Foreign income – The reporting obligations and how to meet them

While UK-resident taxpayers have always had an obligation to report relevant worldwide income to HMRC, recent activity by HMRC means new enquiries from taxpayers on the helpline substantially arise as a result of the receipt of letters from HMRC that are designed to prompt taxpayers to disclose foreign income to HMRC. The letters sent by HMRC are as a result of the receipt by HMRC of information from offshore institutions. The obligation to declare the income is not new, but the level of activity from HMRC and offshore entities is new as explained below.

To summarise the steps that have led to the current obligations for taxpayers:

- UK resident taxpayers have always had the obligations to declare worldwide income unless Double tax Agreements provide otherwise. Note that even if a Double Tax Agreement indicates that otherwise taxable income is exempt from UK tax, it may be necessary to declare the income – and claim the exemption.
- The World Wide Disclosure campaign was intended to encourage the voluntary disclosure of offshore income/gains where relevant.
- The common Reporting Standard (CRS) is an OECD agreement across over 100 countries who share relevant information between offshore institutions. The deadline for the sharing of this information was 30/09/18.
- The deadline of 30/09/18 was to encourage taxpayers to declare relevant offshore non-compliance in advance of HMRC being in receipt of details of the income.
- Nonetheless HMRC issued and continue to issue 'prompt' letters where they are in receipt of details of sources of offshore income.

In more detail:

1. <u>Worldwide Disclosure Facility (2016)</u>

The Worldwide disclosure facility was launched on 05/09/2016, the aim of which was to encourage taxpayers to put their tax affairs right if they had not declared all of their UK tax liabilities that related to offshore income or gains, i.e. much like the let property campaign, which encouraged taxpayers with previously undeclared rental income to make appropriate declarations.

2. <u>Requirement to correct (FA (No2) Act 2017)</u>

The Finance (No 2) Act 2017 included the 'requirement to correct' provision. This required taxpayers to correct existing offshore tax irregularities by 30/09/18 or face higher penalties. This 'requirement to correct' provision relates both to those who were deliberate evaders and those who may have made errors innocently. The 'requirement to correct' relates to anything that HMRC could lawfully assess at 06/04/2017. The rules effectively 'freeze' the time limits at 06/04/2017, so that anything assessable at 06/04/2017 remains assessable until the later of 5 April 2021 (i.e. for another 4 years) or the date on which an assessment can be raised using the normal rules. So, for a careless error in 2015/16, the extension would be six years, to 5 April 2022. It should also be noted that requirement to correct does not apply to the 2016/17 tax year.

3. <u>Common Reporting Standard and deadline of 30/09/2018</u>

The date of 30/09/2018 was the submission deadline under the OECD's Common Reporting Standard (CRS). The CRS was the standard which applied to over 100 countries worldwide by which offshore institutions such as banks and trust companies would automatically provide HMRC with details of assets held by their clients that have a UK address. As a consequence of this deadline, the UK tax legislation required UK taxpayers to correct their offshore tax affairs by 30/09/2018. I.e. it was expected that, as this was the point at which HMRC would have the relevant information from offshore countries under the agreement, UK taxpayers should 'correct' their tax affairs where there were inaccuracies in the declarations already made, or a lack of declarations existed, by the same deadline of 30/09/18.

However prior to 30/09/2018, HMRC issued 'prompt' letters in batches as they received information from offshore entities, so that in the months preceding 30/09/2018 taxpayers had the opportunity to regularise their tax affairs prior to 30/09/2018 with the advantage of HMRC prompts in some cases. (These 'prompting' letters are the letters that gave rise to the calls on the helpline from taxpayers both prior to 30/09/18 and in subsequent months.) Either due to the time at which HMRC received the information from different countries, or the length of time it is taking them to process that information, HMRC continue to issue batches of letters relating to different countries. The key issue here, is that individuals that receive such letters now, that is, after 30/09/2018, are unable to meet the 'requirement to correct' deadline.

4. The Requirement to Correct provision of (FA (No2) Act 2017) in more detail (RTC)

The basics of the 'requirement to correct' provisions are as follows, but further details on how to apply these provisions is included in the flow charts which follow.

4.1 What does the 'requirement to correct' provision apply to?

RTC applies to 'relevant offshore tax non-compliance' which is not corrected by 30/09/2018, ie:

Non-compliance means:

- failure to notify HMRC of chargeability to income tax, or
- failure to make a return, or
- delivery of an inaccurate return.

Offshore means:

- Offshore matter (e.g. income/assets)
- Offshore transfer (transfer of income/assets transferred outside the UK)

Relevant means:

- It is not corrected at 06/04/2017
- It involves potential loss of tax revenue
- HMRC would have been able to assess the tax at 06/04/2017

4.2 How do you correct the non-compliance?

There are various methods that can be used, as follows:

1. A document that should have been submitted previously, can now be submitted (e.g. tax return). This **can apply to some clients dependent on circumstance and it can be more beneficial for some clients to use this method because of the different penalty regime.**

2. Disclosure facility (e.g. WDF) **This is the one seen most frequently**

3. Telling an HMRC officer in an Enquiry **(not often seen on the helpline)**

4. Other method agreed with HMRC **(most likely to apply where a letter to HMRC may be considered appropriate where chargeability exists, but no or little liability)**

The flow charts on the following pages apply these rules.

The flow charts help you to meet the reporting obligations, by guiding you to the correct answers to the relevant questions:

The key questions to resolve are:

1. **What income needs to be declared to HMRC?** I.e. to what extent does income from abroad need to be declared to HMRC . As a general principle, all offshore income needs to be declared, but this is dependent on the provisions in relevant Double Tax Agreements or the rules where Double Tax Agreements are not in place. Guidance is detailed below which refers to the LITRG website as this provides comprehensive detail on the rules around declaring foreign income and Double Tax Agreements.

2. **How many years need to be declared?** In the first instance, a decision between failure to notify and an inaccuracy; then, in a failure to notify case, dependent on whether there is a reasonable excuse, and whether there is negligence; in an inaccuracy case, there is a decision between the behaviours reasonable care/careless/deliberate). The table in HMRC's Compliance Handbook may be of assistance: https://www.gov.uk/hmrc-internal-manuals/compliance-handbook/ch56100.

3. **What method to use to make the declaration**? Most commonly the options are between using tax returns or the World Wide Disclosure facility. It may be necessary to quantify the likely tax liability when making this decision.

4. **What level of penalties are appropriate?** – This is dependent generally on whether the declaration is made before or after 30/09/18 – ie if before 30/09/18 penalties are dependent on nature of behaviour, ie the usual criteria on behaviour for Failure to Notify penalties (FTN), or Inaccuracy penalties, and if after 30/09/18 and RTC applies, the penalties will be failure to correct penalties (FTC) and therefore, are dependent on whether there is a reasonable excuse. For years outside RTC post 30/09/18 the usual FTN and inaccuracy penalties apply and therefore dependent on behaviour.

Finance Act 2019 note:

As a reminder, the Finance Act 2019 included new legislation extending the current four and six year time limits so that HMRC will always be able to assess at least 12 years of back taxes for offshore non- compliance. However, this extended time limit does not apply if HMRC has received information from overseas by mandatory automatic exchange before the time limit that would otherwise apply (4, 6 or 20 years) and HMRC could reasonably have been expected to be aware of the lost tax from that information. It is unclear how this will be interpreted.

Step One - What income needs to be declared to HMRC?

The first step is to decide what income needs to be reported to HMRC. NB you will note in Step 2 and in some instances it may not be necessary to make a declaration to HMRC, dependent on the amount of the tax due. Therefore you should have an idea of the level of tax liability at this stage.

Examples of foreign income and foreign gains include:

- Interest on savings in overseas bank accounts;
- Overseas pension income (see below);
- Income from renting out a property in another country;
- Earnings relating to work duties performed in another country (even if this is for a UK employment, or the earnings are paid in or from the UK);
- Profits from running a business in another country;
- Gains from selling or giving away overseas assets, for example, a house or shares;
- Other overseas investment income, for example, dividends on shares in overseas companies.

The disclosure should take into account rules that may mean some of the income / gains are exempt or do not need to be declared to HMRC. These include:

- The rules specific to overseas pensions:(see https://www.litrg.org.uk/tax-guides/migrants/what-uk-tax-do-i-pay-my-overseas-pension) and

- treaty relief (see https://www.litrg.org.uk/tax-guides/migrants/residence-and-domicile/what-double-taxation-agreement)

- Foreign Tax Credits (see https://www.litrg.org.uk/tax-guides/migrants/residence-and-domicile/what-double-taxation-agreement)

- remittance basis and overseas workday relief (see https://www.litrg.org.uk/tax-guides/migrants/residence-and-domicile/how-are-foreign-income-and-gains-taxed)

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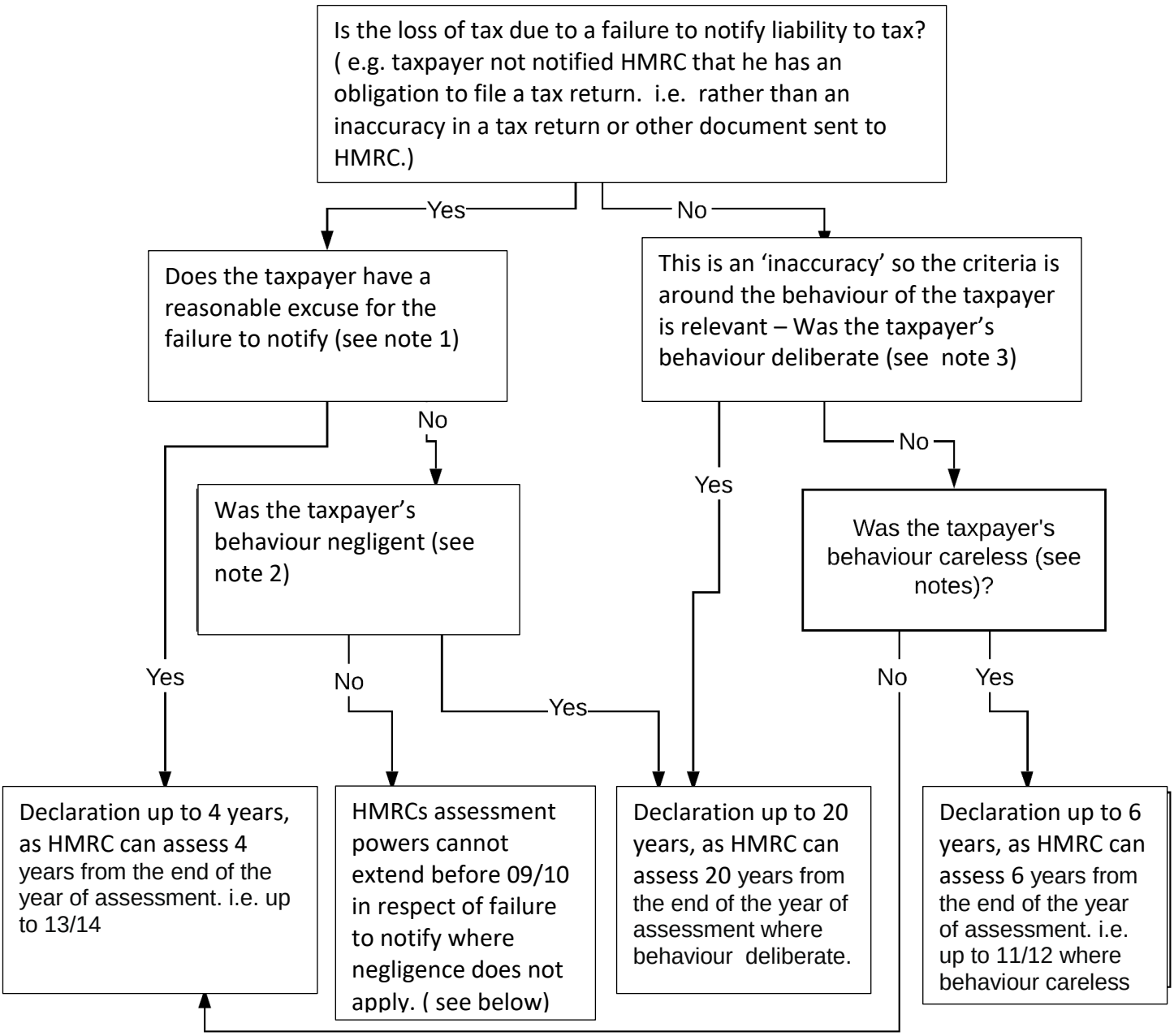
Step Two: How many years need to be declared?

RTC only applies if HMRC can raise an assessment for recover unpaid tax at 06/04/17, so the first question to ask is what years can HMRC raise an assessment for ?

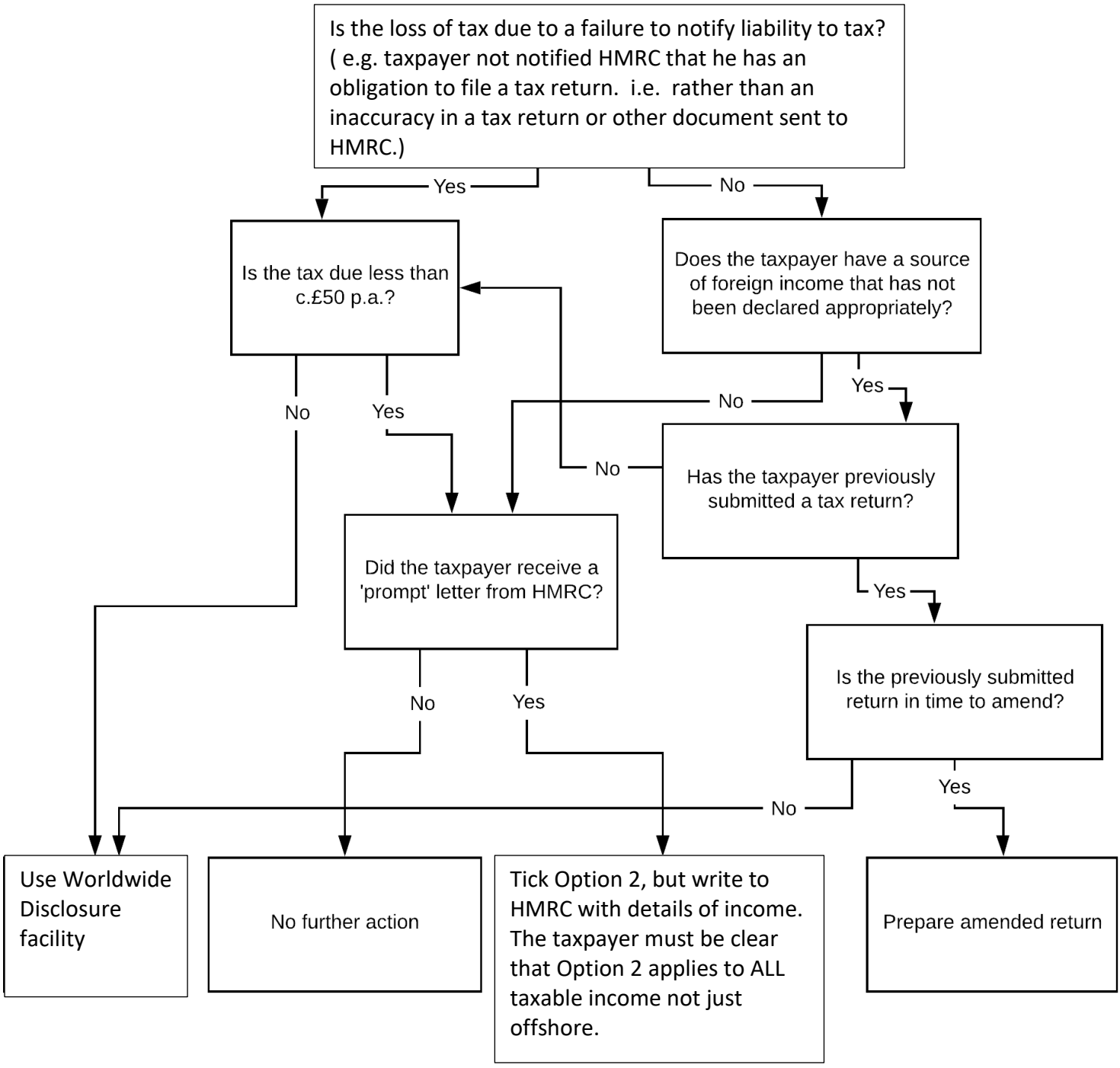


See also https://www.gov.uk/hmrc-internal-manuals/compliance-handbook/ch56100.

Anything assessable at 06/04/2017 remains assessable for another 4 years. Ie where the normal assessment period for assessing the tax concerned would otherwise expire after 6 April 2017 , the period in which HMRC may assess a person to tax in respect of relevant offshore tax non-compliance is extended to 5 April 2021. F(No 2) A 2017, Sch 18 para 26.

Note that in the online disclosure facility, the option of 'not deliberate, no reasonable excuse' will produce a request for a declaration of 20 years, however we believe that legislation limits HMRC powers to 09/10 in these circumstances.

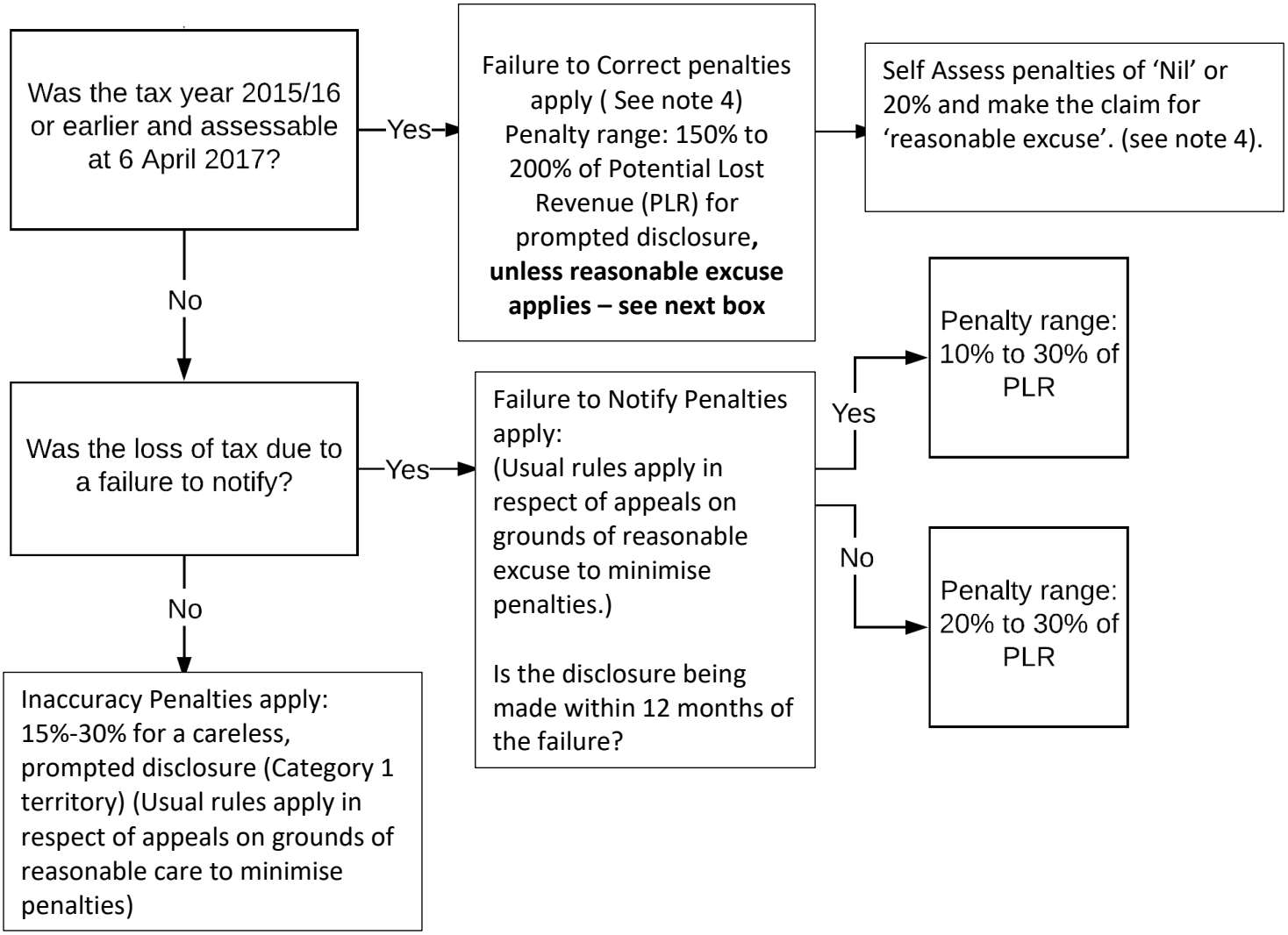
Step Three: What method to use to make the declaration?



There is a risk that by completing the Certificate which, if it turns out to be false or include a false statement, could expose a person to a criminal investigation and prosecution, so care should be taken when recommending this action.

Step Four: What level of penalties are appropriate?

N.B. Flowchart assumes offshore non-compliance is **non-deliberate, not corrected by 30 September 2018** and the disclosure is **prompted**. The taxpayer must consider each tax year separately.



For other cases, please see:
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/799489/CC-FS17_English.pdf

Notes

Definitions of behaviour to determine number of years to declare, ie different consideration depending on whether you are considering a failure to notify or inaccuracy. Reasonable excuse criteria also apply to Failure to correct penalty appeals.

Note 1 - Failure to Notify – Reasonable excuse

Reasonable Excuse (4 years to declare if the taxpayer has a reasonable excuse for the failure to notify; or 20 years where reasonable excuse does not apply, but HMRC cannot assess before 2009/10)

Reasonable Excuse - is not defined by HMRC, but relevant guidance is as follows:

A reasonable excuse is normally an unexpected or unusual event that could not be reasonably foreseen or is beyond the person's control, and which prevents the person from complying with an obligation. An unexpected combination of events may together be a reasonable excuse.

'It is necessary to consider the actions of the person from the perspective of a prudent person exercising reasonable foresight and due diligence, having proper regard for their responsibilities under the tax acts.

'If the person could reasonably have foreseen the event, whether or not it is within their control, we expect the person to take steps to meet their obligations.

A reasonable excuse is something that stopped you meeting a tax obligation that you took reasonable care to meet, for example:

- your partner or another close relative died shortly before the tax return or payment deadline
- you had an unexpected stay in hospital that prevented you from dealing with your tax affairs
- you had a serious or life-threatening illness
- your computer or software failed just before or while you were preparing your online return
- Service issues with HM Revenue and Customs (HMRC) online services
- a fire, flood or theft prevented you from completing your tax return
- postal delays that you could not have predicted
- delays related to a disability you have
- Reasonable excuse does not include ‘no funds to pay’.
- Relying on someone to do something is not a reasonable excuse unless the taxpayer took reasonable care to avoid failure

Where the taxpayer had a reasonable excuse but the excuse has ceased, the taxpayers is to be treated as continuing to have that excuse if the failure is remedied without unreasonable delay after the excuse ceased.

Note 2 –Failure to Notify - Negligence

Negligence (20 years to declare if the taxpayer has no reasonable excuse and was negligent)

Negligence is the omission to do something which a reasonable person would do, or doing something that a prudent and reasonable person would not do.

When judging this, it is necessary to think about the considerations that would ordinarily guide and regulate the conduct of people.

Note 3 Inaccuracy Error -

Reasonable Care (4 years to declare if taxpayer behaviour shows reasonable care) NB 'reasonable care' applies to inaccuracy penalties. This is not the same as reasonable excuse

To decide if the taxpayer took reasonable care, the following guidance should be considered (also see HMRC manuals at CH81130) i.e. reasonable care has been taken if:

- It was reasonable to follow a course of action that was a reasonably arguable view of the situation but it is subsequently not upheld.
- You took advice and thought that it meant one thing, but in the end it turns out that it meant something else.
- You followed advice from HMRC which later proves wrong, but, provided all the details were declared at the time, you followed their advice which was reasonable.
- You accepted using information from another person, but it was not possible to check if it was right. (e.g. generally applies where the information is supplied by an employer or pension provider)

NB HMRC must consider the taxpayers ability and circumstances, e.g. health, numerical skills, life event, (e.g. bereavement) etc. In addition the burden of proof is on HMRC, therefore if the information has not been provided, it would be expected that HMRC have asked for relevant information where they don't already have it.

Careless Behaviour / failure to take reasonable care (6 years to declare if taxpayer behaviour is careless)

This can be identified as 'the omission to do something which a prudent and reasonable man would do.' However, to distinguish from negligence, this needs to be drawn more narrowly. The standard of behaviour against which the taxpayer should be measured is that of a prudent and reasonable taxpayer in the position of the taxpayer in question.

If the taxpayer was not consciously aware of the inaccuracy the behaviour is likely to be defined as careless and not deliberate, i.e. the taxpayer did not intentionally or consciously chose not to find out the correct position.

Deliberate Behaviour (20 years to declare if taxpayer behaviour is deliberate)

What behaviour can be defined as deliberate? Considerations:

- Did the taxpayer have knowledge and intention? It should be noted that different taxpayers may have different levels of knowledge and intention
- Wilful ignorance – did the taxpayer consciously and intentionally chose not to find out the correct position, this could be regarded as wilful ignorance. This has particular reference to taxpayers in circumstances where the person knew that they should have taken advice, but didn't.

Note 4 – Penalties for failure to correct (FTC) where the requirement to correct provision applies

'Failure to Correct' (FTC) penalties apply to failures under the requirement to correct provisions. They are between 100% and 200% of the unpaid tax (irrespective of which Category country is involved). Penalties under FTC for a prompted disclosure will not be less than 150% unless there is a reasonable excuse or special circumstances.

Such penalties can only apply to tax years 2015/16 and earlier (depending on which tax years were assessable at 6 April 2017). FTC penalties cannot apply to the 2016/17 tax year, because a taxpayer cannot be said to have been non-compliant in respect of their offshore income and gains for this year at 5 April 2017. For example, the requirement to notify chargeability for 2016/17 was not until 5 October 2017 and the typical filing deadline for the 2016/17 tax return was not until 31 January 2018.

Special Circumstances - HMRC do have the discretion to reduce or 'stay' a penalty in 'special circumstances'. The legislation does not define what constitutes 'special circumstances' other than to say that it does not include inability to pay or the fact that an underpayment by one person is balanced by an overpayment by another, but this does not preclude an adviser making a 'special circumstances' argument on the basis of the facts of the circumstances of the taxpayer.

Broadly, special circumstances are described by HMRC as either 'uncommon or exceptional' or 'where the strict application of the penalty law produces a result that is contrary to the clear compliance intention of that penalty law'. CH170600

Reasonable excuse - An appeal can be made against the FTC penalties on the basis of reasonable excuse 'Reasonable Excuse' has been explained above (note 1) however in relation to making an appeal against penalties for FTC penalties, RTC legislation imposes additional conditions in respect of reliance on advice:

Reasonable excuse - Specifically excluded from being categorised as a reasonable excuse, is reliance on advice which is 'disqualified', that is advice given in the main by persons without the appropriate expertise or given by those involved in arrangements (e.g. promoters & facilitators,) and advice which is generic or not addressed to the taxpayer. More specifically, disqualified advice is:

i. Advice given by an interested person
ii. Advice given because of an arrangement made between interested parties and the person who gave the advice
iii. Person giving the advice did not have the appropriate expertise
iv. The advice did not take into account all circumstances
v. Main purpose of advice was obtaining tax advantage.
vi. Advice given to someone other than the interested person.

HMRC guidance provides more detail on disqualified advice.

Where a reasonable excuse exists, the follow process is suggested:

Make the reasonable excuse claim against the <u>failure to correct</u> penalties (ie the 100% - 200%) in the disclosure. This would reduce the failure to correct penalties to zero.

Include on the disclosure form the 20% <u>failure to notify</u> penalties, and calculate the interest and therefore total payment on this basis.

HMRC are able to give up the failure to correct penalties and then apply the failure to notify penalties and we are seeing this in practice. Therefore in our current experience this is the expected outcome that is probably the most appropriate for many clients.

It is however possible to make a reasonable excuse claim against the failure to notify penalties also and if you believe this is the correct action for the client you are dealing with please contact the head office to discuss. A successful appeal against the 20% failure to notify penalties may be available in some circumstances.