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UPDATE: New UK Offences of Failure to Prevent Facilitation of Tax Evasion – looming deadline

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In May 2016, we published an Alert about UK proposals to introduce new strict liability corporate criminal offences aimed at preventing the facilitation of tax evasion. Andy Howard, Tax partner in the Ropes & Gray London office, also recently recorded a short video on the topic for our *Trending Legal Topics* series. The UK has recently confirmed that the relevant legislation will come into effect on September 30, 2017. In this Alert we recap on the key aspects of the new offences, and the steps that businesses should take in order to protect themselves ahead of commencement.

These new offences should be seen in the context of a broader trend towards engendering greater corporate responsibility for tax compliance. The UK government is trying to enlist the support of as many businesses as possible in combatting tax evasion, using the threat of criminal liability.

Businesses will not be liable for the offences provided they have established the defence by putting in place and maintaining "reasonable prevention procedures". If they have not taken these steps, they run the risk of unwittingly committing the offence if a rogue employee or agent becomes involved in facilitating tax evasion. HMRC are understood to be allocating resources to investigate cases following commencement.

The UK is at the forefront of international efforts in the sphere of tackling tax evasion and avoidance, being among the early jurisdictions to adopt international automatic exchange of information regimes (such as the Common Reporting Standard), recently introducing a requirement for large businesses to publish an annual "tax strategy" and, more broadly, embracing the recommendations from the OECD's Base Erosion and Profit Shifting (BEPS) project.

Territorial Scope

The offences under Part 3 of the Criminal Finances Act 2017 target non-UK businesses as well as UK businesses, and non-UK tax evasion as well as UK tax evasion. The UK has expressed the hope that other jurisdictions will follow the UK's lead and introduce similar offences. It will be difficult for businesses, of whatever type and wherever located, to get entirely comfortable that they are outside the scope of the offences. In practice, however, it does not seem likely that the UK would prosecute in a case where there is no real UK element.

The new "Failure to Prevent Facilitation of Tax Evasion" Offences

Modelled on the UK's Bribery Act 2010 offence of failure by commercial organisations to prevent bribery, there are 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 third-party 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).

Associated Persons

The category of persons whose acts a business will be responsible for is wide. An *associated person* includes any person (individual or corporate entity) who *performs services for or on behalf of the relevant body*. This includes employees, agents and sub-contractors, but not third parties who merely provide services to a business. Persons acting on their own behalf, for example, employees acting on a frolic of their own or sub-contractors in the course of their other business, are out of scope.

Subsidiaries and other entities in which a business may have an interest (including portfolio companies in an asset management context) are only associated persons if they are in some way providing services on behalf of the business. However, such entities are likely to be within the scope of the offence in their own right. The reputational and financial consequences of non-compliance by such entities are likely to impact on the parent, which is therefore likely to take whatever steps are within its control to encourage compliance. Failure to have adequate procedures in place is also likely to be an issue if the relevant entity is the target of any M&A activity.

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).

Scope

The new 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. Where the evasion relates to UK tax, businesses anywhere in the world are within scope. Where the evasion relates to non-UK tax, some limited nexus to the UK is required. This will be made out where the business has *any* staffing, operational or trading presence in the UK, even if this is not involved in the relevant criminal conduct. For example, a US-headquartered investment firm with a UK branch would be within scope of the offence relating to non-UK tax evasion, even if the UK branch itself had no involvement in the relevant conduct.

Whilst firms providing wealth management/financial advice are an obvious target, all types of business are within scope. To illustrate how non-financial businesses can commit the offences, draft HMRC guidance provides an example of a sub-contractor of a car manufacturer becoming involved in a false invoicing scheme that enables an end customer to evade VAT on the car purchase.

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, the relevant associated persons need to have been knowingly involved in some fairly significant wrongdoing. Although convictions for tax evasion and facilitation are not required, prosecutors must demonstrate to the criminal standard (beyond reasonable doubt) that these offences have been committed, including the requisite intent or knowledge. The legislation is not attempting to re-draw the parameters of tax evasion, avoidance and legitimate tax planning decisions, and does not target tax planning, however aggressive, undertaken by businesses themselves.

The penalty for each corporate offence is an unlimited fine. However, the public relations impact, potential additional regulatory scrutiny and other adverse business consequences of a prosecution (whether successful or not) should not be overlooked. The offences are eligible for deferred prosecution agreement.

Defence: Reasonable Prevention Procedures

Given the strict liability nature and potential breadth of the offence, businesses must focus their attention on meeting the statutory defence of having in place prevention procedures that 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 in place will be a key factor. Resembling other financial crime and anti-money laundering guidance, the draft HMRC guidance sets out a number of principles intended to be applied in a risk-based and proportionate way. Further regulations are expected shortly to bring the draft guidance into operation, and we are aware that a number of industry bodies are also preparing specific guidance on the new offences. It remains to be seen whether such additional industry guidance will receive official approval, as the legislation contemplates.

With the commencement date of the offences of September 30, 2017 only a couple of months away, we have been looking closely at how the legislation and guidance could apply to our clients' businesses, in particular investment firms and asset managers. Businesses that have yet to consider their exposure to the new offences should take action now in order to protect their positions once the offences enter into force this September.

Practical steps to take by September 30, 2017

Risk Assessment

The first step towards establishing the defence is to carry out and document a risk assessment. An initial questionnaire can help to identify business areas that may present a risk under the new offences and help to evaluate the risk level concerned. As a starting point, it may help to consider at a high level the business' interaction with third parties, and whether there could be any possibility of facilitation of tax evasion by those parties. For example, in an asset management context, a risk assessment might start with areas such as fund marketing and investor relations, tax structuring, deal finders, and interactions with carry holders and co-investors. This can form the basis for a questionnaire outlining questions to be answered by the relevant parts of the business. The assessment would use responses to the questionnaire to consider whether associated persons working in these areas have the motive, the opportunity or the means to engage in this type of conduct in practice. In many cases, procedures will already be in place to address the potential risk, for example, carry information being subject to third-party audit, or investor information being subject to rigorous scrutiny by multiple people under CRS and FATCA reporting requirements.

Although tax input will be needed, in our experience the risk assessment is likely to need the input and ownership of compliance and legal personnel as well. It may be possible to avoid duplication of effort by combining with work that otherwise needs to be undertaken through the compliance function, such as ensuring procedures are appropriate to comply with new money laundering regulations (SI 2017/692).

Implementation plan

Businesses that do identify some level of risk in their risk assessment will then need to consider whether new procedures are required to address that risk. Given the short period between the offences being adopted and coming into force, the draft guidance suggests that by the end of September businesses should at least have formulated a clear timetable and strategy for implementation of such procedures, acknowledging that some (such as enhanced IT systems) may take longer to introduce.

More broadly, top-level management will be expected to foster a culture of compliance and communicate commitment to the prevention of tax evasion. This is likely to extend to some level of senior involvement in the development and communication of preventative measures, as well as signing off the risk assessment.

Topics to consider for procedures 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?

The UK Government has emphasised its expectation that "reasonable procedures" is a dynamic concept. Businesses should also consider appropriate arrangements for ongoing monitoring, review and amendment of the risk assessment and procedures as the internal and external business environment changes.

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