

**EXPLANATORY MEMORANDUM TO  
THE PENALTIES, OFFSHORE INCOME ETC. (DESIGNATION OF  
TERRITORIES) ORDER 2011**

**2011 No. [XXXX]**

1. This explanatory memorandum has been prepared by Her Majesty's Treasury and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. **Purpose of the instrument**

This Order, with effect from 6 April 2011, designates territories for the purposes of determining penalties under Schedule 24 to the Finance Act 2007 for non-compliance with UK income tax and capital gains tax obligations with respect to income and gains from overseas.

3. **Matters of special interest to the Select Committee on Statutory Instruments**

None.

4. **Legislative Context**

4.1 This Order is made in exercise of the power conferred by the new paragraph 21A of Schedule 24 to Finance Act 2007 (inserted by paragraph 5 of Schedule 10 to Finance Act 2010), which introduced a new framework for penalising tax non-compliance with respect to income and gains arising outside the UK. The new framework will apply to income tax and capital gains tax only.

4.2 Where a penalty is payable under paragraph 1 of Schedule 24, the new paragraph 4 of Schedule 24 (inserted by paragraph 2 of Schedule 10 to the Finance Act 2010) sets out the amount payable by reference to categories of inaccuracy.

4.3 Category 1 inaccuracies attract penalties of a maximum of 30 percent, 70 percent and 100 percent of the potential lost revenue for careless action, deliberate but not concealed action and deliberate and concealed action, respectively.

4.4 Category 2 inaccuracies attract penalties of a maximum of 45 percent, 105 percent and 150 percent of the potential lost revenue for careless action, deliberate but not concealed action and deliberate and concealed action, respectively.

4.5 Category 3 inaccuracies attract penalties of a maximum of 60 percent, 140 percent and 200 percent of the potential lost revenue for careless action, deliberate but not concealed action and deliberate and concealed action, respectively.

4.6 These penalties will be subject to reductions for disclosure in the same way as under the existing model.

4.7 New paragraph 4A of Schedule 24 (inserted by paragraph 2 of Schedule 10 to the Finance Act 2010) explains the three categories of inaccuracy. All domestic matters fall within category 1 automatically, and as a result will attract a maximum penalty of 100 percent of the potential lost revenue (in cases of deliberate and concealed action), which is the same rate as in the current legislation. Offshore matters concerning taxes other than income tax and capital gains tax are also automatically within category 1 and the same principle applies.

4.8 Offshore matters, i.e. where the income, assets or activities occur outside the UK, which concern income tax and capital gains tax, are placed into the categories of inaccuracy by reference to whether they concern a “category 1 territory”, a “category 2 territory” or a “category 3 territory”.

4.9 For example, an offshore matter concerning a “category 1 territory” is a category 1 inaccuracy.

4.10 This order designates the territories that are a “category 1 territory” and a “category 3 territory” for the purposes of paragraph 21A of Schedule 24 to the Finance Act 2007. All remaining territories fall by default into “category 2”. It is the first use of this power and is therefore subject to the draft affirmative procedure, see paragraph 21A(7) of the Finance Act 2007.

4.11 Paragraph 21A of Schedule 24 to the Finance Act 2007 also has effect in relation to penalties under Schedule 41 to the Finance Act 2008 (penalties: failure to notify and certain VAT and excise wrongdoing) and Schedule 55 to the Finance Act 2009 (penalties for failure to make returns etc) (see paragraph 6A(7) of Schedule 41 to the Finance Act 2008 and paragraph 6A(7) of Schedule 55 to the Finance Act 2009, inserted by paragraphs 8 and 12, respectively, of Schedule 10 to the Finance Act 2010 from a day to be appointed).

## **5. Territorial Extent and Application**

This instrument applies to all of the United Kingdom.

## **6. European Convention on Human Rights**

The Exchequer Secretary to the Treasury has made the following statement regarding Human Rights:

In my view the provisions of the Penalties, Offshore Income etc. (Designation of Territories) Order 2011 are compatible with the Convention rights.

## **7. Policy background**

- *What is being done and why*

7.1 Schedule 10 to Finance Act 2010 introduced a new framework for penalising tax non-compliance with respect to income and gains arising outside the UK. The new framework will apply to income tax and capital gains tax only.

7.2 Penalties for tax non-compliance are currently based upon the tax lost as a result of the inaccuracy or failure in question, the behaviour of the taxpayer, and the degree to which the taxpayer has made a disclosure to HM Revenue and Customs. In future, the location of the income or gain in question will also be factored into this calculation.

7.3 Schedule 10 was introduced in recognition that tax information from overseas is often more difficult to obtain than information from the UK. This means offshore non-compliance is harder to detect and remedy, and as such the deterrent against such non-compliance is reduced compared with deterrence against non-compliance concerning income or gains arising in the UK.

7.4 The new paragraph 21A of Schedule 24 to the Finance Act 2007, inserted by Schedule 10, requires the Treasury to take into account the existence and quality of information sharing arrangements in performing the classification. It also requires the Treasury to pay specific heed to the existence of any arrangements to automatically share information on savings income.

7.5 As a result, the classification is predominately based upon the tax transparency of territories. Where a territory has arrangements with the UK which provide for the automatic sharing of information on savings income, the territory has been placed in category 1. Where the territory has arrangements in place which provide for the exchange of tax information on request with the UK, the territory has been placed in category 2. Where no information sharing arrangements exist, or arrangements are of insufficient quality, the territory has been placed in category 3.

7.6 The new paragraph 21A of Schedule 24 to the Finance Act 2007 also permits the Treasury to take account of the potential benefits of an information sharing agreement, in the case where none exists. This provision has been used to classify the least developed countries in category 2, even if they have no information sharing arrangements with the UK.

7.7 These penalty provisions are not intended to work in isolation. The Government is pursuing a number of policy options to enhance global tax transparency and to reduce the impact of offshore non-compliance, for

example through the signing of new information sharing agreements and the use of disclosure facilities where appropriate.

7.8 An appointed day order will be made by the Treasury in 2011 to commence the new penalties in section 35 and Schedule 10 to the Finance Act 2009, concerning income and gains arising outside the UK, for tax periods commencing on or after 6 April 2011.

- *Consolidation*

7.9 N/A.

## **8. Consultation outcome**

Policy options for tackling offshore non-compliance were the subject of a consultation by the HM Revenue and Customs Review of Powers, Deterrents and Safeguards in December 2009.<sup>1</sup> A summary of responses to that consultation was published in March 2010.<sup>2</sup>

## **9. Guidance**

Guidance on the operation of the new penalty framework will be published by HM Revenue and Customs.

## **10. Impact**

10.1 An Impact Assessment has not been produced for this instrument as it has a negligible impact on business, charities or voluntary bodies.

10.2 The impact on the public sector is negligible.

## **11. Regulating small business**

11.1 The legislation applies to small business, only insofar as the amount of penalty faced by a small business with respect to undeclared income tax or capital gains tax liabilities arising overseas may change.

11.2 No new requirements are placed upon firms by this instrument.

## **12. Monitoring & review**

The classification effected by this instrument will be regularly reviewed, and will be updated to reflect changed circumstances (for example, the coming into force of new arrangements to share tax information).

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<sup>1</sup> Available at <http://www.hmrc.gov.uk/about/tackling-offshore-tax-evasion.htm>

<sup>2</sup> Available at <http://www.hmrc.gov.uk/about/tackling-offshore-tax-evasion.htm>

### **13. Contact**

Chris Walker at HM Revenue and Customs (Tel: 0207 147 2803 or email: [powers.review-of-hmrc@hmrc.gsi.gov.uk](mailto:powers.review-of-hmrc@hmrc.gsi.gov.uk)) can answer any queries regarding the instrument.