

YOU CAN RUN, BUT YOU CAN'T HIDE (FROM THE FRAUD INVESTIGATORS)

Noshir Avari offers advice to UK residents who own assets abroad, who may be open to investigation by HMRC if they fail to disclose their funds and profits in full

There is nothing inherently illegal in a UK resident holding an offshore bank account, property, trust or company. As some of the estimated 1.5 million UK citizens owning foreign property have found, there can be complications with local tax authorities, and countries with large numbers of non-residents owning second homes are now actively engaged in collecting property taxes. Many EU countries (France and Spain, for example) charge an annual income tax based on the rental value of properties owned by non-residents of that country, and some impose wealth taxes on the value of other assets held (France and Spain again).

And this is in addition to problems that will now face many UK residents with existing arrangements of the sort mentioned, where the offshore dream has been financed in ways which may not accord with UK tax law.

NO HIDING PLACE

The trouble is that for many years, all these arrangements have been favoured hiding places for taxpayers concealing funds from the Inland Revenue – now HM Revenue & Customs (HMRC). They may of course have had thoroughly innocent reasons, but officers of HMRC and others of a cynical turn of mind have viewed the use of such vehicles as offensive because, as they believe (and evidence frankly bears this out), a fair proportion of these have been used to shelter undisclosed profits, income and capital gains from the authorities.

Until recently, the advantage lay with the taxpayer hiding behind a cloak of anonymity, and there is no doubt that a great deal of money flowed out of the UK, particularly after the demise of exchange control.

This position has changed radically following recent developments. The European Savings Directive, which came into being on July 1, 2005, provided for exchanges of information between EU member states regarding bank interest arising on an account in one member state, where the depositor's place of residence was in another member state. Importantly, other countries, including Jersey, Guernsey, the Isle of Man and even Switzerland, have adopted the measures in the EU directive and are to provide information to the tax authorities in the member state of residence of account holders. This produced a flow in the opposite direction, but of information useful to HMRC in identifying the location and

ownership of funds stored abroad in bank accounts.

HMRC was already exchanging information with the EU and other jurisdictions, but this flow is becoming a veritable torrent, because landmark legal decisions won by HMRC in four cases since November 2005 against selected UK financial institutions have meant that information held on tens of thousands of UK residents has been passed to HMRC, where bank accounts and/or debit and credit cards are known to be held offshore.

In these successful actions, HMRC adduced evidence indicating that 400,000 UK residents may hold £200bn in offshore accounts, with Jersey currently heading the list. In the case of one institution being targeted, HMRC statistical evidence suggested over 40,000 clients, generating around 9,000 investigations yielding an average of £170,000 per case – a total for that one institution of £1.5bn in lost tax, associated interest and penalty charges.

TEAM EFFORT

This is serious business for HMRC, the financial institutions and a large number of vulnerable taxpayers. There are many trapped by existing arrangements not easily undone, with offshore companies, trusts and properties that they believed would be protected. The increase of money-laundering legislation has strengthened HMRC's hand, with obligatory reporting of bank transactions both within and outside the UK.

HMRC intends to investigate 20% of the 400,000 individuals in the next two years, and it has set up a sophisticated screening process and a network of specialist investigation offices. This has been spearheaded by the Offshore Fraud Project Group based in Bootle, which over the past two years has collected millions of pounds from taxpayers connected with offshore financial centres. This successful effort has been augmented by the creation of civil investigation of fraud (CIF) teams based in London, Bristol, Nottingham, Wolverhampton, Stockport, Southampton, Leeds, Belfast, Cardiff, Glasgow and Edinburgh. HMRC will be allocating investigations by reference to expected yields, so that anything between £50,000 and £500,000 is worked in one of these new offices. The more serious cases, perhaps 5% of the total, will be handled by the existing eight special civil investigation offices (SCI), and the remainder will be dealt with in local tax offices.

The cost-effective intention is to turn over cases quickly, reserving criminal prosecution for a small minority, including repeat offenders, implicated professional advisers and organisers of the worst business frauds. Operation of the new offices will be aided by bringing back to the fold seasoned campaigners from the former special compliance office and enquiry branch, who acquired fearsome reputations in the field of tax fraud investigation, but who have moved elsewhere in the department. HMRC are widely publicising these activities, because it makes their job easier if they meet with little resistance, and many cases will, although large, prove relatively straightforward.

FULL DISCLOSURE

Whether or not someone knows that HMRC are likely to be after them – and there really is no hiding place, because closure of an account may itself trigger an investigation – the best solution is to make an immediate voluntary disclosure, with proper skilful representation. That applies particularly where there is no sign of imminent HMRC interest, since more credit can then be earned than where there is an existing challenge.

Investigations will be conducted under HMRC code of practice nine, which is good news because it means the case will be settled for money, with no prosecution assuming a proper initial disclosure followed by the submission of a report commissioned and paid for by the taxpayer as representing his full disclosure. These reports can be expensive exercises, but if properly prepared and followed by skilful negotiation, can recoup their cost in terms of the final resolution with HMRC.

Following the unification of the revenue and customs departments, these new style investigations also encompass any VAT liabilities, a welcome development avoiding the previous nightmare of a second investigation by one body in succession to the other.

SETTLING UP

Monetary settlement of these cases contains three elements. There is the tax that would have been paid in the first place if the tax returns and accounts had included the correct information. There is an interest charge, to recognise the taxpayer's use of HMRC's money, and there is the penalty, which the law sets at a maximum 100% of the tax unpaid, but discounted to recognise the extent and completeness of the disclosure, the amount of co-operation by the taxpayer and the overall seriousness of the case. With a tax loss of say £200,000, correct handling of the case could save £50,000 in penalties compared with an ineffectual 'head in the sand' approach. The importance of the negotiation process cannot be overemphasised, both in establishing the additional taxable income and in agreeing the appropriate penalty.

The most difficult enquiries tend to involve business profits, since the investigation here will involve an exhaustive examination of the operation of the business, its accounts and the finances of the directors or owners and their families. Almost inevitably there will be grey areas that an investigator will seek to exploit, and there may be many alternative approaches to computing omitted profits. HMRC will take the view that funds concealed from the tax authorities are not placed offshore merely to save tax on the interest arising, but represent fraudulent extractions of profit from the UK business. Investigators in the CIF offices are generally experienced and highly trained; they will expect to increase significantly the amount of many disclosures, and trying to pulling the wool over their eyes



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can be very expensive, financially and worse, and is not therefore recommended.

While an HMRC investigation is a serious matter, the HMRC approach will ensure that for most individuals, their problem with offshore activities can be resolved sensibly and confidentially, with a promise at the outset that no criminal prosecution will be undertaken – providing an accurate report is prepared and submitted on their behalf. It is likely an investigation will take some time to complete – HMRC aims to settle this sort of case within six months – but a professionally represented taxpayer is likely only to meet the investigator concerned at the opening meeting, and possibly at a final settlement meeting to sign an offer in settlement when figures have already been agreed.

Despite the fact that most CIF and SCI officers do their job courteously and efficiently, a long investigation can be harrowing, and a good adviser will also be a counsellor, able to absorb and remove much of the pressure on their client, and well able to use their technical expertise to make use of opportunities to mitigate the overall financial damage.

It is not unusual for a taxpayer to have been suffering for years in the knowledge he has secreted money abroad but cannot afford to use it, or much of it at least, for fear of discovery. In these circumstances it can indeed be a relief to unburden himself and wipe the slate clean – at, inevitably, some cost. ■

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