Analysis

Consultation on the UK's new mandatory disclosure rules

Speed read

The UK mandatory disclosure rules, expected to be enacted this summer, will replace the UK's current DAC 6 regulations. The scope of the new rules is broadly similar to the UK's DAC 6 rules and requires intermediaries and taxpayers to send information to HMRC about certain reportable arrangements and structures. However, intermediaries such as law firms and tax advisers should review the consultation (which closes on 8 February). Promoters, in particular, will need to undertake another look-back exercise in relation to arrangements put in place since 29 October 2014 to see if there are any which are reportable under the new rules.

Veronica McMahon
Osborne Clarke
Veronica McMahon is a knowledge lawyer director in Osborne Clarke's tax practice group. She specialises in corporate tax, having spent many years advising businesses on a range of corporate and commercial tax issues, including the tax aspects of private equity and corporate transactions. Email: veronica.mcmahon@osborneclarke.com; tel: 020 7105 7442.

On 30 November 2021 HMRC published draft regulations and a consultation on the long-awaited new UK mandatory disclosure rules (UK MDR). The consultation closes on 8 February 2022. The new rules implement the OECD's Model Mandatory Disclosure Rules for Common Reporting Standard (CRS) Avoidance Arrangements and Opaque Offshore Structures (known as 'the model rules').

The consultation has been expected since the beginning of 2021 following the conclusion of the Brexit post-transition arrangements when HMRC set out its intention to consult on the model rules (which are applied at a global level) as soon as practicable to replace EU Council Directive 2018/822, known as 'DAC 6'.

DAC 6 was implemented in the UK through the International Tax Enforcement (Disclosable Arrangements) Regulations, SI 2020/25 ('the DAC 6 regulations') and once the draft UK MDR regulations are implemented, which is expected in summer 2022, the DAC 6 regulations will be repealed.

Disclosure rules under DAC 6

The DAC 6 regulations, which came into force on 1 July 2020, originally required 'UK intermediaries' (including law firms, accountants and tax advisers) to report to HMRC (from 1 January 2021) cross-border arrangements that met one of a number of 'hallmarks' (in several categories, from A to D) that could be used to avoid or evade tax. The DAC 6 regulations required intermediaries to disclose relevant arrangements where the first step was taken on or after 25 June 2018 (the 'look-back' period).

Following the final Brexit conclusions in December 2020, the government amended the DAC 6 regulations via the International Tax Enforcement (Disclosable Arrangements) (Amendment) (No. 2) (EU Exit) Regulations, SI 2020/1649, to restrict the application of the rules in the UK to only those arrangements which met hallmarks under Category D. Category D deals with undermining reporting obligations including under the CRS (hallmark D1) and obscuring beneficial ownership (hallmark D2) and shares substantial common ground with the model rules.

Key terminology

The draft UK MDR regulations ('the draft regulations') draw closely on, and many of the definitions cross refer to, the model rules to provide consistency in the application of the rules between jurisdictions.

The draft regulations require 'intermediaries' and (sometimes) 'reportable taxpayers' (with a UK nexus) to send information to HMRC about arrangements and structures that are designed to facilitate non-compliance through the use of 'CRS avoidance arrangements' and 'opaque offshore structures'.

'Intermediaries' are defined in rule 1.3 of the model rules as 'promoters' (those who design or market the CRS avoidance arrangement or opaque offshore structure) and 'service providers' (those who provide 'relevant services' in respect of such an arrangement or structure provided that they could reasonably be expected to know that the arrangement or structure was indeed a CRS avoidance arrangement or an opaque offshore structure). 'Relevant services' is defined as providing assistance or advice with respect to the design, marketing, implementation or organisation of the arrangement or structure. Although the DAC 6 regulations do not include definitions of promoters and service providers, HMRC's guidance in its *International Exchange of Information Manual* (at IEIM621000) specifically identifies these two categories of intermediaries. HMRC also highlights in its consultation that it considers that the definitions are largely equivalent, and it will be unlikely that a person would have a reporting obligation under the DAC 6 regulations but would not have one under UK MDR.

A 'reportable taxpayer' is defined in rule 1.4(l) of the model rules as any actual or potential user of a CRS avoidance arrangement or a natural person whose identity as a beneficial owner cannot be accurately determined due to the opaque offshore structure. Whilst the DAC 6 regulations refer to 'relevant taxpayers' rather than 'reportable taxpayers' HMRC considers there to be no material difference in the definitions.

'CRS avoidance arrangements' are defined in rule 1.1 of the model rules. This definition captures any arrangement 'for which it is reasonable to conclude that it is designed to circumvent or is marketed as, or has the effect of, circumventing the CRS legislation or exploiting an absence thereof' and includes a non-exclusive list of examples. HMRC has previously confirmed in its guidance (at IEIM645010) that an arrangement does not have the effect of undermining or circumventing CRS, simply because, as a consequence of the arrangement, no report under CRS is made (provided that it is reasonable to conclude that such non-reporting does not undermine the policy intent of such CRS legislation). HMRC confirms that it expects this principle to continue to apply following the new rules.

An opaque offshore structure is defined in rule 1.2 of the model rules as being a passive offshore vehicle (broadly one that does not carry on a substantive economic activity in the jurisdiction where it is established or is tax resident) held through an opaque structure and covers much of the same ground as hallmark D2 in the DAC 6 regulations. The commentary to the model rules sets out examples of structures that could fall within the scope of being an opaque offshore structure which HMRC anticipates it will follow.

Given the similarities between UK MDR and DAC 6, HMRC proposes to take a similar approach to the interpretation of UK MDR as it took for DAC 6. HMRC intends to publish guidance on UK MDR once the draft regulations are finalised and before the rules comes into effect, but it envisages that generally the guidance will be consistent with existing guidance currently in its *International Exchange of Information Manual*. HMRC is not expecting to completely rewrite its guidance, but it will make changes that are necessary to ensure alignment with the model rules and commentary, or to address any gaps in the existing guidance.

HMRC appreciates that this will place a big compliance burden on intermediaries and taxpayers to review historic arrangements to determine if any are reportable under UK MDR, so the government has proposed a number of limitations

Lookback period for UK MDR

The consultation proposes, as was the case with DAC 6, a 'look-back period' which requires the reporting of certain pre-existing arrangements. However, the look-back period under UK MDR will stretch to arrangements entered into since 29 October 2014 (to catch arrangements which were put in place following the publication of the CRS but before reporting under the model rules came into force in 2018).

HMRC appreciates that this will place a big compliance burden on intermediaries and taxpayers to review historic arrangements to determine if any are reportable under UK MDR, so the government has proposed a number of limitations which are reflected in the draft regulations:

1. The rules will only require reporting of 'CRS avoidance arrangements', and not 'opaque offshore structures'.
2. The reporting requirement will only apply to 'promoters' and not to 'service providers' or taxpayers (so this should exclude many law firms unless they were also the promoters of the arrangements).
3. The reporting requirement will only be engaged where the value of the financial account that is subject to the CRS avoidance arrangement immediately prior to the implementation of the arrangement was more than US $1m (or sterling equivalent).
4. An arrangement which has been disclosed to HMRC under the DAC 6 regulations does not have to be disclosed again under the UK MDR regulations.

HMRC has said that it welcomes feedback on the look-back period as to whether it has struck the right balance between minimising burdens on business and ensuring the UK MDR regime operates effectively.

Wider territorial scope

The DAC 6 regulations apply to arrangements which 'concern' the UK and any other jurisdiction (or which concern two or more EU member states, or an EU member state and any other jurisdiction). The draft regulations, however, in line with the approach of the model rules, do not include any such territorial limitations, so arrangements and structures will be reportable regardless of which jurisdictions they involve, as long as the intermediary or taxpayer has a reporting obligation in the UK. This will be met if the intermediary or taxpayer has a UK nexus – meaning it is either resident in the UK or, in the case of an intermediary, is either incorporated in the UK, has its place of management in the UK or has a branch or office in the UK through which it carries out the activities that make it an intermediary in respect of the arrangement or structure.

Reporting exemptions

The draft regulations include certain proposed exemptions from reporting under UK MDR, including an exemption (at para 5) for intermediaries if disclosing the information in question would breach legal professional privilege (LPP). Where LPP applies, it is proposed that the lawyer must notify their client in writing of the client's disclosure obligations. There is a similar exemption in para 7 of the DAC 6 regulations; however, under para 7 it is sufficient to notify another intermediary (*or*, if none, the taxpayer) that LPP applied to the arrangement (so that reporting then falls on the other intermediary or the client).

HMRC has confirmed that this change to the LPP exemption is designed to align the draft regulations with the model rules (which refer to the 'client' reporting) but it welcomes feedback to ensure the regulations work as intended. It is therefore possible that this position may change as the consultation progresses.

Other exemptions from reporting will apply where the information has already been reported to HMRC or where information on the arrangement has already been provided to a tax authority in a 'partner jurisdiction'. HMRC expects to include a list of partner jurisdictions in Sch 1 to the draft regulations, but the term is defined in the model rules as being a jurisdiction:

- that has introduced rules that are substantially similar to those set out in this legislation; and
- that, with respect to the particular CRS avoidance arrangement or opaque offshore structure, has international exchange of information instruments in effect with all jurisdictions of residence of the reportable taxpayer.

HMRC's consultation suggests that jurisdictions that have not signed up to exchange under the Multilateral Competent Authority Agreement on the Automatic Exchange regarding CRS Avoidance Arrangements and Opaque Offshore Structures are not expected to be 'partner jurisdictions' as they would not normally be able to automatically exchange this information, unless, exceptionally, other arrangements are in place. HMRC has separately commented that this exemption for partner jurisdictions would not apply to an EU member state (if a report was made under DAC 6 in the EU) as those individual member states have not (as yet) signed up to

the model rules via the competent authority agreement (although they have the opportunity to do so). This could, therefore, lead to some duplicate reporting under UK MDR and DAC 6 in the EU.

While some of the definitions may have changed from DAC 6 to UK MDR, the concepts are broadly the same and the scope of arrangements which are expected to be reportable under UK MDR are broadly similar to those already reportable under DAC 6 in the UK

Time limit for reporting

The time limit for reporting for intermediaries is 30 days after the arrangement or structure is made available for implementation, or 30 days after the intermediary provides assistance or advice in relation to the design or implementation of the arrangement or structure. For taxpayers who have to report, the time limit for reporting is 30 days after the first step in the arrangement or structure has been implemented. These time limits and concepts will be familiar from the DAC 6 regulations.

Final thoughts

Businesses will be relieved that the consultation and draft regulations have finally been published so that they can prepare for its implementation in summer 2022.

While some of the definitions may have changed from DAC 6 to UK MDR, the concepts are broadly the same and the scope of arrangements which are expected to be reportable under UK MDR are broadly similar to those already reportable under DAC 6 in the UK. However, intermediaries will still need to consider whether they have any arrangements which are within the scope of the new reporting rules. Promoters, in particular, will need to undertake a further look-back exercise in relation to arrangements put in place since 29 October 2014 to see if any others (which have not been reported under the DAC 6 regulations) are reportable under UK MDR.

While HMRC is trying to maximise alignment with the model rules to maintain consistency between implementing jurisdictions (and so reducing the reporting burden faced by businesses operating across multiple jurisdictions), there are still some issues to be worked through (in particular, around privilege), though it is hoped that such issues will be ironed out as part of the consultation process. ■

For HMRC's draft regulations and consultation, see bit.ly/33lkL3p. Comments are invited by 11:45pm on 8 February 2022.

For related reading visit www.taxjournal.com

- Tax administration and maintenance day highlights (R Kinghall Were & B Salehy, 1.12.21)
- DAC 6 update: UK narrows scope of mandatory reporting (S Bhogal & A Kaye, 12.1.21)