Offshore Income and Gains

This note discusses the letters ('Nudge Letters') recently issued by HM Revenue & Customs (HMRC) to Italians living in the UK. This note is intended to give you a basic overview to assist you in in dealing with these letters.

Nudge Letters

HMRC has been circulating letters to individuals headed **'Your Offshore Income or Gains'.** This is often referred to as a 'Nudge Letter' because it is designed to encourage you into bringing your tax affairs up to date.

This targeted action, applies not only to Italians but to many other nationalities, and comes about through the automatic transfer of financial information received from overseas tax authorities and banks under information exchange agreements between the UK and many other countries. The letter you received is one of a batch of letters sent to many Italians living in the UK. The letter invites you to make a declaration of previously undeclared offshore income tax and capital gains tax liabilities.

Many Italians who receive these letters are taken by surprise as they were completely unaware that they had to declare income and gains arising in Italy (and/or other countries), often mistakenly believing that they had met all of their tax obligations because they had filed Italian tax returns and paid Italian taxes.

Some of the more common undisclosed sources of income and gains are rental income from Italian property, income from Italian securities and capital gains on the disposal of Italian property.

Certificate of Tax Position

Included with the 'Nudge Letter' is a ***Certificate of Tax Position*** ('Certificate'). The period covered by the Certificate is not restricted to any particular year but extends to all years. The Certificate sets out 4 statements:

1. *I need to bring my tax affairs up to date. I will declare all my outstanding UK tax using HMRC's Worldwide Disclosure Facility.*

2. *I believe I have declared all my overseas income and/or gains correctly on my tax return(s) as shown below:* [*Here you need to identify the relevant tax years and the boxes on tax returns where income and/or gains were entered*].

3. *I have not declared my overseas income and/or gains as they are covered by personal allowances or reliefs.*

4. *I have not declared my overseas income and/or gains as they are not liable to UK tax.*

Is vitally important that you respond to the letter, but please note that there is no legal obligation to complete the Certificate. HMRC have confirmed that they will accept responses by letter should the individual choose not to complete the Certificate.

Generally, if you have simple disclosures to make to bring your tax affairs up to date you should complete the Certificate, sign and date it and send it to HMRC by the date specified on the letter. If, however, no disclosure is needed, or your affairs are particularly complicated you should send a suitable letter to HMRC so as to focus the response to your particular circumstances.

The taxation of non UK income and capital gains

Having responded to the letter it is, where there has been non-disclosure, essential to bring all of your tax affairs up to date and make the relevant tax, penalty and interest calculations and disclosures. However before looking at the calculation and disclosure process, we should examine the basic ideas underlying the taxation of foreign income and capital gains.

Arising Basis**:** the default tax position is that a UK resident is taxable on worldwide income and gains whether or not remitted to the UK. This is known as the ***Arising Basis*** of taxation. It does not matter that the income or gains have been declared, and tax paid, overseas.

Remittance Basis**:** the default tax position may be modified for those persons who are UK resident but not UK domiciled. (Non-Doms). A Non-Dom may choose to be taxed on the *Remittance Basis* of taxation whereby UK source income and gains are taxed as usual but overseas income and gains are taxed only if, and when, the income/gains are remitted to the UK. A claim has to be made for each tax year that the remittance basis is adopted. After a Non

Dom person has been resident in the UK for more than 7 years there is a special charge of £30,000 payable each year if the remittance basis is claimed. This annual remittance basis charge goes up to £60,000 after 12 years of residence. When a person has been resident in the UK for 15 out the previous 20 years *he* becomes deemed UK domiciled and disqualified from claiming the remittance basis.

***Domicile status*:** the domicile of a person is where his homeland (patria) is. Domicile does not translate as 'home address'. Domicile is a legal concept which is applied in certain countries to establish the relevant jurisdiction for personal law matters e.g., divorce. The concept, which derives from ancient Roman Law, has been adopted and adapted by HMRC for tax purposes.

Residence status: this is determined by the Statutory Residence Test (SRT) legislation which came into effect in the tax year 2013/14. It is not primarily based on the concept of centre of interests, but rather on the number of days spent in the UK. When you are resident in the UK it is for the whole of the relevant tax year irrespective of the date of arrival in, or departure from, the UK – although this can be modified in some cases.

Applying UK tax rules: when reporting overseas income or gains it is essential to recompute that income or gains under UK tax rules. For example, certain capital disposals are not taxed in Italy if the assets had been held for more than 5 years – under UK rules there is no such time limit. Another example is that often more deductions against rental income may be available under UK rules than under Italian rules.

Tax year: the tax year for income tax and capital gains tax is from 6th April to the following 5th April. For example the tax year 2021/22 started on 6 April 2021 and will end on 5 April 2022.

Tax Treaties: Tax treaties can modify some of the above rules. Certain articles, for example, restrict taxation to only one of the two treaty countries.

With the benefit of this background we can look at the process of calculating and disclosing the tax liabilities, penalties and interest.

Disclosure process

Having written to HMRC, we recommend the following three steps in the disclosure process:

Step 1 Summarise the tax position.

Step 2 Prepare and file tax returns with a summary covering letter providing context.

Step 3 Complete the Worldwide Disclosure facility (WDF).

Step 1 Summarise the tax position

- Identify all the sources of your Italian income and capital gains since you have been resident in the UK.
- Check whether you can make any 'in date' amendments. It is possible to amend a tax return free of all penalty implications, within the 12 months following the filing date for the tax return. This cannot be done once HMRC have commenced an enquiry into the tax return.
- Determine how many tax years you need to go back (see below).
- Collect the relevant paperwork which may include Italian tax returns, rental records, bank statements, certificates of interest, employment records, accounting records and so on.
- Prepare a list of offshore assets showing maximum values over the previous 5 years.
- Recompute income and gains (and losses) in accordance with UK tax rules.
- Determine, tax year by tax year, whether it is optimal to claim for the remittance basis of taxation for any particular year.
- Identify reliefs and exemptions that may be available to set against tax liabilities.
- Prepare a summary showing by tax year undisclosed income and gains, apply reliefs and calculate the tax, penalties and interest due.

Step 2 Prepare and file tax returns

In order to secure allowances and reliefs it is recommended that you file tax returns for the relevant years since certain claims should be made on the tax return. (Some of these claims may be out of date but it is sometimes possible for them to be allowed when everything is concluded). In filing previously undeclared tax returns it is good practice to write a covering letter to HMRC setting out pertinent background information in order to provide context. It is also useful to table a summary of income, tax liabilities, penalties and interest tax year by tax year.

Step 3 Complete the Worldwide Disclosure facility (WDF)

The tax liabilities, penalties and interest calculations are reported to HMRC using the online Worldwide Disclosure Facility (WDF). Also reported on the WDF is the maximum value of worldwide assets in the previous 5 years.

How far back do you go?

The main time limits are:

- 4 tax years is the minimum period,
- 6 tax years if you had been *careless* regarding your tax affairs
- 20 tax years if the non-disclosure was deliberate
- 20 tax years for *failure to notify* HMRC of chargeability to tax (but not to 2008-09 and earlier years so long as you were not *negligent*)

Careless & Negligence: These are coterminous terms which means failing to take reasonable care. In other words it is necessary *'to consider what a reasonable taxpayer exercising reasonable diligence in the completion and submission of the return would have done'*. Where carelessness, or any other form of culpability, is alleged by HMRC, the onus lies on HMRC to prove their assertion. Note that reliance on the advice of an agent or advisor as a mitigating factor in a negligence matter will not be effective unless you received specific advice on the subject matter and the advice was addressed specifically to you.

Failure to notify: There is a requirement to notify HMRC of chargeability to income and capital gains within 6 months of the end of the relevant tax year. A *failure to notify* arises where tax returns have not been submitted in past years and this results in opening up a 20 year period for disclosures.

Penalties

Penalties are chargeable on outstanding tax liabilities. The determination of penalties is very complicated and depends on a number of factors including the taxpayer's behaviour and the territorial location of the income or gains. Penalties can only be properly assessed on a case by case basis. There are different types of penalty that HMRC can charge. These include:

- Penalties for late payment of tax
- Penalties for late submission of tax returns and other returns

- Penalties for failure to notify about changes to your tax position
- Penalties for errors
- Requirement to correct/Failure to correct penalties

Requirement to correct (RTC) and Failure to correct (FTC)

Requirement to Correct (RTC) legislation was introduced in 2017 and required individuals to declare undisclosed offshore income and gains by 30 September 2018. A Failure to Correct (FTC) Penalty is a penalty for a failure to make a disclosure under RTC legislation. (This should not be confused with a Failure to Notify Penalty). The FTC penalty can only apply to tax years 2015/16 and earlier. The standard FTC penalty is 200% of the tax due. This may be reduced according to the quality of disclosure, and whether the disclosure was prompted or voluntary: 150% where the disclosure was prompted and 100% where the disclosure was voluntary. The statutory minimum is 100%.

Where disclosure had taken place by 30 September 2018 under the Requirement to Correct legislation, an FTC penalty will not apply, however penalties will still be due under other legislation. These other penalties vary according to the foreign territory in which the income or gains arose. Territories are divided into three categories according to the quality of the cooperation arrangements between the territories and the UK. For example, Italy is a category 1 territory while North Korea is a category 3 territory. The maximum penalty for a category 1 territory is 100%. The maximum penalty for a category 2 territory is 150% and for category 3 the maximum penalty is 200%. The minimum penalty is 0%. The factors taken into account in determining these penalties comprise:

- Category of territory, 1, 2 or 3.
- Type of disclosure – (a) Careless, (b) Deliberate or (c) Deliberate and concealed.
- Whether the disclosure was voluntary or prompted.

The penalty is determined by reference to detailed tables.

Interest

Interest applies on outstanding tax and on penalties paid late. Interest is charged at bank base rate (currently 0.1%) plus 2.5% giving 2.6%.

Disclaimer

This note is for guidance only and readers entering into transactions on the basis of the information provided within it, or otherwise relying on, such information should seek the services of a competent professional advisor. While every care has been taken to ensure the accuracy of the contents the writer and his firm cannot accept responsibility for any loss occasioned to any person acting or refraining to act as a result of any statement in it.

Piero Soteriou
Soteriou Banerji, Chartered Accountants
253 Gray's Inn Road
London, WC1X 8QT
Email: info@soban.com
Telephone: 020 7278 8251
Website: www.soban.com

24 May 2021