FAILURE TO PREVENT THE FACILITATION OF TAX EVASION

Criminal Finances Act 2017

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OVERVIEW

- the UK *Criminal Finances Act* 2017 introduces new criminal offences where a company fails to prevent its 'associated persons' from facilitating tax evasion by a third party
- the Act applies to the evasion of both **UK** and **non-UK tax** and **duties**
- the legislation comes into force on **30 September 2017**
- this coincides with the first data exchanges under the Common Reporting Standard

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OVERVIEW

- the legislation resembles the UK *Bribery Act* 2010 by:

  (i) holding companies liable for the acts of their associated persons; and

  (ii) having extensive extra-territorial application

- the **only defence** is for a company to show that it had "reasonable prevention procedures" in place to prevent the facilitation of tax evasion

THE ‘UK’ OFFENCE

- a failure (1) by a company or partnership (a "relevant body") incorporated anywhere in the world (2) to prevent the criminal facilitation (3) by one of its associated persons (4) of the criminal evasion of a **UK tax** or **duty**, payable by another person or entity
- there is no need for the company to have any presence in, or relationship with, the UK for it to be caught by the legislation
- the domestic offence will be prosecuted by HM Revenue & Customs

THE 'FOREIGN' OFFENCE

- a failure (1) by a relevant body (2) to prevent the criminal facilitation (3) by one of its associated persons (4) of the criminal evasion of a **non-UK tax** or **duty** payable by another person or entity
- this offence applies to a relevant body incorporated in the UK or carrying on a business - or part of a business - in the UK (e.g. via a subsidiary or sales operations in the UK, or even via a listing on the London Stock Exchange)
- a company will also be caught where it does not have a UK presence of this type but any part of the facilitation takes place by an associated person in the UK
- "dual criminality" must exist – i.e. there must be criminal evasion according to both UK law and the law of the foreign country
- the foreign offence will be prosecuted by the UK SFO

REMEMBER…

- there is no need for there to have been a prosecution or conviction for tax evasion
- there is no need for the person facilitating the tax evasion to have intended or delivered any benefit to the company
- It is irrelevant that the company was not involved in the facilitation
- it is irrelevant that the company did not know that their associated persons were facilitating tax evasion
- the focus of the offence is the failure to prevent the facilitation

'ASSOCIATED PERSONS'

Definition - any person or entity that provides services "for or on behalf of" the company

  - can include employees, agents, JV partners, contractors or subsidiaries of the company

  - to be determined by reference to "all the relevant circumstances" *i.e.* not merely by reference to the nature of the legal relationship between the company and party in question

- however, the Guidance makes it clear that an assessment of whether 'reasonable procedures' were in place will take into account the level of control which a company exercised over an associated person

- importantly, for both offences, the associated person must be acting **in that capacity** whilst committing the facilitation. Companies cannot be liable for the actions of an associated person who is on a 'frolic of their own' (*e.g.* a rogue employee who facilitates another person's tax evasion in circumstances where their actions have nothing to do with the conduct of their job)

PENALTIES / CONSEQUENCES

- unlimited fines
- risk of debarment / difficulty winning government contracts
- increased scrutiny from other regulators (FCA / NCA / SFO, etc)
  - might a tax issue indicate broader issues such as fraud, bribery or money laundering / systemic failures?
  - regulatory fines / loss of licences, regulatory authorisations
  - implications for individuals - FCA ‘Approved Persons’ / ‘Senior Managers’; lawyers / accountants, etc?
- legislation relating to Deferred Prosecution Agreements applies
- shareholder litigation against management for breach of duty?

DEFENCE OF 'REASONABLE PROCEDURES'

- the defence of 'reasonable' prevention procedures (rather than 'adequate' procedures) suggests a slightly less onerous standard than that which applies under the Bribery Act

- the official Guidance issued by HMRC (dated 1 September 2017) does not seek to define reasonable procedures. Instead, it suggests that reasonable procedures might be based upon the following six key principles:

  1. a risk assessment
  2. procedures that are proportionate to risk
  3. top (board) level commitment
  4. communication and training
  5. due diligence
  6. monitoring and review

- consider adopting or adapting existing processes (e.g. relating to ABC / AML compliance), where appropriate

DEFENCE OF REASONABLE PROCEDURES

- arguably, the most important requirement is the risk assessment, without which it will be difficult to show that any policies and procedures are proportionate or have been tailored to relevant risks

- the absence of a risk assessment - or a proper risk assessment - will make it difficult for a company to take advantage of the 'reasonable procedures' defence

- the first thing a prosecutor is likely to ask for is a copy of the risk assessment (and any associated work product). It should therefore be carefully constructed and drafted

- **in collating information and drafting a risk assessment, do not unwittingly create a 'road map' to potentially incriminating issues within your company or the wider group**

IMPLEMENTATION OF REASONABLE PROCEDURES

“Initial Implementation Period”

- technically, reasonable procedures need to be in place by 30 September 2017 – however, there is likely to be some flexibility…
- the Government has indicated that what will be considered to be reasonable on ‘day one’ will be different from what is considered to be reasonable at the end of ‘year one’
- the Government recognises that certain procedures, such as training and new IT functionality, may take time to roll out - it will therefore take account of procedures that were both implemented and *planned* at the time of any offence
- having said this, the Government expects that there will be “**rapid implementation**” focusing on the major risks and priorities with a “**clear timeframe and implementation plan**” when the law comes into force
- the Government also expects reasonable procedures to be kept under regular review and to evolve as the company discovers more about the risks that it faces and “lessons are learnt”

DO NOT UNDERESTIMATE THE SCOPE OF THE OFFENCE…

- companies need to consider the new offence carefully when preparing their risk assessments
  - what products and services does your company group offer or receive which have a tax angle?
  - who are your associated persons?
  - which of those associated persons might have the motive, skills and opportunity to assist a third party in criminal tax evasion?
  - assess risk by reference to where, how and with whom you are doing business
  - does your company group use any aggressive intra-group tax mitigation structures or engage in activity to reduce or avoid tax?
- remember that subsidiaries can be associated persons
- the offence is not just a matter for the financial services sector…

Import / Export duties

- adjustment of figures or product descriptions to minimise import or export duties, either for the benefit of suppliers or another group entity

Corporation Tax

- manipulation of the date or value of asset acquisitions / tax reliefs
- mis-stating stock valuations / sales in year-end accounts

VAT

- pre- or post-dated sales receipts or purchase invoices
- creative description of good or services sold or purchased
- invoices directed to overseas companies to avoid VAT

DO NOT UNDERESTIMATE THE RANGE OF TAXES…

Income Tax

- use of ‘contractors’, Personal Service Companies, dual contracts, EBTs

Stamp Duty

Property Taxes

Capital Gains Tax

Industry specific taxes

etc, etc..

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LEGACY CASES

- although the new offence is not retrospective, there is a risk in 'legacy' cases that a company could still be exposed to prosecution

- for example, this could occur where an employee has set up an arrangement before 30 September 2017 that was intended to facilitate tax evasion; that employee then leaves the company and the company continues to provide services to the client, ignorant of the tax fraud that is continuing

- if another employee discovers the fraud but continues to provide services, the authorities might consider commencing a criminal investigation on the basis that reasonable procedures were not in place to prevent the fraud from continuing

- in addition, the employee may also be guilty of an aiding and abetting offence and / or may be guilty of an offence under the *Proceeds of Crime Act* 2002 if they fail to fulfil a statutory obligation *e.g.* to report the fraud, or if they become involved in an arrangement relating to the proceeds

CRIMINAL LAW NOT TAX LAW

- beware the proliferation of ‘instant experts’ on this topic - the offences are a matter of criminal law, not tax law
- legal advice should be sought from suitably qualified professionals with relevant experience
- this can be done in conjunction with tax experts (either within the company or externally), where appropriate
- seeking preliminary advice within a legally privileged environment may encourage open discussion so that the subsequent risk assessment is more fruitful

ANY QUESTIONS?

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