TACKLING OFFSHORE TAX EVASION: A NEW CRIMINAL OFFENCE

ICAEW welcomes the opportunity to comment on the consultation document *Tackling offshore tax evasion: A new criminal offence* published by HM Revenue & Customs on 19 August 2014.

This response of 6 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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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation *Tackling offshore tax evasion: A new criminal offence* 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.

KEY POINT SUMMARY

4. ICAEW does not support the introduction of a strict liability (SL) offence for tax evasion as proposed in this consultation document.

5. ICAEW does not condone evasion – it is completely against all our ethical principles and codes. It is right for the Government to address offshore evasion and ICAEW supports reasonable and proportionate measures to tackle those who deliberately evade UK tax. However, as drafted we do not think the measure is reasonable and proportionate, and we are very concerned that individuals who do not and should not fall within the criteria of the new offence will now do so.

6. The consultation does not ask whether the SL offence should be introduced but focuses on options for its implementation. However, we think the fundamental question of whether the new offence is appropriate, necessary or likely to be effective should be examined. The government should go back a step and consult upon the best way to meet the policy objective of tacking offshore tax evasion.

7. There is a serious risk that people with no criminal intent will be found guilty of a criminal offence. The SL offence could apply to those who have made innocent mistakes or acted carelessly but without fraudulent intent. The consequences of a criminal conviction cannot be underestimated. We do not believe there is justification for removing the requirement to prove *mens rea* in tax fraud cases.

8. We do not think that HMRC has provided good enough evidence to support the introduction of the SL offence or to show why current powers are inadequate. The impact assessment is inadequate in the extreme. We also think the new offshore penalty regime should be given time to settle down before the introduction of further powers is considered.

9. Our concerns and comment on aspects of the proposals are explained in detail in the 'Major points' section below.

10. We have made comments in answer to the questions posed in the consultation document. We would like to make clear that providing these comments does not indicate that we support the introduction of the proposed SL offence.

11. The ICAEW Tax Faculty has established *Ten Tenets for a Better Tax System* by which we benchmark proposals to change the tax system (set out in Appendix 1). The current proposals fail to meet two criteria in particular: that legislation should be subject to proper consultation and that it should be fair and reasonable.

MAJOR POINTS

Whether a strict liability offence is appropriate

12. ICAEW is of the firm view that this new offence is not appropriate and not a fair or proper application of good legal principles. It risks unfairly taking people with no criminal intent down the criminal route. It is not an exaggeration to say that it threatens the liberty of innocent taxpayers. We do not believe there is justification for removing the requirement to prove *mens rea* in criminal prosecutions for tax.

13. HMRC's own definition of offshore evasion in *No safe havens* (2014) is: 'using another jurisdiction's systems with the **objective** [our emphasis] of evading UK tax'. This definition therefore incorporates a *mens rea*. However, HMRC intends to introduce an offence which ignores that aspect of the definition.

14. The starting point of the new offence is that anyone who gets things wrong in declaring taxable foreign income or gains will by definition have acted with criminal intent and be punished accordingly. This cannot be right, especially in the context of the UK's complex offshore tax rules.

15. Tax evasion involves breaking the law. Evasion is completely contrary to ICAEW's ethical principles and codes. ICAEW is happy to support reasonable and proportionate measures to address problems in this area, but we do not support this proposal. We are very concerned that people who have not acted with fraudulent intent could find themselves charged with, and found guilty of, this new criminal offence. This will include those who have made innocent errors and taken reasonable care, and those whose behaviour has been careless but not deliberate.

16. If there is criminal intent HMRC already has criminal investigation powers and existing legislation under which prosecutions can be brought. HMRC has not provided convincing evidence that the existing powers are inadequate or why a new power is necessary (see paragraphs 33 et seq below).

17. The offshore penalty regime is still relatively new and HMRC is not giving enough time for it to settle in and provide evidence of its effectiveness in combating offshore evasion. This should be done before rushing to introduce a new criminal power. High penalties under a civil regime are a lower cost route that seems more appropriate for all bar the most serious cases.

Targeting the offence and who may be affected

18. People who have acted honestly and in good faith, taking reasonable care, may have made innocent errors of omission or reported their income or gains incorrectly because they do not understand the complexities of the offshore tax rules. Some may have taken reasonable care by seeking professional advice (for example, on their domicile or residence position) which proves to have been wrong on challenge by HMRC. This could happen even if there are valid and reasonable arguments for the position taken by the taxpayer. These people will fit the criteria of the SL offence and it is completely unacceptable that such behaviour should be criminalised.

19. It is also not right that those who have acted negligently but without fraudulent intent should find their behaviour criminalised under the new offence. People in this category will not have the benefit of the proposed statutory defence of taking reasonable care, but will not have the *mens rea* required for the commission of fraud.

20. The consequences of a criminal conviction for tax fraud cannot be under-estimated. As well as financial penalties and potentially a custodial sentence, these include a criminal record, loss of reputation (due to loss of anonymity) and for many people with a professional or financial role, the loss of their career. There could also be travel restrictions, eg in going to the US. The risk of these consequences for those who are unfairly caught by the new SL offence, because their behaviour has not been fraudulent by any other definition, is too great: it should not be introduced.

21. We set out a number of examples, including cases provided by members from their own experience, of individuals who could be inappropriately and unfairly caught by the SL offence:

    - An elderly lady who did not realise funds were taxable in the UK as they had already been taxed in the local jurisdiction. In the particular case, HMRC accepted that this was careless not deliberate.
    - Non-domiciled individuals who have unwittingly reported their remittances wrongly due to the complex rules.
    - An individual whose domicile was successfully challenged by HMRC, with the result that unremitted income and gains from previous years (from the date when UK domicile was established) became taxable.
    - A person who is advised that they are not UK-domiciled and, as they have been here for less than seven years and not remitted anything to the UK, has not been obliged to declare anything in relation to their overseas income. HMRC subsequently takes the view that the individual is UK-domiciled.
    - An individual who claims non-UK domicile on his tax return but does not quantify his unremitted overseas income (and has no obligation to do so) but is subject to an extensive HMRC enquiry. To bring this to an end, the taxpayer agrees to accept that he is UK-domiciled.
    - An individual with a non-executive directorship, taxable in Sweden, who did not realise that a share option scheme operated by that company had paid out.
    - A trust that had made a capital payout to a non-resident. There were no gains until the following year when the person became resident, but there was deemed a capital gains liability.

22. The figures for offshore non-compliance case in Box 3 (page 18 of the consultation document) show that 72% of offshore cases in 2013/14 involved less than £5,000 of lost revenue. Coupled with a *de minimis*, this means that few cases would fit the SL criteria, and it would be the proverbial 'sledgehammer to crack a nut'. The larger cases of evasion can still be prosecuted under normal procedures, which is only right and proper.

Level of sanctions

23. We agree that the prospect of a criminal conviction is a significant deterrent, but we cannot agree that such a sanction is appropriate for an offence where there is no requirement to prove fraudulent intent.

24. Regarding penalties, as paragraph 4.22 of the consultation says, the potential financial consequences should not be less severe than the equivalent sanction available if the case were settled civilly.

Adequacy of safeguards

25. We find it a strange proposition to have an SL offence with statutory defences. As HMRC notes in the footnote on page 9: 'There is some argument that statutory defences, depending on their nature, may remove the "strict liability" element of the offence.'

26. However, if the SL offence is to be introduced it will need very robust safeguards including statutory defences.

27. In view of the tough nature of the SL offence, safeguards must be in legislation rather than just in HMRC guidance which has no legal standing.

28. HMRC says that one statutory defence would be that the offshore income or gains are not the proceeds of non-compliance, ie they are not taxable in the UK (paragraph 5.2 of the consultation outlines some relevant circumstances). But it should not be necessary for this to be presented as a defence – it is a matter of record whether the income is taxable, and if it is not, the taxpayer should not be charged with the SL offence in the first place.

29. We strongly support having a defence of taking reasonable care. The defence of having taken appropriate professional advice should be part of the reasonable care defence, but not an alternative to it, as it is more narrow and more difficult to define.

30. In judging whether a taxpayer has taken reasonable care, it is important that this is considered in the context of their individual circumstances and what they could be expected to understand.

31. We have noted above our concern that taxpayers could be liable under the SL offence if the take a reasonable position, eg on residence or domicile status, which turns out to wrong on challenge by HMRC. In the meeting of the Tax Investigation Practitioners Group on 9 October 2014, HMRC gave assurances that it does not intend the SL offence to be used in such cases. However, non-statutory assurances are not sufficient protection.

32. A further concern about safeguards is the extent to which defences will in practice be available to defendants in court. Those charged with the SL offence will (we assume) have their case heard in the magistrates court. We have a concern that the courts hearing the cases will not be familiar with the offshore tax rules or the tax rules on reasonable care, etc. This could limit the extent to which they can understand the prosecution case or any defence the individual might offer, particularly if the defendant is not represented and has difficulty putting forward their defence.

Evidence for introducing the offence

33. We do not think HMRC has made a good business case for why it requires this new power.

34. As noted in paragraph 16 above, the evidence for offshore non-compliance cases on page 18 of the consultation document indicates that few cases would fit the SL criteria, and it would be the proverbial 'sledgehammer to crack a nut'.

35. The impact assessment in chapter 6 of the consultation is inadequate in the extreme. HMRC has provided no data or analysis whatsoever, saying that this will depend on the outcome of the consultation. The impact assessment contains the statement that 'the measures **may** [our emphasis] have a positive effect on tax compliance' which seems to us very weak.

36. The evidence and arguments we have seen so far are simply not good enough to support for the decision to introduce this tough new sanction. In short, the impact assessment should make the case as to why this power is needed but it has patently failed to do so. HMRC needs to demonstrate convincingly why it is required.

37. We cannot agree with HMRC's statement in chapter 6 that no impacts are expected on tax-compliant individuals, households or businesses. Taxpayers who have made innocent errors may find themselves within the criteria of the new offence and selected for criminal investigation, and are likely to incur considerable costs in defending their position – particularly in view of the consequences if they are found guilty.

38. From the point of view of ICAEW members, our professional guidance requires that if a client is alleged to have committed a criminal offence, the tax adviser must send them to a solicitor for advice. This runs the risk of driving some non-compliance underground when taxpayers might otherwise have come forward to regularise their affairs. It is also likely to significantly increase costs.

39. The fact that taxpayers who have not acted with fraudulent intent may be forced to incur professional costs if they risk being charged with the SL offence is incompatible with the pledge in the taxpayers' Charter that HMRC will: 'Do all we can to keep the cost of dealing with us to a minimum'.

40. HMRC does not attempt to identify particular groups that might be affected by the new offence and asks for input on this. Examples would be some elderly people, those who mental health issues, and migrants who may have a low UK income but assets in their home country – all of these are likely to struggle with the complexities of the UK tax system and are at risk of making mistakes with their offshore income which put them within the criteria of the new offence.

41. The consultation provides examples of other SL offences (Box 1 on page 7) but we do not think that the existence of these is an argument for introducing an SL offence for tax. The examples are not comparable with the proposed offence for tax. They are offences where it is easy to establish the facts and understand how the law will be broken, and where the individual is doing something they know to be wrong. For example, the question of whether a person is disqualified from driving is a clear-cut one, and it is equally clear that if they drive they are breaking the law. This is very different from a breach of the complex law on offshore tax matters.

RESPONSES TO THE CONSULTATION QUESTIONS

42. We set out below our answers to the consultation questions. The questions are not numbered in the consultation document but we have numbered them here for ease of reference.

43. The fact that we have answered the questions on how the new offence could be implemented should not be taken as support for the proposal. As explained above we have many concerns about the proposal and do not support it.

Scope of the offence

Q1 Do you agree that the applicability of the offence should be limited to income tax and capital gains tax?

Yes. As noted, we do not support the introduction of this offence. Therefore, we certainly would not support extending its scope any wider than proposed – we would like to see it as restricted as possible.

Q2 Do you agree that the offence should be restricted to taxable income and gains which arise offshore?

Yes – on the same basis as the answer to Q1.

Q3 In your opinion, which option (to apply the offence only to investment income or gains, or to apply the offence to all offshore income and gains) would best deliver the policy intention?

It should be restricted only to investment income and gains. As noted, we would like to see it as restricted as possible.

Q4 Do you think that the offence should apply to income and gains which are reported under the Common Reporting Standard?

No, it should not.

Q5 Should all income and gains in CRS jurisdictions be exempted from the offence, or should the offence apply to any income and gains which are not automatically reported to HMRC?

Yes, all income and gains in CRS jurisdictions should be exempted.

However, we think the criterion should be income and gains which are 'reportable' rather than 'reported' as the taxpayer should not be penalised for income and gains which the financial institution has mistakenly omitted.

Q6 Are there any further issues or impacts which should be taken into account when introducing the offence into Scottish and Northern Irish law?

We have no comments on this question.

Proportionality and sanctions

Q7 Do you agree that a *de minimis* threshold is appropriate?

Yes, a *de minimis* is appropriate.

Q8 Should the *de minimis* be set by reference to the potential lost revenue arising from the failure/inaccuracy, or some other measure? If so, should the potential lost revenue be calculated in the same way as it is for the purposes of determining civil penalties?

It makes sense to set the *de minimis* with reference to the potential lost revenue. It should be set as high as possible and we recommend that it should be at least as high as the entry level for cases to be dealt with under Code of Practice 9.

Q9 Should the threshold be incorporated in statute or guidance?

The threshold should in statute. As this is a very tough sanction, safeguards should be in statute rather than just in guidance. If the threshold is only in guidance it is not strictly enforceable and the courts would not be able to consider it. It is also possible that an investigating officer could misuse the threat of criminal charges against a taxpayer below the threshold.

Q10 Are there any further options (for setting the threshold)?

We have no suggestions here.

Q11 Which approach to setting the threshold do you favour?

We strongly disagree with the approach of basing the threshold on the amount of capital, as that is not relevant in determining the income arising offshore or the potential tax lost (assuming it is clean capital). Tax only becomes relevant when there is such income.

Q12 The Government's view is that the threshold should apply for each tax year, rather than in respect of a cumulative amount of potential lost revenue, as a new offence would be committed for each tax period – eg each time an incorrect return is filed. Do you agree?

We agree that the threshold should be applied for each tax period.

Q13 Do you agree with the principle that the available criminal sanction for offshore non-compliance should not be seen as more lenient than the available civil sanction?

We agree with the principle, though in practice it is difficult to evaluate the non-financial aspect of the criminal sanction in order to compare it with the civil penalties.

We would point out that this principle is contradicted by HMRC's own guidance manual at EM6065 which states at the end that a taxpayer whose offences are of the most serious kind could end up with a smaller percentage penalty than another taxpayer whose offences are less serious.

We would also point out that the potential deterrent effect of prosecution and criminal sanctions will depend on HMRC's success in communicating it to the public.

Q14 Should an unlimited financial penalty be available to the courts?

We are not sure what is meant by an 'unlimited' financial penalty, since the proposal is that the penalty would be set with reference to the lost tax revenue.

Q15 Is the harm which could be caused by a failure to declare offshore income and gains sufficient that a custodial sentence could be justified in the most serious cases?

We do not agree that a custodial sentence is appropriate. A person who has made an innocent error or been negligent, without any fraudulent intent, could be found guilty of the new offence. It would be unjust and disproportionate for such a person to be given a prison sentence. Custodial sentences should (as now) continue to be available for cases of fraud, ie where the *mens rea* is established.

Q16 If a custodial element is appropriate, should the maximum sentence be six months?

We do not agree that a custodial sentence is appropriate. If one is introduced, it certainly should not be more than six months.

Safeguards and defences

Q17 Should it be a defence for (i) a person to demonstrate that they had taken reasonable care in conducting their tax affairs, or (ii) a person to demonstrate that they had sought and followed appropriate professional advice? What would be the impact on the likelihood of successful prosecutions if statutory defences are included?

We strongly support having a defence of taking reasonable care. The defence of having taken appropriate professional advice should be part of the reasonable care defence, but not an alternative to it, as it is more narrow and more difficult to define.

In judging whether a taxpayer has taken reasonable care, it is important that this is considered in the context of their individual circumstances and what they could be expected to understand.

The defence should be in statute.

Q18 Should any other statutory defences be introduced?

We have no further comments.

Q19 Are further safeguards appropriate? What should these be?

In view of the risk that people with no fraudulent intent could be charged with this offence, HMRC should have strict guidelines on when it is used. If HMRC undertakes a criminal investigation with the SL offence in mind, or recommends to the Crown Prosecution Service that a case should be dealt with in this way, the decision should be taken at a senior level in the department.

HMRC must ensure that taxpayers are aware of their obligations in respect of overseas income and gains. It must also make them aware of the disclosure opportunities which they could use. This will require communicating some difficult tax concepts. HMRC must carry out sufficient public education – it will not be sufficient to rely on third parties such as advisers and banks.

Assessment of impacts

Q20 Do you have any views, comments or evidence which may help inform our understanding of likely impacts?

See our comments under ‘Evidence for introducing the offence’.

Q21 Do you have any views, comments or evidence which may help inform our understanding of likely equalities impacts?

See our comments under ‘Evidence for introducing the offence’.

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)