# The New UK Corporate Offence of 'Failure to Prevent the Facilitation of Tax Evasion': Implications for Fund Managers and Investors

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The U.K. government expands its crackdown on tax evaders and the persons who assist them, by targeting businesses who fail to prevent tax evasion.

## Overview

The U.K. government has published draft legislation in the Criminal Finances Bill (Bill) that will impose criminal liability on businesses that fail to prevent their employees, agents and other "associated persons" (Associated Persons) from facilitating tax evasion.

To protect against liability, fund managers and other affected persons must have reasonable preventative procedures in place as soon as the new offences come into force (which is expected to be in the first half of 2017), and should now be assessing their businesses in light of the six "Guiding Principles" (Principles) issued by HM Revenue & Customs (HMRC).

The offences will also apply equally to portfolio companies. Due to the U.K. government's belief that the financial services sector poses higher risks of facilitating tax evasion, the procedures that fund managers and others working in the financial services sector (including administrators, custodians, compliance consultants and other service providers to the funds industry) must put in place will be more substantial than for businesses in sectors considered less risky.

Investors, who do not enjoy significant levels of control in traditional fund structures, are unlikely to be caught by the new legislation, because the actors in the fund structure are unlikely to be Associated Persons. However, those involved in joint ventures, managed accounts or similar structures in which their influence is stronger than usual should consider whether their additional rights could make joint venture parties and other participants  Associated Persons and bring the investors within the scope of the legislation.

In addition, investors should seek to ensure that fund partnerships in which they invest have reasonable procedures in place to prevent offences by associated persons, including fund managers and professionals acting on behalf of the fund. Given that the fund is effectively established by the manager, it would seem counterintuitive for the fund to have to analyze its relationship with the manager in this way, but while the guidance issued by HMRC accepts that in certain circumstances it may be reasonable for there to be no procedures in place, this would seem to be a risky view to take unless and until it is confirmed by subsequent guidance.

## Background to the New Criminal Offence

The Bill had its first reading on October 13, 2016. It introduces two new corporate offences relating to the failure to prevent  Associated Persons from: (i) facilitating U.K. tax evasion or (ii) facilitating foreign tax evasion.

This follows significant consultation by HMRC during the course of 2015 and the release of draft legislation and guidance for comment between April and October 2016. As stated by the Home Office in its press release accompanying publication of the Bill, the new offences are aimed at "sending out a clear message that anyone doing business in and with the UK must have the highest possible compliance standards."

### Basic Components

HMRC's draft guidance (updated in October 2016) makes clear that both offences are founded on three basic components:

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- criminal tax evasion by a taxpayer (either an individual or a legal entity) under existing law;
- criminal facilitation of the tax evasion by an Associated Person of a "relevant body" (Relevant Body) (while acting in the capacity of an Associated Person); and
- failure by the Relevant Body to prevent its Associated Person from committing the criminal facilitation act.

Where the tax evasion is in relation to foreign tax, two additional criteria must be met, namely: (d) the Relevant Body must have a sufficient U.K. nexus (*i.e.*, it must be incorporated or conducting business in the U.K., or its Associated Person must have carried out the criminal facilitation in the U.K.); and (e) there must be dual criminality (*i.e.*, the conduct of both the taxpayer and the facilitator must be recognised as criminal in both the U.K. and the jurisdiction to which the foreign tax relates).

**Key Concepts**

Clearly, Relevant Body and Associated Person will be key concepts for the purposes of these new offenses. Potentially problematic from a compliance perspective, however, is that both concepts have a variety of definitions.

Pursuant to Part 3 of the Bill, a Relevant Body may be a body corporate or partnership (wherever incorporated or formed) or a firm or entity of a similar character formed under the law of a foreign country. Similarly, a person will be acting in the capacity of a person associated with a Relevant Body where the person is: (a) an employee of the Relevant Body acting in the capacity of an employee; (b) an agent of the Relevant Body acting in the capacity of agent; or (c) performing services for or on behalf of the Relevant Body and acting in the capacity of a person performing such services. Circumstance (c), in particular, expands the definition of Associated Person to a potentially significant range of entities.

**Primary and Secondary Offences**

In order for either new offence to be committed, both a primary tax evasion offence and secondary "facilitation" offence must first be committed, albeit neither needs to be successfully prosecuted for the new offence to apply.

Current U.K. law contains various statutory tax evasion offences (usually requiring the taxpayer to have been knowingly concerned in the evasion, or in the case of certain taxes, knowingly taking steps with a view to the deliberate and dishonest nonpayment of tax), as well as a more general common law offence of cheating the public revenue (*i.e.*, carrying out deliberate and dishonest conduct (including omissions) with the intention of defrauding the revenue by failing to pay sums lawfully due). As currently drafted, the Bill allows for any of these offences to satisfy the requirement of a primary tax evasion offence.

Similarly, current U.K. law provides a range of facilitation offences relevant to tax evasion, because facilitators may be caught both under the same statutory provisions as the primary taxpayer (as a person knowingly concerned in the evasion, or in the case of certain taxes, knowingly taking steps with a view to the deliberate and dishonest nonpayment of tax by another person) or through the wider "aiding and abetting"-style criminal offences provided by the Serious Crime Act 2007 (*i.e.*, by encouraging or assisting the tax evasion offence either intentionally or believing that the offence would be committed). Again, the Bill allows for any of these offences to satisfy the requirement of a secondary facilitation offence.

Once it is found that a primary tax evasion offence has been committed by a taxpayer and an Associated Person of a Relevant Body committed a secondary facilitation offence in relation to that primary offence (and, where the primary tax evasion offence relates to foreign taxes, the Relevant Body has a sufficient U.K. nexus and there is dual criminality), the Relevant Body is *prima facie* liable for the relevant new corporate offence as a matter of strict liability. Crucially, it is not necessary for there to be any desire or purpose on the part of the Associated Person to benefit the Relevant Body through committing the secondary tax evasion facilitation offence.

**Reasonable Prevention Procedures Defence**

The new provisions allow a defence if the Relevant Body can show reasonable procedures were in place to prevent its Associated Persons from committing any secondary facilitation offence.

The prevention procedures must be those which it would be reasonable in all the circumstances to expect the Relevant Body to have implemented.

These are considered further below in the context of the fund management industry.

**Prosecution and Penalties**

While prosecution under either of these new offences must first satisfy a "public interest" test, in the current political climate it must be expected that multinational organizations will be under scrutiny with a view to being investigated and possibly prosecuted. The examples in the guidance in which prosecution would not be in the public interest relate to matters that do not respect human rights or are in some way discriminatory.

Conviction carries significant penalties. Relevant Bodies face the possibility of unlimited financial penalties as well as other orders, such as confiscation or serious crime prevention orders, not to mention potentially significant reputational damage. Where the Relevant Body in question is also a regulated entity, conviction is likely to have additional knock-on effects for its ability to continue in business.

These penalties on the entity itself are in addition to any penalties or prosecutions that may result from the primary and secondary offences for the actual taxpayer and facilitator involved.

### Implementation

The Bill, currently progressing through Parliament, was given its second reading on October 25, 2016. While there is still a way to go before it receives royal assent, passage of the Bill thus far has been unusually rapid, and there is speculation that it will come into force as early as April 2017. (Initially proposed amendments were withdrawn, despite being viewed favorably by the British government, because of the desire to implement the new law as quickly as possible without significant distraction from considering in detail the suggested changes. However, recently some amendments that would expand the scope of the offence, but they have not yet been conclusively debated.) It is likely that the government will want to stick to its fast pace and so may encourage deferral of these amendments where possible.

Current HMRC guidance provides for an initial implementation period (during which a lower threshold should apply for the "reasonable preventative procedures" defence), but it goes on to highlight that "[at] the same time the Government expects there to be rapid implementation, focusing on the major risks and priorities, with a clear timeframe and implementation plan on entry into force."

## Implications for Fund Managers

### Who Is Caught?

The definition of Relevant Body is likely to capture most private and registered funds with any degree of U.K. nexus, whether as a result of U.K. or foreign tax evasion (provided the latter is also a criminal offence in that jurisdiction). The general partner and manager of the fund, together with the fund's lawyers, accountants, administrators and third-party alternative investment fund managers (AIFMs) are likely to be considered Associated Persons in their capacity as agents of, or service providers to, the fund. Accordingly, if a fund fails to put in place reasonable prevention procedures to prevent the commission of the secondary "facilitation" offence by these Associated Persons, the fund could be guilty of the new criminal offence.

Similarly, the manager itself may be a Relevant Body for the purposes of the Bill and could be held criminally liable if it fails to prevent its employees or service providers from being involved in the criminal facilitation of tax evasion. Even if a manager is based offshore, the new offence could still be committed if U.K. tax is evaded, provided that any of its Associated Persons is guilty of the secondary "facilitation" offence.

### Implications of Criminal Conviction

From a regulatory perspective, a criminal conviction in the U.K. is likely to be disclosable to the regulator of the manager, with potential adverse implications on the manager's regulatory status and ability to carry on business as usual.

### Application of the 'Guiding Principles' to Fund Managers

1. Risk Assessment

The Principles are intended to be "outcomes focussed" and flexible and should be proportionate to risk. When assessing risk, fund managers must "sit at the desk" of their employees, agents and other Associated Persons and ask whether they have a motive, the means and the opportunity to criminally facilitate tax evasion offences and, if so, how this risk might be managed. The Principles make clear that it will be insufficient to simply add "tax" to the list of other procedures such as Know Your Customer (KYC), anti-bribery and corruption policies.

Common themes will include oversight of risk assessment by senior management, allocation of appropriate resources, identification of information sources to enable risk assessment and review, due diligence, documentation of the risk assessment, periodic review, procedures to identify emerging risks and internal challenge to risk assessments.

Fund managers may wish to consider risks based on the Bribery Act guidance: country risk, including secrecy and whether the country subscribes to the Common Reporting Standard, sectoral risk, transaction risk, business opportunity risk, business partnership risk, product risk and customer risk. The Joint Money Laundering Steering Group (JMLSG) guidance on high and low risk factors may also be considered.

Risk assessment should consider whether internal structures, procedures and "culture" add to the level of risk. These would include deficiencies in training, a compensation culture encouraging excessive risk taking (which should be unlikely in the financial services sector), lack of clarity, deficiencies in submission of Suspicious Activity Reports (SARs), lack of whistleblowing procedures and lack of clear messaging from management.

Given the view that the financial services industry presents higher sectoral risk of facilitating tax evasions, it would seem unwise to exclude any of the example procedures on proportionate grounds, unless there are good and well documented reasons for doing so.

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2. Proportionality

The prevention procedures that will be reasonable are likely to include common elements, such as a clearly articulated risk assessment, top-level commitment, articulation of the approach to mitigating risks, overview of strategy and timeframe to implement policies, monitoring and enforcing compliance, reviewing procedures for effectiveness, clear pathway for reporting wrongdoing, protection for whistle-blowers and commitment to compliance over profit.

3. Top-Level Commitment

Senior management will likely be expected to take responsibility for implementing prevention measures, to endorse the policy, to have responsibility for awareness raising, to engage with Associated Persons and external bodies, to be responsible for certifying the assessment of risk, to implement and oversee disciplinary procedures and to commit to adequate whistleblowing processes.

4. Due Diligence

Due diligence procedures should be capable of identifying the risk of criminal facilitation of tax evasion by Associated Persons. This may mean that certain business groups may require increased scrutiny based on the risk assessment.

The examples in the Principles state that for a low-risk business it may only be necessary to perform due diligence on counterparties rather than further along the supply chain. Given the examples stating that the financial services industry is higher risk, this suggests that consideration should be given to persons with whom fund managers deal indirectly as well as directly.

5. Communication (Including Training)

The firm should seek to ensure that its policies and procedures are communicated, embedded and understood throughout the organization, through internal and external communication, including training. Internal communication should make clear the firm's zero tolerance policy and the consequences of breach, and should provide clear lines of communication for persons who have questions. External communications can act as a strong deterrent to those who might otherwise seek to use the firm's services to further illegal activity.

Training is likely to include the firm's policies and procedures, an explanation of when and how to seek advice and report suspicions, an explanation of what constitutes U.K. and foreign "tax evasion" and associated fraud, an explanation of the employee's legal duties, a summary of the penalties, and an overview of the social and economic effects of failing to prevent tax evasion.

Firms publishing their U.K. tax strategies online may also wish to include a statement relating to this topic.

6. Monitoring and Review

The nature of the risks faced will change over time, and the firm should seek internal feedback, perform periodic reviews and work with representative bodies to review their procedures. This might include engaging with industry bodies such as the British Venture Capital Association (BVCA) or the Alternative Investment Management Association (AIMA). Industry bodies can put forward their guidance to HMRC for endorsement.

The manager will also bear the burden of demonstrating in court that it has established effective procedures to prevent the involvement of those acting on its behalf in the criminal facilitation of tax evasion. A suitable audit trail of tax compliance training and procedures should therefore be implemented.

### Fund Documents

Fund documents and investor side letters often include warranties or undertakings from the general partner and manager confirming that they are not in breach of any laws and regulations that may have a material adverse effect on the fund. It is likely that managers should also seek to communicate their policies and procedures to investors, both to demonstrate their own compliance and also to assist investors with their own due diligence.

The offering memoranda and marketing documents may also need to be updated to include appropriate investor disclosures and risk factors relating to the possibility of the fund or manager (or portfolio companies) being held criminally liable for actions attributable to their Associated Persons.

### Service Provider Contracts

Managers may also wish to incorporate appropriate contractual and indemnity protections in their service provider contracts. These could include specific warranties from the relevant service provider confirming that it has not (and will not) engage in activities that could result in the secondary "facilitation" offence, as well as undertakings to implement appropriate tax compliance training and procedures for the staff that routinely provide services to the manager or the fund.

It seems likely that, in line with the Principles' focus on communicating the firm's commitment to third parties, managers may be expected to ensure that contracts with service providers require counterparties to confirm their compliance and commitment to comply with the ongoing assessment and other requirements of the Principles.