Analysis

The UK DAC 6 regulations: the good, the bad and the unknown

Speed read

The UK regulations implementing the EU's 'DAC 6' directive have now been laid before Parliament. Tax professionals had been eagerly awaiting clarification on key issues as they try to determine which transactions could be in scope and implement internal processes for capturing and reporting relevant arrangements. Whilst the final regulations provide some of the answers, there are still significant areas of uncertainty and the HMRC guidance is not expected to be published until June. As a result, getting procedures in place in time for the first reports in August is going to be a challenge.

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The International Tax Enforcement (Disclosable Arrangements) Regulations, SI 2020/25, ('the UK regulations') were laid before Parliament on 13 January 2020 and take effect from 1 July 2020. These implement EU Directive 2018/822 (DAC 6, referred to herein as 'the Directive'), which amends the Directive on Administrative Cooperation in the field of taxation (EU Directive 2011/16/EU).

By way of background, for those lucky enough not to have had to grapple with DAC 6 so far, the Directive requires 'intermediaries' and, in some cases, taxpayers to report arrangements bearing certain characteristics (or 'hallmarks') to tax authorities. Member states were required to implement DAC 6 by 31 December 2019. The UK, still being a member of the EU at that time, was obliged to implement DAC 6, although the December 2019 general election meant the deadline for implementation was narrowly missed. The UK government may take some comfort in knowing that it is not alone in having challenges with implementation, with 14 other member states, including Spain, Italy and most surprisingly, Poland (despite being the earliest and arguably most enthusiastic adopter of DAC 6) having been sent formal notices by the European Commission as regards their implementation of DAC 6.

The UK regulations as laid have been amended in some helpful ways compared to the draft published for consultation last July, indicating that HMRC has been listening to representations. However, it isn't all good news and there are some points where the answers given may not be the ones people were hoping for. In addition, there are, unfortunately, some key points that have not been dealt with in the UK regulations but which HMRC has indicated will be dealt with in guidance to be published in June. This article will explore the good points coming out of the regulations, the not so good points and some of the key areas where we are still waiting for answers.

The good

EU tax advantage

One significant change that has been made relates to when a tax advantage will be in scope. Under the July draft regulations, in relation to those hallmarks that were only engaged where one of the main benefits of the arrangement was the obtaining of a tax advantage, not only was it necessary to consider whether there was a tax advantage as regards taxes arising in EU member states but equivalent taxes in other jurisdictions were also in scope. This went beyond the requirements of the Directive and meant that intermediaries would potentially have needed to understand the purpose behind legislation anywhere in the world in order to determine whether an arrangement was consistent with the intention behind that legislation. The UK regulations have been amended so that it is now clear that a tax advantage is only in scope in relation to taxes to which the Directive applies, i.e. direct taxes in EU member states. This may still require a UK intermediary to consider the purpose behind the legislation of all EU member states (time to brush up on your Slovakian law) but nonetheless this change to the UK regulations marks a considerable improvement.

UK nexus

Also, on territorial scope, changes have been made to the UK regulations to put it beyond doubt that they only impose obligations on intermediaries and taxpayers with a UK connection. This is a helpful clarification and ensures the rules work as intended under the Directive. Care should be taken in respect of other jurisdictions that do not have such a restriction on territorial application, most notably Poland, where it seems that obligations can arise even where an intermediary has no Polish nexus.

Proportionate penalties

Whilst no-one will want to be in a position where they are in breach of the rules and have to rely on penalties not being imposed, there will inevitably be situations where there could be inadvertent breaches given all the uncertainty that remains around the application of DAC 6. As a result, the changes that have been made to take a more proportionate approach to penalties are welcome. The penalty regime as it now stands means that the normal sanction for breach will be a one-off penalty of £5,000, with daily penalties only charged for more serious failures to comply, such as where the failure is deliberate or repeated.

Such daily penalties would also take into account whether the entity has put in place reasonable procedures to ensure it is compliant with the regime. Guidance on what is meant by 'reasonable procedures' would be very helpful here (could we will end up with something like that provided in the context of the corporate criminal offence?). Other factors HMRC may consider include the amount of fees received by the intermediary and the amount of advantage gained by the taxpayer. These factors are not specifically mentioned with respect to the one-off penalty, although this may be set at a lower amount than £5,000 if that would be 'correct or appropriate' and it would make sense for similar considerations to be relevant to determinations in respect of the one-off penalty. HMRC has also indicated that, where there is a reasonable excuse for non-compliance, there should be no penalty due and, in such cases, it should not be necessary to investigate whether there are reasonable procedures. There has also been reassurance from HMRC that there will be some leniency in the application of penalties in relation to arrangements that take place in the period prior to the final guidance being issued, although they will be on the look out for anyone seeking to abuse that leniency.

Privilege

One issue that particularly concerned lawyers (and was one of the most responded to points in the July consultation) was that the draft regulations and certain statements in the consultation document seemed to threaten legal professional privilege. This was a real concern as it put legal professionals in the difficult position of either breaching their obligations under DAC 6 or breaching their obligations towards their clients, potentially infringing fundamental rights which are designed to protect access to justice. Fortunately, HMRC has taken on board comments made during the consultation process and incorporated a few simple but important changes to the final UK regulations to ensure that they do not require a lawyer to breach privilege not only vis-à-vis HMRC but also other parties, including other intermediaries. It remains for HMRC to set out exactly what it considers is and is not covered by privilege in this context, and HMRC has indicated that it intends to work with representatives from the legal sector (as they did with the enablers regime) to provide further guidance in this area. We hope that HMRC has now moved away from earlier statements suggesting factual information is not capable of being privileged and that HMRC will consult on mechanisms for law firms to notify other intermediaries or defend themselves from penalties without breaching privilege.

Taxpayer reports

Another positive change is the amendment to the rules on the reports that have to be made by taxpayers. Previously, taxpayers participating in arrangements with no specific end date (such as a cross-border restructuring) could potentially be required to report indefinitely, adding compliance costs to the taxpayer with no discernible benefit to HMRC. The UK regulations now confirm that after the first year that the taxpayer participates in an arrangement, additional reports are only needed in years where the arrangement has a tax advantage for the taxpayer. It has also been clarified that the report needs to set out the 'tax advantage' of the arrangement, rather than the 'effect' of the arrangement. Where there is no tax advantage, i.e. where the main benefit test is not in point, it appears that the return only has to contain the arrangement reference number (ARN). This taxpayer reporting requirement is not in the Directive at all, so it would have been preferable if the rules were brought back in line with the Directive, but the changes are at least an improvement on the earlier position.

Knowledge

A helpful confirmation in HMRC's summary of responses to consultation (published on 13 January, see bit.ly/31nsqJC) is that intermediaries will not be required to do additional customer due diligence beyond what they would normally do to comply with their existing obligations. The gist seems to be that an intermediary will not be assumed to have knowledge of the facts that make something disclosable (although equally intermediaries can't be wilfully blind to the facts or artificially split up information to avoid any one person having the requisite knowledge). It would also be helpful to have official confirmation that a person must have actual knowledge of the relevant tax implications to be an intermediary within the promoter category. HMRC has informally indicated its view is that a promoter must have a full understanding of the arrangement, including how it works and its potential tax impact, so it is hoped that confirmation on this will follow in guidance. Guidance on what an intermediary would be expected to know in terms of the specific details of the DAC 6 hallmarks would also be welcome; for instance, would a non-tax specialist be expected to know who is on the OECD's list of non-cooperative jurisdictions or what a unilateral transfer pricing safe harbour looks like?

The bad

There are a few areas where the position reached in the UK regulations is less than ideal. For the most part, these seem to be situations where HMRC feels bound by the wording of the Directive itself. For example, representations were made suggesting a partnership should be able to deal with DAC 6 reporting centrally in its place of incorporation. It seems relatively clear now that this will not be the case and that HMRC intends to apply literally the pecking order set out in article 8ab(3) of the Directive. This means that, as a partnership is not resident anywhere, reporting will have to be done in each member state where the partnership has a permanent establishment, i.e. on an office by office basis. The Directive and the UK regulations envisage that in such a case one office would report and other offices would be able to rely on that report, or so the theory goes. Unfortunately, this means that partnerships are faced with the unenviable task of reconciling multiple different interpretations of the law and differing rules on privilege across member states, not to mention practical issues around relying on reports made by others in other jurisdictions (see below).

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This result, whilst unfortunate, is consistent with the wording of the Directive. HMRC's summary of responses makes it clear that HMRC wants to avoid being found in breach of the UK's international obligations and any insinuations that it has not implemented DAC 6 properly. This concern is apparently shared, with many jurisdictions adopting a similar approach, simply tracking the wording of the Directive or cross-referring to the relevant provisions. The other argument cited by HMRC for their literal approach is that any departures from the text of DAC 6 could result in inconsistencies in implementation across EU member states, potentially leading to loopholes that could be exploited, as well as making the rules harder to comply with particularly for large multinational organisations faced with slightly different rules applying in each jurisdiction.

Whilst the logic of this is clear, there are undoubtedly issues with the drafting of DAC 6, which member states are dutifully replicating into national law. The result of this literal interpretation is that in certain instances the compliance burden it imposes could end up out of proportion to the issues DAC 6 is seeking to tackle. Furthermore, some of the concepts used in DAC 6 are vague and difficult to apply, meaning that at some point specific guidance will be needed from the Commission or tax authorities on what transactions they consider to be in or out. With so many jurisdictions simply tracking the wording of DAC 6, it looks as though any colour will only be provided in national guidance which may not be released and/or finalised for months (if at all). For clients (and their advisers) trying to decide whether current transactions will be disclosable as well as those seeking to put in place processes now to track matters within scope, this will have to be done on a 'best guess' basis.

There are further practical issues that arise in the context of partnerships and the self-employed. Unhelpfully, HMRC has stated in its summary of responses that each individual partner and self-employed individual could be an intermediary, and each individual would have a separate reporting obligation under DAC 6. Although there is a helpful concession that this can be done by one partner on another partner's behalf, there is no such concession yet for the self-employed. This raises tricky issues where individual partners take different views on whether an arrangement is reportable and what should be reported, as well as further difficulties around having to rely on reports made by other people.

Further complications arise where privilege applies and so intermediaries are required to notify other intermediaries rather than disclosing to HMRC. Theoretically, if each partner (or self-employed individual) is a separate intermediary, each individual partner in a professional partnership working on a matter could end up having to notify the firm and all other partners at the firm working on the matter and vice versa. This would theoretically extend to an obligation (subject to privilege) to notify other partners in other professional partnerships and self-employed individuals working on the matter. This profusion of notifications cannot be what any tax authority intends, and it is hoped we can reach a pragmatic solution whereby a notification can be made to or by a nominated entity.

The unknown

There are a few areas that could be said to be a combination of the good, the bad and the unknown. These are the ones where HMRC has said it will change the rules for the better (good), but it will only deal with this in guidance and not the legislation (bad) and we don't yet know what exactly the guidance will say (unknown). Many taxpayers and intermediaries have delayed making decisions on whether arrangements entered into from 25 June 2018 were disclosable in the hope that clarity would be given in the final regulations or, at the very least, in guidance on what arrangements HMRC expected to be in and out of scope. With scant detail in the Directive and the UK regulations and HMRC suggesting that final guidance will not be published until June 2020, this gives almost no time for those attempting to wade through their backlog of potentially disclosable matters prior to the first reports having to be made in August 2020.

Some examples of points where helpful guidance has been promised include:

- **Triggers for disclosure:** What does HMRC think the 'first step' of an arrangement will be? When is an arrangement 'made available' for implementation? HMRC has indicated that, after an initial report is made, it will only require additional reports in the very specific circumstances prescribed by the UK regulations. This means that it is not in HMRC's interests to receive reports too early, at a point where the arrangements are half-baked and the information that HMRC would find useful is not yet known. Its preference is that the arrangements are identifiable and close enough to implementation, so that it receives the fullest information possible. A sensible result would be for an arrangement to be 'made available' or for the 'first step' to be treated as having taken place only when the design of the arrangements and any tax analysis is near-final. However, HMRC is understandably wary of practices that it says developed in the context of DOTAS of artificially delaying putting the final touches to arrangements to avoid the timer for reporting starting to run.
- **Relying on reports by others:** As mentioned above, there are various instances where an intermediary may seek to rely on reports by other intermediaries to satisfy its obligations. One point raised in consultation was that where a tax authority is slow in providing an ARN or equivalent to the reporting intermediary, another intermediary could end up being in breach by not reporting in time and not being able to provide an ARN to evidence that a report has been filed by someone else. HMRC has helpfully confirmed that it intends to issue ARNs immediately on receipt of a valid report and has said that it will provide guidance on relying on reports by other people. Our expectation is that HMRC will take a pragmatic approach and not seek to impose penalties where an intermediary is technically in breach as a result of such issues. However, it would be helpful to have official confirmation of this, not least to help persuade other tax authorities to take a similarly pragmatic approach.
- **Hallmarks:** One of the largest areas of uncertainty that remain is in the application of the hallmarks. Further guidance on this has been promised and it will be crucial for those trying to analyse whether specific arrangements are disclosable or not. In particular, guidance has been promised on substantially standardised documents (hallmark A.3) and the conversion of income hallmark (B.2), amongst other things. Many advisers have also asked for lists of relevant jurisdictions that are not bound by automatic exchange of information rules (hallmark D.1), or that apply unilateral safe harbour rules (hallmark E.1). More generally, it would be useful to get a response to the question HMRC was asked in consultation around whether the intention is for arrangements or structures that are well known to HMRC to be reported.

A final unknown concerns the impact of the UK leaving the EU on 31 January. The Treasury report published on 8 January (as required by FA 2019 s 84) covering what will happen in respect of DAC 6 in various Brexit scenarios (see bit.ly/37XE1S3) was light on detail on the future of DAC 6 post-Brexit. The language of the report, with its references to the benefits to HMRC of additional information and transparency in helping it to challenge offshore non-compliance and deterring aggressive tax arrangements, suggests HMRC will not want to give up these tools that are now at its disposal, so we would not anticipate a repeal of the UK regulations post-Brexit. However, changes may be made to 'ensure the rules work as intended' once the UK is not bound by the wording of the Directive. An obvious change, that would help HMRC ensure it only gets reports on the types of arrangements it is most concerned about, would be to widen the main benefit test so that it applies to all hallmarks. This would not help intermediaries that operate in other EU jurisdictions, nor will it stop HMRC being inundated by reports shared by other member states that take a broader view, but it would lead to a more sensible result in respect of UK intermediaries. HMRC would also have the freedom to legislate to fix some of the practical issues that have already arisen and which will no doubt continue to arise as HMRC, taxpayers and intermediaries head into the next phase of trying to apply DAC 6 in practice.

What next?

HMRC has listened to representations and there have been several improvements made to the UK regulations, as far as they go. However, significant areas of uncertainty remain where further guidance is clearly needed. The sooner HMRC publishes its guidance, the better. In the meantime, putting the necessary processes (including IT and other system changes, training and communication plans) takes time, and intermediaries and taxpayers cannot afford to wait for guidance. With the August deadline for the first reports fast approaching, now is the time to act. ■

The author thanks her colleague Helen Buchanan for her contribution to this article.

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- The new EU tax disclosure rules: practical challenges (Brin Rajathurai & Helen Gunson, 29.6.19)
- The EU reportable arrangement rules for intermediaries (Geoff Hippert, 3.5.18)