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Mandatory Disclosure Rules on cross border tax arrangements

Are you ready?

In July 2020, we expect to see the commencement of two new tax regimes, which have the purpose of continuing efforts towards providing visibility to global tax authorities of arrangements which, potentially, could lead to the avoidance of tax.

In the Channel Islands, the Mandatory Disclosure Rules (MDR) will come into effect. These rules are based on OECD rules, designed to prevent the circumventing of Common Reporting Standards (CRS) and to tackle structures which disguise the beneficial owners of offshore structures (Opaque Offshore Structures).

The EU rules on cross border tax arrangements, commonly referred to as DAC6, will take effect in the EU and the UK. These rules are designed to provide EU tax authorities with far greater visibility on cross border arrangements involving at least one EU country, where there is the potential for the tax base to be eroded.

Additional reporting requirements for MDR and DAC6

Both sets of rules bring with them additional reporting requirements for Channel Islands based intermediaries and providers of services to taxpayers, which have cross border elements to their affairs. The strict disclosure requirements and broad scope, in particular of the DAC6, make this one of the most significant changes for service providers and taxpayers in recent years.

The Rules – A Definition

MDR

The MDR requires Channel Islands based intermediaries to report specified information to the Comptroller of Taxes (Jersey) or Guernsey Revenue Services, where it is 'reasonable to conclude' that either:

1. A structure or arrangement is a *CRS avoidance arrangement*, which essentially seeks to circumvent CRS Regulations.
2. A structure or arrangement is an *Opaque Offshore Structure*, being a passive offshore vehicle held through an opaque structure, which allows a natural person to be the beneficial owner of that vehicle without the identity of that person being fully identified.

EU Council Directive 2011/16 – Known as DAC6

The application of DAC6 is broader than the MDR. The DAC6 applies where there is a cross border arrangement between taxpayers in two (or more) EU member states, or a taxpayer in one non–EU state and another in an EU state.

The intent is to require reporting to be undertaken by an intermediary, or in some cases the taxpayer directly, to an EU tax authority, where it is believed that an arrangement meets one or more specified 'hallmarks'.

The DAC 6 was originally billed as counteracting extremely aggressive cross border tax planning. However, the text of the final regulations means that what would normally be viewed as fairly standard commercial arrangements, may require reporting. For example, there can be a need to report cross border financing or rental payments made between related parties, where the recipient is subject to a low/zero rate of tax on the income. To be reportable, one of the categories or 'hallmarks' of tax avoidance must be breached - certain hallmarks have built into them a tax avoidance motive test, but others do not; thus further widening the scope of what may need reporting.

A further difficulty under DAC6 is that although it is based on EU rules, the implementation at national level is left up to individual countries, leading to some important differences in what requires to be reported, and by whom.

When it comes to MDR and DAC6, in particular the latter, identifying what does, and what does not require reporting, will be difficult. There will undoubtedly be some grey areas in between, which are widely open to interpretation.

Who is responsible for reporting?

Similar provisions under both rules mean that the reporting is due by an 'intermediary' which is defined as including both a Promoter, and a Service Provider. Those who will be intermediaries include trust companies, banks, lawyers and tax advisors. There is no get out for not being in the business of providing tax advice.

In certain circumstances, the taxpayer themselves may be required to make a report. For example, under the DAC6, if a Jersey intermediary has no UK nexus (i.e. no office or other presence in the UK), but the arrangement does involve a UK taxpayer, then the requirement to report may fall to the taxpayer directly. Such an intermediary should still decide whether it has a duty to understand that a DAC6 report may be necessary, and advise or assist the taxpayer in making that report.

Thus for a Channel Islands based intermediary, it is important that both the MDR and DAC6 are understood within the business.

What if reporting is missed?

Financial penalties can apply. In some cases, these penalties can be extremely significant.

When is the reporting required?

It is currently anticipated that the rules will apply from July 2020, meaning that the first report will be due in August 2020.

However, there is a consultation ongoing within the EU to defer the implementation of the DAC6 for 3 months. It may also be the case that MDR implementation is also delayed.

With respect to the DAC6, there is a backdating requirement, so that any reportable arrangements since 25 June 2018 require to be included in the first report in August 2020.

Though a degree of backdating will apply under the MDR, it is not such a broad requirement.

After the first report is made, reporting is then due on an ongoing basis, 30 days after the earliest date on which the arrangement is made available, is ready for implementation, or the first step is taken towards implementation.

What are the Next Steps?

It is important that Channel Islands based intermediaries and service providers give both the MDR and DAC6 their attention. Even with a three-month extension, if granted, there is not much time before reports will be due. Such service providers and intermediaries should:

- Determine the extent to which these rules will impact them;
- Understand situations in which reporting may be required;
- Review any potential backdating of reporting that may be required to facilitate making a full initial report;
- Train staff internally on the rules;
- Ensure written practice/procedures are in place internally;
- Have in place a system for recording when disclosures may be required, and indeed for noting reasons why it is felt no disclosure is required;
- Ensure knowledge of reporting channels is in place.

How can we help?

Grant Thornton Channel Islands are supporting a number of clients get ready for this change, by helping them ensure they have robust practices in place. Should you wish to discuss MDR or indeed DAC6 further, please do not hesitate to get in contact with our specialists or your usual contact.

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