Unexplained Wealth Orders and failure to prevent tax evasion:
New 'grip and teeth' in the UK government's fight against economic crime?

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The UK Criminal Finances Act 2017 (the **CFA**) has been in force since 30 September 2017. With its extra-territorial ramifications, it affects not only businesses in the UK, but also those with a UK nexus, including branch offices or those doing business in the UK. Given the potential for severe penalties, businesses have to be astute to the challenges and effects of the CFA, particularly if they are operating in the financial services and accountancy sectors, are fiduciaries and trustees, and/or wealth managers.

This article will look in particular at two sections of the CFA: sections 45 and 46, heralding the newly-focused corporate criminal offences of failure to prevent facilitation of tax evasion, and section 1, introducing powers for HMRC and other UK enforcement bodies to obtain an Unexplained Wealth Order (**UWO**), and an associated interim freezing order (**IFO**) in respect of property owned by certain individuals.

Unexplained Wealth Orders

Starting with the newest tool in HMRC's armour, UWOs were introduced when section 1 CFA came into force on 31 January 2018.[1] It inserts new sections 362A to 362R into the Proceeds of Crime Act 2002 (**POCA**).

Applications for UWOs can only be made by prescribed bodies, being HMRC, the National Crime Agency, the Financial Conduct Authority, the Serious Fraud Office, and the Crown Prosecution Service.[2]

Before it will grant a UWO, the High Court will need to be satisfied that there are reasonable grounds or cause that:

- The respondent holds the property and that the value of the property is greater than £50,000[3]; and
- The known source of the respondent's lawfully obtained income is insufficient to obtain the property.[4]

The High Court must also be satisfied that:

- The respondent is either a politically exposed person (**PEP**); or
- There are reasonable grounds for suspecting that the respondent, or a person connected with them is, or has been, involved in serious crime (whether in a part of the UK or elsewhere).[5]

Importantly, it does not matter:

- That the person's interest is below £50,000 provided the value of the property is over £50,000;
- Whether the property or the respondent are located in the UK or elsewhere;
- That other persons also hold an interest in the property;
- That the property was obtained before 31 January 2018, as s 362A has retrospective effect.[6]

A person served with a UWO is required to provide a statement setting out the nature and extent of their interest in the relevant property, how they obtained it, how it was paid for, and any other information that is specified in the UWO.[7] Relevantly, where the property is held by trustees of a settlement, details of the settlement may also be required to be provided.[8]

References to a person who 'holds' or 'obtains' property include any body corporate, whether incorporated or formed in the UK or a country or territory outside the UK.[9] Therefore, trustees of a settlement in which relevant property is comprised can be served with a UWO, and so can (discretionary) beneficiaries of a settlement of such property.[10] Property held within a settlement is treated as directly owned by the person to the extent of their interest in the settlement.

The effects of the UWO are punitive, and failure to comply gives rise to a rebuttable presumption that the property is recoverable as the proceeds of crime under Part 5 of POCA. Any responses to a UWO will have to be carefully thought through, as a respondent knowingly making a false or misleading statement, or making a statement recklessly, commits an offence carrying up to two years in prison, or a fine, or both.[11] The new provisions also state that responses to UWOs can be relied on by the applicant at a later date in certain circumstances, potentially compounding the adverse effects of any misstatements.

An application to the High Court for a UWO can be made with or without notice. When the court grants a UWO, it can also issue a supporting IFO, provided that it is applied for by the same enforcement authority and during the same proceedings as those in which the UWO is made. An IFO must also be 'necessary' to prevent the risk of any potential recovery order from being frustrated.[12]

Where an IFO is made, anyone with an interest in the subject property is prevented from dealing in any way with it, and the court can appoint a receiver to manage the property in the interim period. IFOs can be varied to allow for living and legal expenses, and although there is no guidance, we anticipate that the Proceeds of Crime Act 2002 (Legal Expenses in Civil Recovery Proceedings) Regulations 2005 SI 2005/3382 will be followed. Compensation provisions provide available relief where an IFO has been discharged.[13]

These are civil orders, and the Civil Procedure Rules therefore apply, including the Practice Direction on Civil Recovery.[14]

There is no reference to a burden or standard of proof, however given that an application will be made to a civil court, it is presumed that the burden will be applied pursuant to the civil standard and test in Part 5 of POCA.

Failure to prevent the facilitation of tax evasion

Sections 45 and 46 CFA came into force in September 2017, and they impose liability on a business for offences committed by an "associated person". Section 45 CFA deals with UK tax evasion facilitation offences, and section 46 CFA with foreign tax evasion facilitation offences.

The offences do not introduce any new liability; neither do they change the definitions of existing offences with regard to tax evasion fraud. They do, however, alter the application of existing offences, and for the first time seek to impose liability on incorporated bodies and partnerships for offences committed by their employees and agents.

Sections 45 and 46 CFA apply to incorporated bodies (typically companies) and partnerships[15], definitions of which will be interpreted in the widest sense. In this article we use the term 'businesses' to describe any entity potentially covered by these measures.

There is only one defence provided under sections 45 and 46 CFA: that businesses have in place procedures which prevent the facilitation of tax offences, or are able to demonstrate that such procedures would have been unreasonable. As such, the requirements are similar to other requirements pre-dating the CFA, for example imposed by anti-money laundering (**AML**) legislation and the Bribery Act 2010. The CFA imposes a number of specific requirements, however, and relying on existing policies and procedures alone will not be sufficient to show compliance with the CFA.

Operation of the offences

Associated persons

Sections 45 and 46 CFA extend liability of "associated persons", the definition of which is fact-dependent and drafted deliberately widely according to HMRC guidance. An associated person "must commit the tax evasion facilitation offence in the capacity of an associated person", and any facilitation committed in a personal capacity will not be deemed relevant.

A relevant association is established by analysing the way in which services are carried out. For example, advice obtained from external Counsel or an overseas law firm, which is charged for by way of disbursement to the client, would fall within the definition of "on behalf of" a business. Importantly, this could for example also include a payroll services provider who, in that capacity, facilitates tax evasion by employees. HMRC has stated that for the purposes of sections 45 and 46 CFA the important factor is that the business continues to control the ongoing relationship between the client and the external adviser. In this respect, the principle is virtually identical to that of section 8 of the Bribery Act 2010.

Businesses are therefore held vicariously liable for the criminal acts of employees, agents and associated persons, even if no senior management of the business (or indeed anybody within the business itself) was involved in, or aware of the impugned conduct.

Strict liability offence

Sections 45 and 46 CFA are strict liability offences. For the offences to be committed there needs to be:

- Criminal tax evasion by a taxpayer under existing laws;
- Criminal facilitation of that tax evasion by an "associated person" of the business, who is acting in that capacity; and
- A failure by the business to prevent its associated person from committing the criminal facilitation act.

Sections 45 and 46 CFA do not, therefore, introduce any new offences; the actions they seek to punish are already offences under the criminal law. Existing statutory offences include the fraudulent evasion of specific taxes, such as VAT[16], or income tax[17], or the common law offence of cheating the public revenue, for example through failing to disclose income or failing to register, or account for, VAT.

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What is new, however, is the introduction of a strict liability for businesses. If stages one and two have occurred, businesses will be guilty of the offence unless they can show that they had reasonable procedures in place to prevent the facilitation of tax evasion.

This also means that it is not necessary for any tax to have been successfully evaded, nor for there to be a conviction at taxpayer-level for the liability to be engaged. So for example, where a taxpayer has self-reported a tax evasion, the business can still be prosecuted, subject to proving to the criminal standard that the evader's conduct was dishonest, and an offence under sections 45 or 46 CFA was committed.

Conversely, negligent or ignorant facilitation of a tax evasion offence will not be covered. Strict liability tax offences, such as failing to deliver a tax return, will therefore not be relevant to sections 45 and 46 CFA.

Dual criminality under section 46 CFA

With regard to facilitation of foreign tax evasion under section 46 CFA, there is a further requirement of dual criminality. Where the tax evasion and facilitation would not be illegal in the UK if committed there, section 46 CFA will not be engaged. The section does not, therefore, impose a requirement on practitioners to familiarise themselves with foreign tax law.

The UK nexus need only be tenuous, however, for section 46 CFA to be engaged. According to examples given by HMRC, the net is drawn so far as to include a trustee of an offshore trust attending a meeting in the UK, where the foreign tax evasion is facilitated.

Explanatory notes published alongside the Criminal Finances Bill's (as it then was) passage through Parliament clarify that where a person associated with an overseas relevant body (and acting as such) commits a tax evasion facilitation offence in relation to UK tax, the new section 46 CFA offence will be committed and can be tried by UK courts. The situation is just the same as where an individual abroad engages in criminal conduct that has its result in the UK or attempts such an offence from abroad.

The consent of the Director of Public Prosecutions or the Director of the Serious Fraud Office will be required before proceedings under section 46 CFA can be commenced in England and Wales. This oversight should provide a safeguard in cases where the UK nexus is wholly incidental, or which would result in prosecutions contrary to UK public policy.

Penalties and sanctions

The sanctions for commission of the offences of failure to prevent the facilitation of UK tax evasion or failure to prevent facilitation of foreign tax evasion include unlimited financial penalties, as well as ancillary orders under the CFA such as confiscation orders.

Equally damaging will be the regulatory sanctions and reputational damage that may follow, with the potential for loss of licences and withdrawal of regulatory consents. As such, the new provisions pose the potential for grave reputational risk to businesses, and should be regarded with utmost seriousness.

One defence: reasonable preventative measures

The only defence available to a business is to show that it had either put in place, "reasonable prevention procedures", designed to stop its associated persons from committing tax evasion facilitation offences, or to show that it was unreasonable to expect it to have such procedures.[18] All businesses will therefore be required to conduct a robust, tailored risk assessment specifically in relation to sections 45 and 46 CFA.

HMRC expects businesses to demonstrate evidence of the following:

- A clear commitment to compliance;
- Top level commitment;
- An initial communication plan; and
- An implementation plan.

HMRC also expects businesses grappling with whether they have in place reasonable prevention procedures to consider three points:

- **Opportunity**: do associated persons have the opportunity and capacity to facilitate client tax evasion;
- **Motive**: is the culture within the business one in which associated persons are dissuaded from committing (alternatively incentivised to commit) a tax evasion facilitation offence; and
- **Means**: does the business promote, offer or hold products and services that are capable of being abused, and what training and monitoring is given to those at risk (theoretically) of abusing those products and services.

HMRC's current guidance states that preventative measures should be informed by six key guiding principles:

- Undertaking a **risk assessment** to assess, identify and prioritise a business's potential exposure;
- Implementing **proportionate risk-based procedures**, including formal policies and practical steps, which will be informed by the nature, scale and complexity of the business;
- Demonstrating **top level commitment** from senior management to preventing persons associated with the business from engaging in criminal facilitation of tax evasion, which includes fostering an appropriate culture and communication of this;
- Conducting appropriate **due diligence** on staff, persons who perform services on behalf of the business and clients;

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- Undertaking internal and external **communication and training** of employees, agents, associated persons and clients, on prevention policies and procedures to ensure that they are culturally embedded within the organisation; and
- Consistent **monitoring and review** of its prevention procedures and processes.

As stated above, the HMRC guidance is similar in many respects to that existing in relation to AML regulations and the Bribery Act 2010. As such, and whilst HMRC have made it clear that it is not enough merely to rely on existing bribery and anti-money laundering guidelines, it is our view that the vast majority of regulated businesses, particularly in the UK and Channel Islands, already have in place a thorough risk and compliance regime, and that the new requirements will therefore have a limited impact in practice.

Discussion

Section 1 CFA targets individuals and enables HMRC and other enforcement bodies to look behind trust structures by identifying suspicious property and tracing back to its ultimate owner. Along the way, it imposes an onus on trustees and businesses to provide information on behalf of the person suspected of ultimately owning the property.

Sections 45 and 46 CFA, on the other hand, focus directly on businesses for the prevention of financial crimes, by holding them account for the actions of their associated persons.

The potential overall exposure for businesses under the new measures is therefore manifold, and could come both from inside the business and those it is doing business with, including third party providers and clients.

Trustees, alongside financial institutions, are most likely to come into contact with UWOs and IFOs in the event that a client or beneficiary is served with either or both of these new measures. Although there is no guidance at this stage, according to the provisions of the CFA as drafted we would expect that a UWO is either served directly on the trustee of a settlement pursuant to which a respondent is said to be a beneficiary as an 'interested party', or that the person served with the UWO will seek information from the trustee in respect of the settlement and any relevant property.

As such, a trustee will need to consider its obligations to beneficiaries under the trust deed, and the relevant trust law. It remains to be seen how the regulatory framework of certain offshore jurisdictions in particular responds to being tested under the new measures. Where an IFO is issued in respect of property, it is vital for any trustee served with it to seek advice immediately and to ensure that the terms of the IFO are adhered to.

On a practical level, trustees and financial services providers should review their own anti-money laundering and other reporting procedures in order to be prepared for the event that they become aware of a UWO in respect of property or a person associated with them. While a UWO may not necessarily amount to "suspicion" for the purposes of POCA, it may nevertheless represent an opportunity to review the client relationship and to reflect on the appropriate future level of due diligence for that client.

It is also likely that in future insurers will routinely take account of potential claims made pursuant to UWOs and IFOs, and where appropriate businesses should insist on such claims being expressly included in 'investigation costs' cover. In relation to the liability under sections 45 and 46 CFA, appropriate amendments may be required to be made to the D&O insurance cover.

As regards the new measures introduced by sections 45 and 46 CFA, we consider that a large number of the businesses to which these sections are likely to be relevant, both in the UK and Channel Islands, will probably already operate within a highly regulated market. Trustees and financial services institutions for example should, in our view, take heed that they are likely to already have in place the right corporate governance mind-set and strategy to comply with the new requirements. With the offshore market in particular coming under increasing scrutiny, there is however no scope for complacency. In the vast majority of trustee businesses our view is that it is likely that only limited amendments will have to be made to an existing AML framework.

Overall, whilst the legislation is potentially very powerful, the extent to which it will be used remains unclear. In an interview to mark the coming into force of UWOs, director of the SFO, Damian Green QC, expressed initial caution on the SFO's use of UWOs, stating that there would not be an immediate rush to use orders, and that instead the SFO would wait for the right case.[19] It therefore came as a surprise to many that a mere 28 days later the NCA obtained two UWOs in respect of two properties at a total value of £22m, believed to belong to a PEP. In addition to the UWOs, IFOs were also granted in respect of the properties.[20]

There have not been any further reported instances of UWOs being granted since February, and it remains to be seen to what extent they will be used in future. Neither the CPS nor any other enforcement agency has issued guidance as to the circumstances in which they will be used. However updated guidance published by the Home Office under Section 2A POCA in January 2018 suggests that asset recovery in particular will continue to feature strongly in future law enforcement.[21] The guidance is however very high level, and it remains to be seen how specific law enforcement bodies will apply the new powers introduced by the CFA, and whether UWOs will be used predominantly in cases where a prosecution is not possible.

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Conclusion

In summary, the new measures introduced by the CFA are important, must be taken seriously but should have a limited effect in practice on the vast majority of regulated financial services providers and trustees, particularly in the UK and Channel Islands.

In terms of the broader picture, we think it important to query whether these measures introduced by the UK government in order to respond to the increasing financial and security threats posed by financial crime will in fact produce the desired result of reducing such crimes. The London and South-East England property market in particular is often accused to be a large contributing factor to the UK's reputation as a safe haven for criminal funds. Whether the new measures introduced by the CFA will provide the UK law enforcement agencies with the additional 'grip and teeth' necessary to prosecute tax evasion offences committed in the context of businesses and individuals operating internationally, remains to be seen.

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Endnotes

1 *Criminal Finances Act 2017 (Commencement No. 4) Regulations 2018 (SI 2018/78).*
2 *s 362A(7) POCA.*
3 *s 362B(2)(a) and (b) POCA.*
4 *s 362B(3) POCA.*
5 *s 362B(4) POCA.*
6 *s 362B(2) to (5) POCA.*
7 *s 362A(3) POCA.*
8 *s 362A(3)(c) POCA.*
9 *s 362H(5) POCA.*
10 *s 362H(2) POCA.*
11 *s 362E(2) POCA.*
12 *s 362J(2) to (4) POCA.*
13 *s 362R POCA.*
14 *Paras 18.1 to 18.19 of the Civil Recovery Practice Direction.*
15 *s 44(2) CFA.*
16 *s 72 of the Value Added Tax Act 1994.*
17 *s 106A of the Taxes Management Act 1970.*
18 *ss 45(2) and 46(3) and (4) CFA.*
19 *https://uk.reuters.com/article/uk-britain-fraud/uk-fraud-prosecutor-combs-through-cases-for-signs-of-unexplained-wealth-idUKKBN1FK2QI.*
20 *http://www.nationalcrimeagency.gov.uk/news/1297.*
21 *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/678293/2018_01_s2A_Guidance.pdf.*

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