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The requirement to correct rule

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Introduction

The Finance (No. 2) Act 2017 contains provisions requiring disclosure of historic non-compliance to HMRC by 30 September 2018: the "requirement to correct" rule. This is part of a range of legislation targeting offshore tax evasion.

HMRC expects the data exchange that will shortly take place as a consequence of the Common Reporting Standard (CRS), and other information exchange programs, will provide them with details they need to establish non-compliance.

Defences for failing to comply with the requirement to correct are limited and it may not be sufficient to have relied on legal or tax advice. Prompt action is required now to potentially avoid very significant penalties.

In this article, Anthony Thompson and Robert Payne discuss the scope of the rule and what action should be taken now as a consequence.

Requirements of the Rule

The rule applies when there has been a failure to comply with an outstanding offshore tax obligation. The disclosure requirement applies to income tax, capital gains tax (including non-resident capital gains tax) and inheritance tax. It applies to individuals, companies, partnerships and trustees.

For the purposes of the rule, non-compliance is defined extremely broadly. It can relate to any non-UK income, assets (again defined broadly and including cash, land, intellectual property and pensions) and activities. The requirement can be breached by failing to file a tax return with HMRC or filing a return that contains an inaccuracy that reduces the tax liability or inflates a tax loss or repayment.

HMRC's guidance provides many examples of how non-compliance may arise. These include renting out property in Spain without declaring the rent and receiving business profits in a non UK bank account that is not declared. For inheritance tax purposes, non-compliance may result from failing to declare non-UK assets which formed part of the death estate of a UK domiciled individual or failure by trustees to report and pay a ten year anniversary charge.

Timing Issues

Action should be taken by 30 September 2018 at the latest (and the earlier the better in case other penalties are accruing).

The requirement to correct covers non-compliance committed before 6 April 2017 (and so will apply to tax returns that were filed, or should have been filed, in the 2015/2016 tax year and earlier tax years).

Further, where the requirement relates to an unpaid liability, HMRC need to be able to raise an assessment to recover the relevant unpaid tax, taking into account usual correction periods. For instance, if there has not been careless or deliberate behaviour the applicable timeframe is four years from the end of the relevant tax year of assessment. If the tax loss is the result of careless or deliberate behaviour, then the relevant deadlines are six years and twenty years respectively from the end of the relevant tax year. Therefore, a review will be needed into how non-compliance may have arisen to consider the period in which correction may be required.

How to correct

There are many ways in which non-compliance may be corrected. These include the Worldwide Disclosure Facility (via HMRC's digital service), notifying a HMRC officer in the course of an enquiry and any other method agreed with HMRC.

Penalties for Non-Compliance

Failure to disclose by 30 September 2018 will result in a minimum penalty of 100% of the tax at stake. This is in addition to the tax due (and any interest accruing as a consequence).

For serious cases of non-compliance, HMRC may also name and shame the culprit.

Standard penalty

HMRC's starting point is to apply a penalty of 200% of the relevant liability (in contrast, the current penalty for a deliberate and concealed (i.e. a very serious) error is 30% – 100% of the additional tax due). They may then apply a reduction in view of relevant criteria as follows:

- whether HMRC were voluntarily notified of the failure to comply
- the extent of any co-operation with HMRC
- the quality of the disclosure provided to HMRC (HMRC's guidance notes that this can involve telling HMRC who enabled non-compliance) and
- the seriousness of the failure.

The penalty cannot be reduced below 100% of the liability.

Asset based penalty
In serious cases, HMRC may also apply a penalty of up to 10% of the value of the assets connected to the non-compliance (in addition to the standard penalty). This additional penalty may apply when the tax at stake exceeds £25,000 in any tax year and the party in default was aware of their non-compliance.

Asset moved abroad to avoid reporting
If assets were moved offshore to avoid their details being reported to HMRC then there will be a further penalty in addition to the standard penalty. It will be set at 50% of the standard penalty.

Defences
Those with a reasonable excuse for failing to make a required correction will not face a penalty (but they will need to settle any tax due and applicable interest). However, this does not necessarily mean that a penalty will not arise as a consequence of other compliance regimes.

In practice, it may be difficult to rely on this defence. Relying on a third party, without taking reasonable care in so relying, will not be a valid defence. Neither will having insufficient assets to meet the tax liability (HMRC's guidance notes that this is the case unless it is a consequence of events outside the person's control, although it is not clear what will be considered such an event).

Advice
In certain cases it will be possible to rely on a defence of reasonable excuse, having relied in good faith on advice that was wrong. However this will not be possible where:

- the person giving the advice did not have the required expertise (HMRC have indicated that anyone that belongs to a UK-recognised legal, accountancy or tax advisory body will have sufficient expertise on UK tax matters);
- the advice did not take into account all relevant circumstances (and in particular the adviser must have been given full and accurate details of all relevant matters and care should have been taken in case the actual circumstances have changed by the time the advice is implemented);
- the advice was not given to the person that is seeking to rely on it, and was instead given to someone else; or
- the advice is given by an "interested person", or an "interested person" was involved in the arrangements (this includes where the advice is given to the taxpayer as a result of arrangements between an "interested person" and the person that gave the advice).

As long as the advice does not fall within one of these headings, it should not matter whether the advice was given when the non-compliance occurred or as part of a subsequent review.

An "interested person" is someone that participated in an arrangement, or received consideration for facilitating entry into an arrangement, where in all the circumstances it would be reasonable to conclude that the main purpose (or one of the main purposes) was to obtain a tax advantage. This should not catch established practices that HMRC has indicated it will accept.

HMRC's guidance sets out how a taxpayer should proceed when there is uncertainty about whether a correction should be made following the receipt of advice. This may include taking further professional advice. HMRC also note that where the matter is not "clear cut", it is possible to provide HMRC with the relevant details without accepting that there is any liability. This will be a valid correction and therefore the requirement to correct penalty regime will not apply.

Summary

Those potentially affected by the new requirement to correct should take advice urgently due to its imminent deadline. The rule applies very broadly and HMRC will shortly have copious information that will enable them to enforce it.

Steps should be taken to review any potential instances of non-compliance, for instance failure to file returns as required. Trustees should review their files to ensure that they have not failed to comply as required (particularly bearing in mind the new naming and shaming provisions, which apply in addition to the penalty regime). Historic advice should be reviewed to confirm that it can be properly relied on in case there is potential non-compliance (for instance, to check that it took into account all relevant factors and was properly implemented).

A comprehensive review of historic actions may be required, but this is likely to be a very worthwhile exercise in view of the scale of the potential penalties.

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