RED LION CHAMBERS

Criminal Finances Update

2018

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Michael Goodwin and Andrew Herd discuss recent regulatory reforms affecting the legal and financial sector in relation to failing to prevent tax evasion, new unexplained wealth orders and the possibility of a broad failure to prevent offence.

INTRODUCTION

On 30th September 2017 two new offences, contained in the Criminal Finances Act 2017, came into force - criminalising failures to prevent the facilitation of tax evasion in the UK and abroad. These far reaching and sweeping changes have given rise to the need to revamp compliance procedures across regulated and non-regulated sectors. This paper explains the new failure to prevent offences and the regulatory framework within which entities are now required to act. It also provides some information on additional aspects of the new regime which are not yet in force pertaining to the introduction of unexplained wealth orders. Finally, it looks to the future and possible expansion of the failure to prevent regime into economic crime more generally which is currently being considered by Parliament.

FAILING TO PREVENT THE FACILITATION OF TAX EVASION

An outline of the new offences

The headline offences contained in the Criminal Finance Act 2017 concern corporate failure to prevent the facilitation of tax evasion

Who could be criminally liable?

Under the new Act, companies and partnerships could be liable for failing to prevent the actions of associated persons. This specifically includes employees and agents. Liability also extends to those who perform services for or on behalf of the company or partnership, determined by reference to all of the relevant circumstances.[1]

1 Criminal Finances Act 2017, s 44

What type of action could trigger criminal liability?

Facilitating UK tax evasion

S 45 (1) provides as follows: "A relevant body (B) is guilty of an offence if a person commits a UK tax evasion facilitation offence [though note there does not need to be a conviction] when acting in the capacity of a person associated with B." [2]

A "UK tax evasion facilitation offence" is an offence of:

(a) being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of a tax by another person;

(b) aiding, abetting, counselling or procuring the commission of a UK tax evasion offence, or

(c) being involved art and part in the commission of an offence consisting of being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of a tax. [3]

"Tax" means a tax imposed under the law of any part of the UK, including national insurance contributions. [4]

Accordingly corporations based anywhere in the world could be held criminally liable for their employees criminally facilitating tax evasion.

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2 Criminal Finances Act 2017, s 40 (1)

3 Criminal Finances Act 2017, s 45 (5)

4 Criminal Finances Act 2017, s45(7)

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Facilitating foreign tax evasion

S 46 creates a similar offence in relation to the facilitation of foreign tax evasion.[5] It contains several addition requirements. The underlying "foreign tax evasion offence" must satisfy a test of dual criminality.[6] Furthermore, one of the following conditions must be satisfied in relation to the relevant body (B), either: B is a body incorporated, or a partnership formed, under the law of any part of the United Kingdom; B carries on business or part of a business in the United Kingdom; or any conduct constituting part of the foreign tax evasion facilitation offence takes place in the United Kingdom.[7]

The scope of the phrase "part of a business" is potentially very wide and could include trading in the United Kingdom, or having a regional office or outpost.[8] So corporations carrying out business in the UK, whose employees facilitate tax evasion in another jurisdiction face possible criminal liability.

Defences

There are two lines of defence to the failure to prevent offences. The first is to show that when the relevant UK or foreign tax evasion offence was committed "B had in place such prevention procedures as it was reasonable in all the circumstances to expect B to have in place."[9] The second is to show that it was not reasonable in all the circumstances to expect B to have any prevention procedures in place.

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5 Criminal Finances Act 2017, s 46

6 Criminal Finances Act 2017, s 46 (6)

7 Criminal Finances Act 2017, s 46 (2)

8 Arguably the extraterritorial drafting of the offence "...places a high burden on the inbound business to put in place additional rules to meet UK standards, on top of whatever the local requirements for preventing tax evasion are." Response to the Government from the British Banking Association, titled "Detailed Evidence on the Criminal Finances Bill", 18 November 2016, paragraph 9

9 Criminal Finances Act 2017, s 45 (2) and s 46 (3)

Shoring up your compliance regime

Guidance has recently been published by HMRC in order to assist organisations in implementing an appropriate anti-tax evasion environment.[10] Close attention must be paid to this but it is not a prescriptive document, or a checklist. Guidance should be used in conjunction with appropriate legal advice to inform the creation of bespoke prevention procedures designed to address a relevant body's particular circumstances and the risks arising from them.

What do businesses need to do?

Businesses must implement and operate a system of reasonable prevention procedures which identify and mitigate against tax evasion facilitation risks. This will provide a sound defence against prosecution where those associated with the business facilitate tax evasion.

The onus will remain on the business, in the case of raising a defence to prove that it had reasonable prevention procedures in place (or that it was unreasonable to expect it to have such procedures).

The decision as to whether prevention procedures are "reasonable" will be a matter for the Courts considering the facts and circumstances of a particular case. One size will not fit all. Reasonable prevention procedures will be proportionate to the risk a business faces taking into account factors such as the size of the business and the nature of the work undertaken.

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10 Tackling tax evasion: Government guidance for the corporate offences of failure to prevent the criminal facilitation of tax evasion. Government guidance: 1st September 2017

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The six principles

The new HMRC guidance contains six principles which the Government suggest should guide reform however businesses must bear in mind that the approach should be outcome focused and ultimately whether there has been compliance will be a matter for the jury in the event of a criminal trial.

Principle 1 – Risk assessment

The first step is for a business to assess "the nature and extent of its exposure to the risk of those who act in the capacity of a person associated with it criminally facilitating tax evasion offences."[11] Assessment is key to promoting the inclusion of tax evasion facilitation risk as part of a businesses wider risk assessment strategy. Relevant bodies need to put themselves in the position of their employees and agents and assess whether they have the motive to commit a facilitation offence and if they do work out how to manage the risk appropriately. Risk assessment procedures will need to be documented, kept under review, and involve senior management.

Principle 2 – Proportionality

HMRC are clear that measures should be proportionate to risk, a sensible approach to avoid any cooling effect from these measures. Key to assessing risk will be the nature, scale and complexity of the activities undertaken by the relevant body. Important steps will include practical steps taken to implement policies, enforcement of compliance and the monitoring of policy effectiveness. Protection for whistleblowers, clear reporting paths and continuous review of strategy are also key considerations.

Principle 3 – Top level commitment

Top down commitment is expected, including zero tolerance towards the criminal facilitation of tax evasion and a commitment not to recommend the services of others without appropriate measures in place.

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10 Tackling tax evasion: Government guidance for the corporate offences of failure to prevent the criminal facilitation of tax evasion. Government guidance: 1st September 2017

Principle 4 – Due diligence

Due diligence should be performed applying a risk based approach, whether internally or externally, in respect of those persons who perform services for the organisation to mitigate risks that have been identified.

Principle 5 – Communication and training

Expectations, policies and procedures must be communicated effectively, and understood, which may involve training.

Principle 6 – Monitoring and review

Risks evolve over time, and so must procedure. An organisation must remain flexible and review the risks it faces to remain compliant.

What are the risks of non-compliance?

Conviction for either offence could lead to an unlimited fine, and reputational damage.[12] A less obvious risk that organisations face is debarment in relation to EU public sector contracts pursuant to the Public Contract Regulations 2015 for "grave professional misconduct".[13]

Are these new offences likely to be prosecuted with any frequency?

In recent years HMRC have been criticised for prioritising volume over complexity.[14] Tax evasion is now a Government priority, and these new offences will make it easier to investigate and prosecute companies in the future.

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12 Criminal Finances Act 2017 s 45 (8) and 46 (7); Fines may be considerable, in Serious Fraud Office v Sweett Group Plc unreported 19 February 2016 Sweett Group plc was ordered by Southwark Crown Court to pay approximately £2.35m for the offence of failing to prevent bribery by an associated person under s 7 of the Bribery Act 2010

13 See Alexandra Webster, "Could a company be debarred following a conviction for failure to prevent bribery?" [2016] CLR for a discussion of this point in relation to the Bribery Act 2010

14 National Audit Office, Tackling tax fraud,2015 page 33 available at: https://www.nao.org.uk/wp-content/uploads/2015/12/Tackling-tax-fraud-how-HMRC-responds-to-tax-evasion-the-hidden-economy-and-criminal-attacks.pdf (last accessed 11 January 2018)

The offences overcome the hurdles imposed by the legal principles preventing the prosecution of companies unless directing minds and sufficiently senior officers have participated with sufficient knowledge of the alleged criminal conduct. The resources are being made available to investigate and prosecute these offences and so the compliance burden they generate should be taken seriously by corporates big and small, and in all sectors. Against this new dawn, self reporting and a co-operative stance will be encouraged by the prosecution authorities as DPAs now appear as firmly entrenched procedures in relation to corporate criminal liability.

UNEXPLAINED WEALTH ORDERS

Another change in the criminal finances regime will be the unexplained wealth order (or UWO) which will require an individual to explain assets which appear to be disproportionate to income. Failure to explain assets will give rise to a rebuttable presumption that the assets are "recoverable" under POCA.

The aim is, where there are unexplained assets, for example a large house in Chelsea owned by an ex-con subsisting low pay, the order will place a disclosure burden on the defence and sidestep the need in recovery proceedings for the prosecution to provide evidence that the asset, this house, is on the balance of probabilities derived from "unlawful conduct".[15] Instead the respondent, will need to explain how he afforded the asset.

Who could the new orders apply to?

UWOs could be made against non-EEA "Politically Exposed Persons" (PEPs), subject to diplomatic immunity, and their connections, so for example the director of a foreign state owned bank. They could also be granted in relation to persons against whom there are "reasonable grounds for suspecting involvement in serious crime" and those connected to them.[16]

15 S 304 Proceeds of Crime Act 2002

16 Criminal Finances Act 2017 s 1 inserting s 362(B)(4) into Proceeds of Crime Act 2002

Who will be able to utilise these orders?

The new powers will be exercisable by the NCA, the Director of the SFO, the CPS, the DPP, HMRC and the FCA.[17]
UWOs will be available on application to the High Court, and can be made without notice.[18]

What criteria will need to be satisfied before an order can be granted?

The High Court will need to be satisfied that there is "reasonable cause to believe" that the respondent holds the property; that the value of the property is greater than £50,000 and that "...there are reasonable grounds for suspecting that the known sources of the respondents lawfully obtained income would have been insufficient for the purposes of enabling the respondent to obtain the property" [19]

Before the Bill went to the Lords the ceiling for an application was £100,000. This was amended after concerns that it would be ineffective in Scotland and Ireland where property prices are lower. [20]

What will be the effect of an order?

The effect of an order will be to require a statement from the respondent. This statement must set out the nature and extent of the respondent's interest in the property and disclose how the property was obtained.

If the property is held by a trustee the statement must set out details of the settlement as specified in the order (the inclusion of trustees was a HOL amendment).[21]

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17 Criminal Finance Act 2017, s 1 inserting s 362A (7) into Proceeds of Crime Act 2002

18 Criminal Finance Act 2017, s 1 inserting s 362B and 362I into Proceeds of Crime Act 2002

19 Criminal Finance Act 2017, s 1 inserting s 362B (3) into Proceeds of Crime Act 2002

20 See Hansard, 26 April 2017 Volume 624 available at: https://hansard.parliament.uk/commons/2017-04-26/debates/35841E55-C673-4D18-B286-BF259EB27F17/CriminalFinancesBill (last accessed 11 January 2018)

21 Criminal Finance Act 2017, s 1 inserting s 362A (3) into Proceeds of Crime Act 2002

If a person fails to comply with an order a rebuttable presumption will be raised that the property is "recoverable property."[22]

Where a respondent replies to an order, the enforcement agency may or may not instigate recovery proceedings.[23]

Where there is purported compliance, which includes a false or misleading statement made either intentionally or recklessly, the Act provides that an offence is committed, punishable by a fine or up to two-years imprisonment.[24]

In summary:

1. The onus has been shifted onto the defence to explain where property has come from.
2. The threshold for an order is low "are there reasonable grounds for suspicion"
3. Care must be taken when responding to these orders, as a misleading statement could constitute an offence even if it's made recklessly.

FURTHER EXPANSION: TOWARDS AN OFFENCE OF FAILURE TO PREVENT ECONOMIC CRIME?

There were several attempts to amend the Criminal Finances Bill to include a broad failure to prevent economic crime offence.[25] There are strong arguments for reform. The amount lost to the UK economy from fraud, (£193 billion) dwarfs that said to be lost from tax evasion (£5.2 billion) and, in comparison to tax evasion facilitation offences, there are plenty of predicate offences upon which a prosecution could be founded.[26] While a new offence was not incorporated into the 2016/17 Bill, the idea of a broader failure to prevent offence has gained traction and the Government, last year, opened a consultation on the matter.[27]

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22 Criminal Finance Act 2017, s 1 inserting s 362(C) into Proceeds of Crime Act 2002
23 Criminal Finance Act 2017, s 1 inserting s 362(D) into Proceeds of Crime Act 2002
24 Criminal Finance Act 2017, s 1 inserting s 362(E) into Proceeds of Crime Act 2002
25 See HOC: Notice of amendments, 12 January 2017, available at: http://www.publications.parliament.uk/pa/bills/cbill/2016-2017/0097/amend/criminal_rm_rep_0112.1-7.html (last accessed, 11 January 2018)
26 Written Evidence submitted by the BOND Anti-Corruption Group and the Business Integrity Network, 15 November 16
27 See https://www.gov.uk/government/consultations/corporate-liability-for-economic-crime-call-for-evidence (last accessed 11 January 2018)

The consultation, which closed on 31 March 2017, examined the case for reforming corporate law and extending corporate liability so that it covers any economic crime committed on behalf of, or in the name of, a corporate entity which could have a huge impact on the regulated sector.

Under the common law, corporate criminal liability can be established through the identification doctrine. The doctrine provides that where someone is acting in a directing capacity on behalf of a company, the will and mind of the company can be attributed to any criminal conduct carried out by that person.[28]

Where an action cannot be traced to a senior officer, however, it is difficult to establish corporate criminal liability. This lacuna in the law has arguably led to a culture of wilful blindness at board level as companies attempt to insulate themselves from criminal conduct further down the chain of command.

Options for reform

During the consultation period views were sought on a variety of policy options. These included: strengthening the existing regime; adding US style vicarious liability to the statute book; and creating a new failure to prevent offence.[29] The language coming from Government is overall, however, notably measured, giving little away in terms of which approach is favored. Justice Minister Sir Oliver Heald QC then commented in relation to the consultation that, "Companies must be held to account for the criminal activity that takes place within them…" and stressed that he wanted "…to restore public faith in business and make sure… [Government has] … the right tools available to crack down on corporate criminality."

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28 See Tesco Supermarkets Ltd v Nattrass [1972] AC 153

29 See https://www.gov.uk/government/news/new-crackdown-on-corporate-economic-crime (last accessed 11 January 2018)

Recent reforms to corporate criminal liability

Statute has to some extent circumvented the issues thrown up by the identification doctrine already through the "failure to prevent" offences discussed above. Essentially, failure to prevent offences are omission based offences which make a company liable for the actions of associated persons where a predicate offence can be proved and proper preventative procedures have not been implemented. So far one other failure to prevent offence has hit the statute books, s 7 of the Bribery Act 2010, the offence of failing to prevent bribery.[30] Expanding corporate liability to encompass all economic crime would however be a revolutionary step, and perhaps the biggest shakeup to corporate criminal law in a decade. Were such a reform to be passed there would likely be a huge step change in the number of DPAs and in prosecutions brought against companies.

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30 Bribery Act 2010, s 7 available at: http://www.legislation.gov.uk/ukpga/2010/23/section/7 (last accessed 11 January 2018)

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