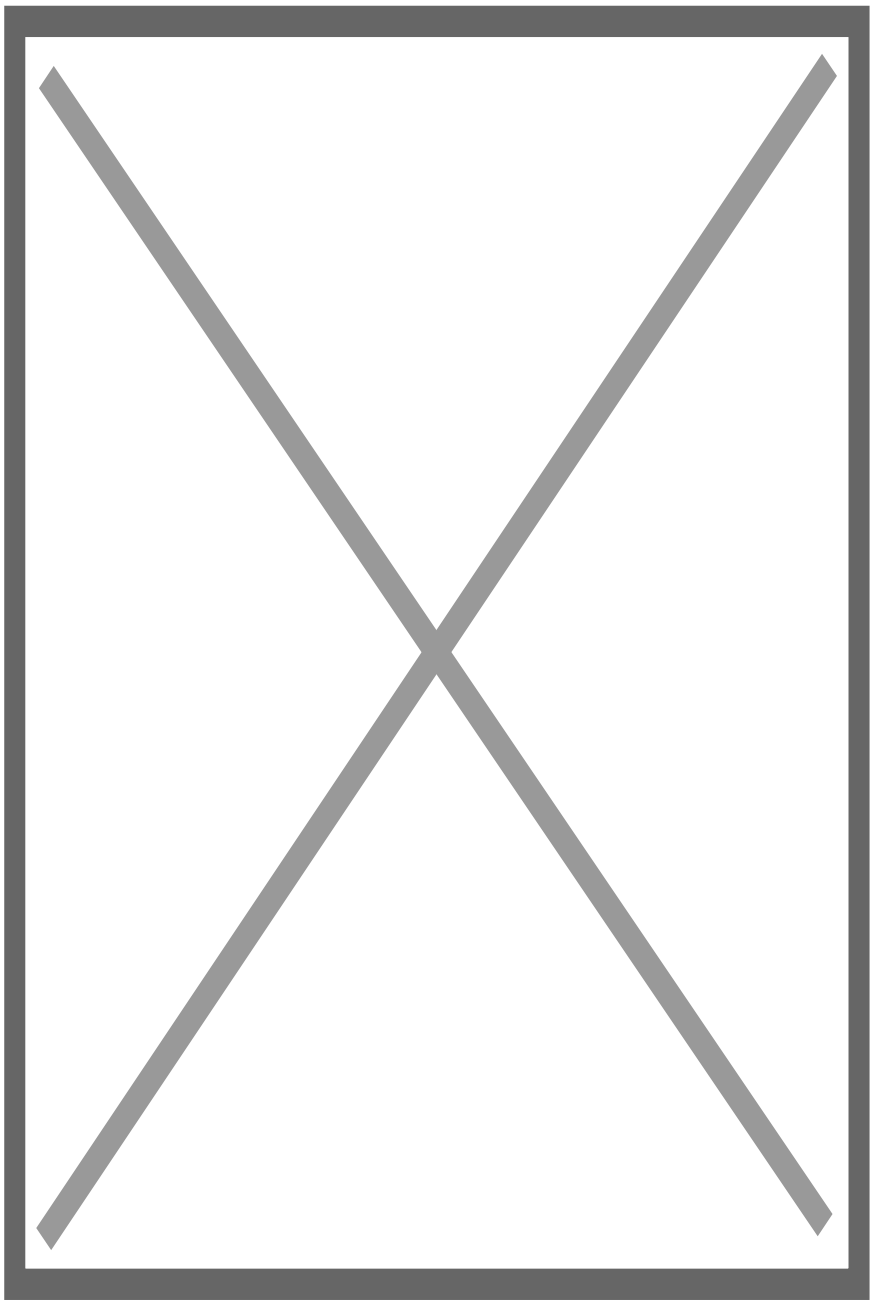
Under pressure

Management of taxes



01 February 2016

Helen Adams and *Jonathan Pitkin* consider the tougher environment taxpayers will face for offshore evasion

Key Points

What is the issue?

HMRC is further strengthening its ability to tackle offshore evasion. Finance Bill 2016 introduces criminal offences for offshore evasion as well as tougher civil sanctions for taxpayers and those who ‘enable’ others to ‘evade’

What does it mean to me?

Clients and advisers need to be aware of the proposed rules and their impact. Some taxpayers may need to review arrangements in place and their domicile status. If issues are identified serious consideration should be given to making voluntary disclosures to rectify past years’ liabilities before HMRC opens its own investigations

What can I take away?

HMRC is no longer offering beneficial terms to those wanting to regularise their tax affairs. The tougher environment taxpayers will face in the future is what now creates the incentive to disclose

For those unsure of the government’s commitment to tackle offshore tax evasion, the measures announced in the 2015 Autumn Statement and Finance Bill 2016 (FB 2016) should leave them in no doubt. Offshore evasion has been in the headlines for many years now and pressure to regularise overseas tax issues has built from all sides. The recent announcements herald a move into a new era as HMRC redoubles its efforts to meet the objective in its ‘No safe havens’ offshore evasion strategy.

The government timed the launch of its campaign to coincide with the Autumn Statement. The comments from David Gauke, the Financial Secretary to the Treasury, confirm that HMRC will be tougher on those who commit offshore evasion in future.

> ‘Hiding money in another country at the expense of honest UK taxpayers is not acceptable and we have made it clear we will put a stop to it,’ Gauke said.
>
> ‘Under our new regime the small minority who evade tax offshore, facilitate or turn a blind eye to offshore tax evasion will face tougher sanctions.
>
> ‘With over 90 jurisdictions now agreeing to automatic exchanges of information, the net is closing in on offshore tax evaders.’

What is this ‘new regime’?

The early end to the Liechtenstein and Crown dependency disclosure facilities indicated that HMRC was advancing its timescale and changing its approach. We now have a clearer picture of what the future will look like as the department adds to its offshore evasion toolkit, which will include:

- a new criminal offence for offshore evasion;
- stricter ‘naming and shaming’ provisions;
- increasingly severe penalties for offshore issues;
- a last chance ‘tougher’ disclosure facility;
- sanctions for those who ‘enable’ others who commit offshore evasion; and

- increasing publicity about offshore tax issues, both directly from HMRC and by introducing requirements for advisers to inform clients about offshore developments.

HMRC is no longer offering beneficial terms as incentives for people to make voluntary disclosures of irregularities; instead, it is creating an environment in which taxpayers will not want to risk the tough sanctions if it discovers evasion.

The driving force behind this shift is the large volume of data that will soon be available to HMRC under automatic exchange of information (AEOI) agreements. By the end of 2015, 96 countries had committed to global exchange of information under the OECD's common reporting standard (CRS). Consequently, all the major financial centres will be exchanging information with tax authorities. However, it is important to remember that HMRC will have a head start on the CRS when the UK Crown dependencies and overseas territories exchange information under separate agreements in September 2016.

Suggestions that HMRC will be unable to deal with the volume of data that it will receive also appear to be untrue. HMRC invested in CONNECT software that processes more than 1bn pieces of information from numerous sources. It can compare information to self-assessment returns to identify anomalies and help HMRC to build a picture of the taxpayer's financial affairs. CONNECT, supported by a team of data analysts, IT experts and HMRC inspectors, will help the department process this offshore data and target its enquiries.

Developments affecting taxpayers

New criminal offence for tax evasion

Key to HMRC's strategy is to have in place effective deterrents against offshore evasion. The 'strict liability' offence has been on the cards for some time and underwent two consultations before the draft legislation was included in FB 2016. The nature of the strict liability offence relieves HMRC of a requirement to prove that the taxpayer intended to commit offshore evasion. The loss of tax in relation to the overseas income, assets or activities must exceed £25,000 before the offence can apply.

The offence will not apply retrospectively; instead, it will be effective from the first year of a commencement order. If one is issued in 2016–17, this will be the first tax year for which the offence can apply.

Interestingly the new offence will not apply to any income, assets or activities that are reportable to HMRC under relevant AEOI agreements, including the CRS. Holding assets in the 96 countries committed to implementing the CRS will be an effective safeguard against the offence as long as they are of a type that is reportable.

Although the scope of the offence will be limited by the safeguards, it will be easier for HMRC to secure prosecutions for offshore evasion. Consideration should be given to reviewing any arrangements that may fall foul of the offence carefully and making voluntary disclosures where necessary.

'Naming and shaming' provisions

Another change that signals how seriously HMRC takes offshore evasion is the restriction of the protection against the 'naming and shaming' provisions in s 94 of the Finance Act 2009. HMRC may publish details of any taxpayer charged a deliberate penalty if the tax in question exceeds £25,000, subject to limited safeguards. Currently, protection from publication is given if the full penalty mitigation is obtained by a taxpayer regardless of whether HMRC prompted the disclosure.

However, changes in FB 2016 provide that the protection from naming available only if an unprompted disclosure is made in relation to the offshore issues. According to HMRC, a disclosure is unprompted when, '…the person making it has no reason to believe that we have discovered or are about to discover the inaccuracy or under-assessment' (CH82420). This change is likely to have a significant impact if the number of investigations by HMRC increases because of AEOI.

FB 2016 also includes provisions to strengthen the 'publishing of deliberate defaulter' power to tackle evasion if it is carried out through an entity such as a trust, company or foundation. Consequently, HMRC will name the individual who is 'benefiting' from the evasion by using the offshore entity.

Offshore penalties

Despite a number of changes in Finance Act 2015 (FA 2015), the offshore penalty regime is about to change again, according to FB 2016.

To recap, from 6 April 2011 every jurisdiction was given a category according to its level of tax transparency. Category 1 was the most transparent and category 3 the least. If an error arises in relation to income, activities or assets in a category 2 or category 3 jurisdiction, an uplift is applied to the penalty up to a maximum of 150% or 200% respectively if the error or failure to notify related to income tax or CGT.

FA 2015 extended the regime to include errors relating to inheritance tax (IHT). It also closed a gap in the original rules by bringing within scope 'offshore transfers'. These refer to liabilities that have a source in the UK but the funds are transferred offshore to avoid detection. This also removes an anomaly whereby a UK business's profits are understated due to funds being deposited in an offshore account. These will now be categorised as an offshore error based on the jurisdiction in which the account is and not a UK error. In addition, FA 2015 introduced an '0' category that attracts no penalty uplift for countries adopting CRS and the US. The uplift that applies to categories 1, 2 and 3 will be adjusted to give maximum penalties of 125%, 150% and 200% respectively. The new classifications for the non-CRS jurisdictions are not yet available, although the existing ones can be found in HMRC's *Compliance Handbook* (CH82484). The FA 2015 changes are expected to take effect for periods starting on or after 1 April 2016, subject to the issue of a statutory instrument.

As well as the above changes, FA 2015 introduced the 'offshore asset moves penalty', which was immediately effective from 27 March 2015. The penalty is intended to discourage taxpayers from moving assets to a less tax transparent jurisdiction in order to avoid HMRC detection. In effect, any taxpayer moving assets to a jurisdiction that is not implementing CRS to avoid reporting will be within scope of the penalty. Moving assets may be as simple as moving a bank account, but it will also cover actions such as the relocation of trustees to change residence. The new penalty is additional to the original one and is calculated as 50% of the original 'deliberate' penalty. In theory, cumulative penalties of up to 300% of the undisclosed tax are possible.

New offshore penalties

Before most of the rules in FA 2015 take effect, HMRC took further steps to strengthen the civil penalty regime to increase its deterrent effect.

FB 2016 will increase the minimum offshore penalty for deliberate and concealed behaviour by 10%. For example, the penalty will increase from 20% to 30% for an unprompted disclosure of a deliberate error arising in a CRS jurisdiction.

The draft legislation in FB 2016 changes the criteria that HMRC will use to assess whether a full disclosure occurred for the purpose of penalty reductions. Taxpayers facing deliberate penalties will need to provide ancillary details, which may include information on:

- the structures used;
- how the funds were transferred offshore; and
- any enabler that facilitated the evasion.

In addition, this will determine whether the taxpayer is protected from the naming provisions when making an unprompted disclosure.

Further consultation will be held in 2016 on the introduction of an asset-based penalty. This is to be calculated as a percentage (potentially 10%) of the value of the offshore asset giving rise to the undeclared liabilities. This could be the value of an investment account or an offshore property on which rental income is not properly declared.

The government will also consult on a requirement for individuals to correct past offshore non-compliance with additional new penalties for those who fail to do so. It will be interesting to see how these new proposed penalties interact with the existing offshore penalty regime, including the changes that are being legislated.

Options for disclosures

Now that the Liechtenstein and Crown dependency disclosure facilities are closed, limited options remain for taxpayers who still need to disclose offshore tax irregularities to HMRC.

At the time of writing, little information is available on the proposed new CRS disclosure facility, which is expected to be available from April 2016 until September 2018. It is thought that, although a bespoke service will be provided, the facility will give no immunity from prosecution and the minimum tax geared penalty will be 30% of the undeclared tax.

Taxpayers who have to regularise issues in their UK tax affairs will need bespoke advice from a specialist in order to consider whether to use the new facility or other options, for example, through the contractual disclosure facility if the issues arose as a consequence of deliberate errors.

Impact on advisers

HMRC announced that there will be further consultation on the introduction of criminal sanctions for corporates that fail to prevent tax evasion. However, draft legislation for civil sanctions is included at clause 67 in FB 2016. The sanctions include significant tax-geared penalties for enabling ‘offshore tax evasion’ and the power to ‘name and shame’ those that are penalised. It should be noted that the draft legislative definition of ‘offshore tax evasion’ is wider than may initially be expected since it includes situations that result in taxpayers being charged penalties for non-deliberate errors and failures.

In addition, s 50 of the Finance (No 2) Act 2015 gave HMRC powers to compel tax, legal and financial advisers to notify current and past clients about the CRS disclosure facility and the consequences of failing to disclose offshore evasion. Further regulations detailing what needs to be communicated to which clients within a specified period are expected this spring.

Conclusion

As part of its tax evasion campaign, HMRC published ‘Ten things about offshore assets and income’, to give taxpayers basic information. Probably the best piece of advice in this list can be found beneath the heading ‘There is nothing wrong with having investments overseas’. It says simply: ‘If you are unsure, we recommend that you speak to an adviser.’

With the complexities that are involved with offshore issues and the increasing sanctions for errors, it is now more important than ever that clients receive the right advice and they and their advisers understand the implications of making mistakes. Early, voluntary disclosures to HMRC before the introduction of further sanctions is advisable, not least because making a full, voluntary disclosure is likely to be cheaper – in terms of fees, penalties and the like – than waiting for HMRC to open an investigation.

Further information

HMRC’s ‘Ten things about offshore assets and income’ can be here.