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Client Alert
Commentary

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The Panama Effect: UK Government accelerates proposals to criminalise failure to prevent tax evasion

10 considerations for professionals and corporates worldwide in advance of the new law.

Overview

In a move widely seen as a response to the so-called "Panama Papers" revelations, the UK Government has enhanced and accelerated its proposals to enact new offences for failure to prevent facilitation of tax evasion, and following a formal consultation is working to bring them into force on 1 January 2017.

The proposed new offences (if enacted in their present form) are likely to have far-reaching consequences for clients and their advisers. First and foremost, the proposals seek to impose criminal liability on corporations in a manner similar to the UK Bribery Act S7 offence (which bypasses the need for senior employees to have been involved in the commission of the offence). Secondly, if the evasion is of UK tax, an offence could be committed by any company or partnership anywhere in the world. If the evasion is of foreign tax (and would also be illegal in the UK), an offence could be committed by a UK body corporate or partnership, or by any company carrying on part of its business in the UK, or by any body corporate or partnership anywhere in the world provided the underlying facilitation takes place in the UK.

The proposed new offences present new risks for corporate clients and their advisers who may incur criminal liability for the acts of an associated person who has criminally facilitated a third party's tax evasion. It will be a defence to show that "*reasonable procedures*" are in place to prevent the facilitation (on which HMRC is to publish guidance).

Whilst adapting to the new tax evasion regime will be onerous for clients and their advisers, by tracking the offence under the Bribery Act of failure to prevent bribery and its defence of "adequate procedures", a compliance platform (and culture) should be in place for many organisations, which should assist greatly in helping businesses prepare quickly and efficiently.

Top 10 concerns for business

Organisations should consider the following in preparing for the coming into force of the proposed offences:

1. **International scope**. Organisations with global operations should assess the extent to which their operations involve the UK: either through UK subsidiaries; establishments in the UK; UK tax; or the activities of associated persons in the UK. Understanding this scope will enable them to

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assess which bodies corporate or partnerships might be a “*relevant body*” within the scope of the proposed offences (discussed below).

2. **International tax burdens**. Organisations with global operations should evaluate what activities might trigger an offence, and in particular what tax liabilities they face, and on what tax liabilities they might be advising third parties, *e.g.* customers and clients, particularly overseas. Organisations involved with foreign tax may also need to consider the possibility of dual criminality under UK tax laws.

3. **Professional services.** The consultation acknowledges that organisations most affected by the new offences include those in the financial services, legal and accounting sectors. These organisations, and any others which offer relevant professional services, might face significant additional costs. The offences add a further regulatory burden to an industry already laden with countering sanctions, anti-money laundering and anti-corruption regulations. Many organisations will, of course, use the experience of identifying associated persons for the purposes of the Bribery Act to enable them to utilise this experience for the purposes of developing internal controls preventing tax evasion facilitation.

4. **Identification of associated persons**. All organisations should assess not only which employees and subsidiaries might be associated with a relevant body, but also which third parties. Businesses should consider carefully third parties such as agencies providing services, referral firms and correspondent tax advisers (among others). Private equity organisations should consider carefully whether their managers or advisers might either be associated with parts of their organisation, or might themselves have associated persons which present them with risk.

5. **Expansion risk.** Organisations should review the risks of facilitating tax evasion when considering any proposed expansions of operations. Organisations should review the potential risks of tax evasion in new jurisdictions or industries, and potentially new customers. Such a review may also expand the category of associated persons, *e.g.* new contractors and service providers as well as local advisers.

6. **Joint ventures**. Operations or expansions undertaken through joint ventures should involve particularly close scrutiny of arrangements, to ensure appropriate controls are implemented as part of the joint venture. Foreign parties in particular will need to be informed of the broad reach of the proposed offences to which they could become liable through the joint venture.

7. **Investments, acquisitions and mergers.** Private equity and M&A buyers should conduct due diligence to identify potential risks in target businesses. Few organisations will have begun to consider the potential risks and how required procedures should be implemented, meaning buyers could be acquiring businesses with significant unknown tax evasion risks. Buyers should look proactively before legislation comes into force and ensure that risks are appropriately assessed in current and future transactions.

8. **Implementation costs.** Reasonable procedures will have potential cost implications, which may impact pricing in M&A transactions. Buyers will want to be aware not only of the scale of risks, but the administrative costs of introducing any required procedures. Purchasers should ensure that current and future management are aware of the risks and have the appropriate skills and support to implement procedures.

9. **Policies and procedures**. Once risks are understood, all organisations should review their policies and procedures to ensure that they are reasonable, and may not only reduce the risk of facilitating tax evasion, but also provide a defence should it occur. Such policies and their effectiveness will need to be monitored.

10. **Administrative costs**. Depending on the size and nature of their activities, organisations might face significant administrative burdens in assessing, drafting, implementing, and monitoring reasonable procedures, as well as in training relevant personnel.

Recent developments and next steps

A previous consultation on the offence had been run from July to October 2015, with initial draft legislation published in December 2015. The UK Government recently published, and Prime Minister David Cameron announced to Parliament, that draft legislation would be brought forward to coincide with the London Anti-Corruption Summit on 12 May 2016, no doubt prompted by the political storm over the release of the "Panama Papers", which has put tax avoidance and evasion under detailed scrutiny and criticism.

The new consultation provides draft guidance along with amendments to the previous draft legislation. Implementation can be expected as early as 1 January 2017, with September 2017 a likely backstop date, as the UK Government looks to legislate prior to the implementation of the Common Reporting Standard, at which time the UK Government will begin to exchange financial information with other governments. This accelerated schedule provides organisations, particularly those with significant international operations, with potentially little time to consider the impact and implement proper internal controls.

The consultation closes on 10 July 2016. Businesses should review the proposed legislation and guidance, and consider whether to provide feedback.

The offences

The offence of failing to prevent tax evasion applies to any "*relevant body*" that failed to prevent the facilitation of UK or foreign tax evasion offences by persons "*associated*" with the relevant body. A relevant body includes any body corporate or partnership, wherever incorporated, and any person performing services for or on behalf of the relevant body is associated with it, including employees (where association is presumed), subsidiaries and agents.

The latest draft legislation introduces a distinction between a UK tax evasion facilitation offence and a foreign tax evasion facilitation offence.

A relevant body commits a UK tax evasion facilitation offence if a person associated with the relevant body facilitates the evasion of tax under the law of any part of the UK, irrespective of the jurisdiction in which that organisation operates.

A relevant body commits a foreign tax evasion facilitation offence in relation to foreign tax, provided that an equivalent tax evasion offence exists within the UK. This additional layer of **dual criminality** ensures that companies will not be prosecuted in the UK if actions considered a foreign tax evasion offence are not also an offence under any UK law.

In addition, a relevant body can only commit a foreign tax evasion facilitation offence if either:

1. The relevant body is incorporated in or (for partnerships) formed under UK law.
2. The relevant body carries on a business or part of a business from an establishment in the UK.
3. The act or omission constituting part of the facilitation (*i.e.* by the associated person) takes place in the UK.

These offences continue to have broad extra-territorial reach, and add to the list of offences under UK law which, exceptionally, criminalise conduct outside the UK. The proposal captures tax evasion facilitation beyond the UK, even if the relevant body has no connection itself with the UK but the facilitation takes place in the UK. This will be a concern for international organisations. This concern is coupled with a broad definition of associated persons, which leaves business open to liability from a wide range of individuals and organisations including employees, agents, advisers, contractors and any other potential service providers.

Defences

Prior to the new consultation the only defence available to a relevant body who failed to prevent facilitation of tax evasion was for it to show it had reasonable procedures designed to prevent the facilitation (discussed below). The revised draft now includes an additional defence that expecting the relevant body to have any prevention procedures in place was unreasonable.

This new defence reflects the UK Government's acknowledgement that risk levels can vary by both industry and the scale of business. The change may protect certain organisations for whom the implementation of significant internal procedures would be overly burdensome and impractical. Large and international businesses are unlikely to benefit from this defence given their size and complexity.

Reasonable procedures

A business will be concerned to understand and assess what reasonable procedures it may have in place or will be required to implement under the legislation to provide relevant bodies with a defence. The draft guidance is formulated around six guiding principles, but emphasises that the guidance is not "one size fits all", and all will depend on what was reasonable for the organisation to have put in place:

1. **Proportionate procedures**: procedures are proportionate to the risk an organisation faced, depending upon the nature, scale and complexity of their activities. This includes both policies and steps taken to implement them.

There will be no one size fits all approach. Larger organisations will be expected to administer more extensive internal measures, including detailed written communication on policies and the implementation of oversight arrangements for service providers not under the day-to-day control of the organisation. This proportionality will be particularly important for overseas organisations who operate through numerous external service providers.

2. **Top-level commitment**: there is clear senior management buy in to prevent facilitation of tax evasion and to create a culture that makes clear such behaviour is unacceptable.

Organisations must ensure that senior management participate in the formation of prevention policies and that senior individuals take on designated responsibilities as part of any measures imposed. This top-level

commitment is likely to include roles similar to those many organisations already have in place as part of their compliance with anti-money laundering or anti-bribery regulations. In general, senior management need to ensure that they consistently articulate a zero tolerance policy towards facilitating tax evasion.

3. **Risk assessment**: organisations make assessments of the nature and extent of their exposure to the risks of associated persons facilitating tax evasion.

Any risk assessments undertaken should include senior management oversight and be a significant consideration within any organisation's wider risk assessment. The draft guidance recommends that organisations refer to the Financial Conduct Authority's guidance on preventing Financial Crime and Chapter 2 of the Law Society's Anti Money Laundering Guidance on taking a risk-based approach to prevention.

4. **Due diligence**: organisations have appropriate due diligence procedures in respect of persons who perform or will perform services on their behalf.

Levels of diligence conducted on associated persons will vary depending upon the level of risk identified under any assessment. Rather than imposing a blanket approach to diligence, organisations may find they only require targeted diligence of certain persons identified as higher risk. The guidance notes that diligence conducted externally by appropriate consultants or advisers will be acceptable.

5. **Communication (including training)**: prevention policies are embedded and understood throughout the organisation and evident through both internal and external communications.

Training should be an important part of any organisation's communications, ensuring representatives are able to identify when they are at risk of engaging in illegal activities and the consequences of their involvement in such. Organisations may wish to include this training as part of their existing financial crime prevention procedures. Similarly, wrapping up external communications into existing anti-money laundering communications or other related transmissions may be reasonable.

6. **Monitoring and review**: organisations continue to monitor and review their procedures and make improvements as necessary.

Organisations may wish to have external parties review procedures periodically or conduct internal reviews with feedback from staff. Looking to other financial crime prevention procedures can provide useful guidance, whilst dialogue with representative bodies or organisations facing similar risks could prove a useful means of reviewing policies and ensuring that these are appropriate to the business operations.

In addition to the draft guidance, the UK Government has confirmed it is open to industry bodies and trade organisations providing industry-specific guidelines on reasonable procedures. Businesses may wish to contact related industry bodies to confirm whether those bodies plan to work with the government in providing any relevant guidance.

Next steps

The consultation remains open until 10 July 2016. Affected organisations should consider whether to provide feedback, either on an individual basis or collectively, for example through a trade organisation.

Affected organisations would be prudent to assume that the offences will come into force broadly in their current form, and should prepare accordingly.

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