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Analysis

The UK's international disclosure rules: where are we now?

Speed read

New international disclosure regulations based on the OECD's mandatory disclosure rules (MDR) came into force in the UK on 28 March 2023. While it is tempting to view the UK's implementation of OECD MDR as a seamless transition from its implementation of the EU DAC6 regime, there are some differences, notably in scope, the professional association nexus criteria and some compliance matters. The new regulations catch pre-existing arrangements from 25 June 2018, which must be reported by 25 September 2023. The new regulations present a number of practical implications for tax professionals, and they give an opportunity to review existing governance.

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On 28 March 2023, regulations came into effect transposing OECD mandatory disclosure rules into UK law. At the same time, the existing rules implementing DAC 6 (or EU MDR) in the UK were revoked. In this article, I examine how the new rules differ from DAC 6 and what action tax professionals should take.

A brief history of international MDR

In 2018, the OECD published its model mandatory disclosure rules for CRS avoidance and opaque offshore structures (OECD MDR). These rules described a framework designed to provide tax administrations with information regarding certain arrangements which could limit their visibility of assets held by taxpayers in other jurisdictions and which might therefore provide opportunities for offshore tax evasion. The primary reporting responsibility would rest with intermediaries; however, the obligation could shift to the client in certain situations. Relevant information would be shared with other tax administrations under existing exchange of information frameworks.

The arrangements potentially requiring disclosure under the OECD's proposals were:

- 'CRS avoidance arrangements': broadly, arrangements which may circumvent the common reporting standard (CRS) rules under which information regarding offshore accounts is collected and automatically exchanged between tax authorities.
- 'Opaque offshore structures': broadly, arrangements which may allow a natural person to be a beneficial owner of a passive offshore vehicle whilst creating the appearance that the person is not a beneficial owner.

These rules were incorporated by the EU into the much broader DAC 6 disclosure regime. The DAC 6 regime is aimed at cross-border tax avoidance more generally and requires the assessment of an arrangement against a series of hallmarks indicative of potential avoidance. Some hallmarks are generic (reflecting 'typical' features of avoidance arrangements), whilst others were specific (targeting common areas of concern in cross-border transactions).

Hallmark D was included in DAC 6 specifically to bring OECD MDR into the EU regime, with the preamble to the directive suggesting that member states could use the OECD's work as a source of illustration or interpretation.

DAC 6 was transposed into UK law via the International Tax Enforcement (Disclosable Arrangements) Regulations, SI 2020/25. But, just before reporting was due to start on 1 January 2021, implementation was scaled back due to the free trade agreement concluded with the EU. In that agreement, both parties agreed to keep disclosure regimes that met the OECD's minimum standard, i.e. OECD MDR.

The government revoked all of the hallmarks other than Hallmark D, but this was only to be a temporary measure. The intention was to replace the UK's 'short-form' version of DAC 6 with a set of rules directly based on OECD MDR over time. Note that the UK's existing domestic disclosure regimes (notably, DOTAS) were and are untouched by these developments.

Consultation process

In November 2021, HMRC issued a consultation on the implementation of OECD MDR and the repeal of the UK's DAC 6 rules. The consultation document emphasised continuity with the existing DAC 6 rules; this was perhaps unsurprising given that the UK had previously sought to interpret the relevant parts of DAC 6 in a way which conformed to OECD MDR, but it was nonetheless a huge relief to businesses and advisers alike, many of whom had built processes and disclosure software based on existing DAC 6 rules and guidance. There were, however, several areas of concern in the 2021 consultation.

The first involved reporting of historical arrangements. The OECD MDR document proposed that pre-existing arrangements going back to 29 October 2014 should be reported if they met the relevant requirements. DAC 6 had only required reporting of arrangements going back to 25 June 2018. The consultation proposed reducing the impact of this 'catch-up' reporting by introducing three limitations:

- reporting would only be required in respect of CRS avoidance arrangements (i.e. not opaque offshore structures);
- reporting would be limited to persons who had been responsible for the design or marketing of the arrangement; and
- the introduction of a de minimis of US $1m arrangement value.

Nevertheless, there were concerns over the ability, in practice, to review historical arrangements and meet statutory obligations, as many documents might have been destroyed under internal document retention policies or GDPR, and significant staff turnover would have taken place. Fortunately, the government subsequently announced (in November 2022) that reporting of pre-existing arrangements would only be required from 25 June 2018. The other proposed limitations on 'catch up' reporting set out in the original consultation would remain.

The second issue raised by the consultation concerned the mechanics of submission. HMRC requires reporting under these regulations to be done online, using an extensible

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markup language (XML) file format to facilitate effective exchange of information with other tax authorities. Many stakeholders considered that an online manual data entry system should be available. Most anticipate needing to make very few, if any, disclosures and the expense of building IT systems or buying in the relevant software would not be justified. On this point, the government has decided that it cannot provide a manual reporting system. Intermediaries and taxpayers alike will need to ensure they have a mechanism available to make the necessarily XML submissions should the need arise, no matter how unlikely a scenario that may seem.

Similarities between MDR and DAC 6

In many ways, the new MDR rules align with the UK's DAC 6 rules. Before examining those similarities, though, it is first worth remembering that the rules are designed to identify arrangements or structures that could be used to side-step international transparency rules and, by implication, *could* be used to facilitate illegal activity. The rules, therefore, are not limited to tax activities or tax professionals. There is no 'tax advantage' test in Hallmark D of DAC 6 or in the OECD rules, nor in the UK's implementation of them.

> Over time, more countries will also introduce the OECD's MDR rules. Mandatory disclosure is here to stay

So, in what ways are the MDR and DAC 6 rules similar?

The statutory instrument implementing OECD MDR (The International Tax Enforcement (Disclosable Arrangements) Regulations, SI 2023/38) pulls in definitions from the OECD 2018 document in the same way that SI 2020/25 pulled in definitions from the directive.

The definitions of CRS avoidance arrangements and opaque offshore structures represented by Hallmarks D1 and D2 under DAC 6 and rules 1.1 and 1.2 of MDR use slightly different words, but it is clear that HMRC sees them as covering the same ground and expects to apply continuity of interpretation.

The regime retains the concept of two types of intermediary liable to reporting obligations. The MDR rules refers to these as promoters and service providers whereas DAC 6 referred to them as primary and secondary intermediaries. The concepts, though, are broadly the same.

The intermediary must have the relevant UK nexus before a reporting obligation arises. The nexus criteria are again very similar, although there is a small difference (explained below).

Aligning with DAC 6, an individual is not to be treated as an intermediary when they are an employee of either an intermediary or relevant taxpayer in relation to an arrangement. This exemption does not extend to partners in partnerships; however, it is expected that the final guidance will include similar helpful language to that in the DAC 6 guidance (which allows the partnership to report on behalf of the partners).

The primary responsibility for reporting lies with the intermediary. However, as with DAC 6, where an intermediary cannot report, the obligation shifts to the relevant taxpayer. The anticipated situations where this would arise are the same as for DAC 6: the work of the intermediary is subject to legal professional privilege (LPP), there is no intermediary in respect of the arrangement (for example, it was developed in-house), the intermediary is not required to make a report (e.g. due to insufficient UK nexus because the intermediary is based overseas).

The reporting deadlines are in-line with DAC 6. For promoters reports need to be made within 30 days of making the arrangement or structure available for implementation. For service providers it is within 30 days of providing the relevant services.

There are a number of exemptions from reporting which are covered in more detail below, but they follow similar patterns to those in DAC 6.

The penalties remain aligned with DAC 6 with initial penalties of £5,000. In the case of a failure of an intermediary to report, failure to report arrangements entered into during the 'catch-up' period, and failures to meet the requirements of certain information notices, HMRC can apply to the First-tier Tribunal for a higher penalty of up to £600 a day. This can be increased to a maximum of £1m if the daily penalty is seen to be insufficient.

Differences between MDR and DAC 6

Arrangements in scope

The main difference arises when looking at the definition of an arrangement for the purposes of DAC 6 and MDR. DAC 6 targets transactions involving EU member states (for the purposes of the UK implementation of DAC 6, the UK was viewed as an EU member state whilst it retained those rules).

DAC 6 defines a 'cross-border arrangement' as an arrangement concerning either 'more than one member state or a member state and a third country'. The definition of arrangement under OECD MDR does not include this limitation, which makes sense since the OECD rules are global and not focused on the EU. So an arrangement under MDR does not need to involve an EU member state or even the UK before it has the potential to come within scope. If an intermediary is promoting or providing services in relation to a relevant arrangement concerning, say, the US and Bermuda, the intermediary will have a reporting obligation if it has the necessary UK nexus. Compare this with DAC 6 where the arrangement would not have fallen within the scope of the rules as the arrangement did not 'concern' an EU member state (or the UK).

This increased scope also applies to the reporting of arrangements entered into since 25 June 2018. Caution needs to be exercised before assuming that anything reportable since then will have already been disclosed under Hallmark D of DAC 6 and that no further work is necessary in relation to this 'catch-up' reporting period.

UK nexus

In order for there to be a UK reporting obligation under either DAC 6 or MDR, it is necessary to have relevant nexus to the UK. The definitions are similar, but there is one difference: under DAC 6, sufficient nexus could arise by virtue of being 'registered with a professional association related to legal, taxation or consultancy services'. This created a potential headache for UK professionals seconded overseas (particularly outside of the EU), especially since the UK was on course to implement the full range of DAC 6 hallmarks. The professional association nexus criteria is not included in OECD MDR.

Other differences

The other differences are largely compliance matters, as follows.

There is no concept of marketable arrangements under MDR. Marketable arrangements under DAC 6 entailed quarterly filing requirements to provide updated information in respect of intermediaries, users, affected member states, and other matters.

DAC 6 required that an arrangement reference number (ARN) was issued on disclosure to the reporting intermediary or taxpayer. This ARN was required to be sent to any person

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who could reasonably be expected to be a UK intermediary or relevant taxpayer in relation to the arrangement. Under MDR, there is no ARN system, although a written notice that a disclosure has been made must be given to any person who the reporting entity could reasonably be expected to know is an intermediary or reportable taxpayer in relation to the arrangement.

The UK's implementation of DAC 6 also introduced an annual filing requirement. Taxpayers were required to make an initial disclosure of involvement in a reportable arrangement. There was also an ongoing annual requirement. Such a requirement does not appear in the new rules.

Under DAC 6 where an intermediary couldn't disclose due to LPP, it was required to notify other intermediaries or, if there were none, the relevant taxpayers of the reporting obligation (i.e. effectively advising other parties that they would need to disclose). This requirement still exists in MDR in relation to relevant taxpayers, but there is no requirement to notify other intermediaries.

Exemptions from reporting under OECD MDR

As detailed above, the rules do not require an intermediary to disclose any information to the extent that it is privileged. In that situation, the intermediary must instead provide written notice within the 30 day reporting window to their client that the client must report the arrangement.

An intermediary need not provide information to HMRC to the extent it has evidence that the information has previously been disclosed to HMRC or that it has been disclosed to the tax authority in a partner jurisdiction with which the intermediary has relevant associations (for example, because it has a branch or a place of management in that partner jurisdiction).

A similar exemption applies for relevant taxpayers when the taxpayer has evidence that the information has been disclosed by an intermediary to the tax authority of a partner jurisdiction under similar rules.

A partner jurisdiction is broadly one which has signed up to the OECD MDR rules but, crucially, has also notified the OECD that it has the relevant rules in place and intends to exchange reports with a list of specific jurisdictions (which have also signed up to OECD MDR). The UK will keep a list of those jurisdictions which it regards as 'partner jurisdictions' at Sch 1 to the regulations. At the time of writing, although 16 other countries have signed up to OECD MDR, none have made it onto Sch 1, indicating they are still in the process of implementing the rules and/or having that implementation recognised by the OECD and the UK.

Transition

The new regulations came into force on 28 March 2023. Arrangements which were made available on or after 28 March 2023, or where assistance was provided on or after 28 March 2023, should be reported through MDR and not DAC 6.

Any arrangements that are reportable in relation to the 'catch-up' period from 25 June 2018 to 28 March 2023 (bearing in mind the limited scope of such reporting) must be reported by 25 September 2023. No disclosure is required if the arrangement has already been disclosed under the UK's implementation of DAC 6.

We understand the DAC 6 service will remain open until 31 May 2023, although note that the current draft guidance refers to 30 April 2023 (rather than 31 May 2023). This is to enable the reporting of any relevant arrangements under the DAC 6 regime as well as amending or correcting previous DAC 6 reports.

HMRC guidance

HMRC has published a number of guidance notes:

- brief guidance on reporting an arrangement which includes notes on who may need to report and how to report;
- links to register to report an arrangement under MDR;
- links to the schema and supporting documents; and
- a section called 'Check if you need to tell HMRC about a cross-border arrangement (MDR)'.

This final section includes links to further guidance for both CRS avoidance arrangements and opaque offshore structures, but currently the linked guidance is for Hallmark D1 and D2 of the DAC 6 rules. These are holding pages for now whilst HMRC finalise specific MDR guidance, but their inclusion does seem to demonstrate HMRC's intention to achieve continuity of interpretation with Hallmark D as far as possible.

It is here where the potential problems lie. The DAC 6 guidance on which arrangements fall within Hallmark D always felt thin. There was little practical insight on common structures, such as trusts or widely held investment funds, making interpretation of the hallmark tricky. In the summary of consultation responses published in November 2022, HMRC said it would work with stakeholders to provide further guidance on these areas. Hopefully this will be available soon.

Practical implications

While it is tempting to view the implementation of OECD MDR as a seamless transition from DAC 6, it is worth thinking through the practical implications. Tax professionals should:

1. Review whether any DAC 6 disclosures need to be made or amended/corrected before the DAC 6 service closes.
2. Consider reporting of arrangements from the catch-up period, especially bearing in mind the wider scope as reporting is not limited to arrangements that involve an EU member state (or the UK). Does further work need to be done? Any further work done and the conclusions drawn should be documented.
3. Use the new rules as an opportunity to revisit existing processes and consider whether they need refreshing, particularly in those areas which have changed.
4. Consider reporting mechanisms. Ensure that software or a supplier is lined up should an MDR report be required, even if that seems unlikely, as trying to find a supplier within the 30-day reporting window can be both challenging and expensive.
5. Refresh training and internal guidance, and again raise awareness of the rules within your teams. Remember the rules are not limited to tax teams. Whilst tax trained individuals should have a healthy dose of professional scepticism, meaning that any structures that seek to side-step transparency laws should ring alarm bells, non-tax staff may not have the same internal radars and may need more focused training or renewed governance.

And finally, remember that, despite the UK's scaling back of the DAC 6 rules and transition to OECD MDR, the full DAC 6 regime continues to operate across the EU. We are also seeing mandatory disclosure developments in other countries such as Mexico. Over time, more countries will also introduce the OECD's MDR rules. Mandatory disclosure is here to stay. ■

For related reading visit taxjournal.com

- Consultation on the UK's new mandatory disclosure rules (V McMahon, 12.1.22)
- DAC 6 update: UK narrows scope of mandatory reporting (S Bhogal & A Kaye, 12.1.21)