Brexit – Implications for the application of the EU mandatory disclosures rules

European Union – Directive on Administrative Cooperation – Mandatory Disclosure Rules – UK – Brexit – Trade and Cooperation Agreement

On December 30, 2020, the EU and the UK signed the Trade and Cooperation Agreement ("EU-UK Agreement"), which sets out the terms of their future cooperation. One of the pillars of the EU-UK Agreement is the Free Trade Agreement ("EU-UK FTA"), covering, *inter alia,* tax transparency issues.

With regard to mandatory disclosure rules (MDRs), the UK committed to exchange information on potential cross-border tax planning arrangements at a level that complies with the OECD mandatory disclosure standard, meaning that from January 1, 2021 the UK applies a curtailed version of the EU MDRs, for a limited period of time.

Background

Mandatory disclosure requirements for intermediaries and relevant taxpayers under the Directive on Administrative Cooperation (DAC6) entered into force in the European Union (EU) on June 25, 2018 and applies as of July 1, 2020.

Under DAC6, intermediaries and, in certain cases, relevant taxpayers are required to report information regarding cross-border arrangements that meet one or more specific characteristics or features (hallmarks).

Pursuant to the text of DAC6, the deadline for intermediaries to disclose reportable transactions the first step of which was implemented between June 25, 2018 and July 1, 2020 (the look-back

period) was initially August 31, 2020. For ongoing reporting, starting from July 1, 2020, the deadline was 30 days from the relevant reporting trigger.

Although the UK left the EU on January 31, 2020, under the terms of the EU-UK Withdrawal Agreement, during the transition period (i.e. between January 31 and December 31, 2020), EU law continued to produce legal effects in respect of the UK as those which it produces within the EU. Furthermore, any reference to Member States in EU law, including EU Directives such as DAC6, included the UK. Therefore, the UK adopted regulations to transpose the provisions of DAC6 into domestic law.

As a result of the severe disruption caused by the COVID-19 pandemic, the EU allowed Member States to defer the DAC6 reporting deadlines by up to six months. At the time of this decision (June 2020), the UK was deemed to be an EU Member State for the purposes of DAC6. Most Member States, including the UK, opted for the six-month deferral, as follows:

- to February 28, 2021 for the look-back period;
- to January 1, 2021 for the start date of the 30-day reporting deadline and for arrangements that met one of the reporting triggers during the deferral period.

Brexit impact on the application of the EU mandatory disclosure rules

As of the end of the transition period, i.e. from December 31, 2020, from an EU perspective, the UK is formally a third country and all EU law, across all policy areas, is no longer applicable to and in the UK.

Prior to the signature of the EU-UK Agreement, the UK was expected to continue to apply mandatory disclosure rules in line with DAC6 and according to the deferred timeline it had opted for. However, according to the FTA, the UK chose to subscribe to the OECD mandatory disclosure standard rather than the EU rules. We understand that UK legislation will be amended to reflect this change.

In order for the UK to comply with its commitments under the FTA, as an interim step, domestic legislation was amended so that reporting will be restricted only to those arrangements that meet hallmarks under Category D of DAC6 and which are considered to be equivalent to the OECD's MDR standard.

Category D hallmarks refer to:

- arrangements which may have the effect of undermining the reporting obligation under agreements on the automatic exchange of information or which takes advantage of the absence of such legislation or agreements (hallmark D.1.);
- arrangement involving a non-transparent legal or beneficial ownership chain with the use of persons, legal arrangements or structures (hallmark D.2.)

Reporting under D hallmarks only will be required for a limited period of time, according to the deadlines set out in DAC6, as follows:

- Going forward: 30 days from the relevant trigger point as of January 1, 2021,
- January 30, 2021 for arrangements that met one of the reporting triggers during the deferral period (July 1 to December 31, 2020), and
- February 28, 2021 for the look-back period.

No disclosures will be required with respect to arrangements that fall into one of the other hallmarks, i.e. categories A, B, C and E of DAC6. This also applies to look-back and deferral period arrangements.

The concrete design and timeline for adoption of the new legislation in the UK is currently unknown. The new UK rules are likely to be based on the OECD Model Mandatory Disclosure Rules for Common Reporting Standard Avoidance Arrangements and Opaque Offshore Structures (published on March 9, 2018). The Model Rules do not represent an OECD minimum standard, but draw extensively on the best practice recommendations in the BEPS Action 12 Report. By contrast, certain provisions on Country-by-Country Reporting (BEPS Action 13) and on the prevention of tax treaty abuse (BEPS Action 6), for instance, are minimum standards and therefore committed to by all members of the OECD Inclusive Framework. Once the UK has implemented the OECD MDR, the remaining regulations related to DAC6 (i.e. those referring to D hallmarks) will be repealed.

EU Tax Centre comment

Whether the UK will have access to the EU Centralised Directory for automatic exchange of information under the Directive on Administrative Cooperation is not specifically addressed in the FTA. In principle, the Directory is for Member States only, so the UK will not be given access by default, absent a specific agreement to that effect. With regard to DAC6 in particular, MDR disclosures made in the UK (i.e. with regard to arrangements related to the D hallmarks) and reports filed in EU Member States that may be relevant for the UK will likely not be automatically exchanged. Disclosures could be exchanged on request, based on equivalent provisions in bilateral treaties in place between the UK and individual Member States.

In practice, this means that intermediaries and taxpayers in EU Member States that are involved in reportable cross-border arrangements for which disclosures are made in the UK, will not be able to rely on such disclosures as evidence that information on a reportable cross-border arrangement has already been filed. EU-based intermediaries and taxpayers that were previously in a position to rely on UK disclosures should carefully assess the impact of the UK no longer being part of the automatic exchange of information system. This is particularly important given the short reporting deadlines and the variations in DAC6 rules among EU Member States, including with regard to availability of a waiver for legal professional privilege, which may complicate the assessment of who should report and where.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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