U.K. CRIMINAL PENALTIES FOR IMPROPER TAX PLANNING – COULD YOU BE AFFECTED?

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BACKGROUND

New powers for H.M.R.C. to ferret out and punish tax evaders have been introduced in the U.K. and more have been proposed for introduction in the coming months. Together, they are expected to have a significant impact on financial institutions and professional advisers based outside the U.K. with employees or associates operating in the U.K. market.

CRIMINAL FINANCES BILL 2017

The recently published Criminal Finances Bill 2017 proposes two new corporate criminal tax offences that affect advisers to taxpayers. These are offense for (i) the failure to prevent facilitation of U.K. tax evasion offences and (ii) the failure to prevent facilitation of foreign tax evasion offences. Each is discussed below.

U.K. Tax Evasion Facilitation Offence

Criminal charges will be asserted against any corporate body or partnership involved in a transaction that constitutes tax evasion. The predicate facts constituting the criminal offense are as follows:

- A client has committed an offence constituting U.K. tax evasion.
- An individual employed or associated with the adviser knowingly acted in a way to assist the person who has been found guilty of the tax evasion offence.
- The adviser does not have reasonable procedures in place to prevent employees and associates from helping the individual commit the tax evasion offence.

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To determine the exposure of a corporation or a partnership to prosecution three questions must be answered.

1. *When does an individual knowingly provide assistance to a person committing tax evasion in the U.K.?*

   There are two instances in which an individual can be viewed to knowingly provide assistance to the persons committing U.K. tax evasion. The first is that the individual was knowingly concerned in the fraudulent act of tax evasion or took steps with a view to assisting in the fraudulent act of another person. The second is that the individual aided, abetted, counselled, or procured the commission of the fraudulent act of tax evasion.

2. *When is an individual employed or associated with a corporation or partnership?*

   A person is associated with a corporate body if that person is an employee or agent of a corporate body or performs services for it or on its behalf. The term associate, as defined, may extend to an individual or an incorporated body. H.M.R.C. has stated that determination is made by reference to all the relevant facts and circumstances, and not merely by reference to the nature of the legal relationship between the individual and the organization. In short, an individual who acts in concert with a corporation may be associated with the corporation if both are carrying out a common enterprise. It does not matter whether the associated person or the relevant body is based in the U.K. or overseas. The U.K. offence may be committed by any corporation or partnership, no matter where incorporated or formed.

3. *Must the client be convicted of a crime in order for H.M.R.C. to prosecute a corporation of partnership?*

   For the corporate offence to be committed there must first be a criminal offence. Noncompliance, falling short of fraud, will not result in the corporate offence being committed. What is fraudulent behavior for these purposes? The legislation is focused on any dishonest activity that intends to divert funds from the public revenue. In the U.K. this could be an offence under common law. There are also a range of statutory offences, such as (i) fraudulently evading Value Added Tax ("V.A.T.") or (ii) fraudulently evading income tax.

   H.M.R.C. has stated that a conviction for tax evasion is not a prerequisite for bringing a prosecution against a relevant body under the legislation. Voluntary disclosures by clients, for example, could still result in a prosecution conducted by H.M.R.C. against the relevant body. This is of particular concern in the current climate. Over the last decade, in line with O.E.C.D. principles, the U.K. has offered individuals the opportunity to regularize untaxed offshore assets by making voluntary disclosures. A voluntary disclosure of tax evasion, after the new offences are enacted, could potentially trigger H.M.R.C. action against any relevant corporate body that served as an adviser and had an employee or associate that provided the relevant degree of assistance. The relevant body may consider making its own voluntary disclosure in these circumstances, unless it has an adequate defense.

Foreign Tax Evasion Facilitation Offence

The foreign offence, is narrower in scope. It can be committed only by a relevant body that is

- incorporated under U.K. law (*e.g.*, a limited company incorporated under U.K. law),
- incorporated outside the U.K. but carrying on a business activity from a permanent establishment within the U.K., or
- incorporated outside the U.K. but whose associated person is located within the U.K. at the time of the criminal act that facilitates the evasion of the overseas tax.

In addition to the above, the foreign offence requires dual criminality. This occurs in two instances. The first is that the overseas jurisdiction has a tax evasion offence at the client level that is comparable to an offence under U.K. tax law, so that the actions carried out by the client would constitute a crime had they taken place in the U.K. Second, the overseas jurisdiction must have an equivalent offence covering the associated person's criminal act of facilitation, so that the actions of the associated person would constitute a crime had they taken place in the U.K.

The legislation also requires personal consent of the Director of Public Prosecutions or the Director of the Serious Fraud Office before proceedings for the foreign offence are issued in England, Wales, or Northern Ireland.

Penalties

The penalties for this offence include unlimited financial penalties and ancillary orders confiscation and injunctions to prevent serious crime after the conviction. H.M.R.C. has stated that a criminal conviction will also have consequences for a relevant body, such as requirements of disclosure to professional regulators.

Deferred Prosecutions

Deferred prosecution agreements ("D.P.A.'s") were introduced in the U.K. in February 2014 and are in place for fraud, bribery, and other economic crimes. A D.P.A. is an agreement between a prosecutor and a defendant organization that is reached under the supervision of a judge. Prosecution is deferred indefinitely, as long as subsequent criminal acts are not committed. D.P.A.'s will likely be pursued for the new corporate criminal tax offences.

Defenses Against the Offences

The principal defense for a corporation or partnership is that it has put in place reasonable procedures to prevent the criminal facilitation of tax evasion by the employee or associated person. H.M.R.C. has published draft government guidance for determining whether reasonable procedures exist. Advisory bodies must undertake risk assessment when taking on a new client, and risk-based prevention procedures must be proportional to the amount at stake. A due diligence procedure must also be in place in order to evaluate new matters. Top level management must be committed to preventing facilitation by employees and associates, and company policy must be communicated to employees and associates. This includes tax fraud prevention training. Finally, there must be a program in place for monitoring and review.

Advisers with clients based outside the U.K. who attempt to establish an account at a U.K. bank have discovered that the process is time consuming and disappointing. Several months and significant fees must be paid to clerks who challenge any arrangement that is not "plain vanilla." With the new act, clients should anticipate that longer periods of time will be required and greater fees will be charged to pursue the simple task of opening a bank account in the U.K. With the new rules, U.K. banks will likely find that business will be ring-fenced to include only "mom and pop" businesses and fortune 100 corporations.

FINANCE ACT 2016

Last year, the U.K. government introduced offshore tax legislation, as part of Finance

Act 2016, related to the following offenses and penalties:

- Offences relating to offshore income, assets, and activities
- Penalties for enablers of offshore tax evasion or noncompliance
- Penalties in connection with offshore matters and offshore transfers
- Asset-based penalties for offshore inaccuracies and failures

Each of these topics is discussed in the following paragraphs.

Offences Relating to Offshore Income, Assets, and Activities

The most significant of the Finance Act 2016 provisions is a strict liability criminal offence against individuals who commit acts of offshore noncompliance, even if it is not evasion. The offence relates to offshore income, assets, or activities involving a person who (i) fails to submit a tax return, (ii) fails to notify liability, or (iii) submits an incorrect return in relation to income or capital gains tax.

The significance of this offence is the absence of a link between the offence and any underlying negligence, carelessness, or fraudulent behavior, which is a predicate fact in relation to most criminal offences. Consequently, there is no requirement for H.M.R.C. to demonstrate the cause of the behavior. Taxpayers may commit an offence by the mere fact of noncompliance involving offshore matters.

As the U.K. imposes tax on a residence basis, rather than a citizenship basis, the offense reflects a view that persons savvy enough to open an offshore account should be savvy enough to arrange for proper reporting. Nonetheless, defenses exist beyond arguing that proper compliance procedures were followed. Thus, for example, a person charged with the offence can argue that reasonable cause exists for noncompliance. Also, H.M.R.C. has introduced a £25,000 threshold for triggering the offense. Finally, H.M.R.C. has suggested that the new offence will be limited to noncompliance involving offshore jurisdictions that have not signed up for automatic exchange of information under the Common Reporting Standard ("C.R.S."). Given the U.S. view that F.A.T.C.A. reporting is equivalent to the C.R.S., it will be interesting to see how the matter will play out in relation to accounts in the U.S.

Penalties for Enablers of Offshore Tax Evasion or Noncompliance

Civil penalties have been enacted with regard to those who advise clients in relation to offshore tax matters. The civil penalty is imposed on those who enable a U.K. taxpayer to commit offshore tax evasion or noncompliance.

An offence is committed when two conditions are met in relation to the adviser's relationship with the client, and the client commits a relevant offshore tax offence or is noncompliant. First, the adviser must know or have reason to know that his or her actions could assist the client in committing offshore tax evasion or noncompliance. Second, the client must have been convicted of a tax offence or, in the case of offshore tax evasion or noncompliance, the client is liable to a relevant penalty. A relevant penalty includes any offshore civil penalty relating to offshore tax matters. This could include circumstances where an adviser is caught for actions that resulted in a client becoming liable to a civil penalty for carelessness. Presumably, H.M.R.C. will not prosecute this type of technical offense, as a conviction would almost be worse for the government than for the adviser.

The legislation also applies, as well to an adviser that turns a "blind eye" to the evasion of the client. The offence effectively extends to tax advisers, legal advisers, trustees, private bankers, and any intermediary based anywhere in the world as long as the facts involve providing services to U.S. resident clients with offshore U.K. tax matters. Risk of prosecution will depend on many factors including the reach of H.M.R.C. to obtain jurisdiction over a person outside the U.K. and the deterrence factor inherent in the defendant. Not all advisers are worth prosecuting.

If found liable, the adviser could be liable for the greater of £3,000 or 100% of the tax revenue lost by the U.K. Reductions to these penalties for unprompted disclosures are possible. In the case of an unprompted disclosure, the penalty can be reduced to £1,000 or 10% of the tax revenue lost, or in cases of prompted disclosures to £3,000 or 30% of the tax lost. Presumably, if a client paid the tax as part of an examination by H.M.R.C., the penalty based on a fixed amount will be due. However, no guidance exists to date.

Penalties in Connection with Offshore Matters and Offshore Transfers

The existing civil penalty regime for offshore matters and offshore transfers is increased. Offshore civil penalties were introduced by Finance Act 2010 that (i) increased the civil penalties under Schedule 24 of Finance Act 2007 for errors and (ii) increased the civil penalties under Schedule 41 of Finance Act 2008 for failure to notify H.M.R.C. relating to income tax and capital gains tax.

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The new legislation increases the penalties when the transfer or matter relates to jurisdictions that have no commitment to exchange of information and the fostering of transparency. In a post-B.E.P.S. world, those jurisdictions are quite limited. If the jurisdiction is categorized as highly non-transparent and has not signed up to the C.R.S., the standard penalty of up to 100% of the potential lost revenue is increased from 100% to 200%. The same principles apply for offshore penalties in relation to minimum penalties for prompted and unprompted disclosures. Finance Act 2016 essentially increases those minimum penalties by 10% where the underlying behavior is deliberate.

H.M.R.C. has also stated that it will require disclosures in any case where reductions to penalties are sought. The information to be disclosed includes structures used, processes for transferring funds offshore, and the identity of all enablers who facilitated the evasion.

Amendments have also been made to the Schedule 94 of Finance Act 2009. This schedule authorizes the publication of names of those who deliberately defaulted on offshore disclosure obligations. H.M.R.C. will publish the details of those who control offshore companies and partnerships, where the person who is subject to the offshore deliberate penalty is the body itself.

Asset-Based Penalties

H.M.R.C. has introduced a new asset-based civil penalty for cases where civil offshore penalties are in point and the potential lost revenue exceeds a threshold of £25,000. The asset-based civil penalty applies where the offshore penalty relates to deliberate behavior and the tax involved is capital gains tax, inheritance tax, or asset-based income tax. The standard amount of the penalty will be limited to the lower of 10% of the value of the asset or ten times the potential lost revenue.

Again, reductions to the penalty are allowed when the person (i) discloses the inaccuracy or failure relating to the standard offshore tax penalty, (ii) provides H.M.R.C. with a reasonable valuation of the asset, or (iii) provides H.M.R.C. with information or access to records that H.M.R.C. requires for the purposes of valuing the asset. The reduction must reflect the quality of the disclosure, valuation, and information provided. The timing, nature, and extent of the disclosure are taken into account when measuring its quality. Guidance regarding the maximum amount of the penalty reduction are left to future regulations.

FINANCE BILL 2017 – REQUIREMENT TO CORRECT OFFENCE

Obligation to Correct

The Autumn Statement 2016 and Schedule 22 of Finance Bill 2017 introduce legislation addressing a Requirement to Correct Offence ("R.T.C.O."). The R.T.C.O. is a civil offense rather than a criminal offense. It will be effective from April 6, 2017, and will require persons with offshore noncompliance in relation to income tax, capital gains tax, and inheritance tax to correct all errors before September 30, 2018. The R.T.C.O. will be timed to coincide with automatic exchanges of information through the C.R.S. Any person who has not rectified past "relevant" offshore tax noncompliance by September 30, 2018, for noncompliance occurring in periods up to and including April 5, 2017, will face significant penalties.

Penalties

The penalty for not correcting the offshore noncompliance by September 30, 2018, may include the following:

- 200% of the potential lost revenue attributable to the uncorrected offshore noncompliance
- An asset-based penalty of up to 10% of the asset value
- A further 50% penalty if assets have been moved to avoid exchange of information
- Public identification of the offender

The penalty is appealable using the usual reasonable cause defense.

Correcting the Offence and Disclosure

Offshore noncompliance may be corrected in several ways, depending on whether the offence relates to (i) the failure to notify, (ii) the failure to file a tax return, or (iii) the submission of an incorrect return. Voluntary disclosure programs with favorable terms were terminated on December 31, 2015, and have been replaced by the new Worldwide Disclosure Facility, launched by H.M.R.C. in September 2016. This is one route by which historical offshore noncompliance can be rectified. However, the Worldwide Disclosure Facility provides no protection from prosecution. Where tax fraud is at issue, a disclosure under Code of Practice 9 (Contractual Disclosure Facility) may be the safer path.

DUTY TO DISCLOSE

According to the Law Society, H.M.R.C. has adopted a practice under its No Safe Havens program that requires law firms that participate in the formation of offshore companies or trusts to report on the beneficial ownership of the offshore entities. Presumably, the failure to report the information may be taken as evidence of a law firm's role in enabling offshore tax evasion or noncompliance.

CONCLUSION

In 2013, H.M.R.C. set out its Offshore Evasion Strategy building on earlier policy statements to counter offshore tax evasion and noncompliance. We have seen many developments in the intervening time, including numerous disclosure campaigns allowing holders of untaxed offshore assets to regularize U.K. tax obligations on favorable tax terms. Now, the offshore campaign is entering a new tougher phase. Individuals with untaxed offshore assets will be required to regularize their positions by September 30, 2018, by reason of the R.T.C.O. rules that will be effective from April 2017. Persons under investigation by H.M.R.C. and found to be noncompliant will face the significant penalties. H.M.R.C. intends to increase the number of criminal investigations to force home the message. If a carrot and a stick can be used to incentivize compliance, the days of the carrot are over. H.M.R.C. is now conducting a vendetta against those holding undeclared wealth offshore.

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