In brief

Views on recent developments in tax

HSBC, tax evasion and criminal prosecution

Criticism of HMRC's failure to prosecute HSBC Swiss tax evaders has been quite unfair. There are problems with criminal prosecution and the decision to focus on tax collection through civil settlement is the right one. It makes little sense to criminally prosecute these cases.

The starting point for HMRC is that it is a revenue gathering body and not a prosecuting authority. Maximising tax recovery with minimum outlay is the paramount objective. Historically, even where dishonest tax evasion has occurred, HMRC has preferred to cut deals with taxpayers rather than invoke the criminal process. Civil settlement guarantees a favourable financial outcome, whereas in a criminal prosecution the verdict lies in the hands of a randomly selected jury. Criminal trials are lengthy, expensive and labour intensive, with little chance of recovering outstanding tax through the confiscation regime. The House of Commons Public Accounts Committee reported in 2013/14 that the confiscation regime secured collection of only 26 pence out of every £100 generated by criminal activity. Insofar as Swiss tax evaders are concerned, HMRC has already recovered £135m in unpaid tax and penalties through making civil settlements.

HMRC's approach is entirely consistent with its broader attack on offshore tax evasion, which offers dishonest tax evaders an opportunity to make a civil settlement and sidestep criminal prosecution.

With increasing international exchange of information, the difference in moral turpitude is not clear cut between a taxpayer who discloses his hidden assets, prompted by the introduction of an HMRC disclosure facility; and a taxpayer who makes full disclosure of his hidden assets, prompted by notice of HMRC's receipt of HSBC's Swiss records. In the case of the Liechtenstein disclosure facility, recovery from dishonest tax evaders has already amounted to £1,023m, with a further £100m received on account in cases where settlement remains to be finalised.

There are potential issues for HMRC if it seeks to rely on HSBC's Swiss records in a criminal prosecution. Although the French authorities have given permission, allowing use of the information for investigating criminal offences, problems remain. In many cases, the evidence amounts to little more than a bank statement establishing the existence of a bank account, with details of the balance, debits and credits. In the absence of an explanation from a taxpayer who has a choice whether or not to cooperate with HMRC's enquiries, it is impossible to determine the source of assets and whether or not the account holder has dishonestly concealed his liability to tax.

Incontrovertibly, the HSBC material has been stolen and represents criminally obtained property in HMRC's hands. It is, therefore, open to a taxpayer to argue that a prosecution should be stayed for abuse of process or alternatively that the documents should not be admitted into evidence because they have been unlawfully obtained.

It is unclear whether Mr Falciani tried to sell the stolen information but, whatever the position, he has been indicted by the Swiss federal government for violating the country's bank secrecy laws and for industrial espionage. His extradition is presently being sought by the Swiss government. Then there is the issue of delay. The information came into HMRC's hands more than five years ago. Following the torrent of publicity directed at HSBC's role and Baron Green of Hurstpierpoint's conduct in particular, a question arises as to whether a taxpayer can get a fair trial.

One criminal prosecution has been brought based on Mr Falciani's documents. The case involved Mr Michael Shanly, a property developer whose fortune was estimated at £132m. In July 2012, Mr Shanly pleaded guilty at Wood Green Crown Court to evading £430,000 of inheritance tax and he was fined £469,444 in fines and costs. He had voluntarily paid £387,000 to HMRC before the prosecution was brought. Apart from a small number of news items, the case attracted little attention. What did HMRC gain from bringing this deterrent prosecution? I suggest the answer is none.

When opportunity knocks, HMRC has been right not to open the box but to take the money. ■

Jonathan Fisher QC, Devereux Chambers (*fisher@devchambers.co.uk*)

Penalties

The penalty for late self-assessment filing needs rethinking. HMRC's recent discussion document is promising.

The OTS report on tax penalties published on 13 November 2014 was joined on 2 February 2015 by an HMRC discussion document (see www.bit.ly/16ei5RQ).

While they cover a number of different issues, both consider one penalty provision that is in desperate need of rethinking: that for self-assessment late filing.

A fundamental principle of the new penalty regime introduced by Finance Acts 2007, 2008 and 2009 is that it should influence behaviour to improve compliance. Penalties should operate fairly, be seen to do so and be proportionate to the degree of non-compliance.

Initially, the late filing penalty was capped at the amount of tax outstanding at 31 January. Now, however, it can easily accumulate to completely disproportionate amounts. The 'per partner' penalty for partnership returns also seems to me to be disproportionate. In practice, I have seen these penalties create as much resentment as compliance. They create a feeling that HMRC wants to catch people out. This is not the effect that was sought (neatly characterised by one senior HMRC official as 'we want the returns, not the penalties') and I question whether it has really delivered for HMRC either in terms of yield or taxpayer attitudes.

A statistic that really struck me in the OTS report was that 16% of ITSA returns show nil liability. A further 8% show a liability of less than £50. That means that around 1.5m returns are being processed to collect not one penny of tax and a further three quarters of a million returns disclose relatively trivial amounts. There must surely be potential for a considerable reduction both of the compliance burden placed on taxpayers and of HMRC's costs – particularly those created by avoidable calls to contact centres and the pursuit of so many individual penalties.

The OTS recommends removing some individuals from self-assessment, improving guidance and training, providing more warnings to taxpayers and issuing a reminder at the beginning of January each year. It also notes that penalties for late filing and late payment in other countries (including Canada, New Zealand and Hong Kong) are based on the tax owing, rather than on a fixed amount. The old capped penalty therefore appears to have compared better internationally.

Encouragingly, HMRC's discussion paper acknowledges the problems with the current system, which makes no distinction between someone who misses a return deadline by a day or two and someone who has made no attempt to comply at all. The department's current thinking looks promising. It is based on five core principles:

1. The penalty regime should be designed from the customer perspective, primarily to encourage compliance and prevent non-compliance. Penalties are not to be applied with the objective of raising revenues.
2. Penalties should be proportionate to the offence and may take into account past behaviour.
3. Penalties must be applied fairly, ensuring that compliant customers are (and are seen to be) in a better position than the non-compliant.
4. Penalties must provide a credible threat. If there is a penalty, we must have the operational capability and capacity to raise it accurately, and if we raise it, we must be able to collect it in a cost efficient manner.
5. Customers should see a consistent and standardised approach. Variations will be those necessary to take into account customer behaviours and particular taxes.

HMRC raises the possibility of using non-financial sanctions and of potentially operating a progressive system similar to penalty points for motoring offences, so that initial financial penalties are avoided, but more substantial penalties then apply for more serious failures or for persistent non-compliance. This demonstrates a significant change in HMRC's thinking.

It seems to me there is a clear win in sight here if HMRC is willing to be bold: reduced compliance costs for taxpayers, reduced processing costs and some reputational credit for HMRC, and all at no net loss of yield. That must be a goal worth pursuing. ■

Paul Aplin, A C Mole & Sons (*paulaplin@acmole.co.uk*)

CJEU judgment in *de Ruyter*

A recent CJEU decision on French social contributions on non-residents triggers a run for refunds.

The CJEU gave its landmark decision on the *de Ruyter* case (C-623/13) published on 26 February 2015. Judges put an end to the application of the French social contributions on non-French tax residents that are subject to foreign social security schemes.

This milestone decision will have a significant impact for foreign individual investors that have been subject to 15.5% social contributions imposed on French-source property income (rental income and capital gains) since 2012.

The ruling will open doors for tax refunds. This means foreign property investors that have paid these additional social contributions in France on the sale of a French property, or on French rental income, may now claim back from the French tax authorities any French social contributions unduly paid over the last three years.

The CJEU decision: Since 2012, non-French tax residents have been subject to the French 15.5% social contributions, so-called CSG-CRDS, on their French-source property capital gains and rental income.

However, the Regulation (EEC) No. 1408/71 provides that EU nationals shall only pay social security contributions in the state in which they receive benefits.

In its judgment, the court holds that the prohibition on social security overlapping laid down by Regulation No. 1408/71 is not conditional to the pursuit of a professional activity and therefore applies irrespective of the source of the income received by the person concerned.

In the present case, given that the plaintiff was subject to the social security scheme of the member state of employment (the Netherlands), his income, whether deriving from an employment relationship or from his assets, cannot be subject, in the member state of residence (France), to levies which have a direct link to the French social security scheme. Otherwise, the plaintiff would be subject to unequal treatment, as compared with other persons residing in France, since those persons are required to contribute only to the French social security scheme.

By extension, it means that French social contributions on French-source property capital gains and rental income on non-residents are considered as illegal under European law.

Practical implications: EU residents that have paid social contributions in France on sales of French properties and/or on French-source rental income are able to claim back from the French tax authorities any French social contributions paid in the past.

In this respect, the situation is pretty clear, as regards French social contributions paid on rental income. A claim can be filed until 31 December of the second year following the year during which the contributions were paid. In practice, it means that foreign taxpayers may claim refunds up to 31 December 2015 with respect to any French-source rental income generated since 2012 (and subject to French social contributions in 2013).

However, the rules applicable for claims relating to property capital gains seem to have recently changed in a less favourable way for taxpayers. In this respect, claims could be filed until 31 December of the year following the tax year during which the contributions were paid. This is actually debatable. In any event, claims for refunds with respect to property sales occurred in 2012 are definitely time-barred unless the procedure has been initiated before 31 December 2014.

It is also good news for non-EU residents, further to a recent French Supreme Tax Court decision given on 21 October 2014, *SCI Saint-Etienne et M. et Mme Aime*, which ruled that non-EU residents may not be treated differently and less favourably than EU residents. On the basis of this judgment, non-EU residents will also be able to lodge a tax claim seeking the reimbursement of any unduly paid French social contributions over the last few years. ■

Bruno Knadjian, Hogan Lovells, Paris (*bruno.knadjian@hoganlovells.com*)