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CLIENT MEMORANDUM

United Kingdom – Obligation on Financial Institutions to Notify Customers of HMRC's Forthcoming Access to New Data on Offshore Income

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Financial institutions that are resident or carry on business in the United Kingdom are required to provide their UK tax-resident individual customers with a one-off notice, in a form that has been prescribed by H.M. Revenue & Customs (**HMRC**) under new regulations. The notice is effectively a warning to such UK taxpayers to voluntarily declare their offshore income before certain information as to their personal financial affairs is reported to HMRC, under international information exchange agreements, and checked against their UK tax returns.

Background

There has been a concerted international effort by tax authorities over the past several years to clamp down on tax avoidance and aggressive tax planning schemes that result in the erosion of the tax base. In addition to tightening up tax laws, governments have been working together to improve information flow.

The UK's *International Tax Compliance Regulations 2015* (the **2015 Regulations**) give effect to the UK's agreement with the United States regarding the U.S. Foreign Account Tax Compliance Act (**FATCA**), the OECD's Common Reporting Standard (**CRS**) and the European Directive on Administrative Cooperation (**DAC**). CRS is effectively an internationalised version of FATCA with many shared concepts, and DAC is the embodiment of CRS in European Union law.

As a result of these new reporting obligations and automatic information exchanges between tax authorities, HMRC will have access to a significant volume of new data. *The International Tax Compliance (Client Notification) Regulations 2016* (the **Regulations**) were introduced as a method of providing a warning to people whose personal overseas assets may now come to the attention of HMRC for the first time. HMRC guidance was released in October 2016 as to the scope and content of these Regulations.

Which entities are required to give notification?

The obligations apply to Specified Financial Institutions and certain tax advisers.

Specified Financial Institutions means 'financial institutions' as defined for CRS, other than Non-Reporting Financial Institutions, or charitable organisations. There are four categories of 'financial institution' under CRS, being custodial institutions, depository institutions, investment entities and specified insurance companies, which broadly includes ***banks, building societies, insurers, fund managers, wealth managers, investment entities and trusts*** (where the trust meets the definition of 'financial institution', usually as an 'investment entity' or 'custodial institution'). This is similar to, although slightly narrower than, the corresponding FATCA concept.

For the Regulations to apply, the financial institution must be resident in the UK or must be a UK branch of a non-UK resident financial institution. This means:

- companies incorporated in the UK or centrally managed and controlled in the UK, or companies that carry on a trade in the UK through a permanent establishment;
- trusts where one or more of the trustees is resident in the UK for tax purposes, unless the trust is resident in another jurisdiction (i.e. the U.S. or a 'participating jurisdiction') with which the UK automatically exchanges financial account information and the trust reports details of reportable accounts in that other jurisdiction. This differs from FATCA, which provides that a trust will only be resident in the UK where most of the trustees are resident in the UK for tax purposes, or where the settlor is both resident and domiciled in the UK for tax purposes; and
- partnerships that submit tax returns in the UK or whose business is controlled and managed in the UK.

The list of '**participating jurisdictions**' (which is contained in Schedule 1 to the 2015 Regulations) is extensive, including almost 100 countries.

Entities that are dual residents will still need to submit information in the UK under CRS, and so will also need to issue notices under the Regulations. It is important to note that an entity may not be a Non-Reporting Financial Institution (and therefore be caught by this notification obligation) even if it is not a Reporting Financial Institution.

The term 'financial institution' covers the entire legal entity. For example, if a UK resident company is a Specified Financial Institution, the notification obligation covers non-UK branches of that company.

The Regulations also require a Specified Financial Institution that is a body corporate and controls an overseas body corporate or partnership, that would have been a Specified Financial Institution if it were carrying on business in the UK, to take all such steps as are reasonably open to it to ensure that the overseas entity makes a notification under the Regulations to individuals who were account holders of the overseas entity at any time in the 12-month period ended September 30, 2016 and whom it reasonably believes to have been UK tax-resident. The overseas entity does not have to obtain new information – reasonable belief is based on the data that it is already obliged to hold, for other legal or regulatory reasons.

Reporting obligations of Specified Financial Institutions

Specified Financial Institutions must identify clients who are ***individuals*** and whom the institution reasonably believes are resident (or will be resident) in the UK for UK income tax purposes in either the 2015-16 or 2016-17 tax year and who are account holders of the Specified Financial Institution on September 30, 2016. For this purpose, a tax year runs from April 6 to the following April 5. The relevant customers should be identified, using one of the following methods:

- The ***services approach*** involves identifying relevant individuals who were account holders of the financial institution (including through a branch) on September 30, 2016 and (i) for whom the financial institution maintained a financial account at any time during the 12 months ended on September 30, 2016 in the United States or a 'participating jurisdiction' (other than the UK), or (ii) whom the financial institution referred at any time during the 12 months ended on September 30, 2016 to another financial institution (wherever located) to provide a financial account for the individual in the United States or a 'participating jurisdiction' (other than the UK).
- The ***high value approach*** involves identifying relevant individuals who held high value accounts with the financial institution on September 30, 2016. 'High value' means worth US $1 million or more, and the financial institution may use the balance as at December 31, 2015 or 2016 to make the determination. This approach is less onerous for the financial institution than the services approach and works on the assumption that high net worth individuals are also likely to have wealth outside the UK.

If an institution operates in more than one jurisdiction, it is a question of fact as to where an account is maintained. A 'financial account' means a depositary account, a custodial account, an equity or debt interest in an investment entity (including a trust), a cash value insurance contract or an annuity contract.

UK resident individuals identified by either the services approach or the high value approach are referred to in the Regulations as ***Specified Clients***.

Notice does not need to be sent if the account holder is an entity (not an individual). Nor is there any obligation on a Specified Financial Institution to trace through a corporate account holder, such as a platform or other nominee, in order to identify any indirect individual UK resident investors – in that situation, any notification obligation falls on the nominee.

Content and method of notification

Specified Financial Institutions must give a notification to Specified Clients no later than **August 31, 2017**.

Notice must be in paper form and can be sent by post or courier. It cannot be delivered by email.

The covering letter must come from the institution and must include the name and address of the customer and certain language as provided in the Regulations. The letter must enclose the form of HMRC notice set out in Schedule 3 of the Regulations, containing links to HMRC guidance.

This is a one-off (not an annual) notification, alerting individual UK taxpayers to the possibility that HMRC may be receiving more information about their personal financial affairs than has been disclosed in tax returns to date.

Notification needs to be sent only once to a Specified Client by any group of connected Specified Financial Institutions that are carrying on business in the UK, but notification by a controlled overseas entity does not satisfy any separate notification obligation of a Specified Financial Institution or vice versa.

Final thoughts

Specified Financial Institutions will need to retain records of account holders as at September 30, 2016.

The Regulations should not impose a significant additional burden on financial institutions that already have reporting obligations under FATCA, CRS or DAC, provided that all the formal requirements set out in the Regulations are followed closely.

If you have any questions regarding this memorandum, please contact Judith Harger in London (+44 20 3580 4705, jharger@willkie.com) or the Willkie attorney with whom you regularly work.

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