Not so last year

Management of taxes

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John Cassidy and Hayley Ives explain why the Liechtenstein Disclosure Facility is still relevant

Key Points

What is the issue?

There are still common misconceptions about taxpayer eligibility for the LDF, not helped by the restrictions on access to ‘full favourable terms’ since August 2014

What does it mean for me?

All advisers encounter instances where clients need to make a disclosure of underpaid tax to HMRC. Advisers need to recognise cases in which the LDF may be appropriate and when to refer them to investigations specialists to avoid potential claims under their professional indemnity insurance

What can I take away?

A better awareness of cases that may benefit from the LDF

The Liechtenstein Disclosure Facility (LDF) has operated for five years and is due to expire on 5 April 2016. Nevertheless, the principality's government and HMRC have continued to vary the arrangements, with the fourth joint declaration signed on 14 August 2014.

The newest memorandum of understanding updates several aspects of the LDF, including:

- introduction of a single charge rate (SCR) for the 2011/12 and 2012/13 tax years; and
- a definition of restrictions on eligibility for the full favourable terms of the LDF for certain participants.

Professional advisers need to keep up to date with the changing disclosure facilities to ensure opportunities are not missed.

Although there are several ways to make voluntary disclosures to HMRC, the LDF continues to offer extremely beneficial terms, despite the new restrictions on eligibility, and remains one of the most direct routes of disclosing to HMRC.

The LDF is commonly overlooked, perhaps because taxpayers and advisers hold the misguided view that it was designed only for wealthy individuals with offshore tax issues. However, there are many scenarios in which participation in the LDF is not obvious, but could prove beneficial. These include:

- taxpayers with undeclared income/gains relating to UK business activities/assets; and
- trusts, whether onshore or offshore.

Recap of the LDF benefits

The message that the LDF offers extremely beneficial terms is undisputed among tax investigation practitioners.

Taxpayers can still acquire ‘relevant property’ in Liechtenstein until 5 April 2016 and, if they held an offshore asset of any nature anywhere in the world on 1 September 2009, they qualify for all beneficial terms of the agreement (unless the new restrictions apply), including:

- a shortened assessment timeframe, starting from 1999/2000;
- a fixed penalty of 10% up to and including 2008/09; and
- the potential to elect for the composite rate option (CRO) and SCR.

It should be remembered that, even where there are restrictions on the full favourable terms, participants in the LDF will still achieve immunity from prosecution and the use of HMRC’s bespoke service. This gives access to a named person at HMRC and matters can be discussed on a no-names basis.

Perhaps because of the need to hold an offshore asset at 1 September 2009, there is a common misconception that the LDF was intended to be used only by wealthy Swiss bank account holders to regularise the tax affairs of those overseas assets. This is untrue. There is no need to have held an offshore asset at all in order to access the LDF. As long as taxpayers have not been notified that they are being investigated criminally or under Code of Practice 9 (COP 9), they are eligible to register for the facility when they have acquired relevant Liechtenstein property.

Restrictions on eligibility for full favourable terms

The additional circumstances announced in August 2014, in which a participant in the LDF will not be entitled to access all its terms, are:

1. The relevant person enters the LDF to settle liabilities HMRC is already aware of (note, if a disclosure is made about known and unknown liabilities, the restriction on favourable terms applies to the known information only).
2. The issue being disclosed has already been subject to an intervention that started more than three months before the date of application (for example, a section 9A enquiry or where a determination or assessment has been issued).
3. There is no substantial connection between the liabilities being disclosed and the offshore asset held by the relevant person as at 1 September 2009 (meaning less than 20% of the liabilities disclosed relate to that offshore asset).

Professional advisers need to take care when interpreting the above restrictions and take expert advice. More importantly, they should not overlook the fact that the restrictions do not prevent access to the LDF altogether; they merely limit the favourable terms available.

It is always best for a taxpayer to voluntarily declare any insufficiency to HMRC, whether brought about innocently, carelessly or deliberately. Not only does this type of proactive action show good faith with HMRC, it also has a massive impact on the overall penalty position.

The LDF remains an excellent disclosure mechanism given the structured process, the single point of contact at HMRC and the fact that it is a disclosure made to the Revenue, rather than a lengthy investigation by the department that has no pre-ordained end date. The effect is that matters are generally dealt with more quickly and the taxpayer suffers less stress than when engaged in a continuous debate with HMRC.

In cases where any of the above restrictions apply, the taxpayer will not be eligible for the shorter limitation period, the fixed penalty or the CRO/SCR under the LDF. Everything else remains available.

Scenario 1 – tax problems closer to home

It is foolish to believe that HMRC are interested only in offshore evasion.

Much investment has been made in the new ‘Connect’ analytical software, allowing HMRC to build a detailed picture of a taxpayer’s wealth and financial affairs to help them identify and investigate fraudulent behaviour and general tax irregularities. HMRC are also assigning more resources to increase the pace and number of tax evasion cases being brought before the criminal and civil courts, leading to employment of extra investigators and risk and intelligence staff.

Taxpayers with issues resulting from UK assets and business activities should always come forward and make a voluntary disclosure before HMRC catch up with them. Advisers need to be pragmatic when making recommendations on how the taxpayer should make a disclosure. For example, if a taxpayer realises he made a one-off chargeable gain exceeding the annual exemption in a previous year which was mistakenly left off his return (and the time limit to amend the return has passed), this is unlikely to warrant the use of the LDF unless fraud is involved and there is a strong risk of prosecution. Obviously the shortfall should be disclosed quickly to HMRC and arrangements made to pay the additional tax, interest and any penalty.

In the following scenario, an individual has been a self-employed electrician for 16 years. He subcontracts for various firms on different phases of projects.

Tax is deducted from his gross pay under the construction industry scheme (CIS) and these amounts are declared on his annual tax returns. In addition, the electrician does a lot of private work in the evenings and at weekends, sometimes receiving cash, sometimes cheques, which supplement his subcontracting earnings considerably. The taxpayer declares most of the cheque payments on his self-employed pages because he knows there is a paper trail, but not the cash.

The electrician has recently bought a brand new car and brags on Facebook about how much money he is earning.

He learns about HMRC’s Connect system, which draws together all kinds of data (including bank account information, activity on websites such as Autotrader, eBay, Gumtree and social media sites) that are likely to raise suspicion about his tax figures when compared with his lifestyle.

He is also paranoid that his neighbour is about to report him using HMRC’s tax evasion helpline.

He has heard about the LDF, but has been told that he is ineligible because he has never held an offshore asset and his tax problem relates solely to his UK business activities.

Clearly, the taxpayer has been deliberately under-declaring his profits from self-employment. If HMRC discover this before the taxpayer comes forward, they may either prosecute him or launch an investigation under COP 9. Either way this is not good news. COP 9 enquiries can go on for a long time, and the taxpayer will be subject to a stressful investigation involving frequent data requests and questioning by HMRC.

This is the sort of case that is perfect for the LDF. Of course, all of the beneficial terms of the facility will not be available because the taxpayer did not own an overseas asset at the relevant date.

The shortened time limit will not apply because the understatement results from deliberate behaviour, although in this case he only has 16 years of underpaid tax to declare. The fixed penalty and use of CRO/SCR will not be available.

However, assuming the taxpayer now uses the LDF to make a full disclosure, he will be immune from prosecution, will have access to the ‘bespoke’ service and will not be investigated by HMRC after registering with them.

Taxpayers are given up to ten months to draft and submit their disclosures with no risk of any interrogation by HMRC during that period. Appealingly, the risk of a lengthy open-ended investigation is diminished. Once the disclosure has been reviewed, HMRC are not obliged to accept it if there are areas that require further explanation, and so questions may arise.

Experience has shown that members of HMRC’s LDF team are approachable and pragmatic, which usually leads to swift settlement of past tax liabilities, even if further queries arise.

The taxpayer in this example will have peace of mind that he will not face prosecution and will be given breathing room to quantify and disclose the shortfalls. He is likely to save money on professional fees because there will be less interaction between his adviser and HMRC than if there was a COP 9 investigation. The penalty will be lower because he made an unprompted disclosure and gave maximum assistance in quantifying how much tax was outstanding. Once the offer is finally accepted, leading to a binding contract settlement, he can feel confident that HMRC will not come after him in respect of these past liabilities.

Even if HMRC have already started an enquiry, the LDF can still be accessed. For example, if the electrician had already been approached by HMRC and had admitted wrongdoing, he can switch out of the enquiry and into the LDF as long as COP 9 or criminal proceedings are not under way.

It should also be noted that there is no need for the taxpayer to have been fraudulent and at risk of COP 9. As noted above, anyone with tax problems to resolve with HMRC can use the LDF.

Scenario 2 – trusts

Trustees have a number of legal obligations to fulfil which depend of the type of trust they administer, as well as any clauses set out by the settlor in the trust deed.

From a tax perspective, trustees are responsible for accounting for the income and gains of the trust and declaring this to HMRC on a timely basis. Trustees are also responsible for reporting inheritance tax (IHT) events to HMRC and paying the correct amount on time. Typically, IHT results from ten-year charges and ‘exit’ charges on distribution of trust capital to beneficiaries.

Trustees elected to deal with small family trusts or otherwise are not commonly ‘professional’ trustees. The tax implications can easily be overlooked.

Many IHT issues go unnoticed because there is no prompt from HMRC, leaving it to the trustee to recognise when there is a tax event. Even if the trustee does register an IHT liability, there can be doubt about whether distributions made to beneficiaries should be treated as capital or income distributions, which can result in underpaid tax. It is inevitable there will also be offshore trusts with exposures to UK tax which historically have not been appreciated.

Whatever the reason, experience shows that there are likely to be trustees with outstanding tax issues to rectify, even if they do not realise it. The LDF may prove a beneficial tool, whether or not the trust held an offshore asset at 1 September 2009. If it did, even better, because the trustee may be able to elect to use the CRO for all years 1999/2000 to 2008/09, subject to the restrictions since August 2014. This would mean paying tax on all income and gains at a flat rate of 40% with any IHT resulting from undeclared ten-year and exit charges falling away.

The LDF can also be used to fully disclose the background and details of the trust so that any non-financial or unclear issues can be aired and agreed with HMRC.

This covers, for example, the true nature of the trust (is it genuinely discretionary?) or other matters such as whether it is an excluded property trust.

It is not uncommon for ten-year charges to have been missed or for trust assets to have been historically thought of as excluded property when they might not be, perhaps due to doubt over the domicile status of the settlor. In such scenarios, the LDF can lead to the correct position being agreed with HMRC – if this leads to agreement that no ten-year charges are due all well and good; if not, the CRO/SCR can remove the ten-year charge liabilities anyway.

Summary

It is clear that the LDF can be used in many circumstances, not just for offshore evasion, so tax advisers should not discard it. We have encountered various scenarios as well as those included above. These might include non-domiciled taxpayers who have made a mistake about their remittance basis, a complex area in itself, and elderly taxpayers who, having already suffered UK taxes, did not realise that the interest arising on an offshore bank account should be declared here.

For clients faced with making disclosures to HMRC, advisers should always question whether the LDF is suitable. Not every case will benefit from this, but considering the possibility will stave off any professional negligence claims for not bringing it to the client's attention. Anyone apparently advising on tax investigation matters who does not recognise and advise on the potential to use the LDF in the right circumstances may find themselves subject to a claim later.

Earlier this year, Crowe Clark Whitehill's Tax Investigations Group published its fourth annual survey of general practitioner accountants. It concluded that there are many issues parties on both sides should address, including that accountants are potentially missing opportunities to square their clients' tax affairs with HMRC through beneficial disclosure facilities. The findings suggest that every accountant has clients who would benefit from making a properly managed disclosure under one of the available HMRC facilities, but a lack of understanding of these facilities means that is not happening.

The same issue has been addressed in the 2014 survey.

The earlier survey also found that a quarter of accountants had not made their clients aware of the LDF and stated that nothing would persuade them to change this approach. Perhaps this will change if they realise that it can benefit all sorts of clients, not just those with vast offshore assets.