# News Analysis: U.K. Targets Criminal Facilitation of Tax Evasion

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By

NANA AMA SARFO

It has been nearly 18 months since the Panama Papers leak revealed a global network of politicians and other elites who stashed vast amounts of wealth in offshore companies created and managed by Panamanian law firm Mossack Fonseca.

Although offshore structures aren't illegal — the companies that Mossack Fonseca creates are incorporated within the bounds of the law — the optics of the scandal were devastating, especially for political leaders who publicly decried tax avoidance while burying their own assets in shell companies.

Unsurprisingly, the disclosures left several governments scrambling to remedy the damage and investigate politicians and other taxpayers implicated in the leaks. Chief among the casualties was former Pakistani Prime Minister Nawaz Sharif, who was not specifically named in the papers but was permanently removed from his post in July by the Supreme Court of Pakistan after the Panama Papers reported that his children owned offshore companies that were not mentioned in his family's wealth statement.

Former Icelandic Prime Minister Sigmundur Davíð Gunnlaugsson stepped down last April, just two days after the Panama Papers alleged that he and his wife owned an offshore company in the British Virgin Islands.

In the United Kingdom, the scandal ensnared former Prime Minister David Cameron, who admitted that he had owned a stake in an offshore trust established by his late father. The Panama Papers provided the perfect climate for the U.K. to introduce, fast-track, and pass criminal finance legislation that holds corporate entities liable for facilitating tax evasion, among other measures.

Money laundering, tax evasion, and financial crime were already in the U.K.'s public discourse before the Panama Papers were released, but the leaks lent a layer of urgency to the discussion. On September 30 the newest weapon in the U.K.'s financial crime arsenal — the corporate offense of the failure to prevent the criminal facilitation of tax evasion — will go live, complementing other recently enacted anti-corruption and anti-bribery laws.

It will work in tandem with the U.K.'s relatively new deferred prosecution agreement regime, which has already been applied to several high-profile bribery cases and will continue to grow in robustness, according to recent remarks by a former U.K. anti-corruption official.

The criminal facilitation law and its potential use with deferred prosecution agreements bears some resemblance to the United States' recent corporate criminal tax enforcement activity. Although the U.S. does not have a failure-to-prevent law, it does have a history of slapping organizations with tax-related conspiracy charges and resolving some of those cases with deferred prosecution agreements.

If recent developments are a predictor of events to come, corporate entities doing business in the U.K. may want to familiarize themselves with the U.K.'s policy on deferred prosecution agreements in preparation for the possibility that HM Revenue and Customs will lean considerably on the agreements.

## The Old Legal Landscape

U.K. common law imposes criminal liability on corporations for economic crimes, but it is extremely difficult to successfully prosecute businesses on those grounds. The problem is that U.K. prosecutors must show that the so-called directing mind and will of an organization — the board of directors or senior management — knew about and participated in the criminal activity. Understandably, it has been challenging to apply this standard, known as the "identification doctrine," to large multinational corporations whose boards and top management typically are not intimately involved with everyday business decisions.

And corporations know how to game the system. According to HMRC, the identification doctrine may have created a disincentive for senior management to actively investigate potential criminal tax-evasion activity, in order to protect the corporate body. The standard also may have created a disincentive to internally report potential criminal activity, since senior management would legally have to act on that information.

In a classic case of the adage "No good deed goes unpunished," companies that actively sought to comply with the law were the most burdened by their commitment to be lawful, and companies that lacked good corporate governance and reporting procedures were harder to prosecute, according to HMRC.

Meanwhile, the U.K. government kept missing opportunities to prosecute corporations for economic crimes. In late 2015 the Crown Prosecution Service (CPS), the public prosecuting service for England and Wales, essentially threw up its hands in exasperation and said it was being thwarted by the identification doctrine. CPS had wanted to impose criminal liability on Rupert Murdoch's News Group Newspapers for its well-publicized phone-hacking scandal but had to abandon the effort because there wasn't enough evidence to reasonably pursue the matter.

In a press statement, CPS said that the U.K.'s corporate liability law makes it difficult to prove that a company is criminally liable when it benefits from criminal activity committed by a regular employee who does not meet the directing mind and will test.

"Unlike other countries, the principles of vicarious liability or poor corporate governance, which are matters that are easier to prove, play no part in establishing corporate criminal liability," CPS said. "The present state of the law means it is especially difficult to establish criminal liability against companies with complex or diffuse management structures."

**The New Standard**

When CPS made its observation, British lawmakers had already enacted one major fix to the nation's corporate criminal liability scheme: the Bribery Act 2010.

The Bribery Act, which went into effect in July 2011, was created to tighten the U.K.'s bribery laws and make it easier to prosecute corporations for committing bribery offenses. The act created a new corporate criminal offense — the failure of commercial organizations to prevent bribery — and applies to entities with a U.K. nexus — companies or partnerships that are incorporated in the U.K. or conduct business in the U.K. Entities face prosecution under the act if an "associated person" engages in bribery on behalf of the organization. However, businesses that have "adequate procedures" in place to prevent bribery activities can rely on those protocols as a defense under the law.

If these provisions sound familiar, it's because the Bribery Act is the inspiration and model for the new criminal facilitation tax offense and its parent law, the Criminal Finances Act 2017.

The Criminal Finances Act 2017, which received royal assent in April, targets financial crimes like money laundering and the financing of terrorism.

Under the failure-to-prevent offense, any corporation that has a U.K. nexus and fails to prevent an associated person from criminally facilitating tax evasion can be held criminally liable for facilitation whether or not the organization knew about the activity. Companies do have a defense — they must prove that they had reasonable prevention procedures in place to prevent their associates from engaging in such activity.

The failure-to-prevent offense applies to U.K. tax-evasion crimes as well as foreign tax-evasion crimes, provided the criminal facilitation occurred in the U.K.

There are three parts to the law. First, a taxpayer must engage in criminal tax evasion. The taxpayer may be the corporate entity, an affiliate, or a client. The tax doesn't have to be successfully evaded, and a conviction at the taxpayer level is not necessary to ultimately pursue a criminal facilitation charge against a corporation.

Second, the taxpayer must have been aided by an "associated person" of the corporation who meant to deliberately and dishonestly facilitate the tax evasion. Associated persons are employees, agents, or people who perform services for or on behalf of the corporation.

Third, the corporate body must have failed to prevent its associate from engaging in criminal activity, unless it can claim the reasonable prevention procedures defense.

Importantly, the law applies only to companies and partnerships, not individuals.

There are several questions that will need to be resolved as the legislation matures, and chief among them is, what constitutes reasonable prevention procedures?

For now, certain sectors, particularly the heavily regulated financial services, accounting, and legal sectors, will have some comfort in complying with preexisting regulations — especially anti-money-laundering, anti-bribery, and anti-corruption regulations — and industry standards, according to Rupert Shiers and Claire Lipworth, London-based partners at Hogan Lovells International LLP. But the attorneys caution that risk assessments and preparation plans cannot start and stop with a review of current industry practices, no matter how stringent they may be.

"The government is extremely clear and the legislation is extremely clear that your processes must be tailored to the specific issue of preventing facilitation of tax evasion, and also to the granular day-to-day reality of your specific business needs," Shiers told Tax Analysts.

## Enforcement Tools

Businesses that are convicted under the failure-to-prevent offense could face unlimited financial penalties, confiscation orders, and serious crime prevention orders, in addition to deferred prosecution agreements, according to HMRC.

Deferred prosecution agreements became available in the U.K. in February 2014 under the Crime and Courts Act 2013. However, they have been used in the U.S. for more than 20 years and have been offered to and accepted by corporate entities in several high-profile criminal tax cases.

U.S. prosecutors have charged corporations on several different grounds, like conspiring to defraud the United States and IRS in violation of 18 USC section 371 or aiding and assisting a taxpayer in preparing fraudulent income tax returns, in violation of 26 USC section 7206(2).

In recent years, the U.S. Department of Justice has inked deferred prosecution agreements with several institutions, including UBS, Credit Suisse, Bank Leumi, and Julius Baer. Those agreements, in combination with the Justice Department's Swiss bank program — which led to several non-prosecution agreements with Swiss banks suspected of helping clients evade U.S. taxes — have provided a precedent for other nations to follow in combating tax-related corporate crime.

The U.K.'s failure-to-prevent offense differs in that corporations will not be charged for the underlying criminal evasion offense or for engaging in a conspiracy. Rather, they will be charged for their failure to prevent a tax-evasion crime regardless of their actual knowledge of the activity.

HMRC has also pledged to apply the law to all sectors and industries. Aside from the financial, legal, and accounting sectors, industries with a lot of cash payments, like the construction industry, will be obvious ones affected by the new law, Shiers said.

Although the U.K. will impose liability on a different basis, it already has some experience navigating failure-to-prevent deferred prosecution agreements thanks to the Bribery Act.

**The First Deferred Prosecution Agreements**

In November 2015 ICBC Standard Bank PLC became the first organization to enter a deferred prosecution agreement with the U.K.'s Serious Fraud Office, after the government alleged that Standard Bank had failed to prevent bribery. The alleged bribe was a $6 million payment that Standard's former sister company, Stanbic Bank Tanzania, had paid to a local Tanzanian organization to increase the bank's chances of being selected for a $600 million private placement with the Tanzanian government.

A group of employees within the Tanzanian unit reported the incident, which worked its way up the corporate chain of command to Standard, which was unaware of the bribe and immediately self-reported the payment to authorities.

The Serious Fraud Office followed that deferred prosecution agreement less than a year later in July 2016 with a second agreement with an unnamed U.K. small to medium-size company publicly referred to as XYZ Ltd. The government alleged that XYZ failed to prevent its agents and associates from offering bribes for foreign contracts.

In January the Serious Fraud Office entered its third agreement with Rolls-Royce PLC, which was accused of failing to prevent bribery in China, Malaysia, and Nigeria, among other charges. The Serious Fraud Office announced a fourth agreement with Tesco Stores Ltd. in April, but the details of that agreement have not been released.

The details of these cases are complex, but there are some notable facets of the three publicly released agreements.

All three companies were able to slash their penalties — Standard Bank by 33 percent, and XYZ and Rolls-Royce by 50 percent — just by cooperating with authorities. U.K. guidelines offer a standard 33 percent discount for companies that plead guilty at the earliest possible opportunity, and offer additional discounts based on various factors, such as a company's cooperation.

Standard Bank and XYZ both self-reported, but a British court that approved the deferred prosecution agreements gave XYZ a higher discount after noting that the Serious Fraud Office might not have discovered the company's fraudulent activity if it hadn't self-reported. The court also increased the discount based on XYZ's financial situation, as a higher penalty might have pushed the company into insolvency.

Rolls-Royce did not self-report and faced several charges for serious alleged misconduct. Despite these negative facts, the company received a 50 percent discount due to its "extraordinary cooperation" with the government's investigation, underscoring the power that cooperation holds within the U.K.'s deferred prosecution agreement regime.

The XYZ case is particularly notable because it demonstrates the long reach of the Bribery Act's failure-to-prevent provision. XYZ is owned by a U.S. parent, which ultimately paid the penalties associated with the matter, although it had no knowledge of XYZ's bribery activities and wasn't in a position in which it should have known. Given that the tax-related offense has a similarly long reach, similar cases may come out of that law.

**What Are the Implications for U.S. Companies?**

It is unclear just how difficult it will be for the U.K. government to seek charges against organizations that fail to prevent tax evasion. However, experiences from the Bribery Act indicate that failure-to-prevent charges are doable and should be expected. Furthermore, the message from the U.K. government has been strikingly clear: This is just the beginning.

In March Ben Morgan, the former joint head of bribery and corruption for the Serious Fraud Office, told an audience of lawyers from top corporations and financial institutions that deferred prosecution agreements will become the "new normal" for corporations that "behave responsibly."

"Disposal of corporate criminal risk through resolutions like those in Standard Bank, XYZ, and Rolls-Royce will become increasingly common," he said. "I have seen lawyers from some firms in the press saying DPAs are not sufficiently attractive, are not here to stay, or have no significance compared to the impact of regulation. In my view, they are wrong — not least because for obdurate companies, prosecution is the alternative."

So what do these developments mean for U.S. companies that have a U.K. nexus?

The XYZ case demonstrates that U.S. companies should not assume that the U.K.'s investigations will only touch U.K. domestic companies. The failure-to-prevent offense is clear about its extraterritorial reach, and we have already seen evidence of a similar reach with the Bribery Act's failure-to-prevent offense.

As organizations review their business protocols, they can rely on six flexible "guiding principles" that HMRC says organizations should consider as they build reasonable prevention procedures. These are:

- risk assessment;
- proportionality of risk-based prevention procedures;
- top-level commitment;
- due diligence;
- communication (including training); and

- monitoring and review.

What the principles offer in broadness, however, they intentionally lack in specificity.

For example, HMRC suggests that organizations should appropriately allocate resources toward monitoring their business risk and should train employees in a manner proportionate to the risks their businesses face. Those trainings could be incorporated into their existing financial crime training or could be highlighted in a separate training session that specifically addresses tax facilitation risks.

Ultimately, HMRC says that "reasonableness" is a facts-and-circumstances-based inquiry that will specifically depend on a business's unique needs and facts and will have to be played out in the courts. So organizations will have to stay tuned.

"Rather unhelpfully, there hasn't been a case in the U.K. where the adequate procedures defense in the Bribery Act has been tested," Jeremy Summers, a partner and head of business crime at Osborne Clarke LLP, told Tax Analysts. "So there's been no helpful guidance yet. In the principal cases we've had to date involving the Bribery Act — Standard Bank, Rolls-Royce, and a construction company called Sweett — the companies accepted that they didn't have adequate prevention procedures in place."

Monitoring and educating associated persons will be particularly critical, especially in light of the foreign tax-evasion component. According to Shiers, other European tax authorities are looking to the U.K. and are encouraging the U.K. to prosecute tax evasion that affects their specific countries.

That said, efficiency may push the government to favor deferred prosecution agreements over full-blown prosecutions, or even no action at all, where foreign tax is involved.

"The idea of prosecuting corporates for not preventing employees and other associated persons from facilitating the evasion of foreign tax is very ambitious, but prosecutors will look at whether it's ultimately in the public interest to pursue, and spend U.K. public funds on, such cases," Lipworth said.

Convictions under the criminal facilitation of tax-evasion offense certainly are possible. But in the case of the Bribery Act and its failure-to-prevent bribery offense, the U.K. has used convictions sparingly. Only Sweett has been convicted of violating that provision so far. Overall, it appears that the U.K. government wants to induce cooperation from corporations when economic crimes are involved and to "reward" them appropriately.

Although there are many unknown variables as to how the tax-related failure-to-prevent offense will play out, if organizations play their cards right, those who are charged under the law may walk away with a deferred prosecution agreement and substantially reduced penalties, given the U.K. government's current track record.

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