UK FINANCE

Mandatory Disclosure Rules - Consultation

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Link
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Sent to: mandatorydisclosure.rules@hmrc.gov.uk

UK Finance is the collective voice for the banking and finance industry.

Representing almost 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation. Our members include businesses that are large and small, international, national and regional, corporate and mutual, retail and wholesale.

General Comments

We welcome the opportunity to respond to the HM Revenue & Customs ('HMRC') 'Mandatory Disclosure Rules - Consultation' ('the Consultation').

We note that Members of the financial services industry invested significant time and resources in recent years in complying with the EU's Directive on Administrative Compliance 6 ('DAC6'). This experience, including the unexpected repeal of this legislation in late 2020, has informed our comments here.

There are two overarching themes to our response:

1. **Practicality**. Reporting under this regime is on an exceptional basis. It is not financially viable for financial institutions to build reporting solutions. It is important that there should be a manual reporting facility, as there is under DAC6. We would also ask HMRC to consider permitting agents to make reports on behalf of financial institutions.

2. **Proportionality**. The draft regulations include at section 3 a transitional period which stretches back to 2014. This is potentially onerous on financial institutions, while the benefit to HMRC of retrospective reporting of potential arrangements which may be over seven years old is unclear. We would ask that HMRC reconsider this retrospective period to i) avoid duplicate reporting under different regulations and ii) to reduce unnecessary administrative burden on FI's who would have already conducted due diligence and reporting under CDOT and CRS.

   The draft regulations propose under section 4.5.4 that there will be no territorial limitations to the application of MDR, resulting in in-scope arrangements and structures being reportable to HMRC, regardless of what jurisdictions are involved, as long as the intermediary or taxpayer has a UK nexus. This widens the scope of reporting when compared to DAC6. We would like HMRC to confirm this is its intention, and to provide clarity regarding how HMRC would treat data received regarding a person resident in a jurisdiction which is not party to MDR.

Below we answer the specific questions included in the Consultation. We have also discussed some of these points on a conference call with the HMRC Mandatory Disclosure Team on 31

January 2022. We would be happy to elaborate on any aspect of this response if this would be of help to HMRC.

Specific Questions

Chapter 2. General Principles

Q1. Are there any areas where you consider there to be potential incompatibility between the UK regulations and guidance and the model rules or commentary which you think would be problematic for businesses seeking to apply the rules?

The main areas of concern relate to the transition provisions under section 3 requiring pre-existing MDR due-diligence and reporting and the proposed reporting rules under section 4.5.4 which remove any territorial limitations from reportable arrangements and opaque structures. Both will be challenging for business to implement as they deviate from the existing DAC6 obligations.

Transitional provisions

While we welcome the proposed limitation on retrospective reporting to Promoters and to high value accounts, we question whether the extension of the retrospective period back to 2014 will provide HMRC with any useful information. Did HMRC's experience with reporting of Hallmark D under DAC6 support this? In any event enquiry windows are likely to be closed before information is exchanged with partner jurisdictions for these early years. We also note that the preamble to the Consultation state that the intention is to obtain "early information". This would not seem to make sense in the context of a pre-existing due diligence period of over seven years.

The requirement to carry out due diligence and reporting under MDR rules back to 29 October 2014 places a significant administrative burden on businesses requiring additional resources to perform a review. Under UK regulations, there was already an obligation for Reporting Financial Institutions ('FI's') to carry out due-diligence and reporting on pre-existing accounts under FATCA from 30 June 2014, under the CDOT rules from 30 June 2014 and under CRS rules from the year ended 2015. Under anti-avoidance provisions in the 2015 regulations UK FIs were required to ignore any arrangements if the main purpose or one of the main purposes of which was to avoid CRS. It is therefore very unlikely that any UK Reporting FI would have promoted CRS avoidance schemes in this retrospective period. Can HMRC agree that UK Reporting FIs may rely on their existing AEOI procedures (including staff training) to satisfy this review requirement?

We ask that HMRC reconsider the retrospective period to i) avoid duplicate reporting under different regulations and ii) to reduce unnecessary administrative burden on FI's who would have already conducted due diligence and reporting under CDOT and CRS.

If HMRC consider that this is necessary to fully implement MDR we would welcome confirmation from HMRC that in practice this will need to be on a best-efforts basis using information available at the time of the review.

No territorial limitations

The draft regulations propose under section 4.5.4 that there will be no territorial limitations to the rules, resulting in in-scope arrangements and structures being reportable to HMRC, regardless of what jurisdictions are involved - as long as the intermediary or taxpayer has a UK nexus. This

proposal will have a significant impact on businesses from both a practical and a cost perspective as it greatly expands the volume of arrangements that will have to be analysed and tracked under the rules and shall require additional resourcing with sufficient skills to carry out this type of analysis.

We ask that HMRC provide examples in the guidance on how to apply the rules in practice. Also, we ask that HMRC provides clarity that data protection rules would be complied with when requesting information on arrangements that are implemented outside of the UK.

Chapter 3. Commencement and Transition

Q2. Do you identify any practical difficulties with the transitional provisions?

Please see our comments under Q1.

Q3. Do you agree with the government's rationale for including the reporting of preexisting arrangements? Please provide a supporting explanation for your answer, where helpful.

In principle it could be reasonable in certain circumstance for pre-existing arrangements to be included within the scope of identification and reporting, especially those which present the greatest opportunity for arrangements to be created and implemented at such time when the law was known but not yet in force. Given the elapsed time, it is however also important any such measures are well targeted and proportionate. As we note in our response to Q1 we believe the measures proposed are disproportionate for the reasons set out

Q4. Do the proposed safeguards and mitigations strike the right balance between minimising burdens on business and ensuring the regime operates effectively? Are there any other safeguards or mitigations that you think the government should consider?

When the rules operate effectively, and the law and its spirit are complied with, it should always be the promoters of CRS Avoidance Arrangements and Opaque Offshore Structures who are the key reporting parties given their closeness to the transaction and availability of information. The proposed safeguards and mitigations appear broadly appropriate in addressing this, particularly in light of the historic work completed in respect of pre-existing transactions considered under DAC 6 for all intermediaries.

One additional consideration to mitigate against this burden is that businesses would not be required to report any arrangement under MDR that had previously been reported at any time to a Tax authority under CRS/DAC2 or CDOT rules. Information has already been obtained by HMRC, so there would be no policy justification for making such arrangements reportable and subjecting business to penalties under any new rules.

Chapter 4. Key concepts

Q5. Do you have any comments on the proposed approach to identifying 'intermediaries' in the draft regulations?

We have no immediate comments on the proposals for identification of Intermediaries. The definitions appear to be in line with the OECD MDR framework and commentary and the original

DAC6 SI 2020/25 and allow for both the Promoter and Service provider definitions to be maintained under MDR.

In addition, keeping the reference to the “knowledge test” for the Service provider to include what a person “knows or could be reasonable expected to know” is important, and, as with DAC6, some guidance on this point would be helpful.

We ask that HMRC provide some practical examples of in-scope hallmarks and whether the services provided may/may not meet the criteria of the knowledge test. For instance, in the case of a Custodian involved in making routine payments to non-CRS participating jurisdictions?

Q6. Do you have any suggestions for how HMRC could improve its approach to dealing with reporting by partners and partnerships?

No comments.

Q7. Do you have any comments on the proposed approach to identifying ‘reportable taxpayers’ in the draft regulations?

It is helpful that the HMRC propose to align the OECD MDR definition of “reportable person” with the DAC6 definition of “relevant taxpayer” as this will assist FI’s with identifying those in scope taxpayers who have a reporting obligation under the MDR. The OECD definition of “reportable person” includes taxpayers that are “actual or potential users” of a CRS avoidance arrangement.

HMRC have helpfully clarified in paragraph 4.2.4, that a reportable taxpayer “would have to express some level of interest or engagement with the arrangement in order to be considered a reportable taxpayer.”

Would it be possible to include some practical examples in the guidance notes of what constitutes as “some level of interest/engagement” from a Taxpayer in order to make a reasonable judgement with identifying such engagements?

Under section 4.2.5 in relation to reportable taxpayers in offshore structures, it is also helpful that HMRC plan to maintain the exclusion of companies and other similar bodies corporate from the definition of a reportable taxpayer in an offshore structure. This is in line with the accepted definition of “beneficial owner” being a “natural person”. This will help reduce the burden for businesses only having to identify and report natural persons.

Under section 4.2.6, would it be possible for the HMRC to include some examples in the guidance of the circumstances where the definition under SI 2020/25 ought to apply?

Q8. Do you have any comments on the proposed definition and interpretation of CRS avoidance arrangements?

The proposals to align the definition of CRS avoidance arrangements and hallmarks with those outlined under the OECD MDR are helpful.

We ask that HMRC provide some practical examples of CRS avoidance arrangements, especially where a CRS non-reportable arrangement would undermine the policy intent of the CRS

legislation. For instance, in the case of transfers from CRS participating to non-CRS participating jurisdictions.

We would also ask whether HMRC have considered how the United States will be treated as an information exchange jurisdiction under MDR. There may be a case for harmonising MDR treatment with the list of CRS Participating Countries used for CRS reporting purposes.

Q9. Do you have any comments on the proposed definition and interpretation of Opaque Offshore Structures?

Section 4.4.6 of the Consultation implies that reliance on Anti Money Laundering procedures to identify beneficial ownership is no longer sufficient, and that there is a new test of having "reason to suspect". We also note that "reason to suspect" appears to be different to the more commonly used "reason to know" test, and potentially to have a much broader impact.

We do not believe a change in policy is justified and the default position should remain that service providers are unlikely to have a reporting obligation where they have followed AML procedures. However, if HMRC consider there are certain circumstances or outlier arrangements where this assumption cannot be made, we would ask that HMRC provide practical examples to aid implementation.

We would further suggest that the extent that we can't rely on the default position then the threshold test is based on "knowledge" or "reason to know" based on the appropriate knowledge of the person carrying out the AML procedures as understood from our earlier DAC 6 discussions.

There are certain "reason to know" circumstance which would benefit from guidance as well. For instance, there may be instance where a Financial Institution has reason to know that a structure is being used in order to obscure beneficial ownership from the tax authorities for a personal reason – for instance in a divorce or for political reasons. In these circumstances, it could be argued that this should not be reportable.

We would like HMRC to confirm that they intend to maintain the point in the DAC6 legislation and guidance referring to the treatment of institutional investors investing into offshore structures and entities wholly owned by one or more institutional investors, are not considered to be structures which obscure beneficial ownership? In addition, to confirm that actively traded shares of widely held entities held in a nominee name by brokers and custodians would not typically trigger reporting obligations under MDR?

Q10. Do you have any comments on the proposed approach to identifying reportable arrangements and structures?

Under section 4.5.4, the draft regulations propose that there will be no territorial limitations to the rules so arrangements and structures will be reportable regardless of what jurisdictions are involves as long as the intermediary or taxpayer has a UK nexus.

Given that this proposal is broader from the requirements under SI2020/25, would it be possible for the HMRC to provide some examples of what arrangements and structures could be in scope of this obligation where they occur outside of the UK and how they need to be linked to a UK entity in order to fall in scope for reporting?

In addition, can HMRC outline how data protection obligations will align with this obligation to obtain information on structures and arrangements that operate outside of the territorial scope of the UK? HMRC will be aware that there are severe financial penalties on FIs that fail to comply with data protection requirements.

Chapter 5. Reporting obligations

Q11. Do you have any comments on the proposed structure of the reporting obligations for both intermediaries and reportable taxpayers?

Section 5.1.4 of the draft regulations references the MDR legislation that has been published in the crown dependencies of Guernsey, Jersey and Isle of Man. Does this mean that the intention is for the reporting and exchange of information to be carried out between the UK and UK Crown Dependencies under MDR - similar to the CRS rules that were implemented through CDOT? If yes, does the HMRC expect that the UK Overseas Territories such as Cayman Islands will also follow suit?

Q12. Do you have any comments on the application of the exemptions from reporting?

There is no reference to an “arrangement id” which was provided for under DAC6, enabling intermediaries to share details of an arrangement that was already reported with other intermediaries and provided a level of comfort that an arrangement had been reported by another intermediary.

Would it be possible for HMRC to provide guidance/clarity on what will be deemed as acceptable evidence in order to exempt an intermediary from the obligation of reporting where the arrangement has already been reported by another intermediary?

With regard to section 5.3.4 of the draft regulations, can HMRC confirm if the UK will exchange information gathered under OECD MDR rules with other partner jurisdictions that have signed up to CRS but have not yet implemented the OECD MDR rules, or if exchanges be limited to partner jurisdictions that have also legislated for the OECD MDR in addition to CRS?

In addition, will the UK be exchanging reporting received under the OECD MDR framework with other EU jurisdictions under the DAC6 framework or will new agreements be required?

Q13. Do you have any comments on the proposed penalty regime?

No comments.

Chapter 6. Practicalities of reporting

Q14. If you need to make a report under the new regulations, what methods could you use?

A report under the MDR would likely be filed using the online manual data entry tool. As UK Finance Members are predominantly brought within scope of the regulations in their capacity as a Service Provider, the volumes of reportable transactions are generally non-existent or very low. This is evidenced from the work completed to date under Hallmark D within DAC6. To build an

inhouse IT solution or purchase an external tool to enable reporting under the MDR would be uneconomical, especially when the costs would be incurred by each Financial Institution.

As discussed on the call held between UK Finance and HMRC MDR team on 31 January 2022, we would invite HMRC to consider whether MDR could adopt the CRS rules which provide that branches are entities in their own rights and that reporting sits with the entity which maintains the reportable account. This would mean that reporting is the responsibility of a branch, rather than a head office, where the branch maintains the account. This would provide welcome clarity and alignment with the CRS provisions.

Q15. Would you expect to report to HMRC yourself or would you want someone else such as an agent to report on your behalf?

Consistent with other exchange of information regimes, having the option of both methods of reporting would be beneficial.

Q16. If your preferred method of reporting was not available, please explain whether this would cause significant difficulties for you or your organisation and why?

If the preferred method of reporting was not available this would present significant challenges to members. It is worth noting, as highlighted in question 14, reporting volumes are anticipated by members to be very low. Combining this with the 30 day timeframe for reporting, which is already very tight, means that a simple solution is needed.

Due to the nature of funding cycles and IT resource constraints large financial institutions always require a lead time of 18 months in order to be able to build, test and operationalise IT solutions. As most members relied on the previously available HMRC online tool for DAC 6 reporting, the unexpected removal of this option would risk many members being unable to report on time based on the legislative timetable of a Summer 2022 implementation. The aggregated cost for all members of building such a solution when it may never be needed, or only needed a handful of times, is also concerning and feels disproportionate to the activity observed under DAC 6, Hallmark D.

Whilst a number of third parties are likely to make XML reporting solutions available, it would not be practical to engage with such parties on an ad-hoc basis once a reportable arrangement is identified given the 30 day reporting timeline and the time required to complete necessary internal governance and approval processes.

Chapter 7. Assessment of impacts

Q17. Do you have any comments on the expected impacts of this measure?

In addition to the comment above, we would ask HMRC to provide clarity on the treatment of overlapping DAC6 and MDR reporting requirements, and to provide a steer on their approach to the alignment of the implementation of MDR in the UK with other implementing jurisdictions.

If you have any questions relating to this response, please contact Mark Schofield (mark.schofield@ukfinance.org.uk)