CLIFFORD CHANCE

FAILURE TO PREVENT THE FACILITATION OF TAX EVASION

THE NEW EXTRA-TERRITORIAL UK CRIMINAL OFFENCE AND ITS IMPACT ON ASIAN FINANCIAL INSTITUTIONS

The UK has enacted a new corporate criminal offence of failing to prevent the facilitation of tax evasion by employees and other associated persons. It is highly extra-territorial, applies to financial institutions and other businesses worldwide, and can apply to the evasion of non-UK taxes as well as UK taxes.

There is only one defence to the offence: that the financial institution has put reasonable procedures in place to prevent the facilitation of tax evasion.

Any large financial institution runs the risk of "rogue" employees facilitating tax evasion by clients. This may now result in UK criminal liability for the institution, with the prospect of unlimited fines and considerable regulatory and reputational damage.

This briefing summarises the new offence, and the prevention measures financial institutions should now have in place so that, if worst comes to the worst, they can avail themselves of the defence.

Why is the UK enacting this legislation?

There have been several well-publicised cases of bank employees outside the UK facilitating tax evasion by UK residents. The UK authorities wished to prosecute the banks involved, but under current law found themselves unable to do so.

The British Government therefore created two new corporate criminal offences in the Criminal Finances Act (**CFA**). One applies to the facilitation of UK tax evasion; the other to the facilitation of foreign tax evasion. Both are "strict liability" – i.e. the intention of a financial institution and its senior personnel is irrelevant, and the mere fact that there has been facilitation of tax evasion by an employee or another associated person is sufficient for a criminal offence to have been committed.

The British Government wishes other countries to adopt similar legislation, and HM Revenue & Customs (**HMRC**) are in active discussions with their counterparts around the world to encourage them to do so. The hope, therefore, is that if the UK passes legislation criminalising the facilitation of (for example) Hong Kong tax evasion, then Hong Kong will respond by criminalising the facilitation of UK tax evasion.

What would be the consequences of a financial institution being successfully prosecuted?

The immediate consequence would be unlimited fines for the financial institution.

However there would in many cases be significant regulatory consequences, as a financial institution's regulatory authorisation in many jurisdictions is dependent on it being a "fit and proper person". Regulators may assert that a financial institution that has been convicted of a criminal offence is not "fit and proper" and therefore, in a worst-case scenario, regulatory authorisations could be lost.

Which financial institutions are within scope of the offences?

All businesses worldwide are within scope if their employees or other associated persons facilitate UK tax evasion, whether or not the businesses themselves have any connection to the UK.

If a business' employees facilitate foreign tax evasion, the business is in scope if it is established in the UK, carries on business in the UK, or any of the conduct which facilitated tax evasion took place in the UK.

So if, for example, a Hong Kong bank has a small UK representative office, then it "carries on business in the UK". The whole of that bank will then be in scope if any of its employees facilitate the evasion of any tax, anywhere in the world. An offence would therefore be committed if an employee in (say) a branch in Jakarta facilitates the evasion of Indonesian tax.

So, in short, a financial institution needs to consider its position under the CFA if:

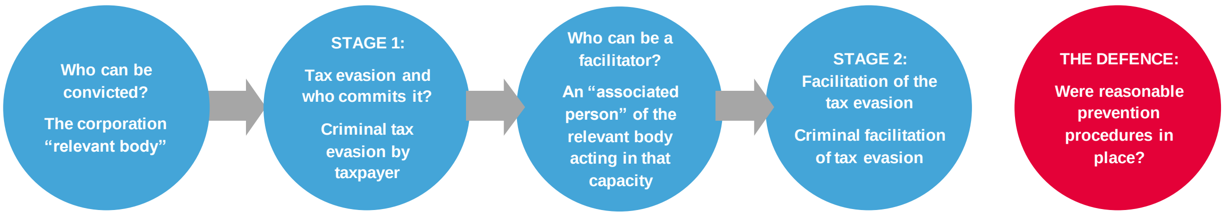
- it has any UK resident customers/counterparties; or
- it has a UK branch, representative office, or otherwise carries on business in the UK.

A purely domestic Hong Kong bank, for example, which accepts no UK customers (even dual residents) and does no business with UK persons, can probably ignore the CFA.

What are the conditions for the offence to apply?

The offence will apply if:

- there has been criminal tax evasion of UK or non-UK taxes by a taxpayer. For evasion of non-UK taxes, the corporate offence will apply if the tax evasion is a criminal offence in the taxpayer's home jurisdiction and would also be an offence if it were committed in relation to UK tax;
- an employee or other "associated person" of a financial institution facilitates tax evasion for that taxpayer (for example if the taxpayer is a client or counterparty of the financial institution); and
- the act of facilitation itself is a criminal offence in the taxpayer's home jurisdiction and (if that is not the UK) would be an offence if it were committed in relation to UK tax.



What are some examples of how a financial institution could commit an offence?

Some examples based upon our previous experience are:

- A customer provides a bank with information as to his/her assets, which a bank employee has reason to know is incorrect, but the employee does not wish to upset the client and so does not query the information.
- A customer asks an employee of a bank to finance a complex structure for holding the client's investments, explaining this is so that the tax authorities cannot establish ownership of the investments. The employee proceeds with the financing.
- An employee of a bank recommends that a foreign client invest in a particular country or product which is outside the Common Reporting Standards (CRS) rules, therefore enabling the client to hide his income from his home tax authorities and therefore evade tax.
- A customer asks an employee of a bank for advice on how to reduce her tax bill and the employee puts the client in touch with a firm of personal tax advisers with a reputation for setting up structures that conceal tax liabilities.

In each of these cases, if the employee's intention was to help the customer evade tax then the bank has potentially committed an offence. Even if the employee was just being careless, a tax authority may well allege that his or her actions must have been deliberate.

What is the defence?

The only defence is that the financial institution had reasonable prevention procedures in place. For a large international financial institution, these procedures will often include:

- commitment from top level management to prevent employees facilitating tax evasion and fostering a culture where tax evasion is unacceptable;
- applying proportionate due diligence procedures to persons it will do business with, to mitigate potential sources of tax evasion risk;
- a risk assessment exercise to assess the risk of tax evasion facilitation by employees and other "associated persons" in the different areas/geographies of its business; and
- putting proportionate measures in place to mitigate risks identified in the risk assessment exercise, for example training or tax evasion-specific guidance and policies.

Some businesses will have extensive procedures in place already; for others this will be a new area. However in all cases it is necessary to take at least some clear steps as a direct response to the CFA.

The principles in relation to reasonable prevention procedures are the same as those required to defend a charge under section 7 of the Bribery Act 2010, so many institutions should already be familiar with them (see our briefing). However, the substance of what is required should be considered on a case-by-case basis by relevant institutions.

Does the offence apply to tax avoidance?

No – the offence only applies to criminal tax evasion.

Sometimes tax authorities and commentators try to blur the boundary between evasion and avoidance, but the difference is that evasion involves deception and/or hiding assets, funds or elements of a transaction or arrangement from a tax authority, whereas avoidance does not involve deception or concealment.

Under what circumstances will the UK prosecute a foreign financial institution for facilitating the evasion of foreign tax?

The UK prosecuting authorities will have no hesitation in prosecuting banks for failing to prevent facilitation of UK tax evasion. In the case of foreign tax evasion, a prosecution will only be brought if there is a public interest in doing so.

So, for example, small scale facilitation of Indonesian tax evasion by employees of an Indonesian bank is unlikely to be of much interest to the UK authorities, even if that bank has a UK representative office and so is technically within the scope of the offence.

However prosecution is much more likely if a particular instance of tax evasion facilitation becomes widely publicised and/or the subject of political controversy in the UK. This is perhaps most plausible if the evasion is particularly large-scale, and/or involves prominent individuals.

CLIFFORD CHANCE

When do the new rules come into force?

The new offences are expected to come into effect from 30 September 2017, and that is likely to be confirmed in the next few weeks.

This creates quite a challenging timeframe for financial institutions. HMRC guidance permits implementation of new prevention measures to take place after 30 September, but the risk assessment exercise must be complete by that date and there must be a implementation plan ready.

Further information

If you would like further details on any aspect of this briefing, or how it applies to your business, please speak to your usual Clifford Chance contact or any of those listed below.

KEY CONTACTS WORLDWIDE

Anthony Fay
Foreign Legal Consultant

T +852 2826 2407
E anthony.fay@cliffordchance.com

Dan Neidle
Partner

T +44 20 7006 8811
E dan.neidle@cliffordchance.com

Elaine Chen
Partner

T +852 2825 8956
E elaine.chen@cliffordchance.com

Chris Davies
Global Practice Area Leader for TPE

T +44 20 7006 8942
E chris.davies@cliffordchance.com

Michael Lyons
Partner

T +44 20 7006 4317
E michael.lyons@cliffordchance.com

David Harkness
Partner

T +44 20 7006 8949
E david.harkness@cliffordchance.com