Penalty decision

Management of taxes

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Are the new penalty provisions Treaty compliant, and how might Brexit affect them, asks *Jeremy Woolf*

Key Points

What is the issue?

Are the new penalty provisions compatible with European Union law and the European Convention on Human Rights?

What does it mean to me?

If the provisions are incompatible this will provide grounds for disputing liability.

What can I take away?

Although the position varies there may be treaty grounds for disputing liability.

The Finance Bill 2016 contains provisions imposing penalties. Some of these provisions are directed at offshore transactions or impose more draconian penalties when related to offshore transactions. In particular:

1. Sch 20 just imposes civil penalties for enablers of offshore evasion, it does not extend to on-shore evasion. The term 'offshore' is defined in para 2 of Sch 20 as extending to an offshore matter, an offshore transfer and an offshore asset move;
2. Sch 21 amends the existing penalty provisions in FA 2007 Sch 24, FA 2008 Sch 41 and FA 2009 Sch 55. These Schedules already potentially impose higher penalties for offshore issues than purely onshore issues. Para 4A(4) of Sch 24 and 6A(4) of Sch 41 and Sch 55 define a matter as 'offshore' if it relates to income, assets or activities outside the UK. Para 4AA of Sched 24 and para 6AA of Sch 41 and
3. Sch 55 are directed at offshore transfers which apply to receipts or transfers outside the UK. The amendments reduce the extent to which reliance can be placed on disclosure to reduce penalties that relate to offshore issues.
4. Sch 22 introduces new-asset based penalties for deliberate offshore errors, capped at 10% of the asset's value or, if lower, ten times the potentially lost revenue. These provisions adopt the same definitions of 'offshore' as are used in FA 2007 Sch 24,
5. FA 2008 Sch 41 and FA 2009 Sch 55.
6. Clause 153 introduces new criminal offences relating to offshore matters, it does not apply to purely onshore matters. 'Offshore' matters are defined in proposed TMA 1970 s 106F(4) as income with an offshore source, assets outside the UK or non-UK activities.

It is questionable how far these differences in treatment between onshore and offshore matters are compatible with European Union law. The Court of Justice has accepted that differences between the treatment of domestic and offshore transactions are a restriction on the freedom to provide services and to move capital but may be justified if they are not manifestly disproportionate. In *EC Commission v French Republic* [1997] STC 584 the court accepted that difficulties in detection may justify higher penalties for cross-border transactions, but any differences must not be manifestly disproportionate. In that case the French provisions were considered contrary because they imposed higher penalties on a cross-border failure that applied automatically and were not dependent on proof of fraud. In *C-155/08 X v Staatssecretaris van Financiën*; *Passenheim-van Schoot v Staatssecretaris van Financiën* [2009] STC 2441 the Court accepted that differential time limits might be justified when the tax authority had no notice of the source but not when they did.

While we remain a member of the European Union or are subject to similar treaty obligations, it follows that any differences in treatment will be open to challenge if they are manifestly disproportionate. Prima facie there must be some force in arguments that a ten times greater penalty breaches this requirement. Even if some increase in penalties for deliberate errors may be proportionate, it might also possibly be contended that this does not extend to careless errors or to cases where there has been an unprompted disclosure.

The European Union freedom to move capital potentially extends to third countries. So these differences in treatment may give rise to an arguable breach in relation to third countries. However, the European provisions for mutual enforcement and exchange of information will make disparities in treatment between errors in the UK and EU more difficult to justify. The position post-Brexit will depend on precisely what is agreed and how it is enacted into UK law

There may unfortunately be added difficulties in mounting such arguments in relation to Crown dependencies. This is because HMRC currently contend that movements to such dependencies should be considered internal, so they do not engage the fundamental freedoms. There has been a reference in relation to *Gibraltar in R (Gibraltar Betting & Gaming Association) v HMRC* [2015] EWHC 1863 (Admin). Even if movement to UK dependencies are considered internal, it is possible that fundamental freedoms may be indirectly engaged if the funds have then been invested in the EU or third countries: note C-524/04 *Thin Cap Group Litigation v IRC* [2007] STC 906 at p 955 paras 94-96.

FB 2016 Cl 146 also imposes a new GAAR penalty. This penalty does not infringe the European Union fundamental freedoms. However, there may be arguments that it is disproportionate and therefore inconsistent with the European Convention of Human Rights. A penalty was successfully challenged on this basis in Lindsay v Customs and Excise [2002] STC 588. The GAAR penalty is fixed at 60%. This is higher than the minimum penalties for deliberate errors if there has been disclosure, which suggests that the penalty may be disproportionate. There are also other reasons why it could be contended that this penalty is disproportionate. In particular, the penalty is calculated by reference to the extent that the GAAR has counteracted advantage. So the penalty capriciously depends on the grounds on which the scheme fails. The penalty can also be avoided by agreeing to an adjustment before the matter is referred to the GAAR panel. So it is effectively a penalty for disputing the legality of a charge.

The penalty for serial tax avoiders introduced by FB 2016 Sch 18 is also potentially 60% if there have been two prior warnings. The proportionality of this penalty may also be in issue. This can no doubt be relied upon as a ground for mitigation: see paras 40 and 41.