U.K. MANDATORY DISCLOSURE REGIME (DAC6)

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Tags
D.A.C.6
Cross-border Arrangement
Hallmark
Intermediary
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BACKGROUND

The E.U. Council Directive 2018/822 ("DAC6") provides for the mandatory disclosure by intermediaries, or individual or corporate taxpayers, to H.M.R.C. of certain cross-border arrangements and structures that could be used to avoid or evade tax and the mandatory automatic exchange of this information among E.U. Member States. A cross-border arrangement is reportable if it meets one or more hallmarks.

From January 2013, the E.U. introduced the Directive of Administrative Co-operation and, over time, Directive of Administrative Co-operation has evolved to include the automatic reporting of various matters. It now includes directors' fees, employment income, insurance premiums, pension income and income from and ownership of immovable property.

Member States are required to have implemented DAC6 into national law by December 31, 2019 and to apply the provisions by July 1, 2020. Reportable cross-border arrangements, where the first step is undertaken between June 25, 2018, and July 1, 2020, will need to be reported by August 31, 2020. The timetable has been affected by the COVID-19 virus, as discussed below.

WHO IS AN INTERMEDIARY?

An intermediary is any person that designs, markets, organizes or makes available for implementation or manages the implementation of a reportable cross-border arrangement. An intermediary can be an individual, a company or a trustee.

The definition of an intermediary envisages two types of intermediaries: "promoters" and "service providers." Promoters are those who design and implement the arrangements, while 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-based defense available to service providers, which means that they do not have an obligation to report when the defense is applicable. No equivalent defense exists for promoters.

An intermediary is a person that meets one of the following conditions:

- It is resident in the U.K. for purposes of U.K. tax.
- It has a permanent establishment in the U.K., through which it provides services in respect of the arrangement.
- It is incorporated in the U.K., or governed by the laws of the U.K.

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- It is registered with a professional association relating to legal, taxation, or consultancy services in the U.K.

Where information relating to a reportable arrangement is covered by legal professional privilege, the legal counsel is not required to report that information to H.M.R.C. Where legal counsel chooses not to disclose information because of a legal privilege enjoyed by the client, an obligation is imposed to inform other intermediaries or relevant taxpayers of their own reporting obligations, as the reporting obligation passes to other intermediaries or or the relevant taxpayer.

"An arrangement will be reportable if it meets at least one of a number of hallmarks."

WHAT IS A CROSS-BORDER ARRANGEMENT?

An arrangement is considered to be a cross-border arrangement where (i) more than one E.U. Member State are involved or a Member State and a third country are involved and (ii) at least one of the following conditions are met:

- Not all participants in the arrangement are tax resident in the same jurisdiction.
- One or more participants in the arrangement are simultaneously resident for tax purposes in more than one jurisdiction.
- A permanent establishment linked to a participant is established in a different jurisdiction and the arrangement forms part of the business of the permanent establishment.
- At least one of the participants in the arrangement carries on business activities in another jurisdiction without being resident for tax purposes or creating a permanent establishment situation in that jurisdiction.
- The arrangement has a possible impact on the automatic exchange of information or the identification of beneficial ownership.

WHAT IS A REPORTABLE ARRANGEMENT?

An arrangement will be reportable if it meets at least one of several hallmarks. For several of the hallmarks, an arrangement will only be reportable if a main benefit test is met regarding the hallmark. Under the main benefits test, obtaining a tax advantage must be one of the main objectives of the arrangement, having regard to all relevant facts and circumstances.

A brief summary of the five hallmark categories is set out below.

Category A

- **Confidentiality** – Arrangements where the participant or taxpayer enters into a confidentiality agreement that prevents disclosure to other intermediaries or tax authorities of information describing how the arrangement could result in a tax advantage. This hallmark is subject to main benefit test.
- **Premium Fee Arrangements** – Arrangements where the intermediary fee is based on the tax saved or a similar advantage gained. This hallmark is subject to main benefit test.

- **Standardized Documentation** – Arrangements involving standardized documentation without substantial customization. This hallmark is subject to main benefit test.

Category B

- **Loss Buying** – Arrangements involving buying a loss-making company to reduce the tax liability. This hallmark is subject to main benefit test.
- **Conversion of Income to Capital** – Arrangements which have the effect of converting income into capital gains or another type of income that is taxable at lower rates. This hallmark is subject to main benefit test.
- **Circular Transactions** - Arrangements involving circular transactions with little or no commercial function. This hallmark is subject to main benefit test.

Category C

- Arrangements involving deductible cross border transactions between associated enterprises where any of the following facts exist:
    - The recipient has no tax residence. Here, the hallmark is not subject to main benefit test.
    - The country of tax residence has a zero or close to zero corporation tax rate. The hallmark is subject to main benefit test.
    - The country is included in the O.E.C.D. list as being a non-cooperative jurisdiction. The hallmark is not subject to main benefit test.
    - The payment is exempt from tax in the hands of the recipient in the jurisdiction of receipt. The hallmark is subject to main benefit test.
    - The payment benefits from a preferential tax regime in the jurisdiction of receipt. The hallmark is subject to main benefit test.
- Arrangements involving deductions in more than one jurisdiction. The hallmark is not subject to main benefit test.
- Arrangements involving the claiming of relief from double taxation on the same item in more than one jurisdiction. The hallmark is not subject to main benefit test.
- Arrangements involving the transfer of assets where there is a material difference in the amount treated as payable in consideration for the assets in the jurisdictions involved. The hallmark is not subject to main benefit test.

Category D

- Arrangements which have the effect of undermining the rules on beneficial ownership or any other equivalent agreement on automatic exchange of financial account information or arrangements structured to take advantage of the absence of such automatic exchanges of information. The hallmark is not subject to main benefit test.

- Arrangements involving a nontransparent legal or beneficial ownership chain with the use of persons, legal arrangements or structures that

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

    - 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.

    This hallmark is not subject to main benefit test.

Category E

- Arrangements concerning transfer pricing, including the use of unilateral safe harbors in one of the jurisdictoins, or the transfer of hard-to-value intangible assets when no reliable comparable transactions exist and the projection of future cash flows or income are highly uncertain. This hallmark is not subject to main benefit test.

GRANDFATHERING OF HISTORICAL ARRANGEMENTS

Transactions which amount to cross border arrangements but which were already in place at June 25, 2018, are not subject to DAC6 reporting. However, if those transactions are adjusted after June 25, 2018, the adjustments will need to be reviewed to determine whether those subsequent arrangements are reportable in their own right.

MULTIPLE REPORTING

Where more than one intermediary participtes in an arranfurinshes proof of reporting by another intermediary. Where there is more than one relevant taxpayer, the Directive imposes the primary obligation onto the particular taxpayer who agreed to the arrangement and then on the one who manages the implementation.

PENALTIES

The penalty for failure to comply with DAC6 is up to £5,000. However, in a number of cases where the £5,000 penalty is inappropriately low, then the penalty can be an initial amount of £600 per day.

EFFECT OF COVID-19

As a result of the disruption to business for COVID-19, the E.U. Commission proposed a three month postponement of deadlines imposed by the Directive. The delay would be as follows:

- For transactions between July 1, 2020, and September 30, 2020, the preporting obligation would be deferred so that all reports are due by October 31, 2020.

- The start of the 30-day reporting obligation would first be effective on October 1, 2020, rather than July 1, 2020.
- The transitional period for reporting existing arrangements effected from June 25, 2018, to June 30, 2020, would be delayed unitl November 30, 2020.
- The date for initial data exchanges now scheduled to begin on October 31, 2020, would be deferred until January 31, 2021.

The new due dates for filings may be deferred by a further three months.

Because DAC6 has been enacted in the U.K., any delay in implementation will require legislation. To date, the Government has not announced any delays. However, H.M.R.C. has stated that where reasonable cause exists for failing to meet the original deadlines, no penalty will be charged. The general view is that COVID-19 disruption should qualify as a Reasonable Excuse. However, that expectation has not been confirmed by H.M.R.C.