U.K. REQUIREMENT TO CORRECT

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BACKGROUND

The "Requirement to Correct" ("R.T.C.") rules became law when the Finance (No. 2) Act 2017 received Royal Assent on November 16, 2017. The legislation required taxpayers who were noncompliant as of April 5, 2017, with regard to offshore tax affairs, to correct the relevant noncompliance by September 30, 2018. The deadline corresponds to the final date for over 100 jurisdictions who have signed up to exchange data on financial accounts information. Under the Model for Automatic Exchange of Financial Account Information in Tax Matters (Common Reporting Standard ("C.R.S.")), H.M.R.C. will have more access to personal financial information about offshore assets held than ever before.

Under the initial legislation, failure to correct by September 30, 2018, would result in a 200% penalty being applied, plus a potential penalty of 10% of the value of the associated asset. Subsequent to government consultation, H.M.R.C. has published updated guidance, which includes a much-welcomed relaxation to the penalties where (i) ahead of the September 30, 2018, deadline, H.M.R.C. has been notified that a disclosure will be made, and (ii) the disclosure is made ahead of the associated deadline for the particular disclosure route taken. The final date is December 29, 2018. Given the significant liability, not to mention the scrutiny and administration costs, it is vital to review historic U.K. tax compliance in advance of this date.

WHAT IS OFFSHORE NONCOMPLIANCE?

The definition of offshore noncompliance is far-reaching and relates to *any* compliance matter where tax is owed to H.M.R.C. as a result of tax noncompliance where there is an offshore connection.

WHAT TAXES ARE COVERED?

The R.T.C. applies to any person with potential undisclosed U.K. income tax, capital gains tax, and/or inheritance tax liabilities.

"Persons" refers to the following:

- Individuals
- Partnerships
- Trustees
- Nonresident landlord individuals/companies

WHAT ARE THE PENALTIES?

The standard penalty is 200% of the tax liability but can be reduced according to factors such as cooperation and quality of the disclosure to H.M.R.C. However, the minimum penalty is 100% of the tax liability. Where, after the deadline, H.M.R.C. opens an enquiry ahead of any disclosure, the penalty cannot be less than 150%.

Where H.M.R.C. believes that the person was aware of the tax noncompliance and failed to correct by the deadline, they can apply an additional penalty to the standard penalty and seek up to 10% of the value of the assets linked to the offshore noncompliance.

There is also potentially a further penalty of 50% if it can be shown that assets were intentionally moved to avoid, for example, an overseas bank reporting the account to H.M.R.C.

In serious cases, which involve over £25,000 in tax any tax year, H.M.R.C. may cause reputational damage by publishing the taxpayer's details on a public website.

REASONABLE EXCUSE

Penalties will be chargeable for failure to correct, unless the taxpayer can demonstrate a "reasonable excuse" existed for not meeting the obligation. The definition of a "reasonable excuse" is very narrow. The legislation makes it clear that a reasonable excuse cannot be based on tax advice received from an "interested person." Such advice will not be accepted and will instead be treated as "disqualified" advice.

If the taxpayer fails to make a correction but has a reasonable excuse for not doing so, a penalty will not be imposed, and an obligation will exist to pay the tax owed and accompanying interest.

WHAT IS CONSIDERED "DISQUALIFIED ADVICE"?

- Advice given to the taxpayer by an interested person
- Advice given to the taxpayer as a result of arrangements made between an interested person and the person giving the advice
- Advice given by an advisor who does not have appropriate expertise in the matter
- Advice which does not consider all of the person's individual circumstances
- Advice that is addressed to, or is given to, a person other than the taxpayer

WHO IS AN INTERESTED PERSON?

An interested person is someone who has participated in the "avoidance arrangement or has received consideration for implementing or facilitating entry into a tax avoidance arrangement."

An interested person includes the following:

- A body of persons both corporate or unincorporated
- Limited companies
- Accounting firms
- Limited liability partnerships

H.M.R.C. guidance on the R.T.C. provides examples of disqualified advice.

Example 1

> *Trustees of an offshore trust obtain advice from an accountancy firm on how best to distribute funds to U.K. and non-U.K. beneficiaries. The firm specializes in giving this advice. After considering the trust and the beneficiaries' circumstances, the accountant advises the trustees on how to make distributions in a way that they minimize their tax position.*
>
> *Some years later, H.M.R.C. challenges the trustees and the beneficiaries for not paying enough tax on the distributions and for failure to correct.*

As the advice was given by an interested person (a firm of accountants) and concerned "avoidance arrangements," it is treated as disqualified advice and cannot be used as a reasonable excuse.

Example 2

> *The facts are the same as in Example 1, however, in this scenario, the trustees later undertook a secondary and independent review from a person with the appropriate expertise who was not involved in facilitating the original arrangements. Provided that the trustees followed the advice given and it took into account the trustees' and beneficiaries' circumstances, then it can be relied on as a reasonable excuse if the trustees fail to make a correction.*

"The legislation requires taxpayers who, as of April 5, 2017, are noncompliant with regards to their offshore tax affairs, to correct the relevant noncompliance by September 30, 2018."

The trustees in Example 1 sought advice in good faith. However, the R.T.C. legislation clearly seeks to disregard advice given by professional advisors paid to do so, and an independent review from a peer, as in Example 2, is necessary to ensure the advice is not considered as disqualified advice.

HOW CAN CORRECTIONS BE MADE?

A correction can be made by refiling tax documents (*e.g.*, a self-assessment tax return). Consideration should be given to using the Worldwide Disclosure Facility ("W.D.F.") or the Contractual Disclosure Facility ("C.D.F."). The latter should be used in cases where the noncompliance results from deliberate behavior.

For taxpayers who are not confident that their offshore affairs are tax complaint, a review should be carried out to assess their tax position by someone whose advice will not be disqualified, and then a disclosure should be made, if appropriate.

As stated above, it is important to take the initiative and file a disclosure, or notify H.M.R.C. of the intention to file, before September 30, 2018. If a tax enquiry is already underway, the disclosure must be made within 60 days. If using the W.D.F., the disclosure should be made within 90 days. If using the C.D.F., the disclosure should be made within 60 days (i.e., the Outline Disclosure deadline).

If there are concerns that H.M.R.C. could successfully dispute a historical tax position, it may be prudent to lodge a "protective" disclosure regarding the potential noncompliance.

WHAT IS THE STATUTE OF LIMITATIONS?

Under "normal" tax rules, H.M.R.C. has the following time limits to make an assessment:

- Four years in circumstances of reasonable care
- Six years in circumstances of careless behavior
- 20 years in circumstances of deliberate behavior

For the purposes of R.T.C., however, the "normal" H.M.R.C. time limits have been extended retroactively by four years. This means that up until April 5, 2021, a person who has failed to correct can still be investigated by H.M.R.C. as follows:

- For assessments not involving careless or deliberate behavior,
- H.M.R.C. can still go back to 2013-14.
- For assessments including careless behavior, H.M.R.C. can still go back
- to 2011-12.
- For assessments involving deliberate behavior, H.M.R.C. can still go back to 1997-98.

WHAT STEPS CAN TAXPAYERS TAKE?

Given the scale of R.T.C. penalties, doing nothing is no longer a viable option where a history of noncompliance exists. A number of options can be taken to regularize the taxpayer's position and avoid penalties, depending on the exact circumstances.

Counsel can assist in analyzing the taxpayer's position and recommend the most appropriate course of action, by taking the following steps:

- Review the historic tax position.
- Perform a tax health check.
- Review any existing advice from previous advisors.
- Where appropriate, assist in making a disclosure to H.M.R.C. or correcting offshore noncompliance.

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