HM Revenue & Customs

Tackling offshore tax evasion: Strengthening civil deterrents

Summary of Responses
10 December 2014

Contents

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1. Introduction

1.1 Earlier this year, HMRC published an update to its offshore evasion strategy *No Safe Havens*. This set out the Government's determination to ensure that those with offshore tax liabilities who fail to take advantage of disclosure facilities should face tough consequences, including strong financial penalties.

1.2 Shortly afterwards, HMRC published "Tackling offshore tax evasion: Strengthening civil deterrents", which set out a number of options for increasing the civil deterrent against offshore evasion, including:

- Extending the scope of the offshore penalties regime to cover Inheritance Tax and the proceeds of domestic non-compliance which are received or moved offshore;
- Strengthening the deterrent against moving funds to escape tax transparency; and
- Updating the classification of territories rules for offshore penalties to reflect the new gold standard for the exchange of tax information.

1.3 Respondents generally emphasised their support for the aims of the consultation, that offshore evaders should face serious consequences. HMRC is grateful to the 13 groups of stakeholders who provided their views at face to face consultation meetings and all 20 stakeholders for their written responses.

1.4 The proposals were generally well received, with the consultation eliciting a number of detailed points on how the policy objectives could best be delivered. Some concerns were expressed about diminishing returns from applying higher penalty rates, and about how the new penalties would operate in practice. However, most respondents recognised the rationale for retaining the highest penalties for those who deliberately get things wrong. These responses are summarised in greater detail in chapter two.

1.5 Therefore:

- Following a largely supportive consultation on civil sanctions, the Government will bring forward legislation to extend the existing offshore civil penalties regime to inheritance tax and to the proceeds of domestic evasion which are hidden offshore; and to update the classification of territories for offshore penalty purposes to reflect the fact that the Common Reporting Standard is the new gold standard in transparency.

- The Government will legislate for a new "aggravated" penalty of moving the proceeds of tax evasion in order to escape tax transparency, with the penalty coming into effect for movements of funds occurring after Royal Assent to the Finance Act. This penalty will increase the total penalties faced by 50%.

2. Responses: Strengthening civil deterrents

2.1 The consultation contained five options, which fall into three broad categories:

Extending the scope of the existing penalty regime for offshore non-compliance

- Option 1 - extending the scope of the offshore penalties regime to Inheritance Tax, where it currently applies to Income Tax and Capital Gains Tax only

- Option 2 - extending the offshore penalties regime to cover non-compliance arising in territories designated in penalty category 1 or 2 where the proceeds are hidden in less transparent territories

Deterring taxpayers from deliberately moving offshore assets to continue evading tax

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

- Option 4 - extending the 20 years' assessing time limit where offshore assets have been deliberately moved to continue evading tax

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

Updating the existing offshore penalties regime to reflect the new global standard in tax information exchange

- Option 6 - introducing a new category into the table of Designated Territories to reflect those territories that have adopted the Common Reporting Standard

Extending the scope of offshore penalties for offshore non-compliance

2.2 Chapter 2 of the consultation considered the case for extending the principle of increased offshore penalties to include:

(1) Inheritance Tax (IHT), where it currently applies to Income Tax and Capital Gains Tax (CGT) only, and

(2) Domestic non-compliance but where the proceeds are hidden offshore.

Option 1 - Extending the scope of the offshore penalties regime to Inheritance Tax

2.3 In general, most of the respondents considered it appropriate that the offshore penalties regime should be extended to include IHT. They supported increasing penalties in relation to death estates where offshore assets are not properly declared so long as "… safeguards were in place and post death those accountable for delivering IHT accounts were not penalised for actions of the deceased." There was also support for increased penalties in relation to lifetime transfers.

2.4 Several respondents raised concerns about the reforms potentially creating a new penalty position where there was previously none. This is not the case. Where a person responsible for delivering an IHT account has taken reasonable care, they would continue to be outside of the scope of these penalties. Similarly penalties would only be due from beneficiaries where they deliberately withhold information or deliberately supply false information, causing an IHT account to be incorrect. Other existing safeguards such as recourse to request an HMRC review and the ability to take a matter to an independent tribunal continue to apply.

1. Do you consider it appropriate to extend the offshore penalties regime in the case of offshore assets which are part of the death estate and liable to IHT? If you do not, please say why.

2.5 Most of the respondents agreed with the proposal, whilst commenting that penalties should not be chargeable on those preparing and delivering IHT accounts, if the individual had acted professionally and taken reasonable steps to ensure accuracy. One respondent objected to the proposal on the grounds that many executors are not acting in a professional advisory capacity, and may not be familiar with IHT. They commented that IHT in particular, is a complex area of taxation and one in which an individual could find themselves as a beneficiary or executor only once or twice in their lifetime and therefore would be less likely to have the appropriate knowledge about the relevant tax obligations, more so than in situations involving taxes such as Income Tax.

2.6 Most respondents recognised the proposal as being evenly balanced, although some sought reassurance that the past behaviour of a deceased person would not impact on the perceived behaviour of those responsible for the preparation and delivery of the IHT return. This responsibility commences from the date of the death or after being appointed to deal with the IHT affairs and so it is only from that date that their behaviour is relevant. The Government notes this advice and recognises that the period over which HMRC will consider a person's behaviour for applying a penalty will depend on whether that accountable person is appointed to act following a person's death, for example, an executor, or if the assets concerned had vested in that person from an earlier date, for example, a beneficiary or someone in receipt of a gift.

2. Do you consider it appropriate to extend the offshore penalties regime in the case of transfers of assets into offshore structures which give rise to IHT? If you do not, please say why.

2.7 Most of the respondents agreed with the proposal, identifying with the policy objective and recognising that this was another instance in which IHT was being evaded. Some respondents cited current inconsistencies between HMRC's treatment of IHT accounts and other returns for the same person, where the same assets were concerned, and so supported the extension.

2.8 While in favour of the proposed extension, some respondents were again concerned for those without the necessary IHT knowledge, for example a top 10 accountancy firm said "…we are conscious that this is an area where it is extremely easy for an individual to be genuinely unaware of his liability." The Government acknowledges that some individuals may be unaware of their tax liability, but would point out that the circumstances in which a person becomes liable to a penalty remain unchanged by this proposal.

2.9 A few respondents considered that the extension may have little effect, saying that HMRC's estimates of underpaid IHT which comprise assets held both onshore and offshore in comparison with other taxes were low. There was a view that resources could be put to better use to tackle the offshore tax gap. The Government notes this comment but believes that the scale of IHT non-compliance involving offshore assets is significant, as evidenced in disclosures received under the Liechtenstein Disclosure Facility, and it is right that this is addressed.

3. Do you agree that offshore penalties for IHT should be calculated using the same classification for territories as applies for IT and CGT? If you do not, what factors should a new classification take into account and why?

2.10 All of the respondents agreed that there should be one single designated table of territories for the purposes of personal taxes covered by the offshore penalties regime, if the extension to IHT comes into effect. Most respondents thought this was the simplest option, avoiding the need to maintain two separate tables and agreed that the existing table sufficiently considered the arrangements for the exchange of tax information between jurisdictions. The Government agrees with the views expressed.

4. Do you agree with our view about the location of assets in relation to a death event? If you do not, what could constitute a better approach?

2.11 Most of the respondents agreed with the proposal to consider the location of the asset(s) concerned at the date of a death, which is the date on which the disposition or transfer of value is considered to take place for the purpose of paying any IHT. One respondent suggested that there was a need to distinguish between the location of the asset and any holding entity if their location differed. For example, a settlor-interested Panamanian Foundation holding a French property – this would result in a penalty rate similar to that chargeable for a domestic offence – even though the structure used in this

example is located in a territory designated in the penalty category attracting the highest rate. The Government notes and agrees with these views, and will seek to address this in the legislation.

2.12 Views from a few respondents including a legal representative body suggested that "… it would be a better approach to levy a higher range of penalties wherever assets were either located offshore, or the use of offshore structures / entities was involved." They noted the comments in paragraph 2.28 of the consultation document with regard to the need to consider the definition of the destination, and in particular agreed that the destination should include the physical location of assets as well as the location or place of establishment of any entity that legally owns the assets. The Government notes and agrees with these views, and is adopting this approach so that the example given in the paragraph above is brought into the scope of the extension and attracts a higher penalty.

5. Do you agree with our view about the location of assets in relation to transfers of value? If you do not, what could constitute a better approach?

2.13 Most of the respondents agreed with the proposal to consider the location of the asset(s) concerned following a chargeable transfer. They supported the proposal to establish whether the assets were located outside of the UK following a transfer irrespective of where they were situated or held prior to the transfer. Most respondents considered this a reasonable approach as it brought into scope of the offshore penalties regime assets that were initially located in the UK, provided they were located outside of the UK following the transfer. The Government notes and agrees with these views, as well as the additional comments in paragraph 2.12 about considering the location of any intermediate legal owners.

2.14 One of the respondents, a taxation representative body, supported the proposal saying, "given that the penalty regime is founded on a consideration of behaviour, we think that it is logical to determine the penalty attributable to the transfer by reference to the factual destination of that transfer. Any subsequent movement of the asset would then be subject to any appropriate additional sanction under the Chapter 3 proposals." The Government notes and agrees with this view.

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

2.15 Most of the respondents considered it appropriate that the offshore penalties regime should be extended to cover cases where the proceeds of domestic non-compliance were located offshore in order to hide the evasion. There were a number of respondents who agreed with the principle but did not think that increasing penalties in this way would increase the deterrent on its own, given the nature of this particular type of taxpayer, but instead would add an element of complexity in the penalty regime.

6. Do you accept the principle that penalties should be strengthened to take account of where the proceeds of evasion are hidden? If you do not, please say why.

2.16 Most of the respondents agreed that the location of the proceeds of non-compliance should be taken into consideration for penalty purposes, because their existence is more difficult to identify than for funds/assets which remain located in the UK, especially since some territories operate exchange of information arrangements that are not based on international standards and some only provide tax information on request. The Government notes and agrees with these views.

2.17 One respondent, an agent, noted that, “using offshore accounts can be practical and not necessarily for evasion” and so were undecided as to whether the extension was appropriate; this view was echoed by a few respondents. The Government notes this view and agrees that there are many reasons why taxpayers hold accounts and own assets located outside of the UK. This proposal is concerned only with the small minority that evade taxes.

2.18 One respondent, a legal representative body said, “we do not think that where the gains or income are hidden is particularly relevant. The key consideration is that the individual has attempted to hide the gains or income.” The Government recognises that non-compliance can occur irrespective of where the proceeds are located and that those found to have taken steps to conceal the non-compliance warrant higher penalties. However, it restates the policy problem - that HMRC’s ability to obtain information from third parties in the UK, whether automatically or on request, is not comparable with the difficulty in doing so where those proceeds are hidden outside the UK.

2.19 Another respondent, a taxation representative body, said that a person’s “… action would in behavioural terms have been no different from banking the money into an undisclosed UK bank account. Is using an offshore account not already covered by CH81160 – “systematically diverting takings into undisclosed bank accounts and covering the traces”.” As with the comments in the preceding paragraph, the Government recognises that view, that a person that takes additional steps to conceal their non-compliance already warrants the highest domestic penalties, however, the requirement to demonstrate that a person has taken additional steps is comparatively more difficult where the level of secrecy or transparency afforded by another jurisdiction is concerned.

7. Do you agree that the extension of offshore penalties should apply to cover all inaccuracies arising and failures relating to category 1 or category 2 territories where the proceeds of that non-compliance are hidden in higher category territories? If you do not, please say why.

2.20 Most of the respondents agreed that non-compliance corresponding to category 1 or category 2 territories, e.g. income arising in France, should also attract higher (offshore) penalties where the proceeds of the non-compliance are located in higher category 2 or category 3 territories respectively.

2.21 One respondent considered the measure should only apply in cases where the potential tax lost was material, favouring the imposition of a de-minimis limit. The Government notes this comment; the offshore penalties regime does not currently include a threshold and it is not considered that the number of penalty cases where the tax liabilities are smaller is disproportionately large or small. It considers the introduction of a threshold would undermine the penalty regime by eroding its deterrent value.

2.22 One respondent disagreed with the proposal, citing the potential problem of identifying the proceeds of non-compliance in category 1 and category 2 territories as well as in other less transparent territories. The Government recognises the significant challenge in obtaining information from other jurisdictions and particularly in these circumstances. The consultation included our thoughts on addressing the problem around satisfactorily linking demonstrable non-compliance with funds identified offshore, proposed a solution and asked for views (see 2.24-2.26 for more information).

2.23 One respondent suggested that this proposal is dropped in favour of one of the options set out in chapter 3. Those options address a different policy problem. For option 2, that it is harder to find the proceeds of non-compliance when they are located offshore, whereas options 3 - 5 focus on the moving of untaxed funds that are already offshore. There is also a difference in the trigger for the higher penalty and the timing of that movement.

8. Do you favour the introduction of such a statutory rule? How else might the link between non-compliance and offshore funds be demonstrated?

2.24 The question asked whether, where offshore funds cannot be demonstrated to have arisen from taxable sources, and where domestic non-compliance has been demonstrated, those offshore funds should be presumed to represent the proceeds of the non-compliance. A few of the respondents considered that the introduction of such a statutory rule of presumption would help determine the source of funds in accounts that comprised mixed funds; a taxation representative body said "… presumption might be appropriate provided that the presumption was rebuttable."

2.25 Most respondents were not in favour of introducing such a rule. One respondent, an agent, suggested such a move would be "unjust and open to abuse by HMRC" and another agent advised that this "approach should form

part of HMRC's guidance and process." Other comments agreed that this level of consideration was something that HMRC was already expected to apply in practice and something which was already effectively set out in published guidance.

2.26 While the Government has considered the supporting views and has explored how such a rebuttable presumption rule / test could operate in practice, it is mindful of the lack of demand for such a rule. It notes the comment about HMRC having recourse to a potentially unnecessary power and that operational practices appear to be sufficient. It has decided against introducing such a rule.

9. Which of the above two methods for ascertaining the category / level of penalty do you consider to be the best way of applying the extension to offshore penalties? Please say why.

2.27 Almost all of the respondents considered that the second method was the most appropriate: consideration of the penalty category for each territory where the proceeds of non-compliance are transferred or received. Several agents and taxation representative bodies said it was, "consistent with the current regime and fairer", "… a just and reasonable apportionment as outlined… would provide the fairer method", "… relating to the categories of each jurisdiction in which the proceeds were transferred or received, is the best way of applying the extension to offshore penalties" and "as producing the result that is most logical, most fair and most consistent with existing legislation." The Government notes and agrees with these views, on the basis that the offshore penalties regime already considers each territory and penalty category in relation to each income or gain, irrespective of whether the sum of total tax lost relates to a single inaccuracy or failure.

2.28 One respondent, a legal representative body said that "where the proceeds of non-compliance are moved to a more opaque jurisdiction… opposes the automatic imposition of the higher penalty on the whole of the proceeds of non-compliance, regardless of the intention of the taxpayer or the length of time the assets are in each jurisdiction." The Government notes this view which also accords with the second method, not to use the category of the jurisdiction in which the majority of the proceeds are transferred or received, and has decided to follow the approach set out in the preceding paragraph, considering that to be consistent with existing legislation.

10. Do you agree that current safeguards would be sufficient? If you do not, in what way would they be inadequate and how should they be amended?

2.29 All of the respondents, bar one, considered that existing safeguards that apply for the purpose of offshore penalties were adequate for the extensions proposed by options 1 and 2. The Government notes these supporting views.

2.30 For the respondent who did not, a legal representative body, they raised concerns that "personal representatives unable to gain access to information about assets in secretive jurisdictions would have to be protected." The Government agrees with this comment and takes this opportunity to restate that

the IHT extension will not create a penalty position for a taxpayer where there was previously none. For the avoidance of doubt, where a person responsible for delivering an IHT account has taken reasonable care to ensure its accuracy, they will continue to be outside of the scope of penalties. Other existing safeguards like recourse to an HMRC review and taking a matter on appeal to an independent tribunal will also continue to apply.

Deterring taxpayers from deliberately moving offshore assets to continue evading tax

11. Do you agree that there should be strengthened sanctions for those who deliberately move assets with the intention of continuing to evade tax? If you do not, please say why.

2.31 Most of the respondents understood the policy intention, and agreed that there should be a deterrent against the movement of a person's hidden offshore funds from a jurisdiction that has committed to adopting the new global standard for the automatic exchange of information under the CRS to another jurisdiction that has not similarly committed to the CRS, because the latter is comparatively opaque for tax purposes.

2.32 Some respondents considered that simply increasing the rate of the penalty in relation to income or gains arising following the movement of assets was unlikely to help build the deterrent effect against this minority group. They considered it was likely to have an adverse effect by discouraging disclosures of historic tax liabilities.

2.33 One respondent suggested that the effectiveness of the existing offshore penalties regime has not yet been evaluated. The Government acknowledges this point; higher penalties were only introduced in respect of hidden income and gains arising in jurisdictions where it was more difficult for HMRC to obtain information, from April 2011. While the impact on customer behaviour is being monitored and more is being learned about the territories involved, we do know that penalty categorisation has had an early impact in the context of voluntary disclosure facilities. A sample analysis of offshore disclosures in which penalties were charged shows 98% of them involved deliberate attempts by the taxpayer to evade tax. New offshore penalties have been charged on a relatively small number of cases to date, but the evidence base is growing all the time.

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

12. Do you consider that option 3 meets the policy objectives set out above? If you do not, please say why.

2.34 Some of the respondents considered that the introduction of a new fixed percentage offshore surcharge would meet the policy objective and build the

deterrent effect. One respondent was concerned that the measure had the potential to apply retrospectively. The Government notes this comment, and for the purpose of clarity confirms that this measure could only have effect from a publicised commencement date.

2.35 Some respondents considered that this measure would be overly complex and onerous on them in practice, it would add unnecessary complexity to the legislation, make settling tax affairs with HMRC unequitable and discourage disclosure. For example, a taxation representative body said “we do not think that introducing a new offshore surcharge to complement the offshore penalties would make any difference in deterring someone who is already potentially liable to a 200% penalty.” The Government has considered these views, and taking into account views about complexity in particular does not propose to take this measure forward.

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

13. Do you consider that option 4 meets the policy objectives set out above? If you do not, please say why.

2.36 Most of the respondents considered that this option did not meet the policy objective. They acknowledged the statistics provided by HMRC in the consultation document which demonstrate the number of years of assessment typically included in investigation cases settled over the last few years, cited the fact that more often than not there is a lack of historic records to establish old liabilities accurately and said that such a measure was likely to discourage disclosure. A typical response, from a taxation representative body was, “we are concerned about the possible extension of the 20 year assessing time limit (Option 4). On a practical level, there is a risk that taxpayers would be unable to defend assessments made outside the 20 year period as a result of an inability to obtain appropriate evidence given the passage of time.”

2.37 While some respondents considered that this option met the policy objective and could work in practice, they doubted its effectiveness. One respondent went further than the proposed option and thought the assessing period restriction should be extended for all types of non-compliance and not restricted to offshore evasion.

2.38 The Government has considered these views and as a result does not propose to take this measure forward.

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

14. Do you consider that option 5 meets the policy objectives set out above? If you do not, please say why.

2.39 Some of the respondents considered that this option met the policy objective, but suggested the deterrent effect becomes weaker as penalties for ongoing offshore non-compliance become higher, and could discourage disclosure.

2.40 Some respondents considered that the measure would make the settlement of tax affairs with HMRC unequitable on the basis the penalties would be higher and in theory have no upper limit, and one agent said it was perhaps "draconian."

2.41 Another respondent, a taxation representative body said, "In principle, we can see some merit in the proposal… It introduces a sanction aimed at discouraging movement of assets to more opaque jurisdictions but without imposing hindsight on historic actions. The sanction would only apply to actions taken after the introduction of the proposals."

2.42 The Government has considered all these views and notes that there is some support for such a measure. However, in the form it was proposed, several respondents thought it was too complex. We comment further in chapter 3: Next Steps.

15. Do you have a preferred calculation method for option 5? If you do, please say which one and why.

2.43 Some of the respondents considered that the first method of calculating the penalty was preferable, where the penalty chargeable for non-compliance that occurred before the movement of funds is stepped up each time there is such a movement, to recognise that the person has taken further steps to continue hiding that non-compliance. They said that a taxpayer should be aware each time they move funds in this way that they are assuming an additional risk in respect not only of presumed future benefits but also in respect of existing crystallised tax advantages.

2.44 Most respondents considered that the first method was overly complicated and would be impractical to operate. The Government recognises that this method could be more difficult to operate in practice as there could be several movements of funds to contend with, each warranting different periods attracting different penalty rates, if being stepped up.

2.45 Some respondents considered that neither of the methods for calculating the new penalty were suitable on the basis that they were too complicated. While one agent said, "if funds have been moved via a category 3 jurisdiction at any time the full category 3 penalty should be levied", which shares some similarity with the second calculation method.

16. Do you have a preference between options 3, 4 and 5? If you do, please say why.

2.46 The Government would like to thank all of the respondents for considering the three different options proposed to address the same policy problem. In general, respondents had no outright preference.

2.47 The following comments demonstrate the mixed views that some respondents had: one agent said “they will all achieve nothing and actively discourage compliance in some cases”, a taxation representative said “on balance we would favour option 3 over options 4 and 5 because it is less complicated that the other two, but we do have some concerns about the likelihood that this will be an effective deterrent”, a legal representative body said “we are not persuaded that options, 3, 4 or 5 will achieve the policy intent or change the behaviour of those determined to evade. It is likely that those individuals undertaking activities falling within options 3, 4 or 5 enforcement could be prosecuted under the proposed strict liability criminal offence or common law fraud. The need for further measures is therefore questioned” and another taxation representative body said “In principle, we can see some merit in the proposal… It introduces a sanction aimed at discouraging movement of assets to more opaque jurisdictions but without imposing hindsight on historic actions. The sanction would only apply to actions taken after the introduction of the proposals.”

2.48 Some responses recognised that the methodology for option 5 more accurately reflected the perception that a subsequent movement of offshore funds is an aggravating feature of existing misconduct, rather than a separate category of misdemeanour.

2.49 How the Government proposes to move forward with the issue these options sought to address is set out in chapter 3: Next Steps.

17. Do you agree that current safeguards would be sufficient? If you do not, in what way would they be inadequate and how could they be amended?

2.50 All of those who answered this question agreed that the current safeguards would be sufficient if any of the three options were taken forward, i.e. no penalty would be chargeable where a taxpayer takes reasonable care with their tax affairs and existing review and appeal procedures will remain.

Updating the offshore penalties regime to reflect the new global standard in tax information exchange

2.51 This chapter in the consultation document discussed the system for categorisation of territories for offshore penalty purposes and whether that system should be updated to reflect the new global standard for the automatic exchange of information, the Common Reporting Standard. The Government proposed introducing a new top category, “category 0”, which could be populated by the most transparent jurisdictions: those that have arrangements in place to exchange comprehensive tax information with the UK.

2.52 Most of the respondents supported the policy intention, with one top 10 accounting firm stating, “…we welcome the view that the harder it is to obtain information from the territory in which the income or gain arises, the tougher the sanctions for non-disclosure and non-compliance should be.” While some

recognised that as jurisdictions concluded arrangements to exchange information under the CRS, the reason for distinguishing between category 1 and the proposed category 0 would become less relevant on the premise that at some point in the future most, if not all category 1 territories will move into the new top category. The Government notes and agrees with these views, and while it recognises there is likely to be a time when category 1 is no longer required, it considers there will be a transitional period during which some territories may not yet have concluded agreements with the UK to share comprehensive information in accordance with the CRS, and some territories may potentially decide against proceeding for some reason.

2.53 Some respondents considered that the changes would add an additional layer of complexity to the penalty regime. One respondent considered that for any updating of the system it was imperative that changes were both targeted and proportionate, stating that this is critical to ensure there is adequate justification to restrict the fundamental freedoms of movement of capital. The Government notes and very much agrees with this view.

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

18. Do you consider it appropriate to update the offshore penalties regime to reflect the new global standard? If you do not, please say why.

2.54 Most of the respondents considered that it was appropriate for the offshore penalties regime to reflect the CRS and agreed with the policy objective. One respondent, a taxation representative body said that “updating of the categorisation of offshore territories to reflect the significantly changed environment following the widespread implementation of the CRS is a logical step.”

2.55 Some respondents agreed with the principle but did not consider that a new, fourth category was necessary, suggesting instead that jurisdictions adopting the new standard should simply be included in the current category 1.

2.56 One respondent, another taxation representative body suggested that category 1 territories attracting a higher penalty rate would be a backward step, and a legal representative body said, “…the deterrent effect will not result from the penalty but through an increased perception that the evader is likely to get caught.”

2.57 The Government considers there is merit in these responses, and is mindful about the significance of the transitional period as discussed above, which should not be discounted. It thanks all respondents for their overall support and confirms that it is taking this measure forward, and will continue to encourage jurisdictions currently designated in category 2 or category 3 to enter into comprehensive information exchange agreements underpinned by the CRS.

19. Recognising the step change in automatic exchange of information standards, which method do you consider better achieves the policy objectives set out above and please say why?

2.58 Most of the respondents preferred option 1, the introduction of a new top category recognising only those territories that have concluded arrangements to exchange comprehensive information in accordance with the CRS, and maintaining the current range of penalties, meaning category 0 would carry a maximum of 100% and category 3 a maximum of 200%. None of the respondents favoured option 2, which proposed establishing new penalty rates with category 0 at 100% and category 3 at a higher rate than the current 200%. They considered that increasing the penalty rate would not increase the deterrent and adversely affect our target group, with one taxation representative stating that "setting maximum penalties above 200% could be a very significant disincentive to disclosure and could also raise issues of proportionality." The Government notes these views and advice, and recognises the balance required between penalty rates and encouraging voluntary disclosure.

2.59 Some respondents did not express a preference but considered that there should be a time lag to allow the CRS to 'bed down' and category 1 jurisdictions to improve their exchange of information arrangements to avoid potentially being downgraded from the top category. The Government notes these views and is mindful that this measure will not come into force immediately. The transitional period discussed above will allow for territories to make progress, turning their international commitments into domestic law and implementing the changes.

2.60 One respondent considered that while there might be a case for higher penalties for offshore tax evasion that this should exclude non-domiciled individuals, and another said that higher penalties would largely be symbolic because they would only be affordable by the wealthiest taxpayers with others legitimately being able to argue hardship. The Government notes these comments, but is not in agreement with excluding non-domiciled individuals from the penalty regime, because existing safeguards ensure that a penalty is only payable where a taxpayer's behaviour was not reasonable. Also, the Government is not aware of any particular problem with significant numbers of offshore penalties being discharged on the grounds of hardship.

20. Do you agree that current safeguards would be sufficient? If you do not, in what way would they be inadequate and how could they be amended?

2.61 All of those who answered this question agreed that the current safeguards would be sufficient, i.e. no penalty would be chargeable where a taxpayer takes reasonable care with their tax affairs and existing review and appeal procedures will remain.

Assessment of Impacts

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

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

2.62 One of the respondents advised HMRC to consider the impacts on international businesses and the entrepreneurs that manage them to ensure that offshore / international operations were not seen as a risk in themselves but as a necessary, albeit complex, part of running an international business. This sentiment was echoed by another respondent who pointed out that there are many legitimate reasons why a person might invest offshore and that this point should not be lost sight of. The Government thanks respondents for this advice; growth is still firmly on its agenda and it is recognised that putting up barriers for business is neither its desire nor the policy intention - only those taxpayers who evade their UK tax obligations offshore face the toughest sanctions.

2.63 A point in relation to taxpayers with historical and/or family connections with other jurisdictions was raised, advising HMRC to ensure appropriate consideration of these factors. The Government agrees with this view; careful consideration of an individual's intention and behaviour remains essential for both tax and penalty purposes, with HMRC taking into account all relevant factors in line with published guidance.

2.64 Other points raised include: customers that may need enhanced support such as those of overseas origin that do not speak English and may misunderstand UK tax rules; some customers are unintentionally ignorant having inherited overseas funds; and non-domiciled individuals whose investment portfolios might comprise UK source income. The Government recognises that care must be taken in accordance to individual customers' needs and where complex rules apply for certain groups (i.e. the internationally mobile). It is updating guidance and working with others to improve its messaging and raise awareness to ensure customers are treated fairly.

3. Next steps

3.1 Chapter 3 of the consultation, *Strengthening civil deterrents*, discussed deterrents against moving hidden offshore funds to avoid tax transparency rather than disclosing to HMRC. The Government has considered the responses received to the questions in that chapter and thanks all of the respondents for their views.

3.2 The Government confirms that it is not taking options 3 or 4 forward. It has reconsidered the proposals in light of the responses, and particularly the view that the options proposed were too complex, and has developed a simplified version of option 5, a new aggravated penalty.

3.3 This new aggravated penalty would apply to taxpayers that:

(a) Either
- move hidden offshore assets from a jurisdiction which has committed to adopting the CRS to one which has not committed to adopting the CRS); or

- put in place arrangements to ensure that the offshore funds are not subject to comprehensive reporting under the CRS; and

(b) that movement of offshore funds (proceeds) takes place after the commencement of the legislation; and

(c) the person making that movement does so with the intention of preventing HMRC from discovering the previous deliberate non-compliance.

3.4 In practice, as well as the penalty for the original non-compliance being chargeable in accordance with the legislation that applied at the time, the taxpayer would face an additional penalty. This new penalty would be set at a value of 50% of the penalty applicable for the original non-compliance. Key features of this measure are that HMRC will have to demonstrate that the taxpayer has deliberately evaded tax, and that they moved the proceeds to keep that evasion from being discovered; that the aggravating action must take place after the enactment of the legislation; and that the new penalty would be calculated by reference to the penalty charged in respect of the original non-compliance.

3.5 This:

- removes the complexity of introducing an altogether new fixed percentage penal regime, i.e. the offshore surcharge;
- preserves the concept of certainty and finality for taxpayers, advisers and HMRC by not seeking to amend the statutory assessing time limits;
- includes a purpose test so that HMRC is required to demonstrate that the reason for the movement of funds was to circumvent increased tax transparency;

- continues to reflect any reductions available for disclosure of the original non-compliance;
- preserves all existing safeguards including appeal and review rights; and
- is focused on non-compliance where a person's behaviour was deliberate.

Summary

3.6 The Government will:

a) legislate for a new "aggravated" penalty of moving the proceeds of tax evasion in order to escape tax transparency, with the penalty coming into effect for movements of funds occurring after Royal Assent to the Finance Act. This penalty will increase the total penalties faced by 50%;
b) legislate to extend the offshore penalty regime (i) to include IHT and (ii) to cover circumstances in which the proceeds of non-compliance are hidden offshore; and
c) legislate to update the penalty classification system to reflect the CRS.

4. List of stakeholders consulted

HMRC is grateful to the following, who provided written responses to the consultation:

Association of Accounting Technicians
Association of Chartered Certified Accountants
Association of Taxation Technicians
Baker Tilly (Baker Tilly Tax and Accounting Limited)
BDO LLP
British Bankers' Association
Buzzacott LLP
Chartered Institute of Taxation
Fieldfisher (Field Fisher Waterhouse LLP)
Grant Thornton LLP
Institute of Chartered Accountants in Scotland
Institute of Financial Accountants
KPMG LLP
Moore Stephens International Limited
PwC LLP
RPC (Reynolds Porter Chamberlain LLP)
The General Council of the Bar of England and Wales
The Law Society
The Law Society of Scotland

One named private individual also provided a response.

HMRC is grateful to the following, who provided responses at face to face meetings:

Association of Accounting Technicians
Association of Chartered Certified Accountants
Association of Taxation Technicians
British Bankers' Association
Chartered Institute of Taxation
Compliance Reform Forum: Fraud Forum
Institute of Chartered Accountants in England and Wales
Institute of Chartered Accountants in Scotland
KPMG LLP
Law Society of Scotland
Low Incomes Tax Reform Group
PwC LLP
Tax Investigations Practitioners' Group

5. Annex A: Summary of penalty category classification system

5.1 The offshore penalties regime (introduced by Schedule 10 to the Finance Act 2010) has applied to liabilities arising from 6 April 2011. The level of penalty is based on the type of behaviour that leads to the understatement of tax, and is linked to the tax transparency – the quality of tax information exchange – of the territory in which the income or gain arises.

5.2 Currently, there are 3 levels of offshore penalty:

- Category 1: up to 100% of the tax (the same as for domestic non-compliance)
- Category 2: up to 150% of the tax
- Category 3: up to 200% of the tax

5.3 The underlying premise is that where it is harder for HMRC to get information from another territory, the more difficult it is to detect and remedy non-compliance and therefore the penalties for failing to declare income and gains arising in that territory will be higher.

5.4 Currently, the criteria for the 3 categories are broadly:

	Penalties of up to 'X' of the potential lost revenue
Category 1: Automatic exchange of information (AEOI) and other tax cooperation agreements, which have similar effect	100%
Category 2: Exchange of Information (EOI) on request to the international standard, and certain less developed territories	150%
Category 3: No EOI or EOI agreements that do not meet international standards	200%