Failure to prevent tax evasion

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Introduction

In recent years, HMRC has increased its focus on legislation designed to influence the behaviour of taxpayers and their advisers. In contrast to what might be termed conventional "revenue raising" legislation which imposes additional requirements to actually pay tax, this type of legislation is designed to encourage taxpayers to take courses of action which result in a greater yield for the exchequer, notwithstanding that they may have a choice not to do so. The first example of this was the disclosure of tax avoidance schemes ("DOTAS") regime, which has expanded significantly since its inception. A return including a reference number under DOTAS is not calculated any differently for tax purposes. However, many taxpayers are aware that the very reference number itself will not endear them to HMRC and may trigger an enquiry or other undesirable consequence. If the result is that such taxpayers do not enter into potentially tax saving arrangements simply to avoid the DOTAS reference, HMRC benefits, without actually imposing a specific tax charge.

HMRC have regarded DOTAS as a successful regime and the same concept of influence can now be found in other areas. The most recent of these is the new corporate offence of failure to prevent tax evasion, legislation which owes much of its wording to the Bribery Act.

The new offences

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. 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.

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.

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);
- 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.

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. Crucially, private equity houses need to consider how these new rules apply not only to them directly, but also to other entities within the structure and to their portfolio companies. 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".

The breadth of the term "associate" and its extension to those performing services for an entity is also something private equity houses will need to consider very carefully. For example, if a portfolio company engages a firm of advisers which has a more aggressive approach to tax planning than the private equity house might think appropriate, there is a danger that the portfolio company could be regarded as committing the offence through the activities of such adviser if they e.g. advise executives of the portfolio company to conduct their affairs so as to engage in tax evasion. Even non-tax advisers who recommend a particular firm or individual to assist in possibly dubious tax arrangements, could be regarded as acting in their capacity as associate of the portfolio company and facilitating tax evasion. This type of potential scenario results in the need for private equity houses to review with their portfolio companies who their advisers and other contractors are and what their remit is. The category of service providers as associates has the potential to create situations in which the portfolio company may be guilty of an offence in circumstances concerning which the private equity house was wholly unaware.

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, all private equity houses will need to approach with care to ensure that they have performed appropriate reviews as to their position and what they are required to do in order to secure protection from potential criminal liability.

Timing

Originally, relevant bodies were required to have their prevention procedures in place by September when the legislation was due to come into effect. However, the upcoming general election may have served to alter this.

In an accelerated progression, the Criminal Finances Bill passed its final stage in the Parliamentary process, as the House of Commons considered the amendments that were introduced in the House of Lords the day before. The Bill then received royal assent on 27 April 2017, thus becoming the Criminal Finances Act 2017. However, although the Act has now become law, key aspects

such as the elements relating to failure to prevent tax evasion require a separate commencement order before coming into force. It is not yet clear when this will happen. There has been some suggestion that it could be as early as September or October 2017, but whether or not that is the case, HMRC has made it clear that relevant bodies cannot wait until the Act comes into force before taking action to prepare for the new corporate tax offence.

To help members get to grips with their responsibilities in this area the BVCA will be arranging a series of workshops before the Summer break. We are also arranging to meet HMRC to discuss industry-specific issues before the Summer and will flag up any helpful thoughts or guidance to emerge from that process. But, given the likely timetable, members need to start work on this legislation now, both at the level of their own businesses and at portfolio company level. A first step would be to identify risk areas, where an associate could get involved in facilitating tax evasion, and introduce or modify procedures to try to stop that happening. The implications, in terms of the house's reputation as well as the new rules, are too serious not to put appropriate, tailored processes in place.