‘first step’ are of particular interest. Stakeholders have provided helpful comments and suggestions during the consultation on how best to approach these concepts and we will discuss this further with stakeholders in producing the guidance.

Question 6.
For the purposes of the ongoing requirement on relevant taxpayers, do you agree that a relevant taxpayer should be regarded as participating in the arrangement in any year

where there is a tax effect or where it could reasonably be expected that there would be a tax effect in a subsequent year?

Summary of responses:

Many respondents felt that this provision was too onerous. In particular, it was noted that some arrangements and structures which would be reportable would have no end date. This could include transfers of assets or risks that were reportable under hallmark E3 (an intragroup cross-border transfer of functions and/or risks and/or assets - see annex B for more details), or structures reportable under hallmark D2 (an arrangement involving a non-transparent legal or beneficial ownership chain - see annex B for more details). If there was no end date, then the arrangement would have to be reported indefinitely. This was seen by many respondents as placing a substantial burden on business while providing little benefit to HMRC. Of respondents who addressed this point, there were mixed views, with some suggesting that after the initial reports, no further report should be required, others suggesting that the taxpayer should only make a further report in the year it entered into the arrangement and others suggesting a time limit after which no further reports would be needed.

Government response:

The Government believes that it will be necessary for taxpayers to report on arrangements that they enter into, in order for the regulations to fulfil their purpose. However, to ensure that the burden on taxpayers does not become unduly onerous, the Government has amended the draft regulations to reduce the burden so that reporting is only required in the first year that the taxpayer participates in the arrangement and any year where there is a direct tax advantage.

<u>Question 7.</u>
Do you agree that the amount of evidence required for intermediaries and taxpayers to satisfy themselves and HMRC that all the necessary information has been reported is appropriate?

Summary of responses:

Of the respondents who addressed this question, most felt that the amount of evidence required was too high. Many commented that having to know not only that a report had been made, but also that the exact same information had been reported was too high a threshold. This was because intermediaries might be unwilling to share the reports they had made and so the other intermediary would not know if the same information had been reported. Others noted that even if intermediaries were willing to share the reports they made, the timelines for reporting and the risk of penalties for failures would lead to intermediaries adopting a risk averse approach, which would lead to duplicate reporting, as noted in the responses to question 2.

A number of responses queried the process for obtaining an Arrangement Reference Number (ARN) and how long it would take for HMRC to provide it, given the obligation to pass this on to other intermediaries. Some queried whether the obligation to pass on the ARN should be included at all, given the potential burdens involved.

Government response:

The Government agrees that duplicate reporting should be avoided where possible to minimise burdens on both business and HMRC. However, the structure of the rules and the requirements of the Directive mean that some multiple reporting is almost inevitable. HMRC will work with interested parties to provide guidance setting out what level of evidence an intermediary will need in order to be exempt from reporting themselves. In particular where an intermediary who is a promoter has reported the arrangement, an intermediary who is a service provider will be able to rely on that report being complete, without having to verify it directly.

The Government believes that sharing ARNs between intermediaries is an essential step to provide other intermediaries with confidence that a report has been made. This in turn is necessary to minimise duplicate reporting as far as possible.

HMRC intends for an ARN to be provided immediately upon receipt of a valid report. HMRC will provide further details as the IT design progresses.

<u>Question 8.</u>
Do you think that the approach to defining the main benefit test and tax advantage is proportionate?

Summary of responses:
Many respondents welcomed clarification that in determining whether a tax advantage is the main benefit or one of the main benefits of the arrangement, it is only necessary to consider tax advantages that are not consistent with the intention of the relevant tax legislation. However, respondents identified a number of potential challenges around how this would work in practice. For example, some respondents suggested that the example of an ISA was straightforward, but queried what would occur where there was no explicit policy statement or intent. Respondents queried whether, where an arrangement or structure was well known and understood by HMRC, with no legislation to prevent it, it could be taken to be consistent with the policy intent, even if there was no explicit statement to that effect.

A number of responses also asked for clarity on whether consideration should be given only to UK policy intent, or the policy intents of other jurisdictions. Many respondents disagreed with the draft regulations' reference to a tax advantage anywhere in the world and suggested it should be limited to a tax advantage that arises in the European Union only, noting that the information sharing provisions were for sharing data with EU member states, and that there would be practical difficulties in assessing the policy intent of legislation across the world.

A number of responses gave examples of how the main benefit test will apply to arrangements, and sought comment from HMRC on whether the main benefit test would be met. Several respondents also asked for further guidance on when a benefit became a 'main' benefit.

Government response:

The Government acknowledges that there are potential challenges in identifying whether a tax advantage is consistent with the policy intent of the underlying legislation. However, the Government remains of the view that this provision is a proportionate way to minimise reporting of benign transactions. HMRC will provide guidance and examples to illustrate where a tax advantage will and will not be consistent with the underlying policy intent.

The Government believes that given the Directive's focus on cross-border arrangements, it would not be appropriate to only consider the policy intent of UK legislation. Rather the legislation requires intermediaries and relevant taxpayers to consider whether any tax advantage is consistent with the intent of the legislation on which the arrangement relies.

The Government agrees with respondents that references to tax advantage should be limited in scope to taxes to which the DAC applies; that is to direct taxes arising in EU member states. The regulations have been amended to reflect this.

Whether or not a benefit of an arrangement is the main benefit or one of the main benefits will depend on the facts of the arrangement. The test is not one of purpose, and so the intentions of the person will not necessarily be the deciding factor, although they may well be relevant.

<u>Question 9.</u>
Do you have any comments on the approach set out for hallmarks under Category A?

Summary of responses:

Some respondents suggested that there was an over-reliance on the main benefit test to exclude benign transactions, when a more focused approach to defining the hallmarks could have been used. Most respondents felt that clear guidance and examples would be needed to minimise burdens on taxpayers and intermediaries.

A number of responses noted the need for clarity on when confidentiality clauses would trigger this hallmark, as it was felt that HMRC's comments in the consultation document were unclear. A small number of responses commented on hallmark A2, remuneration fixed by reference to tax, and raised the query of whether fees dependent on successfully claiming a tax refund were caught.

Many responses focussed on Hallmark A3 (An arrangement that has substantially standardised documentation and/or structure – see annex B for more details) and the common use of standardised documentation, notably in the financial services sector. Respondents provided numerous examples of circumstances where standardised documents are used and could be caught by this hallmark. Most respondents suggested that guidance on whether such arrangements would be reportable would be helpful and some queried whether HMRC would really want their use in such instances to be reported.

Government response:

The Government believes that the main benefit test, which means that certain hallmarks will only be met where the main benefit, or one of the main benefits, of the arrangement is the obtaining of a tax advantage, is the appropriate way to identify arrangements that are reportable under this hallmark. Amending the scope of the hallmarks themselves would risk failing to implement the Directive properly. It would also risk increasing inconsistency with other jurisdictions, which could place additional burdens on businesses. HMRC will work with stakeholders to provide as much clarity in guidance as possible to assist intermediaries and taxpayers in identifying which arrangements are reportable. In particular, we will work with stakeholders to provide clarity on what ‘substantially standardised’ documentation means, and which kinds of documents HMRC would not consider to be substantially standardised for these purposes. We recognise that this is a key concern for a number of sectors, and we want to ensure that the rules operate proportionately.

Question 10.
Do you have any comments on the approach set out for hallmarks under Category B?

Summary of responses:

As with hallmarks under Category A, a number of responses again perceived there to be an over-reliance on the main benefit test to exclude benign transactions. Several responses requested additional guidance, and examples, in particular in relation Hallmark B2 (An arrangement that has the effect of converting income into capital) and what was meant by ‘conversion’ of income into capital or other low tax or non-taxable forms.

Government response:

The Government remains of the view that the main benefit test is the appropriate way to identify arrangements that are reportable under this hallmark, for the reasons set out in the response to question 9. HMRC is grateful for the comments and suggestions received during the consultation, and will build on this to provide guidance to support intermediaries and taxpayers in identifying reportable arrangements. This will include examples of situations where HMRC would consider that there had or had not been a ‘conversion’ of income into capital or other non-taxable forms of revenue, which will likely depend on the facts of the arrangement in question.

Question 11.
Are there any points in the definition of associated enterprise which you think require clarification or explanation in guidance?

Summary of responses:

A small number of respondents raised queries in relation to the definition of associated enterprise. Respondents questioned whether a partnership could meet the definition of ‘acting together’ within the definition of associated enterprise. Respondents also asked whether the definition of associated enterprise should be taken to apply more widely, including in relation to references to intra-group transactions in other hallmarks such as E3 (an intragroup cross-border transfer of functions and/or risks and/or assets - see annex B for more details), and how the concepts of management and control will be interpreted.

Government response:

The Government believes that it is appropriate to use the definition of 'associated enterprise' in the Directive. Amending the definition would create differences with other member states, potentially causing difficulties for intermediaries or creating loopholes in the regime. HMRC will engage further with respondents to the consultation to explore these issues further.

<u>Question 12.</u>
Do you think the above approach will prevent unnecessary reporting of benign activities, while avoiding loopholes that could enable intermediaries and/or relevant taxpayers to avoid their reporting obligations? If you foresee problems with this approach, please provide details of possible solutions.

Summary of responses:

Respondents generally agreed that for the purposes of DAC 6, the 'recipient' of a deductible cross-border payment should be the person who is the recipient for tax purposes. There was, however, some uncertainty about the level of due diligence needed to establish whether a payment was deductible. Some respondents also queried the amount of knowledge that would be 'reasonably expected' of an intermediary.

Government response:

What an intermediary could reasonably be expected to know will depend on the facts of the particular situation. As noted above, HMRC will work with respondents on guidance to provide more clarity and examples on this, in particular around what an intermediary could reasonably be expected to know. As explained in the response to question 4, HMRC does not expect an intermediary to do additional customer due diligence beyond what it normally does, or would normally do, in order to carry out its role.

<u>Question 13.</u>
Do you think that this approach will also work for dealing with Collective Investment Schemes? Alternatively, what other approaches do you think would be better?

Summary of responses:

Some respondents identified that there were particular challenges for the asset management industry and for collective investment schemes. For example, concerns were raised around which participants in the asset management industry would be intermediaries for the purposes of these regulations and about whether funds with investors in different jurisdictions would automatically be caught by these rules.

Government response:

The Government acknowledges the particular issues in applying these rules to asset managers and collective investment vehicles. The Government will work with the sector to provide guidance, to ensure the rules operate in as effective a manner as possible.

Question 14.
Do you think particular guidance is needed in respect of hallmark C(3)?

Summary of responses:

A number of responses suggested that additional guidance would be helpful, including specifically whether HMRC's comments on Hallmark C2 regarding situations where profits are taxable in multiple jurisdictions would also apply to Hallmark C3 (relief from double taxation in respect of the same item of income or capital is claimed in more than one jurisdiction). Respondents suggested that this could help to reduce unnecessary reporting. Some respondents suggested that these clarifications should be included in the regulations rather than in guidance.

Government response:

The Government acknowledges the comments raised and will work with industry to provide guidance to set out situations which would and would not need to be reported. In principle, HMRC anticipate that a similar position will apply to hallmarks C2 and C3. However, the precise application of this will depend on the circumstances of the arrangement. HMRC will work with stakeholders to explore these situations further.

The Government believes that the application of the hallmarks will depend on the facts and circumstances of the arrangements, and that clarification on their application is best provided through guidance and examples. Amending the scope of the hallmarks in the regulations would risk not implementing the Directive properly.

Question 15.
Do you agree that this hallmark should refer to the amount treated as payable for tax purposes? What do you think are the advantages and disadvantages of this approach, and of any other suggested approaches?

Summary of responses:

Many responses agreed that the amount treated as payable should be the amount treated as payable for tax purposes. However, many responses also highlighted that this posed a risk of over-reporting of benign transactions, as differences could arise as a result of the proper functioning of tax law in different jurisdictions.

A number of respondents also queried what was meant by the term 'material difference' in the hallmark. In particular, respondents queried how the hallmark would apply where there are exemptions from tax and suggested that these shouldn't be reportable as they are in line with the policy intent of the legislation.

Government response:

The Government agrees that the hallmark applies to the amount treated as payable for tax purposes. Whether a difference is material in the context of this hallmark will depend on the facts of the arrangement. HMRC will work with industry to provide guidance on this, and to provide examples of when an arrangement will be reportable.

Question 16.
Do you have any general comments about the approach to hallmarks under category C?

Summary of responses:

Many of the responses to question 16 highlighted issues covered elsewhere in the consultation. Other issues that were raised in a number of responses included:

- what would constitute a preferential regime under hallmark C1(d),
- the application of hallmarks C1(a) and C1(b)(i) in jurisdictions that did not have a concept of tax residence,
- the time at which an assessment should be made in respect of whether a country was on a list in hallmark C1(b)(ii), particularly with reference to the period from June 2018 to July 2020.

Government response:

The Government acknowledges the concerns raised. Many of these points are complex, and so HMRC will work closely with stakeholders to provide guidance to clarify the application of these hallmarks.

Question 17.
Do you have any comments about the approach to hallmarks under Category D?

Summary of responses:

A number of respondents asked HMRC to clarify the interaction between Category D hallmarks under DAC 6 (specific hallmarks concerning automatic exchange of information and beneficial ownership) and the OECD's Mandatory Disclosure Rules (MDR). In particular, respondents sought clarity on how HMRC would use the MDR commentary as a source of illustration and interpretation, where the wording of Hallmark D and the MDR was different.

Some respondents raised the practical question about how to assess whether an arrangement undermined reporting obligations under automatic exchange of financial account information, and in particular whether the movement of assets to a non-CRS participating jurisdiction would automatically trigger the hallmark.

Several respondents suggested that additional guidance and examples of arrangements which would be caught by hallmark D would be welcome.

Government response:

The Government acknowledges the need for clarity on the interaction between hallmark D and the MDR, and will work with stakeholders to produce guidance that provides as much certainty as possible. The Government does not believe that an arrangement will be reportable simply because it involves the transfer of money or assets to jurisdictions that have not yet implemented the CRS. In and of itself, that would not be sufficient to undermine the CRS. HMRC will provide guidance on potential indicators that an arrangement could undermine the automatic exchange of information.

Question 18.

Where an arrangement relates to companies which are resident for tax purposes in jurisdictions where corporate tax applies at the group level, should hallmark E3 similarly apply at the level of the sub-group located in that jurisdiction or at the company level? What would be the particular advantages or disadvantages of applying the rules at the group level?

Summary of responses:

Numerous respondents noted that the main benefit test did not apply to this hallmark, and so there was a risk of over-reporting of benign transactions. While some respondents acknowledged that the wording of the directive suggested that this hallmark should be considered at the entity level, this increased the risk of over-reporting. A number of respondents suggested that HMRC should seek to limit the scope of the hallmark if possible.

Government response:

The Government recognises industry concerns around over-reporting and wants to minimise this where possible. However, we need to ensure that the Directive is implemented correctly, and we continue to take the view that hallmark E3 must be considered at the entity level, based on the wording of the Directive. HMRC will work with stakeholders to explore whether steps can be taken to minimise over-reporting through guidance.

Question 19.

Do you have any comments about the approach to hallmarks under Category E?

Summary of responses:

A number of respondents welcomed the undertaking that hallmarks in category E would be applied consistently with UK transfer pricing rules. It was felt that this would reduce burdens on business and minimise the risk of over-reporting of benign transactions.

Many respondents considered Hallmark E3 to be very broad and noted that it was not subject to the main benefit test. They raised concerns that many ordinary commercial transactions could be caught, where there was no tax advantage. Some sector specific points were raised, such as the application of the EBIT test in Hallmark E3 to financial sector entities and funds, and the liquidation of a subsidiary with a foreign parent.

A number of respondents highlighted that Brexit-related re-organisations could be caught by hallmark E3, and queried whether such reorganisations could be excluded from the scope of the rules.

Government response:

The Government recognises the concerns around over-reporting, and agrees that it is necessary to apply hallmarks under Category E consistently with UK transfer pricing legislation, in order for the rules to function as intended by the Directive. For this reason, the Government continues to believe that the inclusion of rules on the application of hallmarks under Category E is appropriate. This will ensure that the regulations do not place an undue burden on small and medium businesses, which do not have to apply UK transfer pricing rules. The Government does not consider that it would be appropriate to carve out Brexit-related re-organisations from the legislation, as that would not be in keeping with the wording or the spirit of the Directive.

HMRC will work with stakeholders to produce guidance to provide more clarity on particular issues that have been raised, in particular continuing to work with industry representatives to explore sector specific issues.

Question 20.

Do you have any suggestions for how the penalty regime could be improved?

Summary of responses:

A significant number of responses, particularly from larger businesses, observed that the rules would be difficult to comply with, and that it would be inevitable that some mistakes would be made. Many of these respondents suggested that rules providing a defence for businesses where they have taken reasonable steps to comply, and/or put reasonable procedures in place to ensure compliance, would be welcome in ensuring that businesses that were trying to comply were not unduly penalised.

Several respondents noted that having a regime based on daily penalties could also potentially be disproportionate where a mistake had been made but not identified until a later time.

Some respondents noted that the total penalty could potentially be very high in daily penalty cases, and requested clarity on how an appropriate penalty level would be arrived at, including what scope there was for mitigation.

Government response:

The Government believes that the penalty regime must provide a sufficient deterrent to ensure compliance with the regime. At the same time the regime must be proportionate, and sufficiently flexible to deal with a range of behaviours. The Government acknowledges the concerns raised by respondents, and has clarified in the legislation that the existence of reasonable procedures to ensure compliance with the regime must be considered in determining whether a reasonable excuse exists for a failure.

Additionally, the penalty regime has been modified so that daily penalties will only be charged for serious failings including where the behaviour leading to the failure was deliberate. Where the behaviour was not deliberate, or there are no other exacerbating factors such as repeated failures, the penalty will be a one-off penalty, with scope for reduction where there are mitigating factors.

HMRC guidance will provide more detail on how the penalty regime will operate in practice and will provide examples of the situations where different levels of penalty will apply.

Question 21.
Do you have any particular comments about the commencement rules, and HMRC's approach to dealing with the backdated reporting requirements?

Summary of responses:

Numerous responses welcomed the proposed approach that intermediaries and taxpayers would not be penalised where there were failures due to a lack of clarity on the rules during the period from June 2018 until the consultation response was published. However, it was widely suggested that there was still insufficient clarity for stakeholders to apply the rules with certainty. It was suggested that HMRC's approach should be extended until the regulations and/or the guidance was finalised

Government response:

The Government agrees that intermediaries and taxpayers should not be penalised where failures occurred due to a lack of clarity over the application of the rules, where the lack of clarity occurred as a result of legislation and/or guidance not having yet been finalised, and where the meaning could not reasonably have been surmised from the Directive itself or from previous publications and statements including the publication of draft legislation and guidance. HMRC guidance will provide more detail on how the penalty regime will operate in practice.

Question 22.
Are there any particular areas of DAC 6 that you would like HMRC to provide guidance on, which are not covered elsewhere in this consultation?

Summary of responses:

Respondents identified a number of areas where they thought guidance would be useful. Most of these have already been identified in the responses to the above questions. The key areas raised are:

- when an arrangement concerns multiple jurisdictions
- when an arrangement is made available
- when aid, advice or assistance is 'given'
- how reporting will work in practice where multiple intermediaries are involved
- how the main benefit test will be interpreted

Government response:

The Government acknowledges the points raised and recognises that there may be challenges in applying the rules in practice. However, the proper application of the rules will often depend on the facts and circumstances of the arrangement. We are grateful for the specific examples provided, and will work stakeholders to produce guidance that is useful to stakeholders and provides as much certainty as possible.

4. Next steps

The regulations implementing EU Directive 2018/822 will be laid before Parliament on 13 January 2020.

HMRC continues to work closely with stakeholders, including many of those who responded to the consultation, to draft the detailed HMRC guidance. This will provide further help to intermediaries and taxpayers so they can meet their obligations under the Directive.

The final guidance will be published in HMRC's International Exchange of Information Manual, available on gov.uk, before the regulations come into force in July 2020.

Depending on the outcome of EU Exit, amendments may be needed to the regulations in due course.

Annex A: List of stakeholders consulted

Akin Gump LLP
Allen & Overy LLP
Association of British Insurers (ABI)
Aviva plc
BDO LLP
BlackRock
Boodle Hatfield LLP
Bryan Cave Leighton Paisner LLP (BCLP Group)
Canada Life
Chartered Institute of Taxation (CIOT)
Cleary Gottlieb Steen + Hamilton LLP
Confederation of British Industry (CBI)
Debevoise & Plimpton LLP
Deloitte LLP
Efficient Frontiers International (EFI)
Ernst & Young LLP
Euroclear UK & Ireland Ltd
Freshfields Bruckhaus Deringer LLP
Grant Thornton UK LLP
Institute of Chartered Accountants in England and Wales (ICAEW)
Institute of Chartered Accountants of Scotland (ICAS)
KPMG LLP
Lloyd's
Macfarlanes LLP
Manx Insurance Association
Maurice Turnor Gardner LLP
Mazars LLP
McDermott Will & Emery UK LLP
Orsted UK
Osborne Clarke LLP
Pinsent Masons LLP
ProcessFlows UK Ltd
Proskauer Rose (UK) LLP
PricewaterhouseCoopers LLP
RSM UK
Ruffer LLP + Personal Investment Management & Financial Advice Association (PIMFA)
Saffery Champness LLP
Saint-Gobain UK & Ireland
SEGRO plc
Sequent (U.K.) Limited
Simmons & Simmons LLP

Skandinaviska Enskilda Banken (London Branch)
Slaughter & May LLP
Smith and Williamson LLP
St James's Place plc
Taylor Wessing LLP
The British Private Equity & Venture Capital Association ("BVCA")
The British Property Federation (BPF)
The City of London Law Society ("CLLS")
The Investment Association (IA)
The Law Society of England and Wales
The Society of Trust and Estate Practitioners (STEP)
Transfer Pricing Solutions Ltd
Travers Smith LLP
UK Finance Limited
Weil, Gotshal & Manges (London) LLP ("Weil London")

Joint Responses

<u>Joint Law Firms response</u>
Allen & Overy LLP
Clifford Chance LLP
Freshfields Bruckhaus Deringer LLP
Linklaters LLP
Slaughter & May LLP

<u>Transatlantic Tax Group</u>
Fried, Frank, Harris, Shriver & Jacobson (London) LLP
Davis Polk & Wardwell London LLP
Ropes & Gray LLP
Morgan, Lewis & Bockius UK LLP
Gibson, Dunn & Crutcher UK LLP
Cadwalader, Wickersham & Taft LLP
Sidley Austin LLP

Annex B: List of hallmarks

Below are the hallmarks included in Annex 4 of the Directive on Administrative Cooperation.

HALLMARKS

Part I. Main benefit test

Generic hallmarks under category A and specific hallmarks under category B and under points (b)(i), (c) and (d) of paragraph 1 of category C may only be taken into account where they fulfil the “main benefit test”.

That test 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.

In the context of hallmark under paragraph 1 of category C, the presence of conditions set out in points (b)(i), (c) or (d) of paragraph 1 of category C cannot alone be a reason for concluding that an arrangement satisfies the main benefit test.

Part II. Categories of hallmarks

A. Generic hallmarks linked to the main benefit test

1. An arrangement where the relevant taxpayer or a participant in the arrangement undertakes to comply with a condition of confidentiality which may require them not to disclose how the arrangement could secure a tax advantage vis-à-vis other intermediaries or the tax authorities.

2. An arrangement where the intermediary is entitled to receive a fee (or interest, remuneration for finance costs and other charges) for the arrangement and that fee is fixed by reference to:

(a) the amount of the tax advantage derived from the arrangement; or

(b) whether or not a tax advantage is actually derived from the arrangement. This would include an obligation on the intermediary to partially or fully refund the fees where the intended tax advantage derived from the arrangement was not partially or fully achieved.

3. An arrangement that has substantially standardised documentation and/or structure and is available to more than one relevant taxpayer without a need to be substantially customised for implementation.

B. Specific hallmarks linked to the main benefit test

1. An arrangement whereby a participant in the arrangement takes contrived steps which consist in acquiring a loss-making company, discontinuing the main activity of such company and using its losses in order to reduce its tax liability, including through a transfer of those losses to another jurisdiction or by the acceleration of the use of those losses.

2. An arrangement that has the effect of converting income into capital, gifts or other categories of revenue which are taxed at a lower level or exempt from tax.

3. An arrangement which includes circular transactions resulting in the round-tripping of funds, namely through involving interposed entities without other primary commercial function or transactions that offset or cancel each other or that have other similar features.

C. Specific hallmarks related to cross-border transactions

1. An arrangement that involves deductible cross-border payments made between two or more associated enterprises where at least one of the following conditions occurs:

(a) the recipient is not resident for tax purposes in any tax jurisdiction;

(b) although the recipient is resident for tax purposes in a jurisdiction, that jurisdiction either:

(i) does not impose any corporate tax or imposes corporate tax at the rate of zero or almost zero; or

(ii) is included in a list of third-country jurisdictions which have been assessed by Member States collectively or within the framework of the OECD as being non-cooperative;

(c) the payment benefits from a full exemption from tax in the jurisdiction where the recipient is resident for tax purposes;

(d) the payment benefits from a preferential tax regime in the jurisdiction where the recipient is resident for tax purposes;

2. Deductions for the same depreciation on the asset are claimed in more than one jurisdiction.

3. Relief from double taxation in respect of the same item of income or capital is claimed in more than one jurisdiction.

4. There is an arrangement that includes transfers of assets and where there is a material difference in the amount being treated as payable in consideration for the assets in those jurisdictions involved.

D. Specific hallmarks concerning automatic exchange of information and beneficial ownership

1. An arrangement which may have the effect of undermining the reporting obligation under the laws implementing Union legislation or any equivalent agreements on the automatic exchange of Financial Account information, including agreements with third countries, or which takes advantage of the absence of such legislation or agreements. Such arrangements include at least the following:

(a) the use of an account, product or investment that is not, or purports not to be, a Financial Account, but has features that are substantially similar to those of a Financial Account;

(b) the transfer of Financial Accounts or assets to, or the use of jurisdictions that are not bound by the automatic exchange of Financial Account information with the State of residence of the relevant taxpayer;

(c) the reclassification of income and capital into products or payments that are not subject to the automatic exchange of Financial Account information;

(d) the transfer or conversion of a Financial Institution or a Financial Account or the assets therein into a Financial Institution or a Financial Account or assets not subject to reporting under the automatic exchange of Financial Account information;

(e) the use of legal entities, arrangements or structures that eliminate or purport to eliminate reporting of one or more Account Holders or Controlling Persons under the automatic exchange of Financial Account information;

(f) arrangements that undermine, or exploit weaknesses in, the due diligence procedures used by Financial Institutions to comply with their obligations to report Financial Account information, including the use of jurisdictions with inadequate or weak regimes of enforcement of anti-money-laundering legislation or with weak transparency requirements for legal persons or legal arrangements.

2. An arrangement involving a non-transparent legal or beneficial ownership chain with the use of persons, legal arrangements or structures:

(a) that do not carry on a substantive economic activity supported by adequate staff, equipment, assets and premises; and

(b) that are incorporated, managed, resident, controlled or established in any jurisdiction other than the jurisdiction of residence of one or more of the beneficial owners of the assets held by such persons, legal arrangements or structures; and

(c) where the beneficial owners of such persons, legal arrangements or structures, as defined in Directive (EU) 2015/849, are made unidentifiable.

E. Specific hallmarks concerning transfer pricing

1. An arrangement which involves the use of unilateral safe harbour rules.

2. An arrangement involving the transfer of hard-to-value intangibles. The term “hard-to-value intangibles” covers intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises:

(a) no reliable comparables exist; and

(b) at the time the transaction was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain, making it difficult to predict the level of ultimate success of the intangible at the time of the transfer.

3. An arrangement involving an intragroup cross-border transfer of functions and/or risks and/or assets, if the projected annual earnings before interest and taxes (EBIT), during the three-year period after the transfer, of the transferor or transferors, are less than 50 % of the projected annual EBIT of such transferor or transferors if the transfer had not been made.

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