The tax man cometh: the criminal offences of failure to prevent tax evasion

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On 30 September 2017, the UK Criminal Finances Act 2017 (the **CFA**) will come into force, along with its newly-focused corporate criminal offences of failure to prevent facilitation of tax evasion. Given the extra-territorial ramifications of the CFA, Channel Islands businesses, especially those in the financial services and accountancy sectors, including branch offices, promotors and managers of investment products, wealth managers, fiduciaries and trustees, will in particular need to be astute to its challenges and effects, and take what HM Revenue & Customs (**HMRC**) has called a, "*risk-based and proportionate*" approach to implementation of preventative procedures.

Introduction

Sir Winston Churchill, with inimitable wit, contended that, "*for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle*". For decades successive UK Chancellors of the Exchequer, and their often beleaguered governments, have bemoaned the curse of lost revenue and talked-tough on tax evasion: from Denis Healey's pledge that, "*The difference between tax avoidance and tax evasion is the thickness of a prison wall*", to Alistair Darling's and George Osborne's open commitment to target tax evasion and (dubiously and self-servingly labelled), *"off-shore tax havens"*.

Those commitments often floundered when it came to quantifiable results, especially last year when the UK Office for Budget Responsibility decried the lack of resources which had resulted in a failure by HMRC to reach its £1.05billion target for recoupment (it in fact fell short by *circa* £780million).

The latest addition to HMRC's tax evasion armoury is the CFA, and its newly-focussed criminal offences of:

- failure to prevent the facilitation of UK tax evasion offences (section 45, CFA); and
- failure to prevent facilitation of foreign tax evasion offences under certain circumstances (section 46, CFA).

The offences

Whilst the offences of failure to prevent the facilitation of UK tax evasion or failure to prevent facilitation of foreign tax evasion are not new *per se*, they will for the first time seek to impose liability on incorporated bodies and partnerships for offences committed by their employees and agents, and local businesses will have to ensure that they have robust procedures in place designed to prevent the facilitation of UK or foreign tax evasion.

As stated, the CFA will apply to incorporated companies or partnerships, definitions of which will be interpreted in the widest sense. Throughout this note we will use the term 'businesses' to describe an entity potentially covered by these new measures.

In the final analysis, businesses will become 'vicariously' liable for the criminal acts of employees, agents and associated persons, even if the senior management of the business was not involved in or aware of the impugned conduct.

HMRC's rationale for this is that (it says) for too long it has been difficult as a result of the state of the existing UK criminal law to hold organisations to account due to the rules of criminal attribution of knowledge to the board of directors or senior management.

Whilst the new offences are aimed only at organisations (and not at their individual principals, directors and management),

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individuals may yet have every reason to feel exposed. If HMRC is able to successfully prosecute an entity for failure to establish robust procedures as required by the CFA, and significant fines are levied, then we venture that directors and managers may be susceptible to a civil suit at the hands of the entity and its stakeholders who may allege breach of duty, misconduct or mismanagement.

Operation of offences

For either offence to occur, three separate stages are required:

- first, there has to be a criminal tax evasion by a taxpayer under existing laws;
- second, the criminal facilitation of the tax evasion must be by an, "*associated person*" of the business, who is acting in that capacity; and
- third, the business must have failed to prevent its associated person from committing the criminal facilitation act.

Importantly, however, it is not necessary for any tax to have been successfully evaded or for there to be a conviction at taxpayer-level for the liability to be engaged. Hence, by way of example, where a tax payer has self-reported a tax evasion, the business can still be prosecuted, subject to proving that the criminal offence was committed (albeit not prosecuted).

It is however necessary in the context of the commission of the offences that the associated person must have taken action deliberately and dishonestly. Accidental, negligent or ignorant facilitation of a tax evasion offence will not be covered. Nevertheless, the new offences are strict liability, and so if stages one and two are committed, the business will be guilty of an offence unless it can demonstrate that it has put in place reasonable preventative procedures.

Penalties / 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.

Defence: what are reasonable preventative measures?

"*The ... tax code was written by 'A' (grade) students. Every April 15, we have to pay somebody who got an 'A' in accounting to keep ourselves from being sent to jail*", P.J. O'Rourke.

A business will have a defence if it can show that it had either put in place, "*reasonable prevention procedures*", designed to stop its associated persons from committing tax evasion facilitation offences, or where it can show that it was unreasonable to expect it to have such procedures.

Draft guidelines published by HMRC in October last year urged that businesses put in place tailored, "*robust procedures*", and that it would not be enough to merely rely on existing bribery and anti-money laundering guidelines. At the same time, it was encouraging to note that HMRC acknowledged that businesses will need time to put in place new procedures and guidelines, and has already said that there will be a phased introduction of prosecutions of the new offences. It does, however, expect business to, "*rapidly*" implement new measures designed to prevent the facilitation of tax evasion, and businesses will have to be able to demonstrate vigilance.

Clearly a starting point for businesses in assessing the proportionality and reasonableness of their anti-facilitation measures will be to consider:

- opportunity – ie. assess whether associated persons have the opportunity and capacity to facilitate client tax evasion;
- motive – ie. as an organisation, is the culture one in which associated persons are dissuaded from committing (alternatively incentivised to commit) a tax evasion facilitation offence?
- means – ie. does the organisation 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?

The current guidance suggests that preventative measures should be informed by six key principles:

1. undertaking a **risk assessment** to assess, identify and prioritise a business's potential exposure;
2. implementing **proportionate risk-based procedures**, including formal policies and practical steps, which will be informed by the nature, scale and complexity of the business;
3. 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;
4. conducting appropriate **due diligence** on staff, persons who perform services on behalf of the business and clients;
5. 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
6. consistent **monitoring and review** of its prevention procedures and processes.

How will it affect Channel Islands (or non UK) businesses?

Businesses anywhere in the world will commit a crime under the CFA if they fail to prevent the facilitation of UK tax evasion offences. Hence, where there is UK tax evasion facilitation, it is irrelevant whether the business is UK-based or established under the law(s) of another country, like Guernsey or Jersey. Furthermore, it is irrelevant whether the associated person who performs the criminal act of facilitation is in the UK or overseas. In any such cases, the new offence will have been committed and can be tried before the UK courts.

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Businesses can also in future be prosecuted in the UK for failure to prevent the facilitation of Guernsey or Jersey (or any other foreign) tax evasion in circumstances where there is a sufficient nexus to the UK. This *nexus* can exist either because the business is incorporated under UK law, or because it carries on a business or other undertaking from a permanent establishment within the UK. Furthermore, there is also sufficient *nexus* where the associated person was in the UK at the time of committing the criminal act that facilitated the evasion of the overseas tax.

However, the CFA requires there to be "*dual criminality*" - this means that: first, the overseas jurisdiction must have an equivalent tax evasion offence at the taxpayer-level to that in the UK; and second, the actions carried out would have to constitute a crime if they took place in the UK. Therefore, an offence cannot be committed where the acts of the associated person would not be criminal if committed in the UK, regardless of what the foreign law would be. In circumstances where, for example, our domestic fiscal evasion laws are very similar to the UK, we expect that there will be very few (if any) loopholes upon which Channel Islands businesses can rely.

Conclusion

HMRC has at its disposal a new weapon in its armoury against tax evasion, one which through its strict liability and extra-territorial approach attempts to circumvent the difficulties it has previously experienced in seeking to collect revenue and impose liability on organisations.

It is vital that Channel Islands businesses protect themselves and put in place bespoke measures that will prevent the facilitation of tax evasion offences by its associated persons. If you would like to discuss the types of measures which your business could or should be putting into place, please contact us.

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