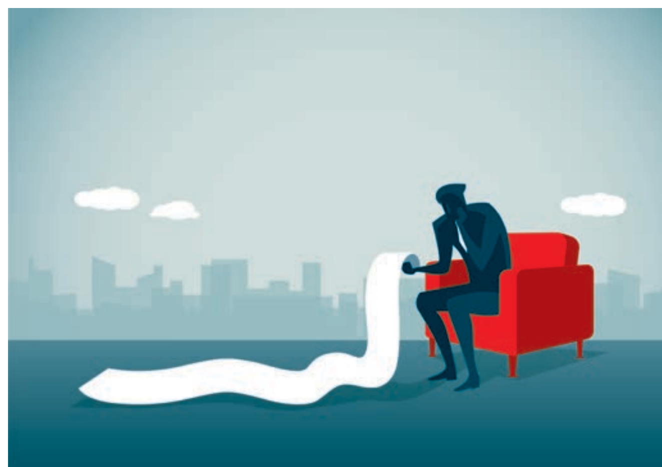
A gentle nudge

If there is one letter that should not be ignored, it is a nudge letter from HMRC. Katherine Bullock explains how best to deal with these missives.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As most practitioners with clients holding offshore assets will know, there is a wide variety of tools and strategies at HMRC's disposal to pursue whatever tax it believes is owed. These range from informal inquiries all the way to strict liability criminal offences and knowing how each works can be essential.

A relatively new tool in HMRC's box is the nudge letter, a tactic made possible in its most recent incarnation by the adoption of the Common Reporting Standard (CRS) in 2017 and the subsequent sharing of information by and to HMRC from across the globe.

HMRC now has the capacity through its data matching tool, Connect, to cross match a vast number of its own and third-party data items to identify anomalies arising from relationships and patterns between individuals, organisations, and information. This, combined with behavioural science techniques aimed at encouraging particular patterns of behaviour and growing desire and need to close the tax gap has resulted in 'nudge letters' addressed to a wide number of taxpayers on a variety of different tax matters.

Increasing use

In their responses published in June 2021 to HMRC's discussion document on helping taxpayers get offshore tax right issued on 23 March 2021, the various professional bodies agree that greater use of nudges and prompts could be effective in encouraging taxpayer compliance and support the proposal for greater use on a timely and tailored basis.

Of particular relevance over the past year, thousands of nudge letters have also been deployed to notify employers suspected of abusing the furlough system, by accepting payments to which they were not entitled, that they may need to repay some or all of the funds which they have received. Although a departure from their normal remit, these nudge letters are not substantially different to the previous batches and should be dealt with in the same manner.

While nudge letters are becoming increasingly common and familiar to tax practitioners, they can still be alarming when received by the taxpayer. This is particularly because the letters, by their nature, tend to be sent to the more compliant majority who submit a tax return rather than the less compliant minority who do not.

The letters from HMRC's risk and intelligence service are formally worded, warn of criminal prosecution and often include a declaration to be signed. Sometimes the client calls their tax adviser, wracking their brains as to what might have prompted the letter, unable to think of anything. Does the letter then just go on file? Sometimes the client files it in the waste paper basket without troubling his adviser – why pay fees over nothing? Or worse still they fill out the form without thinking, or assuming that they must, and send it back. Or perhaps the taxpayer suspects a phishing expedition and does not respond at all.

Key points

- A nudge letter will encourage taxpayers to disclose anything that might have been left off their tax returns.
- Nudge letters are usually sent in response to information HMRC has received (through the CRS for offshore assets).
- Due to the serious consequences of making an incorrect declaration taxpayers should carefully consider whether they should sign and return the certificate of tax position.
- Disclosures following from a nudge letter are considered as prompted and the taxpayer will not qualify for full mitigation from penalties.

What is a nudge letter?

A nudge letter, quite simply, is a non-statutory letter from HMRC intended to give a taxpayer a nudge towards disclosing anything that might have been left off their tax returns, whether by accident or intentionally. They are usually sent in response to information HMRC has received, in the case of offshore assets usually through the CRS, that indicates that the taxpayer's returns do not square with the amount which HMRC believes is owed. These letters therefore represent a calculated approach based on the perceived likelihood or risk of non-compliance; they are not usually random.

This does not always mean that the taxpayer has made a mistake but sending out these letters makes a lot of sense to HMRC, considering the relatively low cost compared with the

potential to recoup large amounts of tax that would otherwise remain unpaid by individuals unaware of their obligations. The heavy lifting of investigating a taxpayer's affairs is passed to the taxpayer, neatly sidestepping the procedure driven enquiry process with its opportunities for the taxpayer or the First-tier Tribunal to call a halt to any fishing expeditions. Instead through education and a well-timed reminder any oversight is remedied.

On the surface this all seems gentle and civil of HMRC, which some may feel is a departure from its usual form. This impression may not hold up quite so well if one considers what is contained within a nudge letter.

Certificate of tax position

The letter will typically suggest that HMRC has decided that the taxpayer's returns do not match up to what it believes is owed and will provide a number of possible reasons why this might be. This could be a simple mistake has been made, or the taxpayer is relying on outdated tax advice due to changes in the law or their circumstances, or professional tax advice may be required. The letter suggests that the taxpayer takes a full account of their affairs before promptly replying to the letter within 30 days to make HMRC aware of any disclosure that needs to be made, or the reason why their returns are correct in their departure from HMRC's estimates.

The more insidious aspect of these letters lies in the enclosed 'certificate of tax position' which accompanies some, wherein the taxpayer is encouraged, with no limits on the timeframe or quantum to which they are attesting, to state categorically that their affairs are correct, incorrect, covered by allowances or reliefs, or not liable for UK tax.

The Chartered Institute of Taxation in its updated guidance to members dated 30 July 2020 suggested that HMRC's rationale in including the declaration is to reduce the number of non-responses that it needs to follow up. This administrative convenience for HMRC can have severe consequences for the taxpayer. Non-disclosure following the receipt of a nudge letter may constitute deliberate misconduct if the taxpayer can be shown to have become aware that a mistake has been made but makes no disclosure of that error. For example, a penalty of up to 200% of the potential lost revenue can be imposed when HMRC successfully argues that conduct relating to an offshore matter is deliberate and concealed. Further, the assessment period for deliberate behaviour can extend to 20 years.

The Chartered Institute of Taxation in its guidance states: 'In view of the serious consequences of making a false declaration, consider very carefully whether your client should sign and return the certificate of tax position.' This is not understating the position.

A nudge letter is not a formal enquiry notice and carries none of the statutory protections that exist in the case of a formal enquiry. The declaration is entirely voluntary, and HMRC has confirmed in its discussion with the CIOT that it has no legal means or mandate to compel the recipient of the nudge letter to complete or sign the certificate of tax position. A taxpayer who does so is warned that making a false statement is a criminal offence and that they can face investigation and criminal prosecution for a false statement made by means of the certificate.

While the declaration that the information provided is 'correct and complete to the best of their knowledge and belief' is the same as that on the self-assessment tax return, the declaration that they understand the consequences of making a false statement is not. Unlike the declaration on a self-assessment tax return, this declaration relates to all amounts without any de minimis. Theoretically £1 of undeclared interest in an overseas bank account can therefore trigger all of the consequences of a false declaration. The certificate also relates to all tax years.

> "It would be wise to take full stock of the client's affairs and position."

It is questionable as to whether any individual could sign such a declaration with confidence unless their tax affairs were very straightforward and their records meticulously maintained, let alone select one of four options that apply to every possible scenario or tax year in such a complex area of tax law.

No mitigation

Further, HMRC will treat any disclosure following the receipt of a nudge letter as having been prompted (see HMRC's *Compliance Handbook* at CH82421) and, as such, the taxpayer will be unable to qualify for full mitigation from any penalties that might arise as a result of incorrectly filing their tax return the first time around.

This is the less obvious purpose of the letter, which potentially increases penalties levied for a careless mistake or deliberate false report of taxes owed. When confronted with a nudge letter, it is advisable, therefore, to consider carefully and document all of the surrounding facts as well as the particular disclosure made. It may still be possible to support an argument for unprompted disclosure in appropriate circumstances with careful submissions.

What to do?

What action should be taken if a client receives a nudge letter?

First, it would be wise to heed HMRC's advice and take full stock of the client's affairs and position. As the letter typically warns, HMRC regularly undertakes checks to ensure compliance so a subsequent investigation that reveals that the taxpayer has not made full disclosure after receiving a nudge letter will be viewed very seriously indeed. HMRC sends these letters only where it feels it has actionable information, so even if no mistake has been made, there is something that HMRC feels is suspicious, and it should be addressed in order to avoid further, more formal, potentially time-consuming and expensive, enquiries.

Common Reporting Standard

There are many reasons why the data generated by the CRS or indeed other sources may differ from that declared on an individual's self-assessment tax return. The information obtained may correspond to the calendar year and not the tax year; figures may not be consolidated in the same way; or income may be classified differently. These types of

discrepancy can be addressed by ensuring that the tax return is correct and complete and, where appropriate, explaining to HMRC where any relevant offshore income and gains are disclosed on the tax return.

However, there may be discrepancies due to ignorance or a misunderstanding of the UK tax system. The taxpayer may believe that any UK tax liability is covered by overseas tax already paid and the associated income or gains does not need to be returned. For example as Amit Puri and Sagar Jain point out in their article 'A little-known fact' (*Taxation,* 4 February 2021, page 20) many Indians resident in the UK mistakenly believe that interest income arising in India is not taxable in the UK and as a result omit it from their tax returns. Most taxpayers will therefore need to take professional tax advice before responding in writing within the allotted 30 days of receiving the nudge letter. If 30 days is not enough time to review all of the circumstances thoroughly or seek suitable professional help, it is possible and sensible to ask for further time. HMRC should be supportive of any reasonable request for such an extension and will often clarify the reason for the letter – if this is not clear.

The 'certificate of tax position', mentioned earlier, has no legal force which requires it to be completed. Indeed, given the repercussions of doing so, completion even in the most straightforward cases should be carefully considered by professional advisers. HMRC will accept a letter rather than completion of the form and this will almost always be the best way to proceed.

However, if HMRC does not hear back, it will inquire further and may escalate matters, so doing nothing is not an option. In particular setting out in writing that there is no additional tax due should reduce the possibility of a formal compliance check, although it will not guarantee to eliminate it altogether. Random compliance checks will still apply to situations covered by a nudge letter. In a nutshell, a written response should avoid further scrutiny but signing and sending the certificate of tax position could carry additional and inadvertent risk to the taxpayer of false disclosure.

If the nudge has proved successful and disclosure is required, careful thought should be given as to how best to make that disclosure. The position here is in essence no different to any other tax investigation and a similar strategic analysis of the situation is required. Thus, a wider perspective may be helpful in identifying other family members who may have similar issues or jointly held assets requiring disclosure on more than one tax return.

As noted above, there is no de minimis for the amounts that must be disclosed. Any matters, related or unrelated, for any periods that need correcting should be included in the disclosure process and consideration should be given, in the case of smaller discrepancies, to making payment of any unpaid tax. The time limits that can apply to any non-disclosure of offshore assets or income add an extra complexity to assessing the most appropriate course of action, particularly as the reason for any mistakes may impact both the time limit and penalty position. While HMRC suggests the use of the worldwide disclosure facility, other options may be more advantageous depending on the circumstances and legal position of the particular taxpayer. For some taxpayers an approach to their customer compliance manager may be more appropriate. For others, the code of practice 9 facility might be the right approach, providing immunity from criminal prosecution upon full voluntary disclosure.

Nudge letters are becoming more prevalent. They are clearly an effective technique which HMRC is choosing to deploy more frequently and there is no evidence that this will slow as it seeks to address non-compliance and fill the tax gap following the pandemic. Exactly how the receipt of such letters will affect penalties and time limits, particularly in relation to offshore matters, remains to be seen. However, at the risk of oversimplifying, for most taxpayers a successful approach might be summarised in a three step 'traffic light' approach:

- Stop: do not rush to immediately complete the certificate of tax position. There is no legal obligation to do so and it may only expose the taxpayer to unnecessary risk.
- Prepare: treat the letter as a prompt to review the client's tax position and refresh the tax advice.
- Go: respond to the letter in writing within the time limit or an agreed extension. Where necessary, make full disclosure but remember that how and where to make that disclosure is your choice.

To be respected, not feared

In short, a nudge letter can be nothing more than HMRC noticing some numbers not adding up and writing to ask the recipient to double check their perfectly correct tax return.

On the other hand, it can also represent the opening stages of a thorough investigation into what HMRC feels are unpaid taxes. In any case, receiving a nudge letter, while not a cause for panic, is a matter which requires prompt and careful attention.

So long as everyone concerned has been diligent in keeping the recipient's affairs in order and a suitable response made, these 'friendly reminders' from HMRC are certainly an improvement over leaping straight into a formal enquiry – to be respected, but not feared.

Planning point

Do not ignore a nudge letter. HMRC will expect a response. Once you are confident in the correct tax position, respond in writing within the agreed timescale – usually 30 days. However, consider carefully before using the enclosed certificate of tax position as doing so may expose the client to additional risk.

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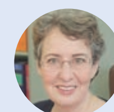

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