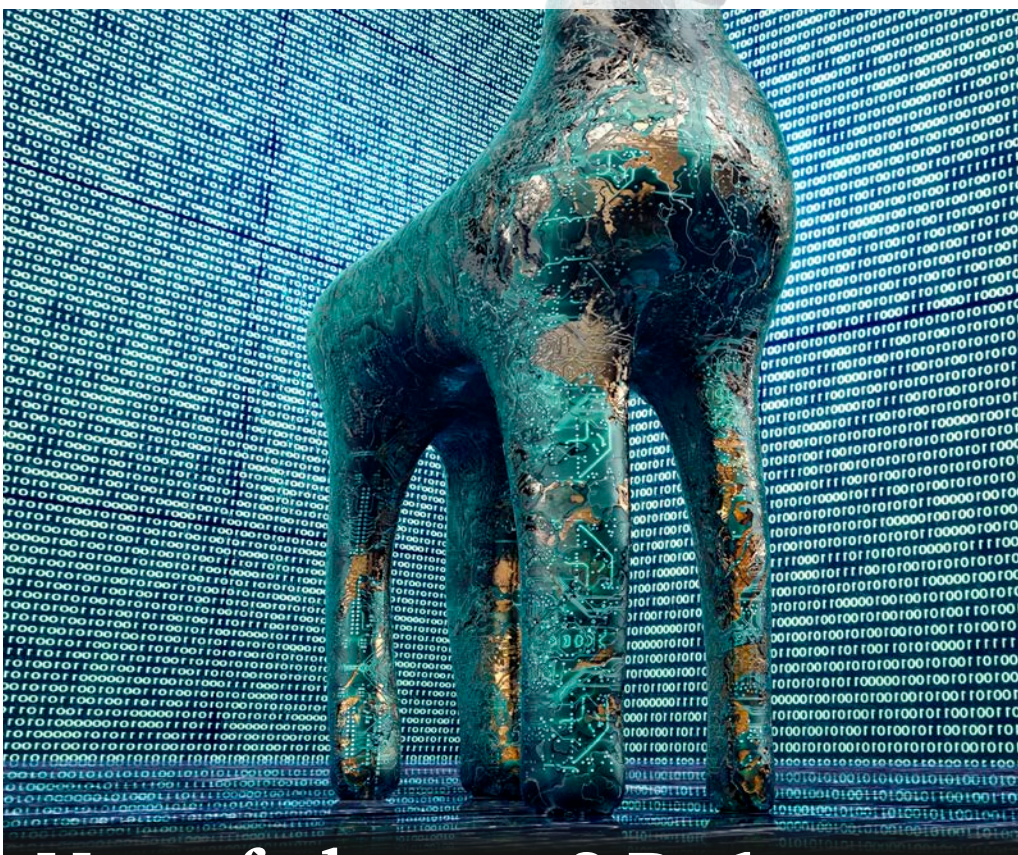


No safe havens? Pt 1

Corporate facilitation of tax evasion: the new frontier. A special two-part analysis by **QEB Hollis Whiteman Chambers**

IN BRIEF

- The Criminal Finances Act 2017 includes new corporate criminal offences of failing to prevent the facilitation of tax evasion, which came into force at the end of September.
- These are strict liability offences coupled with reverse burden 'reasonable prevention procedures' defences, akin to the Bribery Act 2010. They have far-reaching implications.

There is no doubt that the recent years of austerity have naturally triggered debate surrounding the adequacy of the Government's tax enforcement methods. The HSBC Switzerland 'secret accounts', the 'Panama papers', and this month's publication of the 'Paradise papers' scandals have all highlighted significant holes in the current regulatory and criminal enforcement regimes. It is no coincidence that the events in 2015 and 2016 were immediately followed by Government consultations on better tackling tax avoidance and evasion alike.

Following these consultations, the Government has sought to strengthen the legislative tools at its disposal to tackle tax evasion. This article discusses how new law, the Criminal Finances Act 2017 (CFA 2017) and the Finance Act 2016 (FA 2016), represents a departure from existing legislation and an effort to extend the scope of corporate criminal and civil liability for tax evasion to secondary parties. Further, in the case of CFA 2017, these developments are a step towards the enactment of an offence of failing to prevent wider 'economic/financial crime'.

While the aim of these developments is unquestionably legitimate—tax evasion has always been a criminal offence, and existing measures have been wanting—there is reason to pause and consider whether aspects of this new form of enforcement is to be welcomed without question. In addition, corporates are left navigating an increasingly complex framework of parallel criminal, civil and regulatory provisions covering the same or similar areas.

We consider the effect of the new measures on corporates, and identify a controversial trend that transfers an investigative or self-regulating role to the private sector at pain of criminal sanction. Corporates are increasingly threatened with criminal penalties if they fail to regulate/police themselves. We ask whether the additional burden in managing the threat of criminal action is achievable in a globalised economy, where the reach of new legislation extends beyond this jurisdiction. We also analyse whether the legislation is likely to lead to increased levels of enforcement or is more likely to be used as a predominantly dormant threat that will benefit the compliance industry the most.

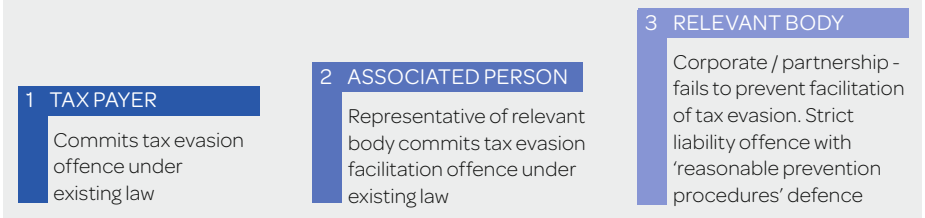
Background

The government's strategy for tackling offshore tax evasion was set out in HMRC's 2014 *No Safe Havens*, even before the scandals of 2015-16. Its general aims were that:

- there are no jurisdictions where UK taxpayers feel safe to hide their income and assets from HMRC;
- would-be offshore evaders realise that the balance of risk is against them;
- offshore evaders voluntarily pay the tax due and remain compliant;
- those who do not come forward are detected and face vigorously enforced sanctions, and
- there will be no place for facilitators of offshore evasion.

As to the first and second aims, the Common Reporting Standard (CRS) marks 'an unprecedented step change' in the ability to tackle offshore evasion. The CRS involves an automatic and much increased exchange of taxpayer information at the international level. As to the third aim, HMRC's approach involved giving people time to come forward to put their affairs in order before adoption of the CRS and a toughening in the government's approach to offshore non-compliance that would follow. Our focus, however, is on the fourth and fifth aims, which have been the subject of a raft of new criminal offences and civil penalties.

Figure 1: Failure to prevent offences



The Criminal Finances Act 2017

CFA 2017 has two principal aims: first to supplement the tools currently available to enforcement agencies in investigating money laundering and recovering the proceeds of crime under the Proceeds of Crime Act 2002; and second to introduce two novel offences of corporate failure to prevent the unlawful facilitation of tax evasion, broadly modelled on the now familiar s 7 of the Bribery Act 2010 albeit with some notable differences. The aspect of CFA 2017 that has received the greatest degree of attention is the latter, and is indeed the focus of this part of the article.

CFA 2017 received Royal Asset on 27 April 2017, having been rushed through Parliament before prorogation in advance of the June 2017 'snap' general election. The two 'failure to prevent' offences had a strong wind behind them from the time the Criminal Finance Bill was first laid before Parliament in October 2016. While some other provisions in the Bill were abandoned so as to ensure its timely enactment, the 'failure to prevent offences' remained ever steadfastly supported across the political spectrum, with few amendments made to them despite a number of key stakeholders in the financial services sector lobbying hard for reconsideration of the extent of their extraterritorial effect.

CFA 2017 is accompanied by the Government's guidance on the application of the offences, 'Tackling tax evasion: Government guidance for the corporate offence of failure to prevent the criminal facilitation of tax evasion', dated 1 September 2017 (the Guidance). The offences came into force shortly afterwards, on 30 September 2017.

The essential structure of the two 'failure to prevent' offences

The Act includes two corporate offences of 'failure to prevent the facilitation of tax evasion'—one in respect of the facilitation of the evasion of UK taxes, and another in respect of the facilitation of the evasion of foreign taxes. They are set out in ss 45 and 46.

'Facilitation', unsurprisingly, is the operative word. The corporate's liability lies in its failure to prevent its associated person, ie a 'person associated with a relevant body', namely an employee, agent or any other person performing services 'for or on behalf of the corporate', from *facilitating* tax evasion by a third party taxpayer. The associated person's act of facilitation must amount to an existing criminal offence of secondary liability in its own right. The Act specifies these existing 'facilitation' offences (see sub-ss 45(5) and 46(6)) however for present purposes it suffices to use the Guidance's helpful summation that the associated person must act 'deliberately and dishonestly' to facilitate the taxpayer's evasion; facilitation *per se* through accident, ignorance or negligence does not amount to offending conduct under CFA 2017 (see p 8 of the Guidance).

While there are important differences between the two new corporate offences (eg requirements of dual criminality and a UK nexus in respect of the 'foreign tax' offence) both follow the same essential structure.

A 'relevant body' (whether a corporate entity or a partnership) ('corporate') will be strictly liable where:

- a taxpayer commits a criminal tax evasion offence; and
- an 'associated person' of the corporate commits a criminal facilitation offence, ie engages in deliberate and dishonest conduct amounting to a criminal offence, to facilitate the taxpayer's evasion.

Where a corporate fails to prevent facilitation of tax evasion, it is itself now guilty of a criminal offence. However, the corporate will have a defence where it can establish to the civil standard that it had in place 'reasonable prevention procedures' intended to prevent the facilitation, or, it was not reasonable in all the circumstances to expect it to have had any prevention procedures in place.

Clearly this mirrors s 7 of the Bribery Act, but it will be noted that '*reasonable* prevention procedures' under the Act constitutes a rephrasing of section 7's 'adequate procedures'. The impact in practice remains to be seen, but may prove positive for defendants if it imports a more traditional objective test in place of potentially capricious 'adequacy'. For present purposes, however, the Guidelines for these offences prescribe 'six guiding principles' for compliance which are identical to those under the Bribery Act's Guidance:

- risk assessment;
- proportionality or risk-based prevention procedures;
- top level commitment;
- due diligence;
- communication (including training); and
- monitoring and review.

Failure to prevent the facilitation of UK tax evasion

The UK tax offence can be committed by any corporate, irrespective of where in the world it is incorporated or based—it does not need to be a UK company or have a UK presence. Neither does the associated person of the corporate need to be in the UK at the time they facilitate the evasion of a UK tax. The goal, therefore, is to enable the UK authorities to tackle facilitation of all UK tax evasion wherever in the world it occurs.

Accordingly, a corporate will be liable for the 'UK offence' where:

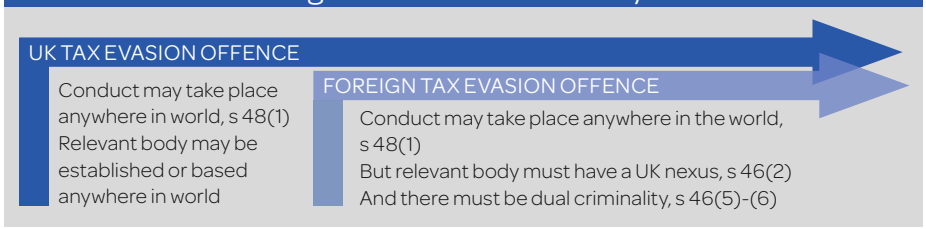
- a taxpayer commits a criminal UK tax evasion offence (eg evasion of UK income tax); and
- an associated person of the corporate commits a UK criminal offence to facilitate the taxpayer's evasion (eg aiding, abetting, counselling or procuring the taxpayer's evasion).

The corporate's defence will depend on its ability to prove that it had in place reasonable procedures to prevent the facilitation of *UK tax* evasion in accordance with the six guiding principles.

Failure to prevent the facilitation of foreign tax evasion

The 'foreign tax offence' has a goal which

Figure 2: Extra-territoriality



is much broader, and more novel, than the 'UK tax offence': tackling the phenomenon of tax evasion worldwide. As stated in the Guidance, its purpose is to prevent any entity with a UK-nexus escaping prosecution for facilitating tax evasion just because the foreign country whose tax has been evaded is unable to bring the prosecution itself (see p 10 of the Guidance).

In light of its somewhat radical extra-territorial outlook, the 'foreign tax offence' can only be committed by a corporate that has a UK-nexus to its business in as much as:

- it is incorporated in the UK;
- it is carrying on business or an undertaking in the UK; or
- the criminal facilitation offence committed by its associated person took place within the UK (eg an employee of a Lux corporate facilitates evasion of Italian tax during a meeting in London).

Many will be caught by the Act in circumstances where the offences inevitably target the financial services industry, of which London is a global hub.

Where a corporate does fall within the jurisdiction of the 'foreign tax offence' an offence will be committed where:

- a taxpayer commits a criminal tax evasion offence in respect of another country's taxes, so long as there is *dual criminality* in the UK in respect of the evasion (eg an Indian taxpayer evades Indian income tax, income tax evasion being a criminal offence in the UK); and
- an associated person of the corporate commits a foreign criminal offence to facilitate the foreign taxpayer's evasion, so long as there is *dual criminality* in the UK in respect of the facilitation (eg the associated person breaches the Indian criminal law offence of aiding and abetting tax evasion, that also being a criminal offence in the UK).

Naturally, the requirement of dual criminality is present both in respect of the taxpayer's offence and the facilitator's offence to ensure that only predicate conduct which is criminally punishable in the UK is capable of giving rise to liability. Therefore, a taxpayer's evasion of an oppressive foreign tax not known at law in the UK would not give rise to liability. Neither would commission of a foreign facilitation offence capable of being committed inadvertently or through negligence give rise to liability, as the UK facilitation offences require deliberate and dishonest conduct (see pages 11-12 of the Guidance).

Where liability is established, the corporate's defence will depend upon its ability to prove that it had in place reasonable procedures to prevent the facilitation of foreign tax evasion in accordance with the six guiding principles. Emphasis is placed on 'foreign'; general procedures relating to UK taxes alone would unlikely be reasonable to prevent facilitation of taxes worldwide—corporates cannot rest on their laurels.

The UK tax offence will be investigated by HMRC, with prosecutions brought by the CPS. Either the Serious Fraud Office (SFO) or the National Crime Agency (NCA) will investigate the foreign tax offence, with the SFO or CPS prosecuting.

Discussion

There is no escaping that the scope of both the 'UK' and 'foreign tax' offences is extremely, and unprecedentedly, broad.

Besides the general aim of tackling evasion generally, the stated purpose of the new offences is to overcome the limitations of the identification principle and encourage improved internal compliance and reporting. This is a common theme. However, the concern is whether the wide extraterritorial effect of CFA 2017 places unmanageably onerous obligations on multinational organisations to foresee and prevent tax evasion risks on a global scale, given that the sanctions for failure are now *criminal* as well as regulatory in nature.

Those hit particularly hard by the 'foreign tax offence' will be multinational financial institutions operating through 'permanent establishments' – also known as 'branches'. As a matter of law, branches are a part of the principal's body corporate and, as most international financial institutions have branches in London, most are immediately caught by the Act. Whether seated in the US, Germany, Japan or Australia, their presence in London makes them immediately liable for the acts of their associated persons on the other side of the world.

While this may have been entirely acceptable in the context of managing bribery risk—most corporates knowing what most forms of bribery look like—the perils are greater in respect of tax due to the considerably greater challenge in instituting, maintaining and enforcing 'reasonable procedures' to prevent a spectrum of employee/agent misconduct which can in some quarters be as intricate and wide-ranging as the tax affairs they oversee.

As underlined in the Guidance, further to firms' existing systems and controls, 'ultimately relevant bodies need to sit at the desk of their employees, agents and those who provide services for them or on their behalf and ask whether they have a motive, the opportunity and the means to criminally facilitate tax evasion offences, and if so, how this risk might be managed'. (p 16 of the Guidance). In the case of many multinational organisations affected, that entails sitting at a lot of desks.

While it is said in respect of procedures that 'burdensome procedures designed to perfectly address every conceivable risk, no matter how remote are not required. Procedures need only be reasonable given the risk posed in the circumstances'. Where 'circumstances' do entail non-'remote' risks on a wide front, combatting those risks on that wide front will prove burdensome, and potentially unmanageably so. Where, for example, a large firm has evidenced 'top level commitment' to preventing facilitation and 'communicated' the same to its associated persons through ongoing training and carried out an initial risk-assessment, the larger part of the focus of its 'reasonable prevention procedures' will be on diligencing and monitoring those associated persons' daily conduct. Tax evasion comes in many forms and can entail the misuse of a myriad of complex but otherwise common and legitimate financial products and structures. While initially identifying risk may be an onerous but ultimately manageable task, monitoring and diligencing the conduct of associate persons dealing in intricate products in fast-moving, equally complex, global markets is far less so. **NLJ**

Next time

- What do the new criminal offences mean in practice? Do they place impossible obligations on corporates? And does this indicate the direction of travel for economic crime more generally?

Nicholas Griffin QC, **Jason Mansell**, **Tom Broomfield** & **Rhys Meggy** practise in QEB Hollis Whiteman's corporate crime & regulatory groups (Website: www.qebholliswhiteman.co.uk).