

Beware financial institution notices

Is HMRC's new power broader than it has accepted, asks Jack Prytherch.

From June 2021, HMRC have the power to issue 'financial institution notices' (FINs) without the normal key safeguards for recipients and taxpayers.

Although the relevant legislation makes clear that FINs can be issued to a broad range of financial institutions, HMRC previously stated that the new power would have only a negligible impact on a very small number of entities such as banks and building societies.

However, a recent response to a freedom of information request submitted by the CMS Tax Disputes & Investigations team indicates that the practical scope of FINs as applied by HMRC may be broader than suggested. HMRC's information powers HMRC have a wide range of statutory powers at their disposal to investigate the tax affairs of both businesses and individuals. This includes the ability to issue 'information notices' under schedule 36 to the Finance Act 2008 (Schedule 36) to compel the sharing of information or documents in order for HMRC to check the tax position of UK taxpayers.

Under Schedule 36, information notices can be issued directly to taxpayers (taxpayer notices) or, alternatively, to third parties in order to obtain information about identified taxpayers (third party notices) or even unknown taxpayers (identity unknown notices).

Taxpayer notices, third party notices and identity unknown notices are subject to different rules but, in each case, there are strict controls and safeguards that must be followed before they can be issued.

For example, HMRC can issue third party notices to require any person (including, for example, financial institutions) to provide information or documents 'reasonably required' for the purpose of checking the tax position (including foreign taxes) of a known taxpayer. The Finance Act 2021 extended this power to also cover information or documents reasonably required for the purpose of collecting a tax debt of the taxpayer.

The first key safeguard, therefore, is that information or documents requested by third party notices must be 'reasonably required' by HMRC for the purposes described above. A second, and more important, safeguard is that third party notices must be approved in advance by the First-tier Tribunal (Tax Chamber) (the Tribunal), unless the relevant taxpayer gives its consent. The Tribunal is not allowed to approve the issue of a third party notice unless various conditions have been met, most notably that HMRC would be justified in issuing the notice in the first place (i.e., that the information or documents requested are actually reasonably required and that HMRC are not simply on a 'fishing expedition').

If the taxpayer has given its consent, the recipient of the third party notice can only appeal to the Tribunal to the extent that it would be 'unduly onerous' to comply with the notice (except where the requested information or documents form part of the taxpayer's statutory record). However, in the more likely scenario where the taxpayer has not so consented, the word of the Tribunal is final – neither the third party nor the taxpayer can appeal against the notice on any grounds. In contrast, taxpayer notices can be issued without prior approval from the Tribunal (although HMRC can elect to seek approval in any case), with the consequence that the taxpayer is given a much broader basis for appeal.

In addition to the rights of appeal and other safeguards described above, there are certain restrictions on the type of information or documents that HMRC can request (for example, information or documents subject to legal professional privilege would not need to be provided).

FINs

FINs were introduced by the Finance Act 2021 as a new type of information notice (amending Schedule 36 to sit alongside taxpayer notices, third party notices and identity unknown notices).

Similar to third party notices, HMRC can issue FINs to require a 'financial institution' to provide information or documents 'reasonably required' for the purpose of either checking the tax position of a known taxpayer or collecting a tax debt of the taxpayer.

However, the key difference with FINs is that no prior approval is required from the Tribunal and no consent is needed from the taxpayer. At the same time, there is no right of appeal (either for the financial institution or for the taxpayer).

Instead, the assessment as to what is 'reasonably required' is solely made by HMRC. Likewise, there is no scope for an appeal on the grounds that it might be 'unduly onerous' for the financial institution to comply with the notice – such decision is left to the 'reasonable opinion' of the HMRC officer issuing the notice.

There are further conditions built into the new power such as the fact that FINs must be approved by an authorised officer of HMRC, but in practice such approval is not difficult to obtain, and this does not provide anything like the same level of objective scrutiny as the Tribunal. FINs are also subject to the same restrictions as other Schedule 36 information notices as to the type of information or documents that must be provided to HMRC (for example, relating to legal professional privilege).

Therefore, although there are certain hoops through which HMRC must jump before they can issue FINs, none of the key safeguards normally associated with Schedule 36 information notices will apply to protect financial institutions or Taxpayers.

What is a 'financial institution'?

In the face of much criticism from tax professionals and the financial services industry, HMRC have attempted to justify the removal of judicial oversight described above on the basis that it was apparently taking too long to comply with requests for third-party financial information from overseas tax authorities (12 months on average compared with the six-month target set under international standards). HMRC highlighted the fact that the UK was the only G20 member to require judicial/ taxpayer approval for the issue of information notices to third parties.

In their policy paper 'Amending HMRC's Civil Information Powers' published on 3 March 2021, HMRC also downplayed the significance of the measures, stating that FINs were expected to have a 'negligible impact on about 20 financial institutions, such as banks and building societies'.

In contrast, however, the new legislation defines a 'financial institution' very widely to include:

- a financial institution under the OECD's Common Reporting Standard (CRS), other than certain investment entities such as family trusts and charities; and
- any person who issues credit cards.

In turn, the CRS definition of 'Financial Institution' includes 'Custodial Institutions', 'Depository Institutions', 'Investment Entities' and 'Specified Insurance Companies' (each as defined within the CRS). It is clear, therefore, that HMRC have the power to potentially issue FINs to a broad range of entities, and not just a small number of banks and building societies as originally suggested (including, as just a couple of examples, certain insurance companies and employee benefit trusts).

The practical scope of FINs as applied by HMRC will likely remain uncertain until further time has passed and, in particular, until the publication of the Treasury's first annual report to Parliament on HMRC's use of their new power (due in Spring 2022). However, in a recent response to a freedom of information request submitted by the CMS Tax Disputes & Investigations team, HMRC confirmed that a number of FINs had already been issued since their introduction just a few months ago, potentially indicating that HMRC's application of FINs may be broader than originally suggested.

Comment

FINs represent a significant and potentially wide-reaching power in HMRC's arsenal. While the practical scope of FINs as applied by HMRC remains unclear, all financial institutions potentially affected – not just a handful of banks and building societies – should ensure that they are adequately prepared.

Many financial institutions are likely to already have procedures in place for dealing with information requests from law enforcement authorities, such as HMRC, to ensure that data

privacy and other relevant obligations are properly complied with. Such institutions may want to consider whether those procedures should now be reviewed in light of the significant development represented by FINs.

Whilst there are no grounds for appealing against FINs, there may be scope for other potential methods of challenge (including, where appropriate, judicial review or appealing against penalties for non-compliance).

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