Risky waters

Management of taxes



01 May 2019

Jon Preshaw looks at the new legislation which imposes civil penalties on those who ‘enable’ offshore non-compliance

Key Points

What is the issue

Legislation introduced in Finance Act 2016 imposes civil penalties on those who ‘enable’ offshore non-compliance. These rules are wider in scope than the new

offence of failing to prevent the facilitation of tax evasion.

What does it mean to me?

The provisions can apply in a broad range of circumstances and advisers will need to consider the extent to which their own position, as well as the position of their clients, is impacted.

What can I take away?

The provision raises significant challenges for advisers when they act for clients making disclosures to HMRC where the issue involves an offshore matter. Careful consideration will need to be given to the extent to which a conflict of interest may arise. Additionally, the rules present risks for those advising on offshore matters more generally. As a result, processes should be put in place to ensure that any penalty risk is addressed.

Tax advisers are facing a wide range of new rules intended to address tax non-compliance by tackling the activities of advisers who HMRC believe are assisting their clients to evade tax. This focus on ‘enablers’ forms an important part of HMRC’s strategy to combat tax evasion. Although HMRC acknowledge that the number of such advisers is small, and it is therefore tempting for the vast majority of advisers to simply disregard these rules as irrelevant to their practices, the relevant provisions are extremely broadly drawn and could have a significant impact on a wide range of professional advisers and financial service providers. With that in mind, it is important that advisers carefully consider the implications of the new rules.

Most of the new rules are untested and HMRC’s willingness to invoke the various provisions formally is as yet not clear. The rules could have significant reputational and financial costs for advisers who are caught by them. There are a very broad range of provisions to consider and this article is not intended to be exhaustive. Instead it focusses on one specific set of rules, the civil provisions intended to address offshore tax non-compliance.

Offshore tax non-compliance

Schedule 20 Finance Act 2016 introduced a stand-alone penalty regime for enablers of offshore tax non-compliance. Schedule 20 is intended to provide a civil regime which mirrors the criminal regime for failing to prevent the facilitation of tax evasion which is found in the Criminal Finances Act 2017 (the 'Corporate Criminal Offence'). The published consultation response documents for the civil penalty regime indicate the use of civil sanctions to deal with enablers is more likely than the use of criminal sanctions, in line with HMRC's selective prosecution policy. The Criminal Finances Act provisions have been the subject of significantly greater focus, both from professionals and financial service providers, than the civil sanctions. However, if the civil and criminal powers are applied in accordance with HMRC's intended approach, the civil sanctions will be used more frequently than the criminal sanctions. It is therefore important for those who may be subject to the rules to understand their scope and the implications for their business.

Schedule 20 applies to acts carried out on or after 1 January 2017 and imposes penalties for errors in respect of income tax, capital gains tax and inheritance tax where those errors relate to an offshore matter. The definition of offshore matter mirrors that used in the Requirement to Correct and offshore taxpayer penalty provisions. It includes circumstances where tax is payable by reference to income arising offshore or assets held offshore along with circumstances where assets or income are transferred offshore.

Given the timing of the introduction of the rules, it is likely that they will come under active consideration during the course of enquiries into 2016/ 17 Self-Assessment returns, which may only recently have been opened.

The legislation imposes a penalty where a person ('P') enables another person ('Q') to carry out offshore non-compliance. Carrying out offshore non-compliance involves either:

- Committing an offence of cheating the public revenue, fraudulent evasion of income tax or the new strict liability criminal offences at s106B-D of TMA 1970; or
- Engaging in conduct which makes Q liable to a tax-geared civil penalty for making an incorrect return, failing to make a return, or making a return more than 12 months late.

‘Enabling’ is very widely drawn to include encouraging, assisting or otherwise facilitating the conduct which gives rise to the offence or to the penalty. The definition is wide enough to cover a range of activities over and above the giving of advice, such as the establishing of corporate structures, the transfer of funds or the provision of banking or investment services.

Penalty charges

The rules impose penalties on the ‘enabler’ of the higher of 100% of the Potential Lost Revenue arising or £3,000. The penalty where there is an offshore asset transfer is the higher of 50% of the Potential Lost Revenue or £3,000. The penalty is subject to the standard reductions for ‘telling, helping and assisting’ and for disclosure, which is a feature of most of the direct tax penalty provisions introduced in recent years. The provisions also include the now-standard power allowing the enabler’s details to be published if the tax loss exceeds £25,000. Clearly the financial consequences of a penalty arising would be significant, but the reputational consequences of the publication of an enabler’s details could have even greater consequences.

Given the penalty mitigation rules, advisers will need to be alert to the potential for conflict in the event that a client either needs to make a disclosure or that an allegation is made that penalties are due from a client in respect of offshore income or gains.

The provisions include a specific right of appeal against both the principle that a penalty will apply and also the quantum of any penalty. However, it should be noted that there is no specific reasonable excuse defence in the rules.

Addressing the risks for advisers and service providers

It is a precondition of the offence that the enabler knew that their actions would enable the offshore non-compliance, or that their actions were likely to enable the offshore non-compliance. The inclusion of the precondition is intended to address circumstances where an enabler turns a blind eye to the consequences of their actions. The consultation which led to the introduction of Schedule 20 indicated: ‘Those who unreasonably adopt a position of wilful blindness to tax evasion which they have enabled are not merely careless and should not be able to rely on a pretence of ignorance to avoid penalties for their deliberate enabling act.’

The test is a subjective one, addressing P's actual state of awareness rather than objectively considering what P ought to have known about their actions. An objective test would have raised even greater levels of complexity. The contrast between the High Court and Court of Appeals' decisions in *Mehjoo v Harben Barker* [2014] EWCA Civ 358 [2014] illustrates the difficulty which such an approach could have created. However, despite the express position adopted in the consultation, the wording of the legislation lacks clarity. In particular, questions arise as to the extent to which a service provider might be penalised in circumstances where it had simply not sufficiently considered the risk of non-compliance, rather than turned a wilful blind eye to it.

Service providers will need to consider their approach in circumstances where a product or service might be used by a client or customer to evade tax, for example by adding additional due diligence procedures. Service providers will also need to consider the extent to which they could be exposed to civil penalties under the Schedule 20 regime in the event that the client fails to comply with their tax obligations.

This risk is likely to be addressed in most circumstances if the service provider establishes reasonable prevention procedures in connection with the Criminal Finances Act 2017 offence of failing to prevent the facilitation of tax evasion. It would be anticipated that the existence of reasonable prevention procedures which addressed the Corporate Criminal Offence risk would enable a service provider to demonstrate that, at the time the service is offered, it had taken specific steps to ensure that offshore non-compliance in the form of tax evasion would not arise.

A second category of risk arises where the product or services being provided give rise to tax complexity such that the client or customer might, without appropriate specialist advice, make errors in reporting tax liabilities associated with it. The service provider is likely to be aware of the inherent complexity and the need for the typical client to take and follow appropriate advice. Service providers may need to consider the extent to which reasonable prevention procedures aimed at addressing the Corporate Criminal Offence risk would be sufficient to address this risk, because such procedures may be intended to address deliberate acts rather than careless errors. With that in mind, service providers and advisers will need to be prepared to defend their approach in the event that any of their products or services are used by clients without taking advice and careless errors subsequently arise on the part of the client.

In the meantime, given the lack of clarity around the scope of the rules, it would be helpful for providers of both financial services and tax advice if HMRC were able to provide specific guidance on how the rules are expected to operate, particularly in the context of careless errors. The guidance provided in respect of the Corporate Criminal Offence provisions has been helpful to both practitioners and service providers in establishing and refining reasonable prevention procedures to ensure they are not exposed to the offence. However, if it is the case that the civil sanctions at Schedule 20 are more likely to be invoked than the criminal sanctions, guidance of equivalent detail from HMRC would be welcome.