Overview

Tax Evasion – the phrase on everyone’s lips

Why customer tax evasion is already a bank’s concern.

The new corporate criminal offence.

How should firms respond?

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International and domestic scrutiny of AML safeguards is increasing. High-profile prosecutions and regulatory action are becoming more frequent. Cross-border coordination means that businesses face an increased likelihood of enforcement actions in multiple jurisdictions when those safeguards fail.

The use of AML systems to prevent tax evasion is of increasing importance to governments and regulators globally. As an indicator of the increased rate of change, the Fourth Money Laundering Directive follows the Financial Action Task Force’s 2012 recommendation by broadening the scope of predicate offences for money laundering within Europe to include tax evasion, and proposed new UK legislation with global effect will be on the statute books next year. We examine why financial institutions need to act now to better recognise tax evasion as a money laundering risk and to ensure that processes are consistent across jurisdictions.

Overview

Governments around the world are engaged in a well-publicised crackdown on tax evasion. This has led to the investigation and prosecution of not just tax evaders but also the financial institutions they hold their funds with.

In the UK, HMRC has been criticised for not doing enough to tackle tax evasion. It has responded by adopting a more aggressive approach. In 2015, HMRC’s conviction rate rose nearly 60%. In addition, draft legislation to make it easier to prosecute tax-evaders by removing the need to prove intent for the most serious cases of failing to declare offshore income and gains will be published in the Finance Bill 2016 this week.

As with other forms of financial crime, Governments expect financial institutions to have in place AML systems designed to monitor customer activity for indicators of tax evasion. They also need to have procedures to investigate and report such activity. The consequences of getting it wrong can be reputational, regulatory and even criminal. Under proposed legislation, financial institutions could be found guilty of a criminal offence if they do not have reasonable procedures to prevent the facilitation of tax evasion.

This briefing looks at the criminal liability financial institutions may face under the new proposals, and the steps they should be taking now to prepare.

Why customer tax evasion is already a bank’s concern.

In the UK, tax evasion is a predicate offence under the Proceeds of Crime Act. As an indicator of the increased rate of change, the Fourth Money Laundering Directive follows the Financial Action Task Force’s recommendation by broadening the scope of predicate offences for money laundering within Europe to include tax evasion, and proposed new UK legislation with global effect will be on the statute books next year. We examine why financial institutions need to act now to better recognise tax evasion as a money laundering risk and to ensure that processes are consistent across jurisdictions.

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Act 2002 (POCA). For example, when a customer, intent upon evading tax, deposits money which should have been paid over in tax, that deposit represents the proceeds of crime – even if the money was legitimately earned. If a financial institution knows or suspects (or ought to know or suspect) that a customer’s funds are the proceeds of crime, then it could fall foul of POCA if it does not report the matter and seek consent to hold or deal with the funds.

Where the proceeds of tax evasion are held in or pass through a bank, a bank could already be at risk of being prosecuted for money laundering if it fails to detect that the funds are the proceeds of tax evasion. It is also at risk of regulatory censure if it does not have in place AML systems and controls. AML systems and controls that do not contain specific procedures for detecting tax evasion are unlikely to be regarded as adequate. Some institutions may have significant exposure in this regard. According to a recent HMRC consultation, many institutions do not routinely or systemically monitor to check if staff are providing services to facilitate tax fraud.

Although tax evasion has always been a predicate offence in the UK for money laundering under POCA, it is now more important than ever that financial institutions examine their AML compliance to ensure their services are not being used to facilitate tax evasion. Tax evasion became a predicate offence under the EU-wide AML regime under the Fourth AML Directive. The Directive, which came into force in June 2015, will be passed into local law across the EU by mid-2017.

Financial institutions are also affected by the greater emphasis on transparency in tax matters from governments worldwide. Under the US Foreign Account Tax Compliance Act (FATCA), financial institutions must already pass details of overseas assets held by US citizens to the US Government. The common reporting standards (CRS) also place disclosure obligations on banks. The CRS are an inter-governmental initiative led by the OECD to increase transparency and cross-border cooperation to tackle tax evasion. As of this month, the CRS require banks to pass to HMRC information on bank accounts and trusts held by UK taxpayers. These obligations will become more onerous as the scope of the CRS widens. From September 2017, revenues in more than 60 jurisdictions will begin to exchange information about account holders and trusts on an automatic basis.

With greater transparency and cross-border information sharing, HMRC will become better equipped to identify tax evasion. To assist with this, the UK Government plans to create a new offence that will remove the need (in certain circumstances) for prosecutors to show intent to evade taxes.

With the net widening to catch more tax evaders, the potential for banks to come under fire for being used to launder the proceeds if tax evasion increases. In the UK, HMRC will add a new corporate offence to its prosecutorial toolkit to make it easier to prosecute institutions whose services are used to facilitate tax evasion.

The new corporate criminal offence.

The proposed corporate offence seeks to ensure that corporations take reasonable steps to prevent anyone representing the corporation from facilitating tax evasion. This ‘failure to prevent’ offence has been modelled on section 7 of the UK Bribery Act. Its purpose is similar — to make it easier for prosecutors to prosecute corporations by removing the need to prove that the ‘directing mind’ of the corporation (ie very senior management) was involved in the offence.

Under the proposals, a corporation will commit an offence if (i) a person who provides services for or on behalf of the corporation facilitates tax evasion and (ii) the corporation did not have reasonable procedures in place to prevent such facilitation:

The offence applies to both UK and non-UK corporations (where the latter carry on business in the UK). This wide reach will affect many, if not most, financial institutions. It relates to the criminal evasion of all types of UK taxes or the criminal evasion of taxes under the law of a country or territory outside the UK.
(referred to in the draft legislation as ‘overseas tax evasion offences’). The wide scope of the offence places a significant burden on financial institutions. This may be one of the areas that is subject to further consultation before the proposals become law.

The person facilitating tax evasion must be an ‘associate person’ of the corporation, acting for or on its behalf. Such a person may be an employee, but could also be, for example, an agent, or a company to whom the corporation subcontracts the provision of its services.

The customer who fails to pay their taxes and the corporation’s representative who facilitates them in doing so must intend to evade taxes. The offence will not apply if the customer is accidentally or innocently failing to pay taxes, or the representative is unaware of the tax evasion.

There is no need for the customer or the representative to have been found guilty of tax evasion or facilitating tax evasion. There may therefore be circumstances where the corporation is prosecuted but the individuals are not, in particular where the tax payer has entered an agreement with HMRC (for example, under a disclosure facility or other non-prosecution settlement). However, the tax evasion and its facilitation must be proved, to the criminal standard, as part of any prosecution of the corporation.

The corporation will have a defence if it had in place ‘reasonable procedures in all the circumstances’ to prevent facilitation. This is akin to the adequate procedures defence under the UK Bribery Act, although the wording of the new draft legislation is wider than the UK Bribery Act.

Interestingly, the Government has decided the procedures must be ‘reasonable’ rather than ‘adequate’ (the language of the UK Bribery Act) to reflect concerns that it would not be reasonable to expect a corporation to be able to stop every instance of non-compliance by its representatives. This divergence from the UK Bribery Act will be watched with interest. Under the UK Bribery Act guidance, the procedures must be proportionate to the bribery risks the organisation faces by reference to the nature, scale and complexity of its activities. We expect the draft guidance on this new corporate offence will take a similar approach. It should be noted that a great deal of regulatory guidance already exists on adequate AML systems and controls; it is hoped that this guidance will be built upon and developed where needed, rather than duplicated or contradicted.

Financial institutions can take some comfort from the Government’s intention to include specific guidance stating that a process that successfully detects and discloses wrongdoing is likely to be found reasonable. This goes beyond the UK Bribery Act guidance, which provides organisations with no such comfort.

How should firms respond?

Financial institutions need to re-visit their AML systems in the light of the broadening ambit of AML concerns. AML and compliance teams often lack experience or expertise in tax matters, and have limited interactions with specialist tax functions within financial institutions. This will need to change.

In the UK, the draft legislation on the new corporate offence will still be subject to further consultation this spring this year, and looks set to become law by September in 2017. However, with the CRS, FATCA and the Fourth Anti-Money Laundering Directive, now is the time for financial institutions to ensure they have robust systems and controls aimed at detecting tax evasion, by, for example:

- Assessing the nature and extent of the tax evasion risks in their businesses. Do existing procedures address these risks? If not, how can they be adapted?
- Using the transparency measures under CRS and FATCA to communicate with customers on the financial institution’s obligations with regard to checking for tax evasion.
- Developing training for frontline staff on how to spot potential tax evasion. Tax evasion involves concealment of funds. Helping frontline staff spot ‘red flags’ and encouraging them to ask questions of customers and insisting on transparency should be at the heart of
a financial institution’s approach.

- Ensuring financial crime teams understand tax evasion, how to spot and investigate it, and that they are empowered to ask questions of front-line staff.
- Adapting IT systems to support staff in identifying and managing the risks.
- Ensuring the procedures address not only staff but also the risk of other ‘associated persons’ facilitating tax evasion when acting for or on behalf of the financial institution.
- Checking that governance processes take account of the risks and that management are aware of their responsibilities in this area.

Financial institutions already have systems that can be adapted to take account of tax fraud risks, and now is the time to take action. Those who fail to act may find themselves at risk of regulatory or even criminal censure in the near future.