The Criminal Finances Act 2017: The Six Guiding Principles to Inform Prevention Procedures

The Criminal Finances Act introduces two new offences (the first relating to the UK and the other to a foreign jurisdiction), each committed where a relevant body (those most affected by the new offence are likely to be in the financial services, legal and accounting sectors) fails to prevent an associated person criminally facilitating the evasion of a tax. This note does not consider those offences but instead provides a summary of matters pertinent to a relevant body's defence when charged with them.

The Defence

Where the relevant body has put in place reasonable prevention procedures to prevent the criminal facilitation of tax evasion by an associated person (or where it is unreasonable to expect such procedures) the relevant body shall have a defence.

Guidance on Reasonable Prevention Procedures

On 1 September 2017, Her Majesty's Revenue and Customs [("**HMRC**")] published guidance ("the **Guidance**") explaining the policy behind the new offences. The Guidance provides suggestions of the types of processes and procedures that can be put in place to prevent associated persons from criminally facilitating tax evasion. Such prevention procedures are, according to the Guidance, to be informed by six non-prescriptive principles. This note will address, in turn, each such principle that the reader should take into consideration when determining how best to formulate prevention procedures on behalf of a relevant body. It is intended to be a succinct overview and not a substitute for reading the Guidance itself.

It is important to note that any investigation into a relevant body for failing to prevent an associated person from criminally facilitating tax evasion is likely to give significant consideration to the extent to which the six principles feature in any prevention procedures. However, it should also be noted from the outset that departure from the suggested Guidance will not mean that an organisation does not have reasonable procedures and, equally, compliance with the Guidance will not render a relevant body immune from prosecution. In each case regard must be had to the size, nature and complexity of relevant body when deciding what prevention procedures are appropriate to it.

The Six Principles

The six principles are intended to be flexible and outcome focussed, allowing for the huge variety of circumstances relevant bodies find themselves in. They are:

- Risk Assessment
- Proportionality of risk-based prevention procedures
- Top level commitment
- Due diligence
- Communication and training
- Monitoring and reviewing

Risk Assessment

> **Principle: The relevant body assesses the nature and extent of its exposure to the risk of those who act in the capacity of a person associated with it criminally facilitating tax evasion offences. The risk assessment is documented and kept under review.**

The purpose of this principle is to promote the inclusion of tax evasion facilitation risk within the relevant body's wider financial crime risk assessment. The Guidance suggests that relevant bodies "sit at the desk" of their employees, agents and those who provide services for them or on their behalf and ask whether they have a motive, the opportunity and the means to facilitate criminally tax evasion offences, and if so how this risk might be managed.

The Guidance identifies a number of commonly encountered risks:

- **Country risk:** this is evidenced by perceived high levels of secrecy or use as a tax shelter. Such countries are also unlikely to subscribe to the Common Reporting Standard and be given a low tax transparency score by the OECD.
- **Sectoral risk:** some sectors pose a higher risk of facilitating tax evasion than others, such as financial services, tax advisory and legal sectors.
- **Transaction risk:** certain types of transaction give rise to higher risks, for example, complex tax planning structures involving high levels of secrecy, overly complex supply chains, or transactions involving politically exposed persons.

- **Business opportunity risk:** such risks might arise in high value projects or with projects involving many parties, jurisdictions or intermediaries.
- **Business partnership risk:** certain relationships may involve higher risk, for example, the use of intermediaries in transactions, where those intermediaries are based in jurisdictions operating lower levels of transparency and disclosure.
- **Product risk:** certain products and services may have a higher risk of misuse by either clients of associated persons.
- **Customer risk:** the identification that a business unit has particular risks related to customers or products is highly likely to indicate that there is a greater risk of the criminal facilitation of tax evasion by an associated person.

The Joint Money Laundering Steering Group (JMLSG) guidance identifies high risk and low risk factors that will also be of assistance in the tax fraud context.

The Guidance notes the potential for risks to evolve. For example, a relevant body may consider that its risk has increased, and thus requires enhanced procedures, where it offers a new product which carries a known risk of being misused by those seeking to evade tax. It would be diligent for relevant bodies to implement mechanisms enabling the identification of evolving or new risks in the light of business developments.

Importantly, relevant bodies should consider the extent to which internal structures or procedures may themselves add to the level of risk such as deficiencies in employee training, skills and knowledge, a bonus culture that rewards excessive risk taking and deficiencies in the organisation's submission of Suspicious Activity Reports (SARs).

Proportionality of risk-based prevention procedures

> **Principle: Reasonable procedures for a relevant body to adopt to prevent persons acting in the capacity of a person associated with it from criminally facilitating tax evasion will be proportionate to the risk the relevant body faces of persons associated with it committing tax evasion facilitation offences. This will depend on the nature, scale and complexity of the relevant body's activities. We recognise that the reasonableness of prevention procedures should take account of the level of control and supervision the organisation is able to exercise over a particular person acting on its behalf, and the proximity of the person to**

> **the relevant body. The new offences do not require relevant bodies to undertake excessively burdensome procedures in order to eradicate all risk, but they do demand more than mere lip-service to preventing the criminal facilitation of tax evasion.**

The term reasonable ‘preventative procedures’ within this guidance is used to mean both:

- formal policies adopted by a relevant body to prevent criminal facilitation of tax evasion by those acting on its behalf, and
- practical steps taken to implement these policies, enforcement of compliance with the policies, and the monitoring of the policies’ effectiveness.

Burdensome procedures designed to perfectly address every conceivable risk, no matter how remote, are not required. Procedures need only be reasonable given the risks posed in the circumstances. To be “reasonable”, prevention procedures should be proportionate to the risks that the organisation faces. In some limited circumstances it may be unreasonable to expect a relevant body to have prevention procedures in place. However, it will rarely be reasonable to have not even conducted a risk assessment.

A number of factors will be relevant when assessing the risk posed to a relevant body by the services it provides and the manner in which it provides them, including the size of the relevant body, the nature and complexity of its business and the jurisdictions in which it operates. When considering the proportionality of reasonable prevention procedures, some suggested risk factors to consider may include the following:

- Opportunity – could someone facilitate tax evasion?
- Motive – why could it happen?
- Means – how could it be done?

Some organisations may face significant risks, and will need more extensive procedures than their counterparts facing limited risks, for example those providing private wealth management services. However, in general small organisations are unlikely to need procedures that are as extensive as those of a large multi-national organisation.

At page 23, the Guidance lists certain common elements that will likely feature in most adequate prevention procedures.

Top-level commitment

> **Principle: The top-level management of a relevant body should be committed to preventing persons acting in the capacity of a person associated with it from engaging in criminal facilitation of tax evasion. They should foster a culture within the relevant body in which activity intended to facilitate tax evasion is never acceptable.**

This principle is intended to encourage the involvement of senior management in the creation and implementation of preventative procedures. It is also intended to encourage senior management involvement in the decision making process in relation to the assessment of risk, where this is appropriate.

The level and nature of the involvement of senior management of a relevant body will vary depending on the size and structure of the relevant body, but is likely to include:

- communication and endorsement of the relevant body's stance on preventing the criminal facilitation of tax evasion, and
- involvement in the development and review of preventative procedures.

In a large multinational organisation, personal involvement in the design and implementation of preventative measures may not be proportionate, and senior management may instead take responsibility for preventative measures by providing oversight of work delegated to a committee and the publication with positive endorsement for the preventative measures thereby created.

Notably, the Guidance intends that senior management involvement is demonstrable internally (i.e. to employees) but also externally to clients and other stakeholders. At page 25, the Guidance suggests topics that formal statements from senior management might include, for example a commitment to zero tolerance towards the criminal facilitation of tax evasion and the consequences for persons associated with the relevant body for breaching the relevant body's policy on the facilitation of tax evasion.

Due Diligence

> **Principle: The organisation applies due diligence procedures, taking an appropriate and risk based approach, in respect of persons who perform or will**

perform services on behalf of the organisation, in order to mitigate identified risks.

Those with exposure to the greatest risk may choose to articulate clearly their due diligence procedures specifically in relation to the corporate offence. In addition, a single relevant body might have differing procedures for different parts of its business reflecting the varying levels of risk across all of its activities.
A relevant body may, upon conducting a risk assessment, decide that services provided to a certain group of its clients pose a higher risk of being misused to perpetrate a tax fraud. As a result they may apply increased scrutiny over those providing services to those clients, or over those who provide those services, to address the specific risks of tax evasion facilitation identified. The due diligence procedures put in place should be proportionate to the identified risk. For example, an organisation may assess the risks as being substantial in relation to a particular associated person, or service, and so apply considerably greater scrutiny in that circumstance.

Communication and training

Principle: The organisation seeks to ensure that its prevention policies and procedures are communicated, embedded and understood throughout the organisation, through internal and external communication, including training. This is proportionate to the risk to which the organisation assesses that it is exposed.

Internal communications should make clear the relevant body's zero tolerance policy for the facilitation of tax evasion by its representatives and the consequences for anyone found to be complicit in illegal activity. An important aspect of internal communication is an established and confidential means for representatives of the organisation to raise concerns about the provision of services to facilitate tax fraud. External communication of an organisation's policy on the provision of services to facilitate tax evasion can act as a strong deterrent to those who would seek to use the organisation's services to further illegal activity. It is important that the relevant body ensures awareness and understanding of its policies amongst those who provide services for or on its behalf.

In is not envisaged that all associated persons will require a detailed understanding of tax rules in any one country, but instead training should equip them to understand the scope of this offence and the associated risks, without needing to understand the underlying tax law. At

page 29, the Guidance provides examples of content relevant bodies may wish to consider including in their training.

Monitoring and Reviewing

> **Principle: The organisation monitors and reviews its preventative procedures and makes improvements where necessary.**

Relevant bodies will need to change their procedures in response to the changes in the risks they face. Although there is no formal on-going obligation to review the effectiveness of preventative procedures, relevant bodies are advised to conduct periodic reviews (either with internal employees or the services of external providers) and to document the outcome of such reviews. 'Periodic' will mean different things depending on the relevant bodies own circumstances but for larger multinationals, reviews on a yearly basis by compliance departments should demonstrate adequate respect for the principle.

As part of a review, the Guidance also suggests working with staff to obtain internal feedback and with other organisations, such as representative bodies or other organisations facing similar risks.

Timescale

What is considered a proportionate timescale for implementing, reviewing and amending procedures to prevent criminal facilitation of tax evasion will depend on the nature, scale and complexity of the relevant body's activities and the resources available to the relevant body. The Government accepts that some procedures (such as training programmes and new IT systems) will take time to roll out, especially for large multi- national organisations. HMRC will therefore take into consideration the prevention procedures that were in place and planned at the time that the facilitation of tax evasion was committed. 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.