THE FRAUD
LAWYERS ASSOCIATION

Tackling offshore tax evasion: A new criminal offence

Response to the HMRC Consultation from the Fraud Lawyers' Association

This response is submitted on behalf of the Fraud Lawyers' Association ('FLA'). The FLA is an organisation established in 2012 to educate and train its 350 members in all matters relating to their practice as fraud lawyers. Its membership consists of solicitors and barristers who practise mainly in the area of criminal and civil fraud: www.thefraudlawyersassociation.org.uk/.

We note that the questions posed by the Consultation Document assume agreement that the introduction of a strict liability offence for offshore tax evasion is itself appropriate. As we strongly disagree with that assertion, we propose to address this issue first in our response. Having done so, and without prejudice to our position on this matter, we turn to deal with the Consultation questions themselves.

Q: Should the Government introduce a strict liability offence to deal with offshore tax evasion.

A: For the reasons set out below, the answer to this question is 'no'.

The inherent nature of tax evasion

We note from the Consultation Document (paragraph 5.6) that HMRC proposes that even those who incompetently fail to declare offshore income or gains (eg. through carelessness) should be liable to prosecution for tax evasion.

Tax evasion is quintessentially an offence of dishonesty, which involves the deliberate concealment of assets. This is self-evident not only from the everyday, ordinary meaning of the phrase, but from HMRC's own working definition of the offence, as set out in paragraph 3.8 of the Consultation Document:

*"...using a non-UK jurisdiction **with the objective** of evading UK tax. This includes moving UK gains, income or assets offshore **to conceal** them from HMRC; not declaring taxable income or gains that arise overseas, or taxable assets kept overseas; and using complex offshore structures **to hide** the beneficial ownership of assets, income or gains."*

[Emphasis added].

It is not possible to square this definition with lesser forms of *mens rea*. One only has to consider other offences of dishonesty in order to make the point. For example, it is not possible to handle stolen goods negligently, or commit insurance fraud carelessly. Any such suggestion would be absurd.

There is no reason to treat tax evasion any differently. In reality, there is only one way of committing the offence and that is dishonestly. There already exists a multitude of offences available to HMRC to prosecute such behaviour and there is no need to add to the statute book (particularly by way of strict liability which is profoundly inconsistent with the concept of dishonesty).

Anything less than dishonest conduct (eg. a negligent failure to declare offshore gains) is not tax evasion at all and should not be criminalised as such. Rather, it should continue to be dealt with by way of repayment of the outstanding tax, along with civil penalties as appropriate. If there are ways and means of making that civil system more robust, then of course these should be explored (see below). What is unacceptable, however, is to stigmatise honest but incompetent taxpayers as tax evaders. Not only is that wholly disproportionate, but it is also inconsistent with HMRC's published policy , which has generally reserved criminal investigation for large scale frauds involving one or more of a number of identified aggravating features. It is on this basis that HMRC's policy of selective prosecution has historically been held rational and thereby lawful (R v IRC (ex. p Mead) [1993] 1 All E.R. 772).

In the absence of such aggravating features, large scale tax frauds (ie those worth over £75,000) are generally dealt with by way of the civil procedures available under Code of Practice 9. Indeed, this procedure is often invoked for frauds worth considerably in excess of this figure. In that light, there can be no justification for prosecuting individuals who have perhaps only been negligent rather than dishonest, and in respect of whom the sums involved may be far smaller.

We would respectfully remind HMRC that to bring criminal proceedings in direct breach of its own policy on criminal investigation is itself potentially abusive (R v Adaway [2004] EWCA Crim 2831).

Leaving these fundamental objections to one side, there are in any event other significant issues with the current proposal.

Flawed rationale for the new offence

According to the Consultation Document, the rationale for the new offence is underpinned by the twin premise that (a) there is presently an effective moratorium for those who come clean about their offshore affairs and (b) strict liability offending is an established concept in relation to other areas of the criminal law.

The FLA submits that both limbs of the premise are flawed.

In relation to the moratorium, this is due to expire in 2016. It is unlikely that any new offence will be on the statute book in advance of that date, whilst the offence could subsist for an indefinite period thereafter. In those circumstances, there will inevitably be prosecutions of those who had no opportunity to take advantage of the concessions presently on offer. That outcome is potentially unfair and also susceptible to challenge.

As for the second limb of the premise, namely that strict liability offending arises elsewhere in the criminal justice system, this is a particularly inapposite consideration. As is plain from the examples given on page 7 of the Consultation Document, instances of strict liability properly arise where the application of *mens rea* is of lesser importance, and where the facts underpinning the offence are susceptible to simple determination (eg. driving whilst disqualified). That is the polar opposite of the position regarding offshore tax evasion, where the mental element is key to the offending and where determination of the underlying liability may be a matter of significant factual and/or legal complexity.

This latter point is of particular concern when one considers the forum in which it is proposed to prosecute the new offence.

<u>The unsuitability of the summary justice system</u>

As matters stand, it is proposed that the new offence will be summary in nature. In other words, prosecutions for offshore tax evasion will be conducted in the Magistrates' Court.

In our submission, this is one of the most flawed aspects of the scheme. As set out above, and as is acknowledged on page 23 of the Consultation Document, ascertaining liability for offshore gains will in some instances be a matter of complexity. If, as we anticipate (see below), any new offence is accompanied by statutory defences (eg that the taxpayer took all reasonable steps to avoid committing the offence), the magistrates trying the case will also have to engage in sophisticated value judgments, often based on expert evidence.

Complex satellite issues, such as waiver of legal professional privilege, are also likely to arise in cases where the taxpayer is relying upon professional advice in order to avoid conviction.

Litigation of this nature is incompatible with the realities of life in the lower courts. Lay magistrates are ill-equipped to deal with the complexities of these issues, which in turn will increase yet further the potential for unfair outcomes. Even if tax cases are reserved for District Judges, the potential length of the trials in question will lead to significant delays in courts which specialise in straightforward, high turnover cases. That is plainly not in the wider interests of justice.

Genuine cases of dishonest tax evasion should therefore continue to be dealt with by the Crown Court, where the advocates and the judge are in a position to provide expert assistance to the jury. Incompetent or negligent failures to declare, on the other hand, should be dealt with, as at present, by HMRC as part of its civil regime. There is no need to trouble the Magistrates' Court at all.

Concluding remarks

We are not unsympathetic to HMRC's desire to clamp down on offshore tax evasion. We have no doubt that it results each year in a significant loss of income to the Exchequer and that it undermines confidence in the taxation system as a whole.

That does not justify reinventing the wheel, however, either by criminalising essentially non-criminal behaviour, or by introducing strict liability offending where it is plainly inappropriate.

We would therefore encourage HMRC to explore alternative solutions, such as:

- Reviewing the investigatory powers available to HMRC to see if they can be supplemented in any way (eg. by acquiring similar powers to those enjoyed by the CPS under s.62 of SOCPA 2005 (the right to conduct compulsory interviews)).[1]
- Increasing the available civil penalties for an incompetent or negligent failure to declare offshore gains.
- Intensifying political and diplomatic efforts to expand the pool of countries presently signed up to the Common Reporting Standard ('CRS').
- Intensifying HMRC's present PR campaign to inform the public more widely of the impact of the CRS and to deter those who might otherwise be tempted to evade their tax.

All of these measures would have the effect of reducing the incidence of off-shore tax evasion without undermining fundamental aspects of the criminal justice system. We therefore urge HMRC to reconsider the essential characteristics of the scheme and to discard the notion of any new offence, particularly one predicated on strict liability.

Without prejudice to that core contention, we go on to provide below our response to the specific questions posed by the Consultation Document itself.

Please note that if HMRC ever wishes to cite any of these responses, whether internally or externally, and whether in whole or in part, it must also be made clear to the recipient that the FLA opposes the introduction of the offence itself.

[1] Should such a power be introduced, it must of course be accompanied by the safeguards presently built into s.2 CJA 1987 and s.62 SOCPA 2005, such as the immunity of legally privileged information and restrictions on the use of the product of the interview.

Scope of the offence

Do you agree that the applicability of the offence should be limited to income tax and capital gains tax?

Ans: Yes.

Do you agree that the offence should be restricted to taxable income and gains which arise offshore?

Ans: Yes

In your opinion, which option (to apply the offence only to investment income or gains, or to apply the offence to all offshore income and gains) would best deliver the policy intention?

Ans: The offence should be limited only to investment income or gains.

Do you think that the offence should apply to income and gains which are reported under the Common Reporting Standard?

Ans: No. The increased powers available to HMRC in relation to the CRS scheme mean that there is insufficient justification for prosecuting cases which arise thereunder.

Should all income and gains in CRS jurisdictions be exempted from the offence, or should the offence apply to any income and gains which are not automatically reported to HMRC?

Ans: All income and gains in CRS jurisdictions should be exempted.

Are there any further issues or impacts which should be taken into account when introducing the offence into Scottish and Northern Irish law?

Ans: We will leave this issue to our colleagues in those jurisdictions.

Proportionality and sanctions

Do you agree that a *de minimis* threshold is appropriate?

Ans: Yes. It should be at least as high as the entry level for cases deemed fit for disposal under COP9 (which we understand to be approximately £75,000). If it is not so, significant frauds committed

by some will continue to be dealt with under COP9, whilst much lesser frauds will be prosecuted under the new offence. That is plainly unsatisfactory.

Should the *de minimis* be set by reference to the potential lost revenue arising from the failure/inaccuracy, or some other measure? If so, should the potential lost revenue be calculated in the same way as it is for the purposes of determining civil penalties?

Ans: See above

Should the threshold be incorporated in statute or guidance?

Ans: In statute

Are there any further options (for setting the threshold)?

Ans: See above

Which approach to setting the threshold do you favour?

Ans: See above

The Government's view is that the threshold should apply for each tax year, rather than in respect of a cumulative amount of potential lost revenue, as a new offence would be committed for each tax period – *e.g.* each time an incorrect return is filed. Do you agree?

Ans: Yes

Do you agree with the principle that the available criminal sanction for offshore non-compliance should not be seen as more lenient than the available civil sanction?

Ans: Yes

Should an unlimited financial penalty be available to the courts?

Ans: Yes, provided that it is tied to the amount of the tax evaded, as set out in paragraph 4.29 of the Consultation Document.

Is the harm which could be caused by a failure to declare offshore income and gains sufficient that a custodial sentence could be justified in the most serious cases?

Ans: It is very difficult to conceive of custodial sentences being imposed for anything other than dishonest instances of evasion. As we believe that this type of offending should continue to be prosecuted only under the powers which are presently available to HMRC, our answer is that custodial sentences should not be available for non-fraudulent (ie incompetent or negligent) instances pursued under the strict liability regime.

If a custodial element is appropriate, should the maximum sentence be six months?

Ans: See above

Safeguards and defences

Should it be a defence for (i) a person to demonstrate that they had taken reasonable care in conducting their tax affairs, or (ii) a person to demonstrate that they had sought and followed appropriate professional advice? What would be the impact on the likelihood of successful prosecutions if statutory defences are included?

Ans: Statutory defences of this nature must be included if the strict liability scheme is to be imposed. They are routinely included in other forms of legislation which give rise to strict liability and there would be no justification for excluding them from the tax regime. To do so could only possibly increase yet further the risk of unfair outcomes.

In relation to the latter defence, the word 'appropriate' should be excluded. If it stays in, taxpayers who sought professional help in good faith but received poor quality advice would be disbarred from raising a defence. This is plainly unfair.

[NB. We don't accept that the inclusion of these defences would justify the imposition of strict liability offending in the first place. There are in essence 2 reasons for this. Firstly, such defences do not circumvent the essential objection to a strict liability scheme, namely that mens rea is paramount in relation to instances of tax evasion. Secondly, whether one characterises the position in legal or evidential terms, the defences involve an effective reversal of the burden of proof. Whilst Parliament has deemed this to be an acceptable outcome in other, less complicated areas of law, this will inevitably lead to unfair outcomes in the complex field of offshore tax evasion].

Should any other statutory defences be introduced?

Ans: In addition to the above, it should be a defence for an individual to demonstrate that he/she did not act dishonestly in failing to declare the income/gains in question.

Are further safeguards appropriate? What should these be?

Ans: In order to avoid abusive prosecutions (eg where the risk of unfairness is acute), no criminal investigation should be instigated without the consent of the Director General of HMRC (or at least an individual of very senior rank). Equally, no prosecutions should subsequently be brought without the authority of the DPP (or at least an individual of very senior rank within the CPS).