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Tackling Tax Evasion: New UK Strict Liability Corporate Criminal Offences

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To engage businesses in the fight against tax evasion and dovetail with ongoing efforts to tackle corruption both nationally and internationally, the UK Government has committed to introduce a corporate offence of failing to prevent tax evasion. Compliance will require some action by all UK businesses, and comes at a time when other initiatives aimed at transparency and openness in tax matters will also require attention, including the obligation for certain businesses to publish their UK tax strategy.

Status

The new offence was first proposed in the March 2015 budget, but the Government has now linked its introduction to the UK's response to the Panama Papers and committed to introducing it in legislation by the end of this year. It is not currently clear whether the legislation will apply immediately or whether businesses will be given an additional window to assess risk and implement policies and procedures. HMRC is currently consulting on detailed legislation and draft guidance; the consultation is open until July 10.

The offence is modelled on the strict liability Bribery Act 2010 offence of failure of commercial organisations to prevent bribery. The prime minister has also indicated an intention to consult on the introduction of further "failure to prevent" offences relating to other economic crimes, such as fraud and money laundering.

The Government is keen to address the concern that under existing law, attribution of criminal liability to companies in this area is governed by the "directing mind" test, which generally requires the involvement of senior management. This makes larger organisations more difficult to prosecute and, according to the consultation document, results in "an environment that does not foster corporate monitoring and self-reporting of criminal activity".

As with the Bribery Act offence, the new offence, which is also strict liability, shifts the burden to businesses to be able to prove the defence, which will apply, broadly, where the business has put in place reasonable procedures to prevent the facilitation of tax evasion by its associated persons.

The Offences

There will be two separate criminal offences: (i) failure to prevent facilitation of *UK* tax evasion offences, and (ii) failure to prevent facilitation of *foreign* tax evasion offences.

Each offence will require the following elements to be satisfied:

- criminal tax evasion by a taxpayer (whether that taxpayer is an individual or corporate entity); and
- criminal facilitation of this offence by a person associated with the relevant body (and acting in that capacity).

The offences can be committed by any "relevant body", defined as any body corporate or partnership (or overseas firm or entity of similar character), wherever incorporated or formed. The territorial scope is broad. In summary, the new offences are potentially relevant for all businesses with any staffing, operational or trading presence in the UK, and the UK offence is potentially relevant even for businesses without any UK presence.

Associated Persons

The category of people whose acts a business will be responsible for is very wide. Based on the Bribery Act 2010 definition, an associated person is any person (individual or corporate entity) who *performs services for or on behalf of the relevant body*. This is includes employees (for whom association with their employer is a rebuttable presumption), agents, subsidiaries and contractors. However, persons acting on their own behalf, for example employees acting on a "frolic" of their own, would be outside of scope. Persons to whom business is simply referred will generally be excluded, according to guidance, but this depends on an analysis of the particular situation, including contractual proximity, control and benefit. The draft guidance invites the submission of examples surrounding referral arrangements, following stakeholder requests for clarity on this issue.

Tax Evasion and Facilitation – UK and Overseas

In respect of UK tax evasion, a taxpayer must be shown to have committed a "UK tax evasion offence", defined as:

- an offence of cheating the public revenue; or
- an offence under the law of any part of the UK consisting of being knowingly concerned in, or taking steps with a view to, the fraudulent evasion of a tax. HMRC draft guidance cites an example using section 72 VATA 1994 (fraudulent evasion of VAT).

In addition, the associated person must be shown to have committed an offence of *facilitating* the commission of that UK tax evasion offence (a "UK tax evasion facilitation offence"). This is defined as a person doing any of the following:

- anything constituting the commission of a UK tax evasion offence by virtue of that person being knowingly concerned in, or taking steps with a view to, the fraudulent evasion of tax by another person (for example under section 72 VATA 1994); or
- aiding, abetting, counselling or procuring the evasion offence (including the Scottish equivalents).

"Dual criminality" is required in respect of foreign tax evasion:

- the evasion must be a criminal offence under the law of the foreign country concerned (relating to the evasion of tax in that country) and, assuming that there was an offence of that kind in the UK in relation to that tax, amount to being *knowingly concerned in or taking steps with a view to the fraudulent evasion of that tax*; and
- the facilitation must be a criminal offence under the law of the foreign country concerned and, if the evasion offence were a UK tax evasion offence, amount to a UK tax evasion facilitation offence (as set out above).

Strict Liability

There is no requirement for directors/senior management of the business to be involved in, or aware of, the illegal activities concerned in order for the business to be liable. However, in respect of the underlying offences, the relevant associated persons need to have been knowingly involved in some fairly significant wrongdoing. Separate prosecutions or convictions for tax evasion and the facilitation are not required (meaning that the corporate offence can be prosecuted even where, as is common, the underlying offence results in a civil settlement) but prosecutors must demonstrate that these predicated offences have been committed to the criminal standard (beyond reasonable doubt), including the requisite intent or knowledge. For example, associated persons acting negligently, in good faith, or those deceived by the evader would fall short of committing a facilitation offence.

The penalty for the corporate offence is an unlimited fine.

Defence: Reasonable Prevention Procedures

Given the strict liability nature of the offence, organisations must focus their attention on meeting the statutory defence of having in place prevention procedures which are *reasonable in all the circumstances* (or that it is reasonable for it not to have any such procedures). As the burden will be on the (defendant) organisation to raise the defence, ensuring appropriate documentation is kept will be a key factor.

Resembling other financial crime and anti-money laundering guidance, the draft guidance sets out a number of principles intended to be applied in a risk-based and proportionate way.

It is also contemplated that trade bodies and sector representatives will develop sector-specific guidance which can be put forward for endorsement by the Government.

Risk Assessment

In practical terms, it will be incumbent on any business within the scope of the new offences first to consider the nature, scale, location and complexity of its activities, and to conduct an initial assessment of tax evasion facilitation risks these pose. As the UK and foreign tax evasion offences are separate, it may be appropriate to also address these risks separately. It can also be observed that different businesses will have different risk profiles in relation to the different offences. For example, a UK-headquartered mining company may have little reason to perceive risk in connection with the UK offence, but if it is active in overseas jurisdictions where tax evasion is relatively commonplace, then it may see enhanced risk in connection with the overseas offence.

Questions to ask as part of an initial assessment might include:

- Who should have responsibility for assessing the level of risk exposure across the organisation? Is external assistance necessary, or can the assessment be conducted in-house?
- Who is an "associated person" (employees/contractors, agents, subsidiaries)?
- Where do they operate and what services do they offer taxpayers?
- What is the scope for the facilitation of tax evasion by such associated persons?
- What effect might the organisation's internal structures/procedures have on the level of risk (e.g., staff training deficiencies, remuneration, communication, reporting)?

Businesses should consider how the risk of facilitation of tax evasion interacts with the wider tax and regulatory context in which they operate. For example, the draft guidance notes that risks to an organisation may be increased where the firm serves customers in jurisdictions that do not report taxpayer information under the Common Reporting Standard (CRS).

For businesses with very low risk exposure, it would be prudent to ensure that such assessment is clearly articulated and reported to the board/senior management for consideration and approval. The statutory defences contemplate that it may be reasonable to conclude that no preventative procedures are required, but businesses should keep such assessments under review in the event that circumstances change.

More broadly, top-level management will be expected to foster a culture of compliance and communicate commitment to the prevention of tax evasion facilitation within the organisation. This is likely to extend to some level of senior involvement in the development of preventative measures (or the decision not to implement such measures).

Compliance Procedures

Businesses which do identify some level of risk in their risk assessment will need to consider what procedures to put in place. Topics to consider include:

- Due diligence conducted on associated persons (including employees, contractors, agents, referral firms): what due diligence/KYC is currently undertaken, and what adjustments can be made to accommodate the new offences?
- Contractual arrangements with associated persons: should informal arrangements be formalised, or amendments made to existing agreements to assert the organisation's stance and facilitate enforcement of its policy?
- Existing policies, procedures and practices: can these be tailored to incorporate tax evasion facilitation prevention, or is a standalone document required? What disciplinary procedures will apply to breaches of procedure?
- Communication/staff training: What needs are identified? Is external communication of the policy appropriate? Are there means for employees to report concerns confidentially?

Other Considerations

A carefully crafted policy document is unlikely to be of value in a trial if it has been left on the shelf to gather dust. Businesses should also consider appropriate arrangements for ongoing monitoring, review and amendment of procedures as the internal and external business environment changes.

Businesses looking to invest in or purchase entities within the scope of these new offences should include tax evasion facilitation risk on the list of due diligence to be conducted on the target, alongside Bribery Act issues. Whilst the penalties for the new offences are purely financial, the public relations impact of association with an entity implicated in tax evasion should not be overlooked.

UK Tax Strategy

Draft legislation has also been released that will require large groups, companies and partnerships to publish their tax strategy annually, with the first publication to be before the end of the first accounting period commencing after royal assent to the Finance Bill 2016 (due in summer 2016). The strategy must be published on the internet and available free of charge to the public for at least one year, or until it is replaced by the following year's strategy.

Scope

UK corporates and partnerships with a turnover of more than £200 million, or with aggregate balance sheet assets of more than £2 billion (by reference to the position at the end of the business's previous financial year), are within the scope of the draft rules. The provisions regarding groups are somewhat surprising, and would capture:

- Groups headed by a UK corporate, where either (i) the total turnover/balance sheet assets of all UK companies within the group meet the above thresholds (and where the group includes at least two UK companies or permanent establishments), or (ii) the group is otherwise classified by the OECD as an MNE group and subject to country-by-country reporting (i.e., turnover of more than €750 million); and
- "UK subgroups" of larger groups headed by a foreign corporate, where either (i) the total turnover/balance sheet assets of all UK companies within the group meet the above thresholds (and, as above, where the group includes at least two UK companies or permanent establishments), or (ii) the group is otherwise classified by the OECD as an MNE group (as above).

The result of this is that large MNE groups with relatively minor UK operations would still be required to publish a tax strategy by virtue of the group's overall size. As the legislation is currently in draft form, it is uncertain whether a *de minimis* threshold will eventually be included to counter this effect.

The requirement for the group to be headed by a "relevant body" (defined as a company or other body corporate, and excluding an LLP) means that in a typical fund context, different investments will generally not be aggregated for the purposes of whether the thresholds are met, provided that these are not held under a "master" holding company.

Content

The legislation requires the following matters in relation to UK taxation to be covered in the published strategy:

- Approach to risk management and governance arrangements
- Attitude towards tax planning
- Level of risk that will be considered acceptable
- Approach towards dealings with HMRC

Discretion is afforded to businesses as to whether to include other information relating to taxation (UK or otherwise), and, in the case of groups, whether the points above are dealt with in the context of the group as a whole or individual companies.

Action points

There are many relevant factors that businesses should consider in preparation for the new rules coming into effect. Chief among these, as for the new criminal offences discussed above, is to involve board/senior management at an early stage in the process and ensure buy-in to the strategy. Time may also be needed to revise internal processes ahead of time to ensure that the business operates in line with the final published strategy.

Reflecting on the draft guidance, more detailed aspects for businesses to consider early on include:

- How the required tax strategy might interact with global tax strategy (whether global strategy is published or not);
- Possible commercial and reputational implications of making the tax strategy public. Public, media and HMRC scrutiny should be anticipated, so businesses should be alive to the risk of being seen to deviate from the stated course or to have done so in the past;
- How to comfortably articulate the level of risk that the business is prepared to accept and the approach to risk management. The draft guidance from HMRC provides some indications of content it expects to see on these topics, including details of the internal governance framework and oversight/involvement of the board; and
- How to formulate and articulate the attitude towards tax planning (so far as it affects UK taxation). The draft guidance from HMRC suggests content here is likely to include details of codes of conduct and why external tax planning advice may be sought.

If you would like to discuss any of the topics raised in this Alert further, please contact one of the attorneys listed above.