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Corporate offences of failure to prevent the facilitation of tax evasion – time to act!

Summary

Two new corporate criminal offences for failure to prevent the facilitation of tax evasion ("FTP" offences) are currently progressing through the UK Parliament in the Criminal Finances Bill, which is expected to receive Royal Assent in the next few months.

The FTP offences impose criminal liability on a company where it has failed to prevent the criminal facilitation of tax evasion by a "person associated" with the company – this is someone who provides services for, or on behalf of, the company (e.g. an employee, contractor or supplier). The aim of the offences is to encourage companies to put in place, and communicate, good corporate governance on preventing tax evasion, and this is achieved through a defence to the charge if a company has "reasonable prevention procedures" in place.

These offences will require all UK companies, irrespective of size or sector, to review their business and supply chains for potential tax evasion risk – of UK and foreign taxes – and to update their compliance policies and procedures to ensure that the company satisfies the defence. Foreign companies are also potentially caught by the scope of both offences, because either the tax evaded is a UK tax, or there is a UK nexus to foreign tax evasion, and so should undertake the same review.

Travers Smith can help – we have experience in assisting companies implement similar procedures for Bribery Act 2010 purposes. We can provide training, standardised compliance implementation packs, or a tailored service for your business.

KEY POINTS

1. Criminal liability for a company.
2. Applies if a company fails to prevent an associated person from facilitating tax evasion.
3. A company can be liable for the actions of an employee, agent, intermediary or supplier.
4. Applies to UK and foreign tax evasion. Applies to all UK and foreign companies, irrespective of size, sector or complexity of business.
5. There is a defence – a company must prove that it has "reasonable prevention procedures" in place.
6. This will require an update to internal compliance procedures, and due diligence in external business with associated persons (e.g. suppliers).
7. Otherwise, the company could be criminally prosecuted and receive an unlimited fine.
8. Companies should conduct a risk assessment now and start implementing revised policies and procedures by 1 September 2017.

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WHY ARE THE OFFENCES BEING INTRODUCED?

In the UK, it is possible to attribute criminal liability to a company for the criminal actions of, for example, an employee. However, in the context of tax offences, this means proving that senior officers or directors of the company had knowledge of the offence such that their 'directing mind and will' could be imputed to the company. The larger the company, the more difficult it is to prove this.

The UK Government has become concerned that senior management may be turning a blind eye, or, more likely, be unaware, of poor practices lower down a company's structure.

Therefore, the UK Government has introduced this statutory offence in order to make it easier for companies to be held responsible for the actions of people over whom they have some control.



WHAT SHOULD ALL COMPANIES BE DOING NOW?

- **Review the scope of the offences**
Compliance, legal and tax departments should familiarise themselves with the offences, **HMRC's draft guidance** ([link here](#)) and, when available, relevant industry guidance.
- **Senior Management involvement**
Senior management of your business should be notified of the offences and have oversight of the risk assessment and policy implementation stages.
- **Risk Assessment**
Identify the areas of your business where there is a high-risk of associated persons facilitating tax evasion.
- **Action Plan**
Decide how you will address those identified risks and start to put in place policies and procedures to mitigate those risks. You should be implementing your revised procedures by 1 September 2017, at the latest, as this is the date that the FTP offences are expected to come into force (although this is not yet finally confirmed).

SCOPE OF THE FTP OFFENCES

There are two FTP offences:

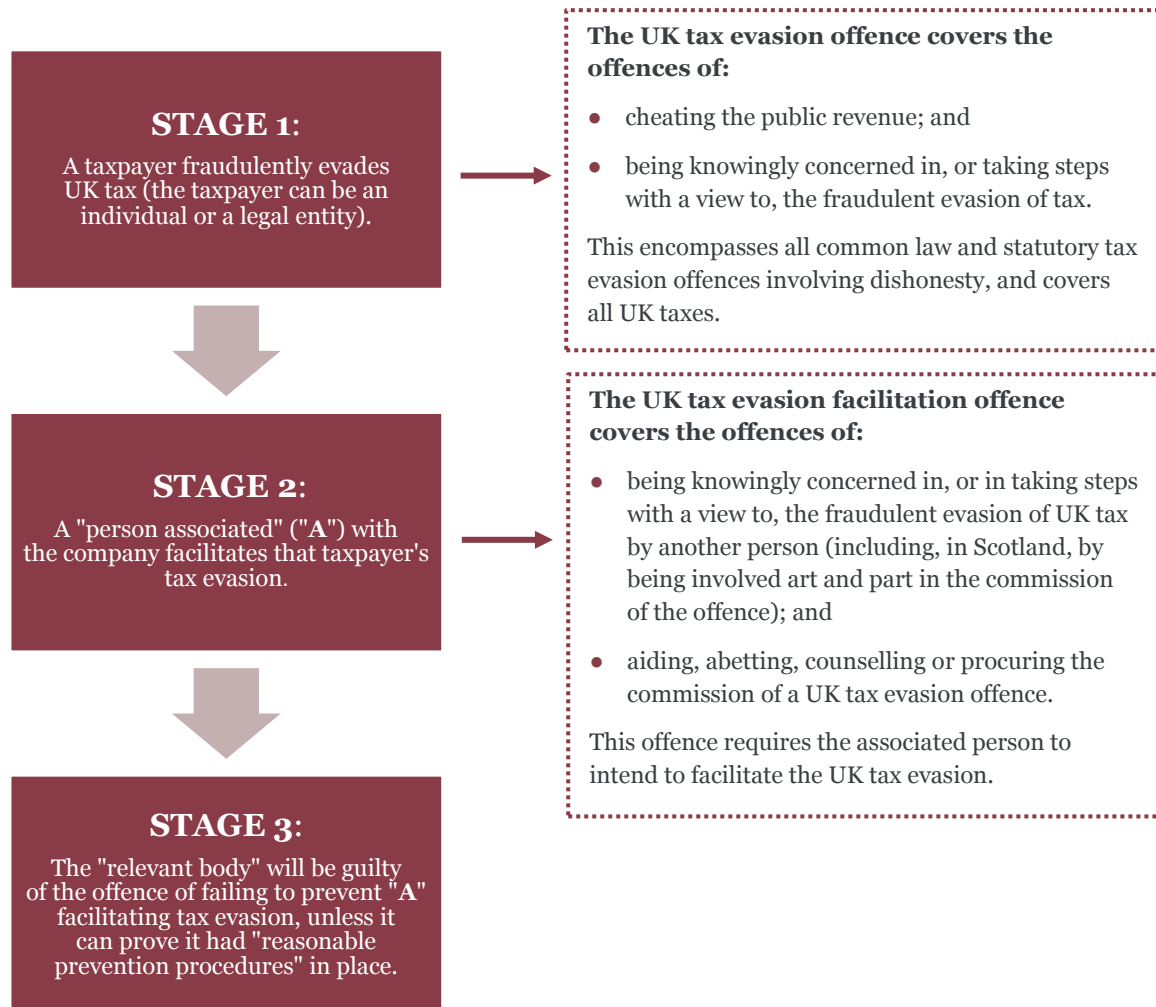
1. Failure to prevent the facilitation of UK tax evasion offences ("**UK FTP offence**"); and
2. Failure to prevent the facilitation of foreign tax evasion offences ("**Foreign FTP offence**").

Under the legislation, it is a "relevant body" that can be charged with a FTP offence. A relevant body means a body corporate or partnership, wherever incorporated, and, therefore, the offences apply to all companies, LLPs and partnerships (or an entity of a similar character formed under the law of a foreign country). For simplicity, this note refers solely to companies.

Before a company can be found guilty of either FTP offence, two underlying offences must be committed. First, there needs to be an underlying tax evasion offence committed by a taxpayer, and then, secondly, a person associated with the company must criminally facilitate that tax evasion. However, in respect of the Foreign FTP offence, there is a requirement for "dual criminality" at each of these stages, as discussed overleaf.

If the underlying tax evaded is a UK tax, then the UK FTP offence could catch a UK or a foreign company. However, if the tax evaded is a non-UK tax, then there needs to be a UK nexus for the Foreign FTP offence to arise (also discussed overleaf).

UK FTP OFFENCE



FOREIGN FTP OFFENCE

The Foreign FTP offence has the same basic stages as the UK FTP offence, however, there is a dual criminality requirement at stage 1 and stage 2.

The stage 1 offence requires the taxpayer to commit an offence under the law of a foreign country, which relates to a breach of duty regarding the imposition of tax – the intention of the legislation is to require the foreign tax evasion to be an offence in the foreign country concerned. It is also a requirement that the offence would be regarded by the UK courts as equivalent to the UK offence of fraudulent evasion of (UK) tax.

Similarly, the stage 2 offence requires the person associated with the company to commit a facilitation offence under the law of the foreign country, which the UK courts would consider to be equivalent to a UK tax evasion facilitation offence.

However, whilst any company (whether UK or foreign) can commit the UK FTP offence, a foreign company will only commit the Foreign FTP offence if there is sufficient UK nexus (see table overleaf). For a UK company, by virtue of being incorporated in the UK, there is sufficient UK nexus for it to be liable for the Foreign FTP offence.

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| UK FTP offence – evasion of UK tax | Foreign FTP offence – evasion of non-UK tax |
|---|--|
| <ul style="list-style-type: none">• Relevant body can be incorporated anywhere – whether in the UK or outside the UK.• It is irrelevant where the conduct committing the UK tax evasion or facilitating the UK tax evasion takes place – it does not need to be in the UK. | <p>One of 3 "UK nexus" conditions needs to be satisfied:</p> <ul style="list-style-type: none">A. The relevant body is incorporated, or partnership formed, in the UK;B. The relevant body carries on a business or part of a business in the UK ("business" includes a branch); orC. Any conduct constituting part of the foreign tax evasion facilitation offence takes place in the UK. <p>Thereafter, it is irrelevant where the conduct committing the foreign tax evasion or facilitating the foreign tax evasion takes place.</p> |

There are examples demonstrating the application of the UK and Foreign FTP offences, overleaf.

WHO IS A "PERSON ASSOCIATED"

WHOSE ACTIONS CAN THE COMPANY BE RESPONSIBLE FOR?

A person is associated with the company if the person is:

- an employee of the company,
- an agent of the company, or
- any other person who performs services *for or on behalf of* the company.

This test is very wide, and a company should consider who it can control, either contractually or through its organisational structure, and where it outsources services. The "person associated" must be acting in their capacity as an employee, agent or service provider to trigger liability for the company, and HMRC's guidance acknowledges that a person will not be acting in that capacity if they facilitate tax evasion in their private life or on a 'frolic of their own'. The key question is whether the person facilitates tax evasion whilst performing services for, or on behalf of, the company.

The test is wide enough to make a company liable for the actions of third party organisations, such as suppliers and subcontractors, and, potentially, organisations to which it refers work.

EXAMPLES OF POTENTIAL THIRD PARTY ASSOCIATED PERSONS

Business suppliers

- Professional advisors
- Trust or company service providers

Contractors and subcontractors

- Distributors & franchisees
- Consultants

Intermediaries

Subsidiaries

Joint venture partners and entities

"Back office"/outsourced service suppliers

- Catering, IT, facilities and maintenance suppliers
- HR/payroll providers

EXAMPLES

The examples below are for illustration purposes only and are not based on any known circumstances.

EXAMPLE 1

A UK based car manufacturer operates a number of different dealer agreements, including an arrangement with a car parts supplier (also based in the UK), which is authorised by the car manufacturer to supply car parts for its car models to third party garages. A director of the car parts supplier assists the owner of one of the garages to recover more UK VAT than due on the supply of the car parts through a false invoicing scheme. *An employee of the car parts supplier has facilitated the evasion of a UK tax. There is a real risk that the car parts supplier could be an associated person of the car manufacturer. If so, the car manufacturer would be criminally liable for the UK FTP offence unless it could satisfy the reasonable procedures defence.*

EXAMPLE 2

A large international haulier, headquartered in France, uses a UK based driver agency to source its UK drivers and administer UK payroll functions. A number of the drivers, in consultation with staff at the agency, agree to proceed on the basis that the drivers are self-employed, even when they all know that this is incorrect, and a significant number of drivers are paid "off-payroll", in cash. Many of the drivers do not declare their income to HMRC. *Staff at the driver agency have facilitated the evasion of UK tax and NICs, and the agency is likely to be an associated person of the haulier. If so, the haulier would be criminally liable for the UK FTP offence unless it could satisfy the reasonable procedures defence.*

EXAMPLE 3

A UK bank refers a wealthy German client to its wealth advisory team in its Swiss branch. The advisory team in Switzerland *knowingly* facilitates the evasion of German income tax by setting up offshore bank accounts to help the German individual avoid declaring his income to the German tax authorities. *The UK bank could be found guilty of failing to prevent its associated persons (employees in its Swiss branch) from facilitating the evasion of foreign taxes. It is an offence in Germany to evade tax, and to facilitate the evasion of tax, as it is in the UK. The fact that the bank is incorporated in the UK is sufficient for the Foreign FTP offence to be charged, even though the tax evaded is not a UK tax, and the conduct facilitating the tax evasion occurred outside the UK.*

PROSECUTION AND PENALTIES

If a company is found guilty of either FTP offence, it could be liable for financial penalties. There is no penalty cap in the legislation, so the penalty could be unlimited. The company could also be subject to ancillary orders, such as confiscation orders or serious crime prevention orders.

The UK FTP will be investigated by HMRC, with prosecutions brought by the Crown Prosecution Service ("CPS"). The Foreign FTP offence will be investigated by the Serious Fraud Office ("SFO"), or the National Crime Agency, and prosecutions brought by the SFO or the CPS. Due to the extra-territoriality of the Foreign FTP offence, proceedings cannot be brought against a company for this offence unless the Director of Public Prosecutions or the Director of the SFO gives their consent. HMRC's draft guidance states that it will be preferable for the jurisdiction that has suffered the tax loss to bring any prosecution.

It is likely that there would be adverse publicity for a company found guilty of a FTP offence, and a regulated business would need to consider the regulatory impact resulting from any prosecution.

THE DEFENCE

REASONABLE PREVENTION PROCEDURES

It is a defence for the company to prove that, at the time its associated person facilitated the tax evasion offence, it had in place prevention procedures that were reasonable in all circumstances. Companies should conduct a risk assessment of where its associated persons could facilitate tax evasion, which will inform the type of policies and procedures that the company should implement.

The procedures do not have to be fool-proof – if they fail to prevent an associated person from facilitating tax evasion, the company will still be able to claim the defence as long as the procedures were "reasonable in all circumstances".

What is considered "reasonable in all circumstances" will depend upon the particular business of the company. HMRC's draft guidance confirms that the procedures should be proportionate to the risk the company faces. High-risk factors, which mean that more robust policies and procedures are required, include:









| High risk factors | Examples |
|---|---|
| Does your business operate in, or use services in, high-risk countries ? | <ul style="list-style-type: none"> • Countries that are not signed up for the Common Reporting Standard – click here for list • Countries that are low on the OECD's international tax transparency ratings – click here for list |
| Does your business operate in high-risk sectors ? | <ul style="list-style-type: none"> • Financial services • Tax advisory services • Legal services • Fiduciaries and trusts • Company service providers and other corporate infrastructure providers (e.g. virtual offices) |
| Is your business involved in high-risk transactions ? | <ul style="list-style-type: none"> • Complex supply chains • High value projects • Numerous parties and/or jurisdictions • Transactions involving intermediaries • Cash transactions/cash-intensive businesses |
| Does your business transact with high-risk customers ? | <ul style="list-style-type: none"> • Non-resident customers |

The UK Government does not expect the same level of procedures to be in place on the first day of the new offences coming into force (likely to be 1 September 2017, although this is still to be confirmed), as it does after the offences have been in place for a few years. However, companies should have an action plan for implementation by 1 September 2017, and be progressing this to a good timetable.

Various industry representative bodies are producing sector guidance, which companies should consider alongside HMRC's general guidance.

WHAT COULD THE PREVENTION PROCEDURES INVOLVE?

"Reasonable prevention procedures" refers to both formal policies and the practical steps taken to enforce compliance. Formal policies can be incorporated into existing Anti-Money Laundering and Bribery Act prevention policies. However, the policy must consider the risk of tax evasion facilitation independently – it will not be enough to simply add "including tax evasion" to existing policies and training manuals. Prevention policies will need to be regularly reviewed to reflect changes to the company's risk. Here are some examples of procedures:

| | |
|--|---|
|  <p>Formal policy on preventing the facilitation of tax evasion. Formal commitment not to recommend services of other organisations that do not have equivalent standards on tax evasion prevention.</p> |  <p>Senior management commitment to preventing the facilitation of tax evasion and a communication of this stance internally and externally (on website, and notification to third party associated persons).</p> |
|  <p>Internal training for employees and encourage external associated persons to have similar training in place.</p> |  <p>Contractual terms & conditions with associated persons (e.g. in employment contracts, commercial contracts).</p> |
|  <p>Due diligence on associated persons - this could, for example, include due diligence on a supplier's policies and procedures.</p> |  <p>Monitor compliance by supervising employee work.</p> |
|  <p>Decide disciplinary procedures for breach by employees.</p> |  <p>Clear whistle-blowing pathway, and protection for whistle-blowers.</p> |

HOW CAN WE HELP?

Travers Smith can help - we have experience in assisting companies to implement similar procedures for UK Bribery Act 2010 purposes. We can provide training, standardised compliance implementation packs, or a tailored service for your business.

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TIER 1 SUPPORT

Template document pack, including:

- Policy document and short form statement
- Guidance setting out an explanation of the offences and requirements for the reasonable procedures defence
- Contractual protection for typical agreements – e.g. share purchase agreements, commercial contracts, investment agreements, executive service contracts, employment contracts
- Due diligence questionnaires
- Risk assessment checklist, and
- 2 hour board training session (if desired).

TIER 2 SUPPORT

- Assistance to analyse the risks to your specific business
- Tailoring the template document pack to reflect the specific risks identified, including providing contractual provisions relevant to your business
- Assisting to prepare a realistic implementation timeline, and
- Bespoke training, both at board level and also to other top-tier management (if desired).

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