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Data Analytics and the Tax Transparent World

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In an increasingly digital society HM Revenue & Customs ("HMRC"), in the U.K., like other tax authorities, is reviewing its operations and capabilities to respond to new demands upon the tax system. Beginning with HMRC's 2015 Making Tax Digital roadmap, this article looks at some key initiatives within HMRC, how these interact with increased data flows reaching HMRC under the Common Reporting Standard and other measures, and finally considers the key impacts of these trends on the private wealth world.

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I. Tax Authorities and Data Analytics

The past 20 years has seen the increasing digitalization of communication, lifestyles and professional life and government bodies around the world are considering how to adapt their processes and structures to interact efficiently with an online society.

HMRC has been particularly proactive in addressing this and the U.K. tax authorities' interest in Making Tax Digital (a title adopted for the six interlinked consultations released in August 2016) has been building for some time.

On December 14, 2015, HMRC published their Making Tax Digital roadmap ("HMRC 2015 roadmap"), which expressed their desire to remove bureaucratic form-filling, eliminate unnecessary time delays, and give taxpayers access to their data in one place, signalling the end of the tax return. At the same time, HMRC are clear that there will be no loss of support for those who struggle to access digital services.

The six HMRC consultations released in August 2016 build on HMRC's 2015 roadmap by offering further detail on what a digital tax system could look like, ranging from proposals for HMRC to directly gather an increased amount of third party data from banks, building societies, and potentially pension providers, to administrative points around how filing deadlines, late filing penalties and enquiry powers will be updated to reflect a digital, real-time tax system.

Whilst HMRC's 2015 roadmap understandably focuses on simplifying the tax system and improving the customer experience, there is also a focus on reducing the scope for error. As such, the consultation "Making Tax Digital: Transforming the tax system through the better use of information" proposes removing the burden of information-gathering from taxpayers, but taxpayers will still have an obligation to check that the information held on them by HMRC is complete and accurate.

It would be reasonable to expect that HMRC might hope that the digital agenda will assist in identifying more accurately tax risks and where they occur. For example, increasingly automated flows of third party data could help reduce inaccurate tax reporting

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through innocent error. As well as the immediate impact on the tax gap, HMRC's interventions on remaining errors could be more narrowly targeted. HMRC suggests that any remaining errors identified in a digital tax age are more quickly identified as deliberate, rather than careless or innocent errors.

Indeed, HMRC already moved to centralised risk review teams some years ago, using computerized risk profiling tools to identify cases which are perceived to be at a higher risk of containing tax avoidance or tax evasion. These risk profiling tools have become increasingly sophisticated over the past decade, allowing HMRC to direct resources to areas which the department perceives as most high-risk, whether this relates to particular sectors, geographical locations or technical issues.

This is part of a wider, global, trend and a recent OECD report "Advanced Analytics for Better Tax Administration" noted that tax authorities as a whole are moving in their use of data analytics from a generation 1 approach, focusing on predictive analysis, to a generation 2 approach, focusing on prescriptive analytics. Under prescriptive analytics, tax authorities aim not just to identify areas of risk, but also to identify the impact of their actions, so as to effectively and proactively influence specific groups. Seen in this context, data analytics could prove an important tool in HMRC's "Promote, Prevent, Respond" strategy, which aims to create significant behavioral change in the taxpayer population.

HMRC is aided in this by the introduction of their long-awaited Connect database. Introduced in 2008, but not fully operational until 2014, and with rumors that it cost between 45-80 million pounds to build and holds more data than the British Library, the database allows HMRC to see on a single screen what assets are held by a taxpayer, what businesses, properties and individuals a taxpayer is linked to, and to draw on data from other bodies such as the Land Registry and other government departments. What used to take a team of inspectors weeks to gather, can now happen at the touch of a button.

Moreover, this appreciation of the inter-connected state of a taxpayer's affairs is reflected in the creation of the new Wealthy and Mid-Sized Business Compliance directorate in HMRC, which aims to review business and the entrepreneurs behind them in a holistic manner. This new directorate is a reminder that whilst to some the HMRC 2015 roadmap can appear daunting, the increasingly holistic approach within HMRC can also be useful in aiding understanding of taxpayers' affairs.

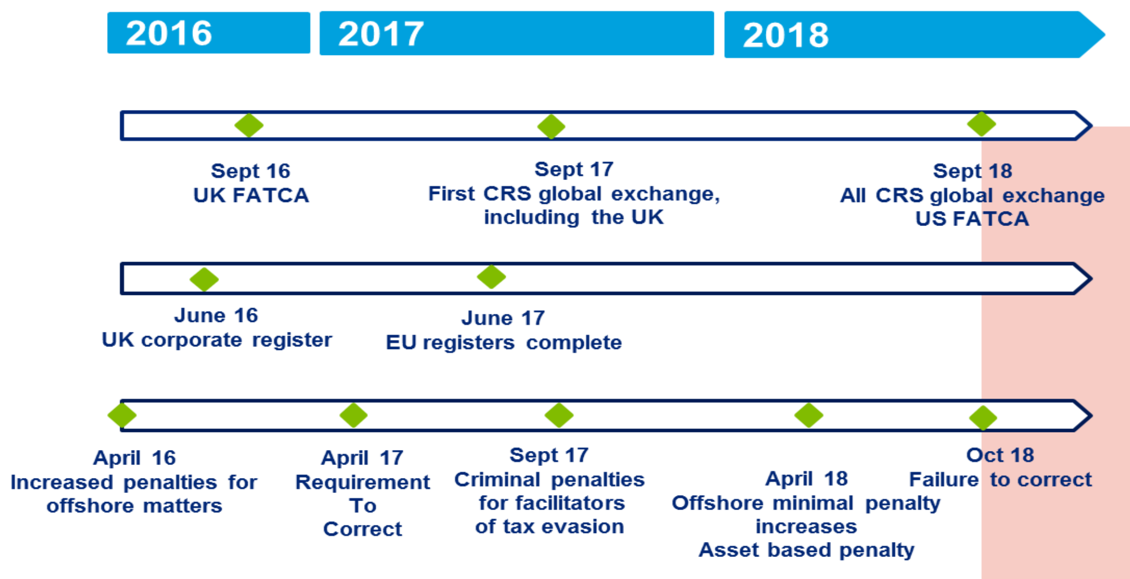
Finally, it is worth mentioning what may be HMRC's biggest data challenge at present, the Panama Papers. HMRC have joined a multi-body task force with the Serious Fraud Office, the Financial Conduct Authority and the National Crime Agency to analyze the data from the much publicized leak. HMRC announced on November 8 it is launching over 30 criminal and civil investigations. The practical challenges of analyzing this data could be seen as a forerunner of issues potentially arising around the Common Reporting Standard, whilst it might be reasonable to expect that the four bodies in the task force are pooling their knowledge as well as their resources to respond effectively to new data flows.

II. The Common Reporting Standard and Global Data Flows

The Common Reporting Standard ("CRS"), in force from September 2017, is often seen as the culmination of the automatic exchange of information trend that began with U.S. FATCA. However, the CRS is also the start of data analysis on a global scale by HMRC and the driver for further transparency initiatives.

Below are some key dates on these initiatives.

As seen, the U.K. has shown a willingness to act early on transparency and on data exchange. Beneficial ownership registers for other EU countries will not be in place until June 2017, with some jurisdictions yet to decide the terms and conditions of their registers. In April 2016, HM Treasury was at the forefront of a proposal for countries to automatically exchange the data in these registers, in addition to CRS



data. The U.K. has also chosen to be a CRS "early adopter," whilst U.K. FATCA effectively brings the Crown Dependencies and Overseas Territories into CRS a further 12 months early.

HMRC has responded these increased data flows and the U.K. Government's commitment to the transparency agenda by introducing further initiatives and reviews of HMRC's powers, timed to coincide with the timeframes around CRS.

In August 2016, HMRC released a consultation on a new statutory Requirement to Correct ("RTC") historic errors relating to offshore income and assets in years up to and including 2015-16 tax year. RTC will be in place from April 2017–September 2018, being succeeded by Failure to Correct ("FTC") sanctions from October 2018. HMRC is consulting on the FTC sanctions, but both models currently proposed by HMRC include the potential for public "naming and shaming" of offenders, and under one model penalties could start at 100 percent of the tax due and rise to 300 percent of the tax due.

Alongside this, the terms of the Worldwide Disclosure Facility ("WDF") that opened on September 5, 2016 will be revised with effect from October 1, 2018 to coincide with the introduction of Failure to Correct and the full-scale CRS data exchange. At present, most disclosures will need to be filed with HMRC within 90 days of registration with HMRC, and there will be an up-front self-assessment of the behaviors involved in triggering the disclosure, including whether the disclosure is prompted by HMRC correspondence.

HMRC's consultation on corporate criminal sanctions for the failure to prevent facilitation of tax evasion will also be in situ from September 2017, requiring that U.K. businesses update their procedures to minimize risk. In a further sign of joined-up working, it is understood that voluntary disclosures to HMRC may in the future focus as much on which parties advised the taxpayer as on the ultimate tax liabilities.

III. The Impact on Private Wealth

Automatic global data flows and increasingly-refined data analytic tools within HMRC impact the whole taxpayer population; however, the greatest impact is likely to be felt by high net worth individuals and families, due to the complexity and volume of their financial affairs. In particular, non-U.K. domiciled U.K. residents who file their U.K. returns on the remittance basis may face a perception issue around what has been reported on their U.K. returns, compared with the new data reaching HMRC.

HMRC have also made it clear that RTC applies to complex situations where advice has been taken but the tax position has changed over time, rather than solely to the minority who deliberately evade tax. HMRC's consultation on RTC recommends that taxpayers seek up-to-date advice on their affairs and this recommendation will be repeated in CRS notification letters which banks and professional firms must send to their clients by August 2017.

In an era of data transparency, and where the tools to analyze this data to a granular level are increasingly available, taxpayers will want to review their affairs to ensure they have a full understanding of their own position. In some cases it may come to light that structures which were thought to be wound up or resolved are still active; in other cases, the emphasis will be on having an advance understanding so as to be able to quickly and thoroughly respond to any queries from the U.K. authorities on offshore wealth, and decide who within a family or family office co-ordinates responses to queries.

Where a disclosure is necessary, it is equally important to act swiftly and any delay is likely to meet with increased sanctions. The most obvious are the FTC sanctions in place from October 2018, and mentioned above. Alongside this, the measures introduced in Finance Act 2016—including a strict liability offense for offshore tax evasion, further increases in tax-geared penalties relating to offshore matters, and a lowering of the threshold for "naming and shaming" through HMRC's Publishing Deliberate Defaulters regime—are currently awaiting their start date and it seems unlikely that HMRC will wait long before activating these further penalties.

Within the existing rules and the current terms for the WDF, the minimum tax-geared penalties on a disclosure will be increased if there has been a significant delay in making a disclosure, and/or if a taxpayer ignored the opportunity to enter previous disclosure facilities. At present, a significant delay is defined as three years, but this can be less if the error being disclosed existed over several years.

The final point for consideration is that a discussion of data analytics and data flows should not to lose sight of the fundamental importance of the relationship with HMRC. The sheer volume of data reaching HMRC will need careful interpretation by the tax authorities. Now is the time to build a positive relationship with HMRC, so as to provide a clear context for the data under review. The longer term benefits in handling perceptions of risk and mitigating the impact of any HMRC enquiry are clear.

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This article reflects the understanding of the law and HMRC practice or intended practice as at September 5, 2016. The matters discussed are complex and many considerations which need to be taken into account in determining when and how to apply the RTC, FTC or WDF. If you intend to make a disclosure to HMRC, please seek professional advice.

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