Offshore Penalties

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John Cassidy reviews the developing penalty landscape where there is an offshore connection.

There was a time when penalties were relatively simple. If a tax return was wrong, other than through human error, a penalty was charged as a percentage of the additional tax identified.

Then along came HMRC's offshore project, under which many different current and proposed penalties have been created. This is a brief summary of the main changes.

There were two Finance Acts in 2015, the first of which saw several fundamental changes.

New categorisation of territories

The penalty regime provides for higher penalties if the misdemeanour relates to an overseas matter. Until this year, if the country concerned was termed 'category 1' the penalty remained the same as for an onshore matter (up to 100%). For 'category 2' countries the penalty was 50% higher (up to 150%), and for 'category 3' countries the penalty doubled, so, in principle, up to 200% of the tax.

FA 2015 introduced a new ‘category 0’ to include countries previously in category 1 who have adopted the Common Reporting Standard (CRS). This is a mechanism under which countries will automatically provide annual information to HMRC concerning offshore assets such as bank accounts, investments and structures. This demonstrates that the government is prepared to use the penalty system to encourage behavioural change at a national level, i.e. transparency and sharing of tax-related data. Category 1 issues will be subject to penalties of 125% of the normal rate with categories 2 and 3 remaining the same.

Widening the scope

FA 2015 also widened the scope of offshore penalties by, for example, bringing Inheritance Tax (IHT) into the offshore penalties regime. This means the territory where the assets are situated immediately after the transfer of value (that gives rise to the IHT) is used to determine which of the categories applies. Similarly, penalties for failure to notify and late filing are brought into the tougher offshore regime for the first time.

As well as widening the scope of the offshore regime by updating existing penalties, an entirely new concept was introduced, called an ‘offshore transfer’. This applies to deliberate inaccuracies where a domestic matter becomes an offshore matter. This could arise if, for example, taxable income or the proceeds of disposal of a chargeable asset are received in or transferred outside the UK, or if assets that give rise to a chargeable IHT transfer are transferred outside the UK.

FA 2015 then went a step further by introducing penalty legislation which applies where assets are moved from a ‘specified territory’ to a ‘non-specified territory’. It is intended that territories will qualify as ‘specified’ once they have committed to automatic exchange of information under the CRS.

There are various conditions which need to be satisfied for this penalty to apply, but it is squarely aimed at those who see the potential for HMRC to catch up with them and then move the assets. For example, under the UK/Swiss tax agreement the Swiss asset holder knew that, unless a penal financial levy was paid, the Swiss would be obliged to breach confidentiality and reveal the asset and its owner to HMRC. To avoid this, some people moved assets out of Switzerland. Under the new regime

evaders, once caught – which is almost inevitable due to CRS – face a normal offshore penalty plus a further penalty for moving the asset. The additional penalty is a flat rate of 50% of the original penalty charged.

The government has developed the new regime so it is not possible to ‘move’ assets without appearing to do so. For example, it will still apply where the owner ceases to be resident in a specified territory and becomes resident in a non-specified territory, or where ownership appears to change but the person, in reality, remains the beneficial owner of the asset.

Yet more changes

Although the second Finance Act of 2015 does not outline any more penalty points, it does include a requirement for advisors of all types to write to clients (and possibly former clients) to educate them on HMRC’s project against offshore evasion, including enhanced penalties. Details of what this requirement means in practice are still being discussed with HMRC.

It is also the case that there are to be more changes to the offshore penalty rules. After the Summer Budget several consultation documents were also issued proposing yet more sanctions where the tax problem concerns offshore matters. Some of these are not covered here, as they are not aimed at the taxpayers but at advisers. This includes the proposal to punish ‘enablers’ of tax evasion or those guilty of the somewhat tortuous double negative of failing to prevent the facilitation of evasion.

However, there was also a consultation document relating to taxpayers, which refers to yet more strengthening of penalties in offshore cases. The proposals include a number of options:

- creating a higher minimum penalty for all disclosures that relate to offshore income or gains from a given future date. At present the minimum, assuming deliberate behaviour, is 20%, but this is proposed to increase to 30% or 35% for offshore matters.
- Making it tougher to obtain the maximum reduction in penalties which will only be available if a full account of the evasion is given, including how the monies were moved offshore and who assisted the evader.

- Introducing an asset based penalty, being a flat rate of 10% of the offshore assets in question. A percentage of the total asset is obviously potentially a much higher figure than a percentage of the tax on income generated by the asset.
- Bringing in a special penalty to apply only in the most serious of cases which would see 100% of the offshore assets forfeited, subject to agreement of the Upper Tribunal.

Overall summary and conclusion

Despite the numerous changes already made, HMRC clearly also means business going forward. Anyone who fails to voluntarily come forward before these proposed changes should prepare themselves for not only far more complex penalty negotiations, but for a much higher financial penalty. As more jurisdictions sign up for greater automatic exchange of information under the CRS, the risk of detection increases dramatically.

It is easy to think that these changes will only affect a relatively small number of people who, as tax evaders, should not be surprised. However, many people have offshore assets that lead to tax problems for all sorts of valid reasons; I have seen many cases that are a very long way from evasion.

HMRC has also confirmed proposals for a ‘strict liability’ rule for offshore under-declarations providing an automatic assumption of tax evasion without any need to prove fraud, so enhanced penalties may, in principle, apply automatically.