



TACKLING OFFSHORE TAX EVASION: STRENGTHENING CIVIL DETERRENTS

ICAEW welcomes the opportunity to comment on the consultation document *Tackling offshore tax evasion: Strengthening civil deterrents* published by HM Revenue & Customs on 19 August 2014.

This response of November 2014 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's *Ten Tenets for a Better Tax System*, by which we benchmark proposals for changes to the tax system.

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For more information, please contact ICAEW Tax Faculty: taxfac@icaew.com

icaew.com

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation *Tackling offshore tax evasion: Strengthening civil deterrents* published by HM Revenue & Customs on 19 August 2014.
2. We should be pleased to discuss any aspect of our comments and to take part in all further consultations on this area.
3. On 16 October 2014 we attended a meeting with HMRC in which we were able to put forward some key comments and concerns and discuss aspects of the consultation document. HMRC also attended our Tax Investigation Practitioners Group meeting on 9 October 2014 where the subject was discussed. Previously ICAEW has been actively involved in the review of HMRC's powers including consultations on offshore evasion.
4. We have set out, in Appendix 1, the ICAEW Tax Faculty's *Ten Tenets for a Better Tax System* by which we benchmark proposals to change the tax system.

MAJOR POINTS

5. In general terms we do not disagree with the proposal to strengthen civil sanctions for offshore evasion. This is in the context that the proposals in this document should apply to those who know full well that their offshore assets have not been properly taxed and may have taken steps to move assets between jurisdictions rather than taking advantage of the available disclosure facilities.
6. Strengthening the civil penalty regime may encourage the non-compliant to finally come forward – though alternatively they might be encouraged to leave the UK without paying what they owe.
7. It is essential that adequate safeguards are put in place to protect those who have made innocent errors and taken reasonable care. This is particularly important in view of the complexity of the tax regime.
8. We have comments and concerns about certain aspects of the proposals which are set out in the next section.
9. We also have some general concerns. One is that HMRC should not rush to bring in new measures before those recently introduced have had time to demonstrate their impact. The offshore penalty regime is still relatively new and should be given enough time to settle in and provide evidence of its effectiveness before extending it.
10. A second concern is that implementing all, or even some, of the measures in options 2 to 6 will result in a complicated penalty regime and a potentially very heavy penalty burden. The complexity of the regime may mean that people do not have a clear idea of what offences will be penalised and in what way. They may also be deterred from coming forward by the risk of very heavy penalties. Both these things could weaken the deterrent effect. HMRC should consider the combined effect of all the proposed changes and ensure that this does not create 'penalty overload'.

11. It is essential that HMRC publicises both the UK rules for taxing offshore income and gains, and the existing disclosure opportunities, before the enhanced penalties come into effect. This will allow those who have underdeclared tax to be aware of their situation and come forward.
12. We have responded separately to the consultation *Tackling offshore tax evasion: A new criminal offence* in TAXREP 58/14. ICAEW does not support the introduction of a strict liability (SL) offence for tax evasion as proposed in that consultation. In our response we questioned whether there is a need for the new offence, and paragraph 1.6 in the current consultation is relevant here, as it says that ‘the majority of cases are still likely to be investigated and settled through civil means’. If so, we question why the SL offence is required.

RESPONSES TO THE CONSULTATION QUESTIONS

13. We have not answered each individual question but set out below our comments on each of the six options.

Option 1: Extending the scope of the offshore penalties regime to inheritance tax

14. We agree that extending the penalty regime to IHT as proposed in Q1 and Q2 is a logical step.
15. We agree that it is sensible, in the interests of simplicity, for the structure of IHT penalties to be aligned with the IT and CGT penalties.
16. However, it is essential that there should be adequate safeguards in both statute and guidance to protect those who have made innocent errors or taken reasonable care. This is particularly important due to the complexity of the rules in the area of IHT and international matters.
17. We think that Q2, which asks if the offshore penalty regime should be extended to ‘transfers of assets into offshore structures which give rise to IHT’, is poorly phrased. It is important to be clear that use of offshore structures correctly set up under existing law can be for a variety of reasons and should not automatically result in a presumption of avoidance or evasion that should be penalised. If assets are passed out of a donor’s estate they would, after a number of years, generally be outside of IHT for the donor if they were all within the UK; simple use of an overseas structure should not result in a different outcome.
18. In addition it will be important that any penalties are charged on the correct person. The enhanced penalties should not be imposed simply by reference to receipt of funds. They should only apply to those knowingly negligent, and not be imposed on someone simply on the grounds that funds have vested in them without their having been complicit.
19. In the context of the death estate, we are concerned about the position of personal representatives. If the deceased person has hidden assets offshore, their representatives may not be aware of them despite taking reasonable care in administering the estate. Representatives should not be liable for penalties in respect of errors or omissions which are not due to their own default.
20. We have concerns about the proposals in the context of trusts. Case Study 4 assumes a chargeable settlor. If the settlor is not alive (or within the jurisdiction), the position is more difficult. It is questionable whether the trustees outside the jurisdiction could be held liable to penalties and have these properly enforced on them – which leaves the question of the liability of beneficiaries who receive distributions. Case Study 5 takes the example of a

beneficiary who has been complicit in not declaring the distributions. In contrast, beneficiaries who are not complicit and not aware of IHT liabilities attaching to distributions should **not** be subject to penalties. It follows that penalties may not be justifiable when the only persons from whom IHT can be recovered are beneficiaries within the jurisdiction who are innocent of any evasion, even if the trustees were aware of it.

21. We agree with the approach suggested in Q4 and Q5 regarding location of assets.

Option 2: Extending the offshore penalties regime to cover inaccuracies in category 1 or category 2 territories where the proceeds are hidden in higher category territories

22. We strongly disagree with the proposal to introduce a statutory rule to create a presumption that offshore funds are the results of non-compliance unless the taxpayer can show they have arisen from taxable sources.
23. We can see that a statutory rule would make it easier for HMRC to determine how penalties should be applied, given that there may be practical difficulties in establishing a link between the original non-compliance and funds held offshore. However, this is not an adequate reason for introducing a statutory rule.
24. We have a major concern that the presumption that offshore funds are the result of non-compliance will create a fundamental change in the burden of proof, putting it onto the taxpayer so that have to show that the funds are not linked to non-compliance.
25. There must be apportionment otherwise significantly unfair results could ensue. If only 51% were in category 3 area the majority based rule proposed would be patently unfair. Furthermore the consultation again simply assumes the matter under discussion relates to assets moving territory. It is important that due regard is had to the entities involved and their tax consequences. For example, an opaque trust in a category 3 location investing in an EU territory should suffer higher penalties if tax is avoided due to the location of the trust, whereas a trust in a category 1 area that invests funds in a category 3 area should be penalised on category 1 basis.
26. Broadly we are happy with the current safeguards system applying. We are concerned that the rules about taking reasonable care and reasonable excuse are considered carefully in how they would apply to the new regime. Reasonable excuse may, for example, need to embrace matters such as divorce issues.

Option 3: Introducing a new offshore surcharge to complement the offshore penalties regime where offshore assets have been deliberately moved to continue evading tax

27. Question 11 asks the general question (applicable to options 3 to 5) as to whether there should be strengthened sanctions for those who deliberately move assets with the intention of continuing to evade tax. In principle we agree, particularly if the new sanctions are targeted at those who know that their offshore assets have not been properly taxed and may have taken steps to move jurisdiction (eg, away from Switzerland) rather than take advantage of available disclosure facilities. However, we think the deterrence effect may be of limited value as such persons are likely to keep moving the funds/assets anyway.
28. The proposal in option 3 might achieve the policy objective but there is a risk that adding surcharges on top of already high levels of penalty may not act as a deterrent. Those evaders who are already exposed to the higher offshore penalties are unlikely to be deterred by an extra penalty. Further, very high total potential penalties may tend to discourage voluntary disclosure.

Option 4: Extending the 20 years assessing time limits where offshore assets have been deliberately moved to continue evading tax

29. It is fair to say that our committee members have differing views on this proposal. Some support the change, with the view that it is fair and gives a tough, clear message and that the risk of continuing penalties in the long term would be a sound deterrent. Others do not support it, taking the view that it is overly harsh and may be disproportionate.
30. We do have concerns that extending the time would remove the important principle of finality. Also, in practical terms, the information to enable underpaid tax to be quantified may not be available from so far back.

Option 5: Increasing the quantum of offshore penalties to reflect the number of times offshore assets have been deliberately moved to continue evading tax

31. In principle we have no objection to this proposal but we think it will be much too complex to operate or for people to understand.
32. The examples in the consultation do not reflect the potential complexity of the measure. In practice we think it is unlikely that funds are moved from one jurisdiction to another *en bloc* and far more likely that they are mixed with other funds and moved around in 'chunks' at different times across various jurisdictions.
33. We also think that, if introduced along with the other proposals, it will contribute to 'penalty overkill', which will be counter-productive.

Option 6: Introducing a new category into the table of Designated Territories

34. We agree it seems reasonable that the offshore penalties regime should reflect the new global Common Reporting Standard (CRS). We support measures that encourage transparency under the CRS.
35. However, we do not understand the problem set out at 4.6. Would it not be possible simply to put all CRS countries into category 1? Even if some category 1 countries have yet to sign up to CRS, they are by definition in category 1 because of automatic exchange of information agreements. For this reason we do not see the need to create a new category in the penalties regime.
36. As noted in respect of some of the other options, we are concerned that penalties which are too high or too complicated will undermine the deterrent effect.

Assessment of impacts

37. We think this impact assessment is inadequate. It contains insufficient information in this impact statement on which to judge whether these proposals will be effective.
38. We note that the final costings will depend on the outcome of consultation. We trust that HMRC will produce a much more robust and detailed assessment of the measures before final decisions are made as to which proposals will be taken forward.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)