LLOYD'S

Market Bulletin

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Title	Criminal Finances Act 2017 – Corporate Criminal Facilitation of Tax Evasion Offence
Purpose	To inform market participants of the implementation of the above
Type	Event
From	Andy Wragg, Senior Manager Lloyd's International Regulatory Affairs 020 7327 6387 & andy.wragg@lloyds.com
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SUMMARY

The Criminal Finances Act 2017 ("CFA 2017") will bring into effect from 30 September 2017, two new corporate criminal offences of failure to prevent the facilitation of UK, and foreign tax evasion, by a person associated with a "relevant body". The legislation does not seek to amend what is criminal but widen the net as to who can be held accountable so that corporates can be held criminally liable for the acts of their associated persons who criminally facilitate the evasion of tax.

A relevant body – a legal entity such as a company or partnership can commit the offence but not a natural person. Penalties for these offences include unlimited criminal fines.

A relevant body will have a defence to the offences if it has reasonable procedures in place to prevent the offence.

An associated person can be an individual or a corporate body and could be associated to the relevant body through employment, agency or the performance of services for or on their behalf, including underwriting and/or claims handling authority delegated to Coverholders and Third Party Administrators ("TPAs").

HM Revenue and Customs ("HMRC'") has issued guidance (see annex) with regard to the reasonable procedures a relevant body should put in place to prevent the criminal

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facilitation of tax evasion. The guidance, currently in draft, focuses on the six principles below. They are not designed to be prescriptive but to be applied in a risk based and proportionate way.

- Risk Assessment
- Proportionality
- Top-level commitment
- Due Diligence
- Communication
- Monitoring and Review

Whilst some compliance procedures will take time to implement, HMRC expects that the following should be in place by 30 September 2017:

- The demonstration of senior management's clear commitment to preventing the facilitation of tax evasion including a communication plan;
- A robust risk assessment; and
- A rapid implementation plan with a clear timeframe focusing on the major risks.

Managing agents

Managing agents may be able to build upon their existing anti-bribery and corruption and anti-money laundering compliance measures but the review should not be limited to adding a nominal reference to the new offences in financial crime policies.

It is expected that all managing agents will carry out and document an effective risk assessment. The risk assessment should consider which insurance products and areas within the managing agent may be particularly exposed to the risk of tax evasion facilitation. It should include any impact from overseas operations and Coverholder or TPA arrangements and assess the services provided for or on its behalf by its associated persons.

A plan should be initiated to address any gaps in controls as soon as possible. Whilst there is no specific insurance related guidance on this subject, Lloyd's expects that managing agents review HMRC's draft guidance noting that it contains a number of case studies to demonstrate what HMRC considers to be good or poor practice. In due course, it is expected that the Government will issue guidance specific to financial services, the drafting of which the Association of British Insurers is involved in. We will circulate this once issued.

HMRC guidance does not provide specific examples of how the provision of general insurance may be impacted by the offence, however, analysis of past cases suggests that some forms of financial or finite reinsurance have been misused as methods to bolster an insurers' financial positions by avoiding real risk transfer and creating tax evasion possibilities.

Internationally, and by way of example, Belgian legislation (Circular D.207 of 30 November 2001 issued by the National Bank of Belgium ("NBB")) has focussed on "special

mechanisms" having as their aim or effect to promote tax evasion on the part of third parties. Whilst life assurance appears to be the focus of that legislation, this might have broader application as examples given by the NBB of tax evasion include contracts where no insurance risk is present.

Whilst exposure to these types of schemes may only impact certain classes of business, managing agents should consider how these offences may impact other insurance arrangements they are involved in, as well as considering any non-insurance activities which might represent exposure to these offences. For example, where managing agents have business interests in Funds at Lloyd's ("FAL"), through the provision of third party capital and or ownership or control of a member vehicle, the risk assessment needs to also consider such activities.

Members' agents

Members' agents should also undertake a robust and documented risk assessment to assess which existing or new anti-financial crime controls can be developed further or introduced.

As introducers of capital to Lloyd's, the risk assessment and controls developed, need to also consider the 'associated person' risk the agent faces from any capital introduced being structured for tax evasion purposes.

Lloyd's will be conducting its own risk assessment to any exposure it might face which could lead to changes in its interaction with Members including its management of FAL. Any changes will be communicated to the Market.

Firms which are authorised by the Financial Conduct Authority are required to establish and maintain effective systems and controls to prevent the firm from being used to further financial crime. As a result, authorised firms will need to consider how best they ensure that their associated persons should not criminally facilitate the evasion of tax.

Further detail about the offences is contained in the Annex to this bulletin.

ANNEX

Further information about the corporate criminal offence of failure to prevent the facilitation of UK and foreign tax evasion is set out below. The content focuses on:

1) What are the offences;
2) Who is in scope of committing the offences;
3) How the offences might be triggered and its scope;
4) Who is an associated party;
5) Penalties;
6) The timings for implementing the legislation and reasonable procedures; and
7) What firms should do to implement reasonable procedures.

1. What are the offences?

Under the CFA 2017, a new corporate offence of failure to prevent the criminal facilitation of tax evasion ("the Corporate Criminal Offence") will be introduced from September 2017.

It does not significantly change existing criminal law but its objective is to hold corporate bodies liable if they fail to prevent criminal facilitation of tax evasion by those who act for or on their behalf regardless of whether the corporate body itself benefits from the evasion.

2. Who is in scope – relevant body

Only a "relevant body", namely companies and partnerships, not natural persons, can commit the new offence.

3. How is the offence committed?

The offence can be committed by facilitating the evasion of both UK and foreign taxes. However for the Corporate Criminal Offence (stage three) to be triggered, two criminal offences (stages one and two below) must have already taken place under existing law.

3.1 UK and Foreign tax evasion facilitation offence

1. **Stage one**: For the Corporate Criminal Offence to be committed, a criminal offence at the taxpayer level must have already occurred.

   There are a number of offences under existing common and statutory law that would be perpetrated by the fraudulent evasion of taxes or diversion of funds from the public revenue. As these offences can be committed by ***dishonestly taking steps with a view to or be knowingly concerned*** in the evasion of the tax, the successful act of tax evasion is not a prerequisite to meet the offences.

   In order to bring a prosecution against a relevant body, there does not need to be a conviction at the tax payer level (e.g. if it would not serve the interests of justice) but it must be proven beyond reasonable doubt that the tax payer level offence has been committed.

2. **Stage two**: The tax evasion has been criminally facilitated by a person acting on behalf of a relevant body (an associated person). It is an existing crime to deliberately and dishonestly facilitate the commission of tax fraud by another person. It is already a crime for a person to be knowingly concerned in or take steps with a view to another person fraudulently evading tax that they owe. It is also a crime to aid and abet another person in committing a revenue fraud. If the associated person is only proved to have accidentally, ignorantly or negligently facilitated tax evasion, then the new offence is not committed by the relevant body.

3. **Stage three:** Where the relevant body does not have reasonable procedures in place to prevent such facilitation and is liable for having **failed to prevent** an associated person from committing the criminal act at stage two. This is a strict liability offence if stages one and two have already been committed and the relevant body failed to put in place reasonable preventative procedures. The relevant body has a defence if it has put in place reasonable procedures to prevent the criminal facilitation of tax evasion by an associated person or where it is unreasonable to expect such procedures. HMRC's guidance provides suggestions of the processes and procedures that can be put in place to prevent associated persons from criminally facilitating tax evasion.

   The relevant body does not have to show that it benefitted from the actions of the associated person in order to be guilty of the offence.

   An associated person may circumvent a relevant body's policies and procedures to commit financial crime. However, as long as the relevant body has done as much as it can reasonably be expected to do to address this risk then it will have a defence of having put in place reasonable procedures.

3.2 Who falls within the scope of the offences?

UK tax evasion offence

Where there is a UK tax evasion facilitation offence it does not matter if the relevant body is UK based or established under the laws of another country, or whether the associated person who performs the facilitation offence is in the UK or overseas. The offence can still be tried under UK law.

The offence applies to any entity for UK tax, or for non-UK tax if:

- The relevant firm is incorporated in the UK;
- The relevant firm has a place of business in the UK through a branch, i.e. where the office in the UK is part of the same legal entity operating in other jurisdictions, as opposed to a subsidiary; and
- Any part of the offence occurs in the UK.

Foreign tax evasion offence

In order to prosecute a foreign tax evasion offence, the legislation requires that there is "dual criminality", meaning that the offence (tax evasion and the facilitation of tax evasion) in the foreign jurisdiction must also be an offence in the UK.

The foreign tax offence can only be committed by a relevant body:

- If the relevant body is incorporated under UK law;
- Carries on any part of its business from a permanent establishment in the UK (e.g. a company incorporated under German Law but operating from the UK);
- Whose associated person is located within the UK at the time the criminal act takes place that facilitates the evasion of the overseas tax, for example a company incorporated under German law whose employee helps another person to commit a foreign tax evasion offence whilst in London.

The foreign offence operates in a similar way to the UK offence; in that there must be criminal tax evasion by a tax payer at stage one, followed by criminal facilitation of tax evasion by an associated person at stage two. The relevant body is then criminally liable unless it can show it has put in place reasonable preventative procedures, in which case it should have a defence.

The foreign offence though is slightly narrower in scope in that only relevant bodies with a UK nexus can commit the foreign tax offence.

The tax evasion and the facilitation offences must both be criminal offences in the foreign jurisdictions where they are committed, and the same conduct would need to constitute a criminal offence if it took place in the UK.

Therefore, the corporate criminal offence cannot be committed where the acts of the associated person would not be criminal if committed in the UK, regardless of what the foreign criminal law may be.

Even where the foreign law declares that inadvertent or negligent facilitation of tax evasion is criminal, the corporate offence will not be committed because the requirement for dual criminality will not be met. **Only deliberate and dishonest acts of facilitation are deemed criminal.**

Prior to a foreign tax offence being taken forward, it must have approval from the Director of Public Prosecutions or Director of the Serious Fraud Office ("SFO") to make sure it is in the public interest to prosecute.

Difference between avoidance and evasion

Avoidance is the legal exploitation of the tax system to decrease current or future tax liabilities; a form of tax planning which results in an outcome unintended by HMRC.

Evasion is the illegal practice of not paying taxes, by not reporting income, reporting expenses not legally permitted or failing to pay taxes owed. Typically evasion involves fraud, deceit or omission of information to the tax authorities. The tax evasion facilitation offence is facilitating the perpetration by another person of a UK tax evasion offence through aiding, abetting, counselling or procuring the commission of a UK tax evasion offence.

4. Who is an Associated Person?

A person is associated with a relevant body if that person is an employee, agent or other person who performs services for or on behalf of the relevant body. The offence is triggered where the facilitation offences are committed by someone acting in the capacity of an associated person. An associated person can be an individual or incorporated body.

HMRC advise that whether someone is associated is a question of fact. The contractual status does not matter and employees, agents and sub-contractors can be associated persons. The concept of a person performing services for or on behalf of the organisation is intended to be broad to include the whole range of persons who might be capable of facilitating tax evasion whilst acting on behalf of the relevant body. Employees will be treated as associated persons unless they act outside of their capacity as an employee, carrying out activities that are far removed from their employment (not just an employee acting outside of their normal role).

Subsidiaries and joint ventures are not automatically associated persons because they are in the same group as the relevant body. Instead it will depend whether services are provided for or on behalf of the relevant body.

The level of control that a relevant body will be able to operate over some categories of persons such as direct employees is greater than others such as the staff of a sub-contractor and reasonable procedures will need to take account of the level of control, proximity and supervision it is able to exercise.

The case studies in HMRC’s guidance may be beneficial for determining who would be considered an associated person.

5. Penalties

Investigations into the UK tax offence will be carried out by HMRC and prosecutions will be brought by the Crown Prosecution Service (“CPS”). The foreign tax offence will be investigated by the SFO or National Crime Agency (“NCA”) and prosecutions will be brought by either the SFO or CPS.

The penalties for this offence include unlimited criminal fines set at a minimum fine of 100% of the tax evaded with aggravating or mitigating factors taken into account. In addition, orders such as confiscation or serious crime prevention orders may be imposed upon perpetrators.

The SFO or CPS may agree to Deferred Prosecution Agreements ("DPA") for a relevant body whereby prosecution is suspended on agreeing to certain conditions such as paying a financial penalty, strengthening weaknesses in compliance, or co-operation in the prosecution of a facilitator.

Voluntary self-disclosure is encouraged and timely self-reporting is viewed as an indicator that a relevant body has reasonable procedures in place.

6. Implementation timings

HMRC recognises that the time between the announcement and implementation of the offences does not give firms much time to implement a fully designed compliance framework. It acknowledges that it will not be reasonable to expect that all necessary system and process enhancements will be in place prior to implementation day. However HMRC expects that at a minimum, the following should be adopted:

- The demonstration of a clear commitment to compliance including a risk assessment;
- Senior management commitment and an initial communication plan; and
- An implementation plan for tackling the risk in a proportionate and timely manner.

HMRC recognises that some procedures (such as training programmes and systems) will take time to roll out, especially for large multinational organisations. HMRC will therefore take into consideration the prevention of procedures that were in place and planned at the time that any facilitation of tax evasion was committed.

However, it is still expected that by the date the legislation is in force, firms will have an implementation plan in place, focussing on high risk areas with clear deadlines. In addition, HMRC is aware that procedures that are considered reasonable will change as time moves on and will therefore require ongoing review.

7. What should firms do?

HMRC guidance sets out seven principles:

Principle 1 – Risk assessment

The relevant body assesses the nature and extent of its exposure to the risk of those who act for or on its behalf engaging in activity during the course of business to criminally facilitate tax evasion.

Managing agents and members' agents already carry out financial crime risk assessments relating to their business and these should be expanded to include the risk of facilitation of tax evasion. The risk of tax evasion facilitation should be clearly articulated and the risk assessment should be documented. To assist firms identify risk, HMRC suggest consulting the Financial Conduct Authority's ("FCA") guide for firms on preventing financial crime, the

Joint Money Laundering Steering Group's ("JMLSG") and the Ministry of Justice's Bribery Act guidance – considering them from a tax fraud perspective.

In addition, the risk assessment should include consideration of the following risks, assessing which areas are high, medium or low risks and ensuring that sufficient controls are in place to manage them.

- Country risk
- Sectoral risk
- Business partnership risk
- Business opportunity risk
- Transaction risk
- Product risk
- Customer risk

The review should ensure that all relevant departments are covered and that all relevant external and internal information sources are examined to determine if there are any gaps in process, such as in customer due diligence processes, policies and procedures, internal communications and reporting, external communications (for example with suppliers) and what contractual protections may be required. Adequate resource should be allocated to the risk assessment and ongoing management of the risk and senior management should be involved in the oversight.

In addition, the identification of emerging risks should be part of a process to ensure that the risk assessment remains up to date. HMRC advise that examples of increased risk may be if the provision of services takes place in jurisdictions where they do not report tax payer information under the Common Reporting Standard and therefore score low on the tax transparency register by the OECD or if a new product is offered which carries a known risk of being misused for the purposes of tax evasion.

The risk assessment should be documented.

Once recommendations are implemented, ongoing monitoring of the risk and controls is required to maintain a compliant environment.

Principle 2 – Proportionality of risk-based prevention procedures

Reasonable procedures will be proportionate to the risk a 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.

This principle relates to the reasonable prevention procedures, i.e. policies and practical measures, which a firm should have in place to mitigate against the risk of tax evasion facilitation by its associated persons.

Risk assessments should identify any associated persons – HMRC have suggested the following factors to consider:

Opportunity – who?

- Do any associated persons have the opportunity to facilitate client tax evasion?
- Is their work subject to oversight and what detection processes are in place?

Motive – why?

- Does the firm's corporate culture (including disciplinary and reward measures) incentivise or dissuade potential criminal facilitation of tax evasion, or whistle-blowing when tax evasion is uncovered?
- What are the consequences of wrong-doing?

Means – how?

- How might associated persons criminally facilitate tax fraud?
- What is the risk of misuse of particular products, services or systems?
- Is there targeted and regular training for higher risk areas?

The risk assessment will help drive which procedures are required to alleviate the risks that a firm faces, and set out the practical steps required ensuring that they are proportionate and not necessarily burdensome. The procedures should set out the firm's position on criminal facilitation of tax evasion and any services which pose a high risk of being misused to commit a tax crime.

Whilst it may be appropriate to put in place stand-alone policies, as long as there is sufficient coverage of the issue, the subject could equally be part of a wider set of financial crime policies such as anti-money laundering, anti-bribery or fraud prevention procedures.

The procedures should be tailored to each organisation and whilst they should be designed to implement the firm's preventative policies for identified risk mitigation they should also address the risk of criminal wrongdoing by those providing services on behalf of the firm. Some common features would be the inclusion of the following:

- A clearly articulated risk assessment and risk mitigation approach including the procedures and methods used to assess and address the risk; the type of due diligence to be conducted in relation to persons associated with the relevant body;
- The involvement of the firm's senior management to demonstrate tone from the top;
- How this is to be communicated;
- The process and timeline;
- Monitoring and enforcing compliance with procedures;
- A review process of policies and procedures; and
- Reporting for wrongdoing clearly set down including whistleblowing processes.

Principle 3 – Top level commitment

The top-level management of a relevant body should be committed to preventing persons 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.

The Guidance recommends senior management are involved in the communication and endorsement of the firm's policy on prevention of criminal facilitation of tax evasion. Such communications may include a formal policy statement regarding zero tolerance towards the criminal facilitation of tax evasion and a summary of the consequences if associated persons contravene the organisation's policy.

Where appropriate, it is also considered to be best practice for senior management to be involved in the risk assessment process, design and implementation of policies and procedures. Depending on the size of the organisation, it may not be appropriate for senior management to be involved in the day to day management of the above but at a minimum, senior management should have designated responsibility for the oversight of preventative and disciplinary measures whilst endorsing the company's policy.

Principle 4 – Due diligence

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.

The Guidance recognises that financial services will already carry out due diligence procedures in relation to its customers, jurisdictions and transactions but that the application of existing due diligence procedures is not necessarily adequate for addressing the risk of tax evasion facilitation. Nevertheless procedures should be proportionate to the risk. In some cases, a firm may operate specific due diligence procedures to address the risk of facilitation of tax evasion and or have varying procedures for different parts of its business according to risk exposure, including enhanced due diligence for high risk services. It may also be that the risk exposure is so low that no additional procedures are required.

It is therefore recommended that firms review their procedures to assess their adequacy, amending where necessary and ensuring that they are subject to regular review.

Principle 5 – Communication (including training)

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.

It is important that the firm's policy of zero tolerance to criminal facilitation of tax evasion is clearly stated and embedded within the firm at all levels. Dissemination of this message to those who provide services for or on a firm's behalf is also recommended as a deterrent measure.

Reporting methods should be clearly stated to those within the relevant body and those providing services on its behalf. Such reporting methods should include a confidential channel.

It is recommended that training is risk based, bespoke to the subject and risk areas or as part of existing anti-financial crime training. Where appropriate, training could be extended to associated parties at higher risk of exposure so that they are able to identify the risk of tax evasion facilitation and know how to report. Otherwise firms may wish to ensure that its associated parties have relevant training in place.

The training should explain tax evasion and associated fraud, the scope of the new offence and related risks, the company's preventative policies and procedures, the obligations of employees and associated persons and the penalties for non-compliance.

Principle 6 – Monitoring and review

The organisation monitors and reviews its prevention procedures and makes improvements where necessary.

A review of a company's policies and procedures may be conducted internally or by an external party. The review should be documented and take place periodically according to the company's risk profile.

Guidance

HMRC's draft guidance and factsheets can be found here:

- HMRC draft guidance
- Criminal Finances Act Factsheets
- Criminal Finances Act 2017

Further information

For any queries, please contact:

Andy Wragg
Senior Manager
Lloyd’s International Regulatory Affairs
e: andy.wragg@lloyds.com
t: +44 (0)20 7327 6387

Chris Po-Ba
Policy Manager
Lloyd’s International Regulatory Affairs
e: chris.po-ba@lloyds.com
t: +44 (0)20 7327 5473

Rachael Penny
Senior Executive
Lloyd’s International Regulatory Affairs
e: rachael.penny@lloyds.com
t: +44 (0)20 7327 6380