PERSONAL TAX UPDATE

ITEMS

- Offshore Disclosure Facility
- Will Planning

1. VOLUNTARY DISCLOSURE OF UNPAID TAX LIABILITY - A WINDOW OF OPPORTUNITY?

HM Revenue & Customs have unveiled a new "Offshore Disclosure Facility". It is designed to enable those who have previously failed to disclose taxable income from offshore investments to bring their tax affairs in order.

Essentially, the new facility ensures that taxpayers who make full disclosure of unreported income within set time limits will have tax penalties fixed at 10% of the unpaid tax. No penalty will be imposed if the unreported income comes to less than £2,500. Normally, penalties of up to 100% of the unpaid tax can be imposed when further unreported income comes to light – the exact level of penalty involved will depend upon what mitigating circumstances may be present.

Scope of new rules

The primary motivation for these measures is to target previously undeclared offshore bank accounts and the move complements the considerable efforts made by HMRC in recent years to identify unreported offshore accounts held by UK taxpayers. However for other taxes, if disclosure is made on the same terms as set out in the facility, HMRC have confirmed that they will take a similar approach to that set out in the new regime.

Other taxes that may be relevant here include:-

- Personal Income Tax, CGT and IHT
- Tax Credits
- Employment taxes and National Insurance
- Corporation Tax
- VAT.

The new regime is not available in respect of serious organised tax fraud. It is also not appropriate for underpaid tax which has resulted from an entirely innocent error. For innocent mistakes, the income should be reported to the local tax office and no penalty should be due.

Timetable

The regime will impose a strict (and short) timetable for those wishing to use the facility. There are three steps to the disclosure process:-

- The person must give notice to HMRC by 22 June 2007 of an intention to make a disclosure.
- By 26 November 2007, the person must go on to make full disclosure of the unreported income and pay the tax, interest and the 10% penalty.
- HMRC will decide by 30 April 2008 whether they accept the disclosure.

Briefing

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1. VOLUNTARY DISCLOSURE OF UNPAID TAX LIABILITY - A WINDOW OF OPPORTUNITY?

Foreign domiciliaries

The HMRC guidance acknowledges that UK resident foreign domiciliaries would not have any additional tax liability to disclose in respect of foreign income and gains which have not been remitted to the UK. Nonetheless, it is possible that a tax liability could arise e.g. where an offshore account contains an element of previously undeclared UK source income, or a remittance of foreign income has been made to the UK but has not been reported. In such cases, disclosure should be made in accordance with the new facility.

It would appear that where foreign domiciliaries may wish to disclose an unreported liability under the facility, they will also be required to disclose a list of all non-UK assets held as at 5 April 2006. This could be an unduly onerous disclosure requirement for very wealthy foreign domiciliaries who only have a relatively small amount of undeclared liability.

The HMRC guidance suggests that those who may be unsure that they have retained their foreign domicile status should seek professional advice or contact them directly if they do not have an adviser.

Our view

The HMRC initiative is a welcome approach to enable taxpayers to bring their tax affairs up to date in the knowledge that they will not suffer unduly harsh penalties. HMRC will take a more aggressive stance where they become aware of taxpayers with unreported income who did not disclose under the facility. They have indicated that they will use the information gathered from various banking institutions, along with that obtained through the European Union Savings Directive, to target those with offshore bank accounts at the end of the notification period.

The timetable is tight and may prove impossible to meet for those whose tax affairs are particularly complex. However, those taxpayers should in any case be taking advice with a view to making full disclosure of undeclared liabilities as soon as possible.

Previous tax cases such as the Court of Appeal decision in Langham v Veltema demonstrate the importance of making full disclosure in accordance with the law. Nevertheless, in a climate where HMRC seek to impose an increasingly burdensome disclosure regime on taxpayers, professional advisers have an important role to play in ensuring that taxpayers' rights are safeguarded in their dealings with the tax authorities. For example, it is noteworthy that the guidance accompanying the new regime states HMRC's view that foreign domiciliaries are taxable on Irish source income whether or not it is remitted here. It now appears that the European Commission may challenge this rule as being contrary to EU law.

As far as a possible change of domicile status is concerned, we see no reason why this should not continue to be dealt with under the existing self-assessment framework. Previous guidance issued by HMRC on this point indicates that they will not normally change the basis of assessment for individuals becoming UK domiciled until the tax year following the year of change, or where the matter is the subject of an enquiry and the date of change is difficult to pinpoint, the tax year following the conclusion of the enquiry.

2. WILL PLANNING - THE DEVIL IS IN THE DETAIL!

HMRC have won a recent case before the Special Commissioners (Phizackerley) concerning Inheritance Tax ("IHT") planning for families where the family home is the main asset.

Typically, spouses will establish "nil-rate band" discretionary trusts in their Wills to ensure that on the death of the first spouse, that spouse's nil rate band is not wasted. If the principal asset concerned was the family home, the use of a nil-rate band discretionary trust to hold the deceased spouse's share in the home could prove problematic. Where the surviving spouse may effectively have a lifetime entitlement to occupy the home, there was a risk that HMRC could treat that share of the home comprised in the nil-rate band trust as forming part of his or her IHT estate and consequently it would also be subject to IHT on the death of the second spouse.

To avoid this risk it was common practice to put a debt relating to the home within the nil-rate band discretionary trust rather than having that trust own the property share directly. For technical reasons, this strategy was unsuccessful in the Phizackerley case. HMRC successfully invoked an anti-avoidance provision to ensure that the debt held within the nil-rate band trust was not deductible against the surviving husband's estate because the husband alone had funded the initial acquisition of the property. The net result was that this share of the family home remained within the charge to IHT on the death of the husband.

The case demonstrates the importance of taking professional advice when executing Wills and implementing any related planning. Unfortunately, it appears that even where a married couple or civil partners attempt the most basic IHT planning to use both their nil-rate bands, HMRC will nevertheless seek to attack the implementation on technical grounds where possible.

Planning with nil-rate band discretionary trusts is generally more straightforward where it is intended that assets other than the family home will be held within the trust. For those who do not have significant chargeable assets apart from the home, we can advise as to how the planning can be implemented without falling foul of the technical pitfalls highlighted in the Phizackerley case.

If you would like to discuss either of the two issues covered in this edition of Briefing, please contact the Rawlinson & Hunter partner who normally deals with your affairs. If you are not a client of the firm, please call and ask to speak to any of the firm's private client partners.

The information contained in this bulletin does not constitute advice and is intended solely to provide the reader with an outline of the provisions. It is not a substitute for specialist advice in respect of individual situations.

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