The UK’s new corporate criminal offense

How adopting a robust risk-based approach could open the pathway for future global compliance
The UK’s new corporate criminal offense (CCO) of the failure to prevent the facilitation of tax evasion entered into force on 30 September 2017. The CCO, which was included in the Criminal Finances Act enacted on 27 April 2017, subjects business entities themselves to criminal liability if they fail to prevent those who act for them, or on their behalf, from criminally facilitating tax evasion. An offense by a corporate entity or partnership could result in its criminal prosecution, an unlimited financial penalty, a public record of conviction and potential implications on the ability to trade.

The CCO legislation is exceedingly broad and also has a wide-ranging extraterritorial effect. It applies not only to all entities in the world where the underlying tax is owed to HM Revenue & Customs (HMRC), but also to non-UK taxes where an entity is incorporated in the United Kingdom, has a place of business in the United Kingdom or has had any aspect of the offense(s) occur in the United Kingdom. Moreover, while the financial services sector is one of the industries at higher risk, the CCO legislation applies to all industries, and there are a number of risks that may permeate across many industries.

By now, HMRC expects organizations to have undertaken a risk assessment and have in place an implementation plan of enhanced processes to ensure compliance with the new legislation. In this article, we explain the key concepts in the legislation and how businesses are responding.\(^1\)

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How does a CCO arise?

An offense occurs when an “associated person” – a person acting on behalf of a business (defined as a “relevant body”), such as an employee, agent or service provider – facilitates the evasion of tax of a third party while acting on behalf of the business. If the business cannot demonstrate that it had reasonable procedures in place to prevent its associated persons from facilitating tax evasion, then it could be subject to a corporate criminal conviction and an unlimited fine.

The “facilitation of tax evasion” concerns both UK tax evasion and foreign tax evasion offenses, again evidencing the global reach of the legislation. Businesses are now attempting to identify the potential ways in which their associated persons could potentially facilitate the tax evasion of third parties while acting on behalf of the business. Some hypothetical examples include:

- An employee of a UK-based multinational bank knowingly refers a corporate client to an offshore accounting firm with the express intention of assisting the corporate client to set up a tax-evading structure, enabling the client to evade either UK or foreign income tax.
- An agent acting for a business colludes with a customer to disguise the source country of origin of goods in order to reduce the level of duties paid when importing said goods.
- A salesperson agrees to mis-describe the nature of goods or services sold in order to enable the customer to obtain a more favorable tax treatment (for example, to claim a deduction as opposed to capital expenditure).
- A payroll administrator agrees to mask the true travel plans of a globally mobile executive to evade income tax due in another territory.
- A member of the accounts payable staff agrees to submit payment to a supplier’s bank account in a low- or no-tax territory in the knowledge that the income is not being declared.

What is a defense?

When there has been an instance of tax evasion, and it has been facilitated by an associated person acting on behalf of a business, the only defense against a prosecution is that the business had put in place reasonable procedures to prevent associated persons from facilitating tax evasion; or, that it was not reasonable to have expected the relevant body to have any prevention procedures in place.

“Reasonable” is, of course, a subjective term, and the level of effort required to meet this test will vary from business to business, subject to the level of the risk of facilitation by associated persons. HMRC has set out six “guiding principles” that businesses should consider when developing reasonable procedures to prevent associated persons from facilitating tax evasion.2

### Reasonable prevention procedures - six guiding principles

**Risk assessment:** the relevant body must assess 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.

**Proportionality of risk-based prevention procedures:** to be “reasonable,” prevention procedures should be proportionate to the risks a relevant body faces of persons associated with it committing tax evasion facilitation offenses. This will depend on the nature, scale and complexity of the relevant body's activities; the procedures should take into account the level of control and supervision the organization is able to exercise over a particular person acting on its behalf and the proximity of the person to the relevant body.

**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. Top management should foster a culture within the relevant body in which activity intended to facilitate tax evasion is never acceptable.

**Due diligence:** the organization should apply due diligence procedures, taking an appropriate risk-based approach, in respect of persons who perform or will perform services on behalf of the organization, in order to mitigate identified risks.

**Communication (including training):** the organization must take steps to ensure that its prevention policies and procedures are communicated, embedded and understood throughout the organization, through internal and external communication, including training. The communication should be proportionate to the risk to which the organization assesses that it is exposed.

**Monitoring and review:** because the nature of the risks faced by an organization will change and evolve over time, the organization must monitor and review its prevention procedures and make improvements where necessary.

Carrying out a risk assessment is a fundamental starting point for identifying the risks of facilitation in the business and evaluating how well existing controls may already address those risks. In essence, the risk assessment drives the response to the legislation: until a business identifies where its CCO risks may arise, it is impossible to know whether existing controls can sufficiently manage the risk.

Investing in a robust risk assessment can pay dividends in terms of building a proportionate response and demonstrating that any subsequent actions are grounded in the risks that the business faces. A robust risk assessment can also help minimize the unnecessary waste of resources.
Risk assessments: compliance lessons thus far

When the CCO legislation was enacted in April 2017, many businesses at first did not appreciate the global reach of the legislation. However, as businesses have studied the CCO more closely, many have recognized that a risk assessment should be undertaken on a group-wide basis, given that trying to exempt parts of a global organization can quickly become impractical. Indeed, in a recent EY survey of more than 400 respondents, the highest proportion (38%) said their organization has approached their CCO risk assessment by reviewing their global operations; 24% of the respondents said they are reviewing their UK operations first and will move on to their global operations later (see Figure 1).

Our CCO readiness work with a number of companies to date provides several key insights.

Financial services

Given that HMRC has stated that the financial services sector is a sector it believes is at higher risk (and also given their prior experience in reacting to new multi-territorial requirements), in general, financial services businesses are, we believe, ahead of nonfinancial services businesses in terms of carrying out their risk assessments. And while businesses in the financial services sector carry out a diverse range of activities, some common risk factors have emerged. In particular, the wide range of bespoke financial products that financial services businesses may provide, and the close relationships that often develop between financial service providers and their clients, create a higher risk that an associated person will facilitate tax evasion, according to HMRC.

Based on our CCO readiness work with clients, businesses in the wealth and private banking sectors tend to have higher CCO risks. Small business banking can also present higher risks in some circumstances. Other higher-risk areas that have been identified include property and real estate investments and specific customer and investor types.

Businesses in the financial services sector have a number of existing controls to leverage – the key question is how best to incorporate tax controls into their wider financial crime and compliance framework. The CCO risk assessments carried out by financial services businesses have tended to be very client-focused; this makes sense, as this is where the higher risks lie in the banking area. However, it is equally important that financial services businesses include other business units – such as human resources, accounts payable, and supplier and vendor management – in their risk assessments.

Other sectors

For nonfinancial services businesses, a key question when identifying potential CCO risks is whether there are areas within the business that may increase the motive of associated persons to facilitate tax evasion. For example, could a desire to keep key customers happy create pressure to help a customer evade tax? Similarly, could a competitive “reward culture” lead individuals to help customers evade tax to secure their own bonus payments? On the supplier side, could the pressure to drive down costs in the supply chain lead to cost savings being delivered via the facilitation of tax evasion of a supplier? Focusing on the motives of associated persons to potentially facilitate tax evasion has helped many of our clients to identify potential risk areas better.

We are also seeing businesses assess whether there are robust controls regarding sales invoices. While many businesses have controls in place in respect of invoice values, existing controls often do not consider the risk of facilitating tax evasion through the mis-description of the goods and services provided, and those with responsibilities for processing payment and invoicing may not be aware of the red flags.

Activities with customers or suppliers in jurisdictions that have low tax transparency, low (or no) taxes, or higher risks of bribery or corruption naturally present additional risks that businesses must manage appropriately. A number of businesses have sought to build on their existing processes and controls to manage the risk of bribery and corruption, and address the identified risks for facilitating tax evasion.

Intermediaries and due diligence

The use of contractors and intermediaries may also create CCO risks, in our experience. Businesses should review their controls to manage any risk that a contractor should actually be treated as an employee (and thus pay higher tax) to ensure that nobody in the business has the opportunity (whether intentional or not) to facilitate a contractor’s tax evasion. Furthermore, businesses should consider clarifying how an intermediary that is supplying contractors is managing the risk that it might be facilitating a contractor’s tax evasion, as an intermediary may possibly be classified as an associated person of the business, upon scrutiny.

Businesses are also assessing their due diligence procedures. Many already perform due diligence when considering with whom they want to do business and when carrying out merger and acquisition (M&A) activities; businesses should now include the facilitation of tax evasion risk in those due diligence procedures. Businesses might also find that other businesses they want to work with will want to know how they are managing their CCO risks. Organizations should therefore be prepared to provide evidence on how those risks are being managed within their business. This is relevant to not only new and existing business relationships, but also in the context of due diligence related to potential M&A activity.
Beyond the risk assessment

Carrying out a CCO risk assessment can be a challenging exercise, and it may be tempting to think that the hard part is over once the risk assessment has been completed. It would be incorrect to do so, however. Businesses should instead sustain their commitment and momentum, which will enable them to implement necessary changes, maintain compliance in the long term and adapt to evolving requirements.

After completing their initial risk assessment, it is likely that many organizations may need to take follow-up actions, such as:

- Deep-dive risk assessment: where a lack of information or granularity has led an organization to conclude that a business unit should be treated as higher risk, performing a deep-dive assessment could aid the business in better identifying and quantifying risks (for example, in a global business unit, with varying processes around the world).

- Controls effectiveness testing: many organizations have not yet conducted controls effectiveness testing for CCO purposes, and are instead relying on existing testing and management information. Controls effectiveness should be considered as part of a longer-term implementation plan, either as part of the business's existing processes or as a stand-alone process.

Businesses should now be looking to rapidly implement any changes needed to address risks identified across the business and put in place key controls identified by HMRC, including top-level commitment, training and due diligence on employees and third parties. The ultimate goal should be to embed CCO reasonable prevention measures into an organization's business-as-usual model. If a business views this as purely a policy or training exercise, it is highly unlikely the business will be able to show it has reasonable procedures in place.
In the EY survey mentioned earlier, 50% of the respondents said they anticipate their implementation efforts will be “moderate” based on their organization’s CCO risk assessment; 37% said their implementation efforts will be “minimal”; and 13% said theirs will be “significant” (see Figure 2). On the question of where they anticipate having to invest the most effort after performing a risk assessment, the top response was “updates to recurring business processes” at 37%, followed by “communication with key stakeholders and senior leadership” at 32%, and “training” at 24% (see Figure 3).

The bigger picture

The CCO is a broad regime and affects many different business units, so it will be very important to involve all the different stakeholders across the business (including compliance, risk, legal and internal audit) when performing the risk assessment and when implementing any changes. Our experience from working with businesses across a range of sectors is that the risk assessment provides the platform to determine a reasonable and proportionate response. For many businesses that have completed their risk assessment, they are confident that the existing control frameworks go a long way – but possibly not far enough – to address the risks identified.

The CCO does not discriminate between different tax types; in that regard, nor should a CCO risk assessment. Instead, the tax function should lead a process that addresses the CCO holistically and not in a piecemeal fashion.

Businesses operating outside the United Kingdom should also bear in mind that the CCO is a risk-based measure that necessitates a risk-based approach. Therefore, not all global companies will need a resource-intensive approach. Instead, they should adopt an approach that addresses the level of risk posed by their business with, and in, the United Kingdom and leverage the controls and procedures they may already have in place.

The United Kingdom is not the only country looking closely at tax evasion. The Organisation for Economic Co-operation and Development (OECD) held its Fifth Forum on Tax and Crime in London on 7-8 November 2017, publishing new recommendations on tackling tax and economic crime more effectively.3 We are also seeing a range of other developments globally, including the wider introduction of tax evasion as an anti-money laundering offense and the use of data by regulators to identify tax evaders and other criminals. Ultimately, global organizations will need to consider all of these developments, and in our view, developing a robust approach to complying with the CCO can provide a solid platform for global compliance.

For some businesses, this may mean further developing their existing protocols. For other businesses, such protocols may need to be built from the ground up. But whatever the case, the clock is ticking, and all businesses must reach the point where they can confidently demonstrate that “reasonable procedures” are – and have been – in place.

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3. The documents published at the Fifth OECD Forum on Tax and Crime.
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