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Tax Alert

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Corporate Criminal Offence: Failure to Prevent Facilitation of Tax Evasion

The Criminal Finances Act 2017 received Royal Assent on April 27, 2017, making its way onto the statute book before the halting of Parliamentary business ahead of this year's general election. As well as giving enforcement agencies further powers to recover the proceeds of crime and tackle money laundering, the Act introduces two new criminal offences for businesses that fail to prevent the facilitation of tax evasion.

Businesses should now be reviewing their internal risk assessment processes to ensure that adequate prevention procedures are in place ahead of the implementation date for the new law, which is expected to be September 2017.

Introduction

The first of the new offences relates to the evasion of UK tax (the "**Domestic Offence**"), whereas the second relates to the evasion of foreign tax (the "**Foreign Offence**"). In each case, liability for the relevant business will be strict unless the business can prove that it had in place reasonable measures to prevent the facilitation of the tax evasion (or that it was unreasonable in all of the circumstances to expect it to do so). The new offences are cast widely and will apply to all businesses, including funds, portfolio companies, fund managers, special purpose vehicles and others in the financial services sector, which is a particular target and likely to be most affected.

Key Components of the Offences

Both the Domestic Offence and the Foreign Offence are based on three key components (or "stages"), each of which must be satisfied in order for a company or partnership (wherever incorporated or formed) (the "**Relevant Body**") to be criminally liable:

Stage One – Criminal Tax Evasion by Taxpayer

For either of the offences to be committed, a taxpayer (either an individual or a legal entity) must commit a criminal offence of evading tax under existing law (the "**Tax Evasion Offence**"). In the UK, this will broadly speaking include tax fraud or the act of aiding and abetting tax fraud. However, in the case of both the Domestic Offence and the Foreign Offence it is not necessary that any tax actually be successfully evaded or for the relevant taxpayer to be convicted (for example, if HMRC ultimately chooses not to prosecute). For the Foreign Offence to be committed, the Tax Evasion Offence must be recognized as an offence both in the UK and the jurisdiction in which the Tax Evasion Offence takes place.

Stage Two – Criminal Facilitation of Tax Evasion by Associated Person

The second criterion is that there has been criminal facilitation of the Tax Evasion Offence by any person (an "**Associated Person**") when acting in the capacity of a person associated with the Relevant Body (the "**Facilitation Offence**"). For both the Domestic Offence and the Foreign Offence, a person (natural or legal) will be an "Associated Person" of the Relevant Body if that person is an employee, agent or other person who performs services for or on behalf of that Relevant Body and is acting in its capacity as such. In each case it is the substance of the relationship that is considered, and not the contractual position. As such, the concept is a broad one and could potentially encompass various third-party arrangements involving asset managers, brokers, administrators, sub-contractors and others, as well as more informal arrangements.

As at stage one, the Associated Person must commit a criminal offence under existing law, which will include deliberately and dishonestly taking action to facilitate the commission of a Tax Evasion Offence; negligence will not suffice. Again, for the Foreign Offence to be committed, the Facilitation Offence must be recognized as an offence both in the UK and the jurisdiction in which the Tax Evasion Offence takes place.

Stage Three – Failure to Prevent Facilitation of Tax Evasion by Relevant Body

In circumstances where both a Tax Evasion Offence and a Facilitation Offence have been committed, criminal liability for the Relevant Body will be strict: it is not required that the Relevant Body (or any of the senior members of the Relevant Body) are actively involved in, or even aware of, the Facilitation Offence being committed. The only defence will be that the Relevant Body is able to prove that when the Facilitation Offence was committed it had in place reasonable procedures to prevent such a Facilitation Offence (or it was unreasonable to expect such procedures). It is expected that it will rarely be the case that it is unreasonable to have any prevention procedures in place.

Territorial Scope

The Domestic Offence can apply to any Relevant Body (body corporate or partnership), irrespective of where that Relevant Body is established or carries on business, and whether or not the Tax Evasion Offence or Facilitation Offence took place in the UK. The Foreign Offence, on the other hand, will only be committed where either: (i) the Relevant Body is established or carries on its business or any part thereof in the UK (e.g. through a branch or permanent establishment), or (ii) any part of the Facilitation Offence takes place in the UK. However, the territorial scope of the Foreign Offence remains wide and limb (i) above could technically result in a Relevant Body being capable of committing the Foreign Offence simply by having a branch in the UK, even if that branch is not itself involved in the facilitation of the Tax Evasion Offence.

Reasonable Prevention Procedures Defence

This should now be the key focus area for Relevant Bodies. Draft guidance published in October 2016 indicates that the prevention procedures put in place by Relevant Bodies should be informed by six key principles: risk assessment; proportionality of risk-based prevention procedures; top level commitment; due diligence; communication (including training); monitoring and review. However, the draft guidance indicates that the size, complexity, industry focus and risk-profile of a Relevant Body will ultimately inform what prevention procedures HMRC would consider reasonable in a particular context. The guidance also recognizes that a Relevant Body may leverage existing controls (e.g. relating to anti-bribery), but that simply incorporating tax evasion into these controls is unlikely to be sufficient.

Identification of Risks

Relevant Bodies are required to “sit at the desk” of their Associated Persons and ask whether those persons have a motive, opportunity and the means to commit a Facilitation Offence and, if so, how this risk can be managed. Guidance issued in respect of the UK’s Bribery Act and by the Joint Money Laundering Steering Group outline various factors that may be considered when determining the level of risk associated with the Relevant Body’s business. For example, a Relevant Person is likely to face increased risk where its activities involve countries, sectors, transactions, clients or service providers that have a greater propensity to result in tax evasion. In particular, HMRC expects those engaged in the financial services, legal and accounting sectors (and particularly those operating in offshore jurisdictions) to be most affected.

Reasonable Procedures

The prevention procedures adopted by the Relevant Body should be proportionate to the risks (as identified through appropriate risk assessments procedures) and there is not a one-size-fits-all approach. However, appropriate procedures are likely to include common elements such as having adequate risk identification and due diligence procedures, the commitment of senior managers, a clearly articulated approach to mitigating risk, an overview of the strategy, and a timeframe for implementation of policies. The Relevant Body should also monitor and enforce compliance, review procedures for effectiveness, and have a pathway for reporting wrongdoing.

The Relevant Body is not required to publish policies externally, but may wish to summarize key principles within corporate materials (e.g. communications with investors). However, internal communications (including with all Associated Persons) should make clear the Relevant Body’s policies on the facilitation of tax evasion and ensure (through training if appropriate) that Associated Persons are aware of the consequences for anyone found to be complicit in such activity. This may be included in existing training or communications on compliance procedures.

Implementation

In order to protect themselves against the possibility of strict criminal liability under either the Domestic Offence or the Foreign Offence, Relevant Bodies should have in place reasonable prevention procedures from the date on which the new offences become effective. In their draft guidance HMRC acknowledge that some procedures will take time to implement, and that during this initial period a lower threshold for the reasonable procedures defence should apply. Nevertheless, the Government expects there to be rapid implementation, focusing on major risks and priorities, with a clear timeframe and implementation plan in place from day one.

Prosecution and Penalties

If the Relevant Body were to be found guilty of either the Domestic Offence or the Foreign Offence, the Relevant Body could be faced with unlimited financial penalties as well as ancillary orders such as confiscation orders or serious crime prevention orders. Moreover, a criminal conviction is likely to lead to significant reputational damage, and may require disclosure to professional regulators both in the UK and abroad. This could have a severe impact upon the Relevant Body's regulatory status and their ability to carry on business as usual.

Next Steps

In light of the above, all businesses (particularly those participating in high-risk jurisdictions or sectors) should consider the potential impact of these new offences, and ensure that reasonable preventative procedures are put in place ahead of the offences coming into effect later this year.

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