

RTC: failure to correct & the penalty regime (Lecture P1072 – 9.48 minutes)

Introduction

There are eye-watering financial penalties for taxpayers who fail to correct any 'relevant offshore tax non-compliance' by 30 September 2018. This draconian penalty regime is clearly a "carrot" being dangled by HMRC to incentive taxpayers to disclose any anomalies sooner rather than later. It's the equivalent of the slipper now or the cane later.

It is important to note here that Failure to Correct (FTC) penalties will be levied for the failure to correct, not for the original offence or behaviour which triggered the tax liability. The FTC penalty regime from 1 October 2018 therefore stands in place of the 'traditional' penalty regime which would have applied had the error been disclosed under the RTC.

Failure to Correct (FTC) penalties

The new FTC penalties are far more punitive than the existing penalties for late or incorrect returns or for failure to notify.

There is a tax-gearred penalty of between 100% and 200% of the tax not corrected under the RTC. The starting point here is a 200% penalty which can be reduced to no lower than 100%. This is the new standard.

Penalties will be reduced within this range to reflect the taxpayer's co-operation with HMRC, the seriousness of the failure to correct, whether the disclosure to HMRC was unprompted and the quality of that disclosure. Those affected will therefore have to pay the tax outstanding, and then pay at least the same amount of the tax again, and then pay interest on top. And there is more....

A potential additional penalty of 50% of the above standard penalty if HMRC can show that assets or funds had been moved in an attempt to avoid having details reported to HMRC under exchange of information agreements. This can therefore increase the penalty to an eye-catching 300% of the tax. But it doesn't stop there....

An additional "asset-based" penalty of up to 10% of the value of the asset connected to the failure. This is capped at 10 times the potential lost revenue which now increases the possible penalty to a staggering 1300% of the uncorrected tax! This is only levied in 'serious cases' where the tax at stake is over £25,000 in any tax year and the taxpayer was aware he had an offshore compliance failure and took no steps to correct it. And then for good measure...

A potential reputational damage penalty of "naming and shaming" offenders on a public website. Again this is reserved for cases where taxpayer was aware he had an offshore compliance failure and where over £25,000 of tax per investigation is involved. Naming and shaming can also apply if a taxpayer has had 5 or more penalties levied for offshore tax non-compliance. This penalty is clearly aimed at those for whom the embarrassment of being publicly associated with tax cheats is more of an incentive to comply than the slap-on-the-wrist fine. Naming and shaming will extend to the publication of the disgraced taxpayer's address (or registered office) thereby giving the miscreant no place to hide.

Penalties are payable within 30 days of the issue of the penalty notice.

The above penalties will apply to everyone, so the assumption that the FTC penalty regime is reserved for the “hard-core tax avoiders” lurking among us is misplaced. The same penalties will therefore apply to those who are found to have tax liabilities relating to offshore matters which have arisen as a result of careless behaviour or innocent oversights (rather than something more conscious or blatant).

There is some solace in that penalties for innocent errors will probably be punishable only by the standard penalty, but this is still a minimum of 100% of the tax found to be due. Practitioners may therefore think that a targeted review of these issues in respect of their clients’ pre-April 2017 tax returns would be a good use of their time.

The FTC penalties will apply not only to current and future tax years, but to all offshore irregularities, no matter when they occurred as long as the period in question is still within the assessment time limits.

Under discovery rules, this is 4 years for non-careless behaviour, 6 years where there is a loss of tax due to careless conduct and 20 years for deliberate action.

However the RTC provisions have extended HMRC’s enquiry window for taxpayers with overseas affairs. HMRC now has until 5 April 2021 to assess any tax in respect of overseas matters which was due at 5 April 2017. This effectively extends the above assessment time limits to 8, 10 and 24 years respectively.

The carrot in this equation is that taxpayers who correct any errors or omissions by 30 September 2018 in accordance with the RTC will be dealt with under the existing penalty regime. This means that careless errors which result in an unprompted disclosure - and by the way, the mere existence of the RTC is not a “prompt” for disclosure purposes - could therefore result in a penalty being mitigated to zero. There is therefore a huge incentive for taxpayers to find and correct any offshore irregularities now before the failure to correct regime kicks-in in a few months time.

No penalty will be chargeable where the taxpayer has a “reasonable excuse” for failing to correct the position. In this case the tax (plus interest) will remain payable but any penalty will be waived.

What is “reasonable” is typically narrow and will follow existing models and established principles from case law. However recent Tribunal decisions have suggested that acting under professional guidance is evidence of the taxpayer having taken ‘reasonable care’, hence it would be reasonable to expect a penalty to be cancelled in these circumstances.

HMRC has therefore suggested that taxpayers should engage a suitable professional to undertake a detailed review of their offshore affairs before 30 September 2018 to ensure that a) they have submitted tax returns for all years up to and including 2016/17 for which they owed tax on offshore income or gains and b) all tax returns previously submitted are correct and complete.

However, care must be taken here because Sch 18 para 23 of the Finance (No. 2) Act 2017 specifically states that any advice that is ‘disqualified’ will not be taken into account when considering grounds for a penalty appeal. ‘Disqualified advice’ includes any advice given by any person who received any consideration when helping the taxpayer enter into the offshore arrangements in the first place. As the existing tax adviser, accountant or lawyer may therefore have provided ‘disqualified advice’, commissioning the service of a third party is generally advised.

This seems harsh for taxpayers who previously acted responsibly in relation to their overseas matters and took proper advice from a reputable adviser. It is now suggested that to protect themselves from a FTC penalty, these people now need to pay for refreshed advice before 30

September from a different person to that who gave them perfectly good advice in the first place. Whether this will lead to the tactical “swapping” of clients between tax advisers remains to be seen. In an ironical twist of fate it could be that while tax authorities are exchanging information, tax practitioners are exchanging clients.

At the very least advisers should make sure their clients are aware of the RTC and offer the option of a third party review (even if the practitioner is not aware that a particular client has any offshore assets – in these cases, now might be a good time to fess-up).

Also note that where a practitioner – on behalf and with the consent of his client – has taken a position on the UK tax treatment of an offshore issue which arose before April 2017 and there is some doubt about the technical argument, a “non-tax” disclosure should be considered to HMRC before 30 September 2018. Any tax which falls-out of any subsequent discussions would not therefore be exposed to the FTC penalties.

Post April 2017 offshore non-compliance

The above FTC penalties are “historical” in that they only apply to a person who had any offshore non-compliance to correct at the end of the 2016/17 tax year.

Errors in relation to offshore matters for periods after 6 April 2017 should be disclosed to HMRC in the normal way (typically via an amendment to the tax return within the amendment window or otherwise by means of a disclosure to HMRC followed by a discovery assessment).

Any penalties for these errors will be levied under the existing “non-FTC” rules which we all know and (now) love.

Example 1:

Danesh is UK resident but is non-UK domiciled and uses the remittance basis. He has two overseas bank accounts from which he periodically remits money to the UK. The banks are both situated in a CRS participating territory. The banks will provide personal and financial information about the accounts and the account-holder to the local tax authorities who will in turn notify HMRC in the UK under the CRS. HMRC will check the information acquired via the CRS against Danesh’s UK tax returns.

Danesh checks his remittances for all years up to and including 2016/17 and remembers that a remittance of £100,000 in 2015/16 which he had knowingly failed to report was actually an income remittance giving rise to a tax charge at 45% (ie, £45,000).

Danesh discloses this to HMRC in September 2018. HMRC finds that the error was deliberate but not concealed. The disclosure is unprompted so the penalty is 20% of the tax lost being £9,000.

However if Danesh did not disclose this error but it was subsequently discovered by HMRC as a result of data supplied to them under the CRS, the FTC penalty regime will apply. Danesh will therefore suffer a penalty of between 100% and 200% of the outstanding tax liability (so somewhere between £45,000 and £90,000).

As Danesh seems to have been aware of the error during the RTC period and the tax exceeds £25,000, a 10% asset-based penalty could also be charged (the asset in this case being the bank account from which the unreported sum was remitted). He could also be “named and shamed” on a public website.

Example 2:

A non-domiciled taxpayer settled assets on trust in December 2004. The trust is non-UK resident. The settled funds were invested in non-UK assets. In 2006 the Trustees invested some of the settled funds in a UK residential property. A principal charge of £10,000 arose in December 2014 in respect of the UK property. Due to an innocent oversight by the Trustees, no IHT 100 was filed and no inheritance tax was paid.

If the Trustees discover this error as part of a RTC review and disclose this voluntarily to HMRC, it is likely that the penalty will be attributed to careless behaviour and will be reduced to nil.

However if the error is not disclosed under the RTC but is discovered as part of a HMRC enquiry after a CRS data exchange, the penalty is between 100% and 200% of the tax.

The total exposure could therefore be:

	£
Tax	10,000
Penalty (say 110% after appropriate mitigation)	11,000
Interest at 3% since June 2015 (approx.)	<u>1,000</u>
	<u>22,000</u>

Final thoughts

Finally here remember that the FTC penalties above only apply to unreported errors in respect of “offshore matters”. Errors in relation to UK matters with no offshore connection do not fall within the FTC regime.

We are therefore faced with a slightly odd (some would say unfair) situation that a careless oversight in relation to the non-reporting of some offshore income could be punished with a penalty up to 200% of the tax, while a more deliberate and serious error in relation to the conscious concealment of (say) a UK gain, will suffer a much less punitive penalty under the traditional penalty regime.

We all know that the government must be seen by the electorate to be taking action against the evils of offshore tax evasion, but this regime could very severely punish the unwary.

Detailed HMRC Guidance on RTC is given at:

<https://www.gov.uk/guidance/requirement-to-correct-tax-due-on-offshore-assets#penalties-and-other-sanctions-for-not-correcting-on-or-before-30-september-2018>

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