Failure to prevent the facilitation of tax evasion: an update

Jenny Wheater
Linklaters

Mavnick Nerwal
Linklaters

Introduction

The new offence of failure to prevent the facilitation of tax evasion came into force on 30 September 2017. It has caused some concern within the investment fund industry given its potentially wide remit and the increased media attention to any suggestion of impropriety in relation to tax. However, some comfort has been gained from discussions between the BVCA and HMRC, during the course of which the anticipated approach of HMRC should serve to secure a sensible interpretation of the law.

Actual offence

The new offence is contained in what is now the Criminal Finances Act 2017 and is, in reality, two separate offences. The first is the offence of failure to prevent the facilitation of UK tax evasion (the "Domestic Offence"). The second is the offence of failure to prevent facilitation of foreign tax evasion (the "Foreign Offence"). However, they have some key features in common. In each case, a body corporate or a partnership (referred to as a "relevant body"), whether established for business or non-business purposes, may be prosecuted for failure to prevent the facilitation of tax evasion if:

- a person ("T") evades tax;
- an associate ("A") of the relevant body criminally facilitates that evasion while acting in the capacity of an associate of the relevant body; and
- the relevant body is unable to show they had in place "reasonable prevention procedures" (or that it wasn't reasonable for prevention procedures to be in place).

The offences are both strict liability offences and thus require no knowledge or intention on the part of the relevant body. T need not have been prosecuted for evasion and A need not have been prosecuted for criminal facilitation. T (or A) may in fact have made a disclosure of the evasion (or criminal facilitation) in order to secure immunity from prosecution or similar. However, T and A must nonetheless have committed the offences in question before any offence can be committed by the relevant body. As discussed further below, both evasion and facilitation have a high standard of knowledge and intention – thus, relevant bodies will not be exposed based on e.g. mere error by A or by T arranging his affairs in a tax-efficient manner not amounting to evasion. Strict liability may attach to the new offences but those which are necessarily committed first have a high degree of culpability.

A person is an "associate" of the relevant body if the person "performs services for or on behalf of" that body (for example, as an employee, agent or subcontractor). The substance of the relationship will be considered, not just the form. A relevant body will not, however, commit the offence if the associate commits the offence of facilitation on a personal basis – the action must be in their capacity of an associate of the relevant body. The concept of a person who "performs services for or on behalf of" the organisation is intended to be broad in scope, to embrace the whole range of persons who might be capable of facilitating tax evasion whilst acting on behalf of the relevant body. This is important in considering the potential scope of the offence and addressing reasonable prevention procedures discussed below.

The Domestic Offence can be committed by a relevant body irrespective of where they are established or carry on business, and whether or not any part of the criminal facilitation took place in the UK. In fact, wholly non-UK conduct by a non-UK entity can be included, if it is directed at the evasion of UK tax. In such cases, the government still considers that the new offence can be

tried by the courts of the UK. Again, while broad, this is necessarily subject to a defence based on reasonable (or even no) procedures. HMRC does appear to accept that it may not be reasonable for relevant bodies in such cases to even be aware this offence exists.

The Foreign Offence can only be committed where:

- the relevant body is established in the UK, or carries on any part of their business in the UK (for example, through a branch); or
- any part of the criminal facilitation took place in the UK.

Once again, this gives the law a broad extra-territorial scope: a body corporate may fall within scope and be capable of committing the Foreign Offence merely by virtue of having a UK branch, even if that branch is not itself involved in the facilitation or the evasion. Equally, technically speaking, a one-off business visit to the UK by an associate of an entity with little UK connection could result in the Foreign Offence being committed if the associates facilitates foreign evasion during the visit.

For the Domestic Offence, a UK tax evasion offence is the common law offence of cheating the public revenue and an offence in any part of the United Kingdom consisting of being knowingly involved in, or taking steps with a view to, the fraudulent evasion of tax. In the case of the Foreign Offence a foreign tax evasion offence has two elements. First, it must be criminal offence under the law of the foreign territory relating to tax imposed under the law of that country, and second, it must involve conduct which would be regarded by the UK Courts as an offence of being knowingly concerned in, or taking steps with a view to, the fraudulent evasion of tax (if it had occurred in the UK).

Facilitation, as anticipated, is subject to a wide interpretation. The person must do an act anticipating that it will assist another person to evade UK tax. Examples in the draft HMRC guidance (the "Guidance") of activities potentially amounting to facilitation (if conducted with the necessary intention to assist the evader), include:

- Delivery and maintenance of infrastructure - for example, trust and company formation and setting up and maintaining bank accounts.
- Financial assistance – helping an evader move money around, providing banking services.
- Acting as a broker or conduit – i.e. arranging access to others in the supply chain.
- Providing planning advice.

It is a complete defence to both of the offences if the relevant body can prove that, when the tax evasion facilitation offence was committed, either (a) the relevant body had in place reasonable prevention procedures; or (b) in all the circumstances it was not reasonable to expect the relevant body to have any prevention procedures in place.

Prevention procedures are those designed to prevent associates from committing tax evasion facilitation offences. As with the Bribery Act, the Guidance states that the formulation of measures to prevent facilitation should be informed by the following six principles:

- Risk Assessment;
- Proportionality of risk-based prevention procedures;
- Top level commitment;
- Due diligence;
- Communication (including training); and
- Monitoring and review.

The Guidance recognises that procedures may leverage existing controls. However, the appropriateness of controls will need to be informed by a considered risk assessment, and simply adding "and tax evasion" to a long list of diverse prohibited activities under existing ethics policies is not expected to be sufficient.

Unlimited fines can be imposed upon conviction and orders for confiscation of assets may also be made. In order to encourage self-reporting by relevant bodies, Deferred Prosecution Agreements (DPAs) will also be an available tool for prosecutors. DPAs, which are a mechanism for resolving certain types of offending by corporate entities, involve charges being laid but the prosecution being suspended for a specified period provided certain agreed conditions are met.

Application to private equity

The question of how this legislation applies to the private equity fund industry is highly dependent upon the private equity house involved but a number of key areas can be identified as requiring general attention.

Portfolio companies themselves need to consider the rules on a separate basis but the interaction between the private equity house and the portfolio company results in the potential for some ambiguity and areas of risk. For example, a director of a portfolio company who is an appointee of the private equity house arguably has a dual potential capacity as an "associate". Clearly they are a director of the portfolio company but they may also be acting as an associate of the private equity house in relation to their director activities. Thus, reasonable prevention procedures may need to consider this aspect of the role of employees and other possible "associates". Discussions with HMRC have elicited the understanding that, in cases in which an individual can have more than one capacity, the focus is on their capacity when committing the offence. The issue is to ascertain the entity on whose behalf they are acting at the time of committing the actions amounting to the offence.

The breadth of the term "associate" and its extension to those performing services for an entity is also something private equity houses will also need to consider. Helpfully, HMRC have suggested in discussions that only in exceptional circumstances would a portfolio company itself be regarded as an "associate" of the private equity fund or manager. It would appear that the expectation is that the facilitator is invariably an individual. Nonetheless, although portfolio company issues are unlikely to result in issues for the private equity house in terms of the new offence, it is important from the point of view of potential future sale to ensure that portfolio companies have their own reasonable procedures in place.

International issues may also require careful review. It is fair to say that most UK private equity houses have some kind of international activity or presence and this, again, could present issues. If an individual employee of a private equity house is also a board member or employee of e.g. the Luxembourg General Partner of a fund, they could be considered to be acting in that capacity in certain circumstances and, given the breadth of the Domestic Offence, any activity in Luxembourg by an associate of the Luxembourg GP might still be subject to the new rules. Thus, reasonable prevention procedures need to take this into account and may need to extend to the GP itself.

The concept of what amounts to "reasonable" in terms of prevention procedures will require some internal analysis and this will need to be considered on a case-by case basis. However, some assistance has been obtained in the course of HMRC discussions. Risk assessment is regarded as extremely important. Indeed, taking fewer steps to address the offence, but targeting those steps to risk areas may even be looked upon more favourably than a non-targeted approach. Accordingly, private equity houses who have not yet reached the point of having procedures in place should focus their attention on risk assessment. High level commitment is another area emphasised by HMRC. It is crucial that senior personnel are seen to endorse and support steps taken to address the new offence.

Actual risk assessment documents and related procedures will vary according to the size and complexity of the organisation in question.

Further help

The BVCA website has the BVCA guidance and slides from the seminars on a dedicated page:

www.bvca.co.uk/Policy/Tax-Legal-and-Regulatory/Matters-on-our-agenda/Taxation/Failure-to-prevent-the-facilitation-of-tax-evasion-offence