The failure to prevent tax evasion

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The Criminal Finances Act 2017 ("the Act")[1] came into force on 30 September 2017. The Act contains a patchwork of new powers, and amendments to existing legislation, largely directed at combatting money laundering and terrorist financing. It also creates a new corporate criminal offence of failing to prevent the facilitation of tax evasion, which poses significant risk to financial services firms.

This article summarises the offences and identifies key aspects of HMRC's guiding principles. In doing so, it aims to highlight some central issues which businesses should consider.

The framework of the offence will be familiar to the compliance industry. It largely mirrors section 7 of the Bribery Act 2010, which criminalises the failure of commercial organisations to prevent bribery. Once a person 'associated' with a company is found to have committed an applicable offence, that company will be criminally liable, unless it discharges its burden of showing that it procedures for preventing the relevant misconduct were reasonable in all the circumstances.

Financial services firms should carefully consider the risks posed by their specific business model, the products in which they deal and the countries in which they operates. Thereafter, they must create and foster a compliance model which proportionately addresses those risks. As ever, the challenge lies in determining what policies and procedures will meet the statutory objective standard of reasonableness.

Before assessing the potential risk, it is essential to have a clear understanding of the scope of the new offences, how they operate and to whom they apply. Thereafter, compliance professionals, in considering whether existing procedures are adequate, should carefully apply the guiding principles set out in HMRC's Guidance, dated 1 September 2017.[2]

Foreign scope of the offence

The Act creates offences for the failure to prevent the facilitation of both UK and foreign tax evasion respectively. The UK offence (section 45) will apply to any corporate body (company or partnership), wherever incorporated or formed, provided the underlying offence relates to the evasion of UK taxes.

The foreign tax offence (section 46) captures the conduct of a corporate body where:

- It was incorporated / formed in the UK;
- It carries on part of its business in the UK; **OR**
- Conduct constituting part of the foreign tax evasion facilitation offence takes place in the UK.

AND

- Where there is dual-criminality, i.e. the conduct amounting to tax evasion and the conduct amounting to facilitation, would constitute a criminal offence both in the UK, if committed there, as well as in the country which has suffered the tax loss.

The scope of this offence raises significant challenges, and effectively demands harmonised standards for any company operating in the UK. The Guidance states that an international company will be doing business in the UK, for the purposes of the Act, where it has a UK branch. On the face of this provision, transnational companies will have to apply UK standards to the prevention procedures implemented in each of the countries in which it operates. In doing so it will have to assess the specific risk each country poses. Even if a company has a common business model, the risk of tax evasion arising from each of the jurisdictions in which it operates may be materially different.

The Guidance states that, where a section 46 offence is suspected, a criminal or civil action by the country suffering the tax loss will normally be preferred. However, it goes on to acknowledge that there may be circumstances where an effective foreign action is not possible (e.g. lack of resources or corruption), and therefore, if it is in the public interest to do so, the UK Government may be inclined to prosecute.

The framework of the offence

Subject to the observations above, the framework for each offence is broadly the same. A company will be liable where:

1. an “associated” person, whilst acting in that capacity,
2. commits a facilitation of tax evasion offence, and
3. the company fails to show (on the balance of probabilities) that its prevention procedures, in place at the time, were reasonable in all the circumstances.

i) Who poses a risk? - ‘associated’ persons

In order to be liable, a person “associated” with the company must have committed a facilitation offence, when acting in that “associated” capacity, i.e. for and on the company’s behalf. An “associated” person can be an employee, an agent or someone who performs services for the company. The Guidance acknowledges that contractors could be ‘associated’ persons for the purposes of the Act.

However, crucially the Guidance recognises that the standard of prevention procedures considered reasonable will depend on *how* the facilitating offender is "associated" with the company. Companies cannot be expected to apply similar levels of supervision and control over employees and contractors. The viability, and hence reasonableness, of any policy or procedure will be shaped by the relationship between the company and any potential "associated" person.

Businesses should therefore, in formulating their compliance procedures, consider who could be defined as "associated persons" for the purposes of the Act, and assess the risk posed by each category of person, before tailoring a package of prevention procedures for each.

ii) What poses a risk? - offences of facilitating tax evasion

The procedures implemented by a company will be shaped by how any associated person can themselves commit a facilitation offence. Section 45(5) of the Act sets out the ways that a facilitation offence can be committed. From a company's perspective, when formulating its procedures, the important point is that the facilitation of tax evasion is committed knowingly, i.e. with the knowledge that one's conduct is facilitating tax evasion. Accordingly, companies do not need to develop and implement policies and procedures that would protect against an act of negligence, or that would serve to actively root out tax evaders. Such an approach *may* prove effective at meeting the standards expected under the Act. However, in failing to target the risk which the Act seeks to tackle —the knowing facilitation of tax evasion—such an approach may at best be inefficient, and at worse inadequate.

In developing appropriate procedures, companies will need to identify which persons are most at risk of committing facilitation offences. In the context of the financial services sector, the risk is naturally most acute for customer-facing roles. That assessment will be based, not only on the type of customers which personnel are in contact with, but also the products and services which the personnel are tasked to promote or advise on, and the terms of any incentive scheme which apply. The Guidance encapsulates these issues by highlighting three factors: Opportunity, Motive and Means.

iii) How is the risk combatted? – reasonable procedures

Under the Guidance, HMRC has set out six Guiding Principles aimed to assist relevant firms in identifying what may constitute "reasonable procedures". Unsurprisingly, the Principles come with a Government health warning: they are "not prescriptive", are intended to be "flexible and outcome focused" and any procedures adopted should be "proportionate to risk".

The Principles are:

1. Risk assessment. As articulated above, any company will need to assess the nature and extent of its exposure to risk: who are its "associated persons"; which of them are most liable to commit a facilitation offence (dependent on sector); in what circumstances (specific transactions, products or services); in relation to which clients; and in which jurisdictions. In assessing those risks the Guidance suggests that there will be cross-over with guidance for other risk-based assessments (e.g. the Joint Money Laundering Steering Group Guidance). A company will need to keep its risk assessment under constant review.

2. Proportionality of Risk Based Prevention Procedures. The prevention procedures should be proportionate to the risks identified and include both formal policies and practical steps through which to monitor their application. The specific procedures adopted will depend on the level of control and supervision the company is able to exercise over the category of person acting on its behalf.

3. Top Level Commitment. The expression of this principle effectively puts the importance of a firm's culture on a statutory footing. Procedures may only be reasonable if a firm's top-level management fosters a culture where the facilitation of tax evasion is considered unacceptable and which allows the effective monitoring and supervision of those most at risk.

4. Due Diligence. Companies must apply due diligence procedures to their customers and to any associated persons in high-risk positions.

5. Communication (including training). Companies must communicate and embed, throughout the organisation, their policy of tackling any activities which could facilitate tax evasion. Communication should come from all levels within the company.

6. Monitoring and review. A company must constantly monitor and review its prevention procedures. The implementation of any improvements deemed necessary should be considered routine.

Final word: Documentation

Companies must rigorously document their risk assessment and implementation of the procedures deemed proportionate. If a bad actor facilitates an offence of tax evasion in its ranks, an organisation will have the burden of demonstrating the reasonableness of its procedures. Companies must therefore ensure that their application of each of the Guiding Principles is well documented.

This article was co-authored by Paralegal Chloe Salter.

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[1] www.legislation.gov.uk/ukpga/2017/22/contents/enacted

[2] www.gov.uk/government/uploads/system/uploads/attachment_data/file/642714/Tackling-tax-evasion-corporate-offences.pdf