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Dear Sir or Madam

INTRODUCTION

The CLLS represents approximately 21,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 22 specialist committees. This response to the Consultation has been prepared by the CLLS Tax Committee. The current members of the Committee can be found at www.clls.org.

This technical response is made on behalf of the City of London Law Society Tax Committee, and relates to the Cryptoasset Service Providers (Due Diligence and Reporting Requirements) Regulations 2025 ('**the CARF Regulations'**) published in draft form on 30 October 2024, implementing the OECD's CARF rules into UK law.

Whilst the response focuses on two aspects of the CARF Regulations in particular (obligations and penalties for cryptoasset users, and the anti-avoidance provision), we have also included some general comments about the manner of implementation of CARF and other OECD provisions into domestic law.

1. **Implementation and interpretation of CARF**

1.1 The CARF Regulations, once enacted, will be the latest in a series of statutory instruments giving effect to OECD arrangements for the international exchange of tax information, earlier examples including the International Tax Compliance Regulations 2015 ('**the CRS Regulations**'), the International Tax Enforcement (Disclosable Arrangements) Regulations 2020 ('**the MDR Regulations**') and the Platform Operators (Due Diligence and Reporting Requirements) Regulations 2023 ('**the Platform Operators Regulations**') (together the '**Regulations**"). The draft CARF Regulations follow the same format as these earlier Regulations, which is to implement complex OECD rules (and guidance - see below) into UK law with minimal interpretation or adaptation. In some cases, for example the penalty regime, the equivalent provisions of the Platform Operators Regulations have been included, despite the fact that those regulations have not been in force long enough for government and industry to understand how well the provisions will work in practice.

1.2 We would observe that, the draft CARF Regulations rely even more heavily on cyptoasset service providers having knowledge and understanding of the underlying OECD provisions, than do the earlier Regulations. The draft CARF Regulations lacks some of the clarification included in earlier Regulations; for example, clarification on the UK law meaning of 'Entity' is included in the Platform Operators Regulations (at paragraph 2(1)(4)(c)) but there is no equivalent clarification in the CARF Regulations. Amendments made in 2017 to the drafting of the CRS Regulations (for example, to the anti-avoidance provision at paragraph 23, see further below) have not been taken into account in drafting the CARF Regulations. We would recommend that the draft CARF Regulations are reviewed, taking into account the value that such clarifications provide for taxpayers who may be unfamiliar with the underlying OECD provisions.

1.3 We have also noticed a change in the approach taken to OECD Commentary in the past few years. Whereas in the past OECD Commentary has been viewed as a mere aid to interpretation and has had only persuasive authority, HMRC practices in this regard appear to be changing. Paragraph 2 of the draft CARF Regulations define the relevant "rules" as *"the rules and commentary set out in the OECD Crypto-Asset Reporting Framework"* (emphasis added). This *prima facie* gives the OECD Commentary more than mere persuasive authority – it incorporates the OECD Commentary into the draft CARF Regulations such that it has binding legal effect.. By way of example, this will mean that, pursuant to draft CARF Regulation 3(2), notifications given under I(H) of "the rules" must adhere to the corresponding commentary – that commentary will not be applied as an interpretive aid in a case of ambiguity or otherwise, but forms a substantive part of the legislation.

1.4 This is in contrast to past practices whereby OECD Commentary has had only persuasive authority. For example IEM220700 explains that, in the context of the CRS Regulations, *"commentary to the model tax convention is a useful tool in interpreting certain key terms and concepts in exchange of information".* If the intention was to include the OECD Commentary as part of implementation of the OECD CARF rules into UK law, this should have been drawn to the attention of industry participants and other stakeholders, to provide the opportunity to comment on such Commentary at an early stage of its development. We would recommend that the definition of "rules" is amended to remove the reference to OECD Commentary in order to be consistent with the approach to OECD commentary adopted in prior Regulations.

1.5 By way of a technical point on interpretation, as noted above the draft CARF Regulations rely on the definitions of several terms in the OECD CARF rules. In order for this to be effective, the term used in the domestic legislation should be identical to the OECD term. The OECD rules use the hyphenated formulation 'crypto-asset' throughout; we would suggest that the CARF Regulations should be amended to adopt the same formulation (instead of 'cryptoasset' as currently used in the draft CARF Regulations).

2. Obligations and penalties for crypto-asset users (paragraphs 5 and 13 of the CARF Regulations)

2.1 The draft CARF Regulations include an obligation (paragraph 5) on cryptoasset users to provide self-certification when requested to do so by a UK reporting cryptoasset service provider. A user who fails to provide such self-certification on request may suffer a penalty (paragraph 13). We note that the government also proposes to amend the CRS Regulations to include a similar provision (new paragraph 12GA of the CRS Regulations), together with penalties for failure (new paragraph 22H of the CRS Regulations).

2.2 In our view, imposing penalties on individual (and 'entity') cryptoasset users for failure to respond to a self-certification request is disproportionate and will have negative impacts on the UK cryptoasset industry. The emphasis in the original Consultation document was on the penalty regime applying to RCASPs for failure to **collect** valid self-certification, rather than on the possibility of penalties for crypto-asset users for failure to **provide** self-certification; therefore cryptoasset industry participants may not have realised that the UK was considering this possibility, and that they were being asked to comment on the proposal.

2.3 Whilst we understand the need for 'strong measures' to encourage compliance with CARF, there is no expectation within the OECD CARF rules themselves, that jurisdictions will impose obligations directly on cryptoasset users, and there are other ways in which compliance could be achieved. For example, there is no equivalent obligation imposed directly on sellers to self-certify under the Platform Operators Regulations, and no penalties for failure to do so. Rather, guidance to reporting platform operators ('**RPOs**') in HMRC's International Exchange of Information manual states:

Where a Seller, explicitly or otherwise, declines to co-operate with the RPO, the RPO would need to consider what further action if any to take. This could include actions such as temporarily suspending the Seller's access to the Platform until the Seller starts to co-operate, e.g. by providing further documentation or addressing the RPO's questions or concerns (see 902430). It is up to the RPO to decide in the circumstances what action(s) it will take, but it is ultimately the responsibility of the RPO to ensure it meets its due diligence obligations.

As noted above, the Platform Operators Regulations are very new, however there is no reason to think that this approach has not been sufficient to ensure sellers comply with requests for self-certification. Equivalent measures in the CARF Regulations would be an alternative way of ensuring that cryptoasset users provide valid self-certification. Indeed, it might be seen as unfair to single out cryptoasset users for penalties, and even create a stigma around cryptoasset use.

2.4 Further, cryptoasset users may well be unaware of their obligation to self-certify, and potential penalties for failure to do so. It is unclear what steps cryptoasset service providers are required to take to bring their request for self-certification to the attention of the user, such that penalties for non-compliance could be triggered? Standard forms, and obligations contained only in 'the small print', are easily overlooked; whereas overly detailed requests could be seen as inconvenient and thus create barriers to participation in cryptoasset activity. The multiplicity of reporting regimes which now exist could increase the number of such requests an individual receives, making inadvertent non-compliance more likely.

2.5 We also note that the draft CARF Regulations do not include a timeframe for the provision of self-certification following a request, meaning that the timing of imposition of penalties under paragraph 13 is currently unclear. We would recommend that clarificatory drafting is included in the draft CARF Regulations in relation to deadlines for provision of information where failing to do so could result in a penalty.

2.6 As there is no equivalent provision in the Platform Operators Regulations (on which the penalty regime in the CARF Regulations is stated to have been modelled), there has been no indication of the level of penalty proposed. We would suggest that, if (contrary to our strong preference) penalties are imposed as currently suggested, such penalties should be very low for the reasons stated above. As presently drafted, there is no exemption for cryptoasset users who do not have taxable profits from their crypto asset transactions. In this case, there is no loss to the exchequer where information is not reported, and yet the

failure to self-certify itself carries a penalty. We would therefore recommend that at the very least the penalty at paragraph 13 is set at the lesser of the amount of tax payable by the crypoasset user in respect of the relevant transaction and £[amount]. We would also encourage HMRC to adopt a reasonable grace period following implementation of the CARF Regulations before any penalties apply. This should be a sufficient period to allow cryptoasset platforms falling within the scope of the CARF Regulations an opportunity to implement all necessary internal systems to ensure compliance with the regulations and the time to adopt effective communication systems with their users in relation to the collection of information and self-certification.

2.7 The stated aim of CARF is to address tax compliance risk; surely a better way to achieve this aim, whilst encouraging participation in cryptoasset activity, is to make it as easy as possible for cryptoasset users to accurately report taxable transactions in cryptoassets. HMRC resources would be better directed to helping taxpayers do this, for example, by supporting cryptoasset service providers to notify users of information regarding their taxable transactions, than pursuing individuals for failed self-certification.

3. **Anti-avoidance provision (paragraph 26 of the CARF Regulations)**

3.1 The anti-avoidance provision at paragraph 26 requires further thought. As currently drafted, if any person enters into avoidance arrangements, reporting cryptoasset service providers (and presumably others) are to apply the CARF Regulations as if those arrangements had not been entered into. This is the case even if the service provider is not a party to the avoidance arrangements, and indeed even if they are not aware of the arrangements. At the very least, regulation 26 should be amended so that it applies only to arrangements (i) to which a reporting cryptoasset service provider (or other person having obligations under the CARF Regulations) is a party and (ii) the main purpose (or one of the main purposes) of the arrangements is to avoid an obligation which would otherwise fall on that service provider (or other person). This would reflect the drafting of the equivalent anti-avoidance provision (paragraph 23) of the CRS Regulations.

3.2 We would also suggest that only the parties to the arrangements should be required to apply the CARF Regulations as if the avoidance arrangements did not exist. This would avoid inadvertent breaches of the CARF Regulations by other persons who may have no knowledge of the avoidance arrangements and yet, with paragraph 26 in its current form, would be expected to apply the Regulations as if those arrangements did not exist (and presumably to hypothesise an alternative arrangement to that which in reality exists).

3.3 Further, paragraph 26 as currently drafted is technically ineffective, as it does not exclude itself from its disapplication of the Regulations. If avoidance arrangements exist, the Regulations (including regulation 26 itself) are to have effect as if the arrangements had not been entered into; but in the hypothetical situation where the arrangements had not been entered into, regulation 26 would not itself apply (because there would be no avoidance arrangements), and therefore the situation is circular.

CONTACT DETAILS

Should you have any queries or require any clarifications in respect of our response or any aspect of this letter, please feel free to contact me by telephone on 020 7296 5783 or by email at Philip.harle@hoganlovells.com.

Yours faithfully

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Chair City of London Law Society Revenue Law Committee