New Corporate Offences of Failing to Prevent the Facilitation of Tax Evasion:

Ten Frequently Asked Questions

September 2017

Introduction

The Criminal Finances Act 2017 (CFA) is now on the statute book and it will hold firms criminally liable where employees or their “associates” facilitate tax evasion by clients. To protect themselves, firms must implement reasonable prevention procedures to mitigate the risk of facilitating a tax evasion offence. The CFA comes into force on 30 September 2017 so there is little time left to prepare.

It is, of course, already a crime to dishonestly evade tax and already a crime to assist a taxpayer to do so. Conduct by the taxpayer and employee is, therefore, already criminalised. Instead, the CFA addresses the position of the employer, the firm holding the client relationship. In the UK, it is notoriously difficult to criminally prosecute a large company because of the “governing mind” principle. This can be contrasted with the United States where it is relatively easy to prosecute corporates on the principle of vicarious liability. English law creates an incentive on the part of management to turn a blind eye to non-compliant behaviour. The absence of senior management knowledge or involvement in wrongdoing makes it difficult to prosecute. If prosecutors cannot prove the knowledge or involvement of senior management they will struggle to secure a conviction. The CFA will shake this up by introducing strict liability. Firms have to show that they have reasonable preventative procedures in place to escape prosecution.

Here are 10 questions that financial institutions should be thinking of with a view to complying with its requirements.

Q1. Reviewing existing financial crime and AML policies

Financial institutions need to update their current AML and financial crime policies. It will not be sufficient to rely on what you already do. In fact financial institutions are already subject to financial crime systems and controls under FCA rules and, in any event, should be updating them as a result of the new Money Laundering Regulations 2017 which came into effect on 26 June 2017. As tax evasion is a money laundering predicate offence, existing procedures will be a starting point in developing reasonable prevention procedures under the Act.

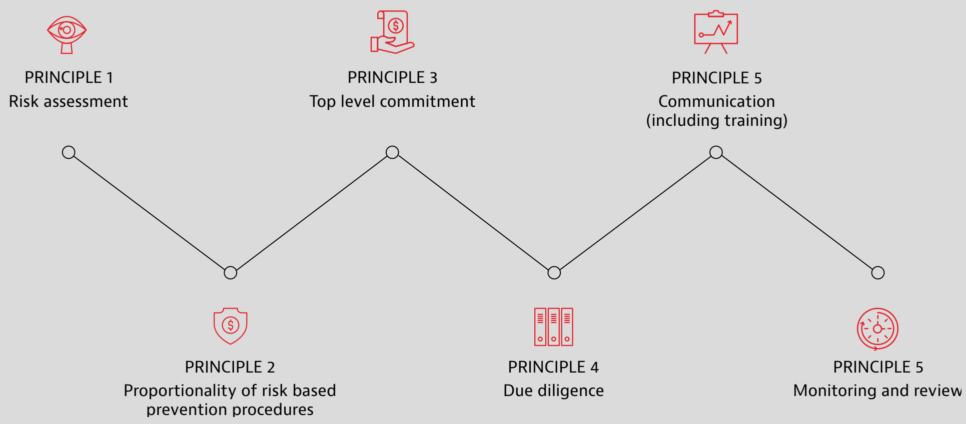
HMRC are clear, however, that the CFA is intended to "promote" awareness of tax evasion as a topic within a firm's policies. In other words, greater priority will need to be attached to this issue. HMRC have stated that merely applying old procedures tailored to different types of risk will not be an adequate response. HMRC have also said that firms with a higher risk profile may choose to articulate their CFA procedures separately.

Q2. What will reasonable preventative procedures look like?

HRMC has published Guidance for firms on what is expected of them. The Guidance scopes out the elements of the prevention procedures that HMRC expects firms to put in place (see Tackling tax evasion: Government *guidance* for the corporate offence of failure to prevent the criminal facilitation of tax evasion). These procedures fall under six Guiding Principles:

(a) Risk assessment; (b) Proportionality of risk based prevention procedures; (c) Top level commitment; (d) Due diligence; (e) Communication (including training); (f) Monitoring and review.

GUIDING PRINCIPLES FOR REASONABLE PREVENTION MEASURES



The above Principles will already be embedded within existing AML and financial crime controls. Firms will be familiar with the concept of performing a risk assessment which then drives the firm's approach to due diligence and monitoring of individual customers and transactions. What firms need to do differently is to separately identify and address the risks of employees or agents assisting clients to evade UK or foreign tax.

Training is a key aspect of the required policies. Firms should develop training modules that specifically address the risk that their employees or other "associates" acting on their behalf may facilitate tax evasion. Training will need to be tailored. For example, front office staff dealing with customers from a particular jurisdiction are likely to be expected to have a better understanding of that country's local environment and laws.

Q3. What are the higher risk business lines for the purpose of the Act?

HMRC states in its Guidance that higher risk business lines will be those involved in giving bespoke financial advice or tax advice. A steer on what constitutes higher risk business for these purposes can also be taken from the Joint European Supervisory Authorities (ESA) Guidelines on Simplified and Enhanced Due Diligence and also the JMLSG (the latter being expressly referred to in the HMRC Guidance).

While the ESA Guidelines cover money laundering risks generally, they are strongly influenced by considerations relating to tax evasion. Geographical risk factors include connections to "tax havens", "secrecy havens" or "offshore jurisdictions". The use of trusts, asset holding vehicles and multiple jurisdictions are all indicators of higher risk. The Guidelines focus on cross-border business and suggest that firms who provide services to non-resident clients should ask themselves whether the clients would be better serviced elsewhere.

Q4. Client risk profiles and PEPs

Firms need to review their methodologies for building client risk profiles. The risk factors and risk weightings which produce the client's risk rating need to be revised to reflect risks around tax evasion. Risk weightings may need to be adjusted upwards to give greater prominence, for example, to country risks (e.g., connections to "tax haven" jurisdictions) and to ensure that tax considerations are promoted. Politically Exposed Persons (PEPs) trigger enhanced due diligence requirements under the Money Laundering Directive, though this does not mean that they have to default to the firm's highest risk category.

The CFA does, however, highlight the need for firms to focus on the source of wealth of clients who are PEPs. Unexplained Wealth Orders are an innovation under the CFA originating from overseas. These orders focus on the potential of a disparity between a client's wealth and the client's declared sources of income. Clearly, the new power targets clients who have undeclared incomes for tax purposes or who have acquired assets through criminally derived funds. Law enforcement authorities will be able to apply to the High Court for orders requiring foreign PEPs to explain how they have acquired specified property. Such an order will be available where there are reasonable grounds to suspect that a person's known sources of income would not have been sufficient to fund the purchase of the property concerned. This emphasises the need for firms to properly investigate PEPs' source of wealth. Law enforcement action in this area might otherwise expose deficiencies in the firm's process.

Q5. Liability for third parties

Firms will be held criminal liable for acts of their "associated persons". This term includes employees, agents and other third parties who act on the firm's behalf. The concept of an associated person is therefore broad, giving rise to the potential that firms will be held criminally liable for non-employees acting outside the control environment of the firm itself. In order to address this risk, firms need to review the role of agents and third parties who might fall within the definition of associated persons for these purposes and ensure that risk mitigation procedures are extended to cover such parties. Firms should focus on parties such as financial advisers who may have introduced business to the firm or may intermediate the relationship between the firm and the client. Such parties might provide services to the underlying client but might also be treated as the firm's agent.

Overview of Offences

Two new offences: Failure to prevent the criminal facilitation of tax evasion.

- Stage one: Criminal UK or foreign tax evasion by a taxpayer (either an individual or a legal entity)
- Stage two: Criminal facilitation of the tax evasion by an associated person of the relevant body who is acting in that capacity.
- Stage three: Firm fails to prevent its representative from committing the criminal facilitation act
- Defence: Are there reasonable prevention procedures?

Q6. Do I need to become a tax expert?

The answer to this is no. The new offences are directed at deliberate or dishonest behaviour. HMRC also say that if an employee is only shown to have acted accidentally, ignorantly or negligently in facilitating tax evasion by a client, no offence will be committed. However, the position is a little more nuanced. It is also clear that there are expectations that if a firm is targeting a particular market (e.g., wealthy individuals from France) staff will have a greater knowledge of requirements in that market.

Q7. Does the CFA apply to people outside the UK?

Yes, the CFA has an extremely broad reach. The Act criminalises the failure to prevent the facilitation of both UK and foreign taxes.

Facilitating UK tax offence

The offence of failure to prevent the facilitation of UK tax evasion can be committed by a business anywhere in the world. The only hook required for UK criminal law jurisdiction is that a tax payer is evading a UK tax. Businesses outside the UK need to be compliant. A group subsidiary or branch located outside the UK could be guilty of a criminal offence under UK law if an employee or agent has facilitated the evasion of UK taxes. For example, a UK firm could commit an offence if an employee or agent of its Singapore branch has helped a client booked in Singapore to evade UK tax.

Facilitating foreign tax offence

This offence is narrower in scope in that it can only be committed where the offender is a UK company or partnership, the offender carries on part of its business in the UK, or any relevant conduct takes place in the UK.

Deconstructing the above, the wide jurisdictional scope of the CFA means that:

- Branches of a UK firm operating outside the UK are fully within the scope of the CFA and must have UK level preventative procedures.
- The "Head Office" of a foreign bank with a UK branch is also fully within scope. The UK offence applies extra-territorially to activities outside the UK. The foreign offence applies because the firm is carrying on part of its business in the UK, even though the UK branch is not involved in assisting the evasion of the foreign tax. A German bank with a London branch therefore needs to consider the application of the Act to activities carried on in Germany in relation to German clients.

Extra-territoriality

UK tax evasion	Foreign tax evasion	UK presence	Overseas presence
✓	✓	Head Office + branch	
✓	✓	Head Office	Branch
✓			Head Office and Branch
✓	✓	Branch	Head Office

Q8. Do we need to review our Terms of Business Agreements (ToBAs) and other documentation?

Firms should review ToBAs, marketing materials and other literature to ensure that these provide an accurate description of services being provided. Firms should, where appropriate, remove wording that suggests they provide services relating to tax structuring or tax advice. ToBAs should contain an express stipulation that the firm does not provide tax advice or related services, if this is the case.

Q9. Should we consider de-risking?

Depending on their business model, firms may seek to mitigate risks by not providing certain higher risk services or reviewing the firm's portfolio of clients.

Q10. Enhancing monitoring and surveillance

Firms will need to amend monitoring processes to ensure that staff are complying with procedures put in place to ensure compliance with the CFA. If firms decide to stop giving advice or being involved in structuring, then monitor procedures should focus on this. Surveillance presently carried on to monitor conduct and market abuse issues could also be extended to include potential facilitation of tax evasion.

Future of Corporate Liability

The CFA is a foretaste of things to come. The Government has conducted a Call for Evidence on corporate liability for economic crime, where one option would extend similar obligations across other types of economic crime. Both the CFA and the Call for Evidence mark the criminalisation of conduct that would otherwise have been categorised as a regulatory systems and controls failing. With the imposition of strict liability, prosecuting a business will become much easier.

Action Points

What steps can you take to minimise risk?

- Prepare a risk assessment, consider how your business is affected.
- Review as relevant your existing compliance policies and their implementation.
- Undertake a GAP analysis to identify a path to compliance, and develop your procedures and processes.
- Design, develop and roll out training from eLearning to bespoke study.
- Draw on Baker McKenzie's cross-disciplinary legal, regulatory and tax expertise as part of your implementation team.

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