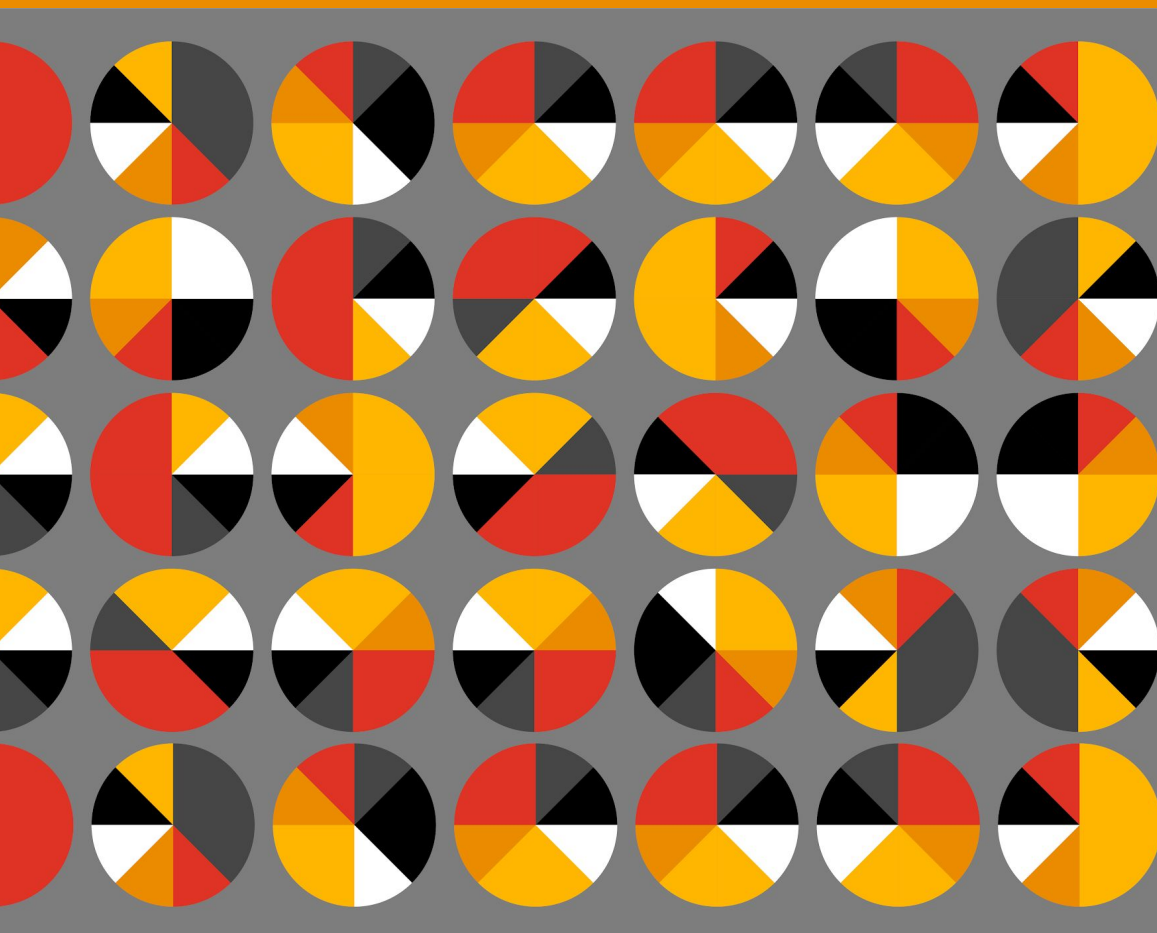


EU's Mandatory Disclosure Regime ("EU MDR") Implications for Middle East businesses

March 2020



In brief

Under a recent European Union (“EU”) Directive, the EU Mandatory Disclosure Regime (“MDR”) imposes mandatory reporting of potentially aggressive tax planning arrangements involving EU Member States (also known as “DAC6”).

EU MDR came into force on 25 June 2018 however the deadline for disclosure is fast approaching, by 31 August 2020.

This regime is broadly drafted and may capture various ordinary commercial transactions (e.g. equipment leasing agreements, etc.)

Implications for businesses in the Middle East

EU Advisers to or intermediaries for Middle East based individuals and companies undertaking transactions into or within the EU may be obliged to make a disclosure to EU tax authorities.

In detail

The Council Directive (EU) 2018/822 amending Directive 2011/16/EU in regards to the mandatory automatic exchange of information in the field of taxation aims to mandate the disclosure of cross-border arrangements by EU based intermediaries or taxpayers to the tax authorities and requires the automatic exchange of this information among the EU Member States.

EU MDR applies to cross-border arrangements, either involving more than one Member State or concerning a Member State and a third country.

A hallmark has to be met for the cross-border arrangement to be reportable, that may or may not be subject to the tax main benefit test.

If a Middle East business has the obligation to report, it is in the member state where it:

- Is resident for tax purposes
- Has PE benefiting from the arrangement;
- Receives income or generates profits, if it has no PE; or
- Carries on an activity, if it has no PE.

Who is an intermediary?

An intermediary is any person (individual or a company such as banks, asset managers, funds, accountants, lawyers, bankers, etc.) that designs, markets, organises or makes available for the implementation or manages the implementation of a reportable cross-border arrangement. Such intermediaries should report information on the arrangements to the tax authorities of their home Member State. If a Middle East based bank or other intermediary has an EU branch/subsidiary/taxable presence, it will be subject to the EU rules and the disclosure obligation will be on the EU branch/subsidiary. If there is no EU intermediary with an obligation to report, the EU taxpayer itself has an obligation to report.

What is a reportable arrangement?

An arrangement will be reportable if it meets at least one of the Hallmarks categories.

What is a hallmark?

A hallmark means a characteristic or feature of a cross-border arrangement that presents an indication of a potential risk of tax avoidance. There are several hallmarks and these are split between hallmarks which require the main tax benefit test to be met and hallmarks which do not require the main benefit test to be met. The hallmarks are split between 5 categories which are lettered from A to E.

Hallmarks which require the main benefit test to be met

The main benefit test would be satisfied if it can be established that the main benefit or one of the main benefits for an arrangement is to reasonably expect to obtain a tax advantage (having regard to all relevant facts and circumstances).

A. Generic hallmarks - Certain confidentiality and fee arrangements with intermediaries and the use of standardized documentation and/or structures.

B. Specific hallmarks - The following types of cross-border transaction: Acquiring a loss making company, converting income into capital which is taxed at a lower level or exempt from tax, and circular or offsetting transactions.

C. Specific hallmarks related to cross border transactions - Tax-deductible cross-border payments between two or more associated enterprises, where the recipient is resident in a state where the corporate tax rate is zero or "almost zero" (not defined), or the receipt benefits from a full exemption from tax, or the receipt benefits from a preferential tax regime.

Hallmarks which do not require the main benefit test to be met

C. Specific hallmarks related to cross border transactions - refers to tax-deductible cross-border payments between two or more associated enterprises, where the recipient meets a certain set of requirements.

D. Specific hallmarks concerning the automatic exchange of information and beneficial ownership - includes structures involving holding companies and trusts, whereby the identity of the beneficial owners is made "unidentifiable".

E. Specific hallmarks related to transfer pricing - concerns transfer pricing and includes arrangements involving unilateral "safe harbor" rules, arrangements involving the transfer of hard-to-value intangibles; and cross-border transfer of functions/risks/assets which result in the EBIT of the transferor to fall to less than 50% of what it would have been if the transfer had not been made.

The EU MDR rules go live in four months. There is still a material amount of ambiguity which is unlikely to be fully addressed and time is now running short. Firms need to ensure they are ready to meet the requirements and demonstrate compliance.

Recent Developments – 2020 YTD

- EU has written to 10 EU countries requesting explanation as to why regulations were not introduced by 31 December 2019.
- Regulations otherwise have been largely finalised.
- Draft Guidance has been/is being updated.
- Cayman Islands has been added to the EU list of uncooperative jurisdictions.
- Countries have started to issue reporting schema e.g. Germany with a large data set.

What to expect between now and the end of June

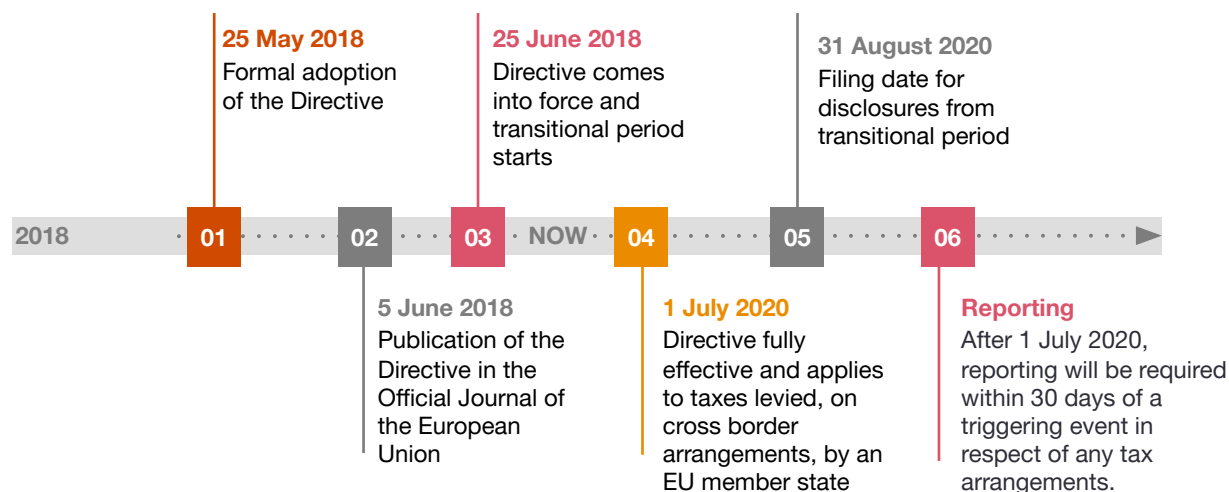
- Further dialogue with tax authorities.
- Finalisation of guidance.
- Potential clarification on key areas of ambiguity.
- Issuance of final reporting schemas.

Timeline

Although the directive is not effective until 1 July 2020, taxpayers and intermediaries need to monitor their cross-border agreements as of 25 June 2018.

Under the MDR, cross-border arrangements where the first step is taken after 25 June 2018 and before 1 July 2020 must be reported no later than 31 August 2020, and Member States will automatically exchange this information.

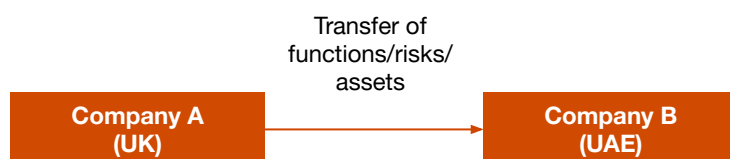
After 1 July 2020, intermediaries and taxpayers will be required to report within 30 days of a triggering event in respect of any tax arrangements.



Illustrative Example

Transfer of operations from one jurisdiction to another

Company A in the UK transfers operations from the UK to Company B in the UAE



Scenario

- Transfer of operations from the UK to the UAE.

Potential application to EU MDR

- Is there an arrangement? – **Yes**
- Is the arrangement cross-border? – **Yes**
- Does it involve either more than one Member State or a Member State and a third country? – **Yes**
- Is there a tax main benefit? – **No**
- Are any of the other hallmarks met? – **Potentially, Hallmark E (Transfer of functions, risks, assets reducing EBIT by >50%)**
- Is the arrangement reportable? – **Yes**

Implications

Businesses operating in the Middle East are not protected from reporting under MDR if they are transacting into or within the EU through an EU branch or subsidiary and a thorough assessment should be done to identify whether MDR reporting could arise.

Middle East business' if caught by the rules should be identifying who has the reporting obligation and if it is a third party advisor ensuring the disclosures are factually correct before being made.

If the Middle East business itself has the reporting obligation then it should be ensuring that it knows what has to be disclosed in the relevant EU member state and by when.

Failure to comply with DAC6 could mean facing significant sanctions under local law in EU countries and reputational risks for businesses, individuals and intermediaries.

How can PwC help?

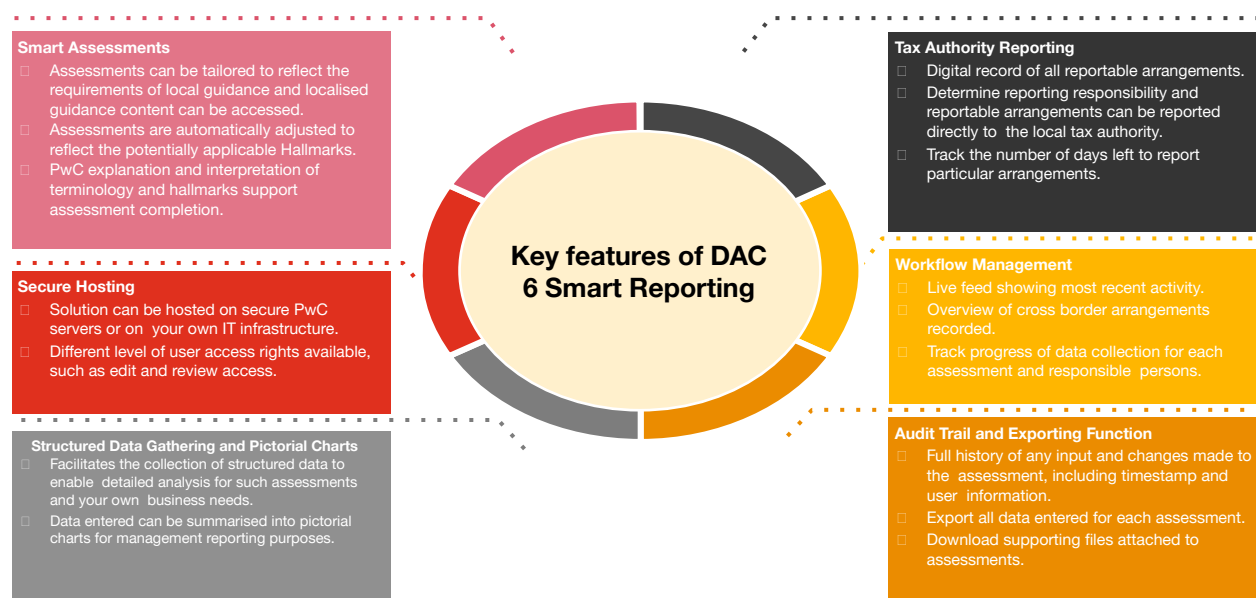
Individuals and companies in the Middle East Region should consider conducting an impact assessment to measure its exposure to the EU MDR. If any reportable arrangements are found, individuals and companies are recommended to manage the backlog of the reportable arrangements as of 25 June 2018 and begin developing a new governance framework to capture and report reportable arrangements ahead of 31 August 2020.

Our team combines experts in tax, people, processes, data and technology. By bringing together these different skill sets, we can help clients to understand DAC6, and the broader tax policy context, and implement effective controls and processes to ensure all reportable cross-border arrangements are proactively identified and managed.

- **Impact assessment:** We can analyze your current and planned activities so that you understand the impact the directive has on your reporting obligations.
- **Manage the backlog of reportable arrangements** - looking back to the arrangements entered into since 25 June 2018 and preparing these for reporting.
- **Governance framework:** We can help you to develop a comprehensively documented governance framework to define roles and responsibilities with respect to the reporting obligations and to identify and manage risks.
- **Reporting:** Using technology, we can assist you to fulfill multiple reporting requirements using the same data set and reporting mechanism in the required format, and with preparing the necessary paperwork.
- **Communication:** Developing an internal and external communication strategy building awareness within the organization through training and considering policy decisions and other entities in the group.

EU MDR - PwC Smart Reporting Tool

PwC has developed a solution to support businesses with EU MDR classification of transactions and reporting to EU competent authorities.



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Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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