ReedSmith
Newsletter

Accountancy forum

Welcome to Reed Smith's accountancy forum newsletter. This newsletter will cover a range of issues affecting accounting firms, with a core focus on liability and regulatory risk. In this edition, we look at the new corporate criminal offences for failure to prevent the facilitation of tax evasion, recent court decisions and hot topics in the industry, such as the inquiry into the Paradise Papers. Please do get in touch with any questions and let us know if there's a particular issue/case that you'd like us to cover in an upcoming edition, we would love to hear from you.

In this issue...

Lead article

The corporate criminal offences for failure to prevent the facilitation of tax evasion - where are we now?

Case summaries

Court of Appeal rules on duty to warn: guidance for professionals

Court of Appeal addresses comparison between auditors' and bankers' duties in negligence

Canadian Supreme Court rules on duty of care of auditors

Industry news

EU tax inquiry to commence in the wake of Paradise Papers revelations

SEC announces strategy for more cases on cryptocurrency coin offerings

Change to the name of insolvency registrars

GDPR for accountants and insolvency practitioners: how to prepare

Key dates

The corporate criminal offences for failure to prevent the facilitation of tax evasion – where are we now?

by Jane Howard | Partner, London Head of professional liability

It is almost six months since the new corporate criminal offences (CCOs) for failure to prevent the facilitation of tax evasion came into effect with the enactment of the Criminal Finances Act 2017 (the CFA) on 30 September 2017. Like the corporate offence contained in the UK Bribery Act 2010, prosecutors will no longer be required to show that a senior member of a relevant body was involved in and aware of the illegal activity for criminal liability to be attributed to the relevant body.

This is but one of the many reforms the UK government has made in bolstering corporate transparency and fighting corruption. Others include the Modern Slavery Act 2015 requirements for certain organisations to develop a slavery and human trafficking statement and the more recent introduction of unexplained wealth orders (a new measure to tackle asset recovery and money laundering provided under the CFA (effective 31 January 2018)). The UK government's publication of the United Kingdom Anti-Corruption Strategy 2017-2022 in December last year also made clear the government's agenda is fixated on tackling corruption. The strategy includes plans for a new national economic crime centre, the appointment of a new Minister for Economic Crime in the Home Office and proposed amendments to the Crime and Courts Act 2013 to include the Serious Fraud Office (SFO) in the list of organisations the Director General of the National Crime Agency can directly task to investigate cases of economic crime. The proposed reforms (and those already in place) impose a significant increased legal burden on corporations, with regular reporting on corporate criminality a common occurrence.

The CCOs are expected to affect the accounting profession, in particular, given its role in undertaking tax advisory work. An explanation of the new offences follows.

What are the new offences?

There are two new corporate offences under the CFA:

1. Failure to prevent facilitation of UK tax evasion offences (s. 45 of the CFA)

2. Failure to prevent facilitation of foreign tax evasion offences (s. 46 of the CFA)

The UK government published an updated guidance on the offences on 1 September 2017 (Guidance), which identifies three elements to each of the CCOs:

1. Criminal tax evasion by a taxpayer (either an individual or a legal entity)
    - No conviction of the taxpayer is required before a prosecution can be brought against a relevant body although the prosecution would still have to prove, to the criminal standard of beyond all reasonable doubt, that the taxpayer-level offence had been committed
    - For an offence to constitute a foreign tax evasion offence, it must be a criminal offence under the law of a foreign country and be conduct which would be regarded by the UK courts as amounting to being "knowingly concerned in", or taking steps with a view to, the fraudulent evasion of tax. As such there must be 'dual criminality'. Further, for these offences to be committed it is not necessary that any tax is actually successfully evaded.
2. Criminal facilitation of the tax evasion by a person associated with the relevant body
    - The definitions of a 'relevant body' and 'associated person' are provided below.
3. Failure by the relevant body to prevent the associated person from committing the criminal facilitation act
    - The CCOs are strict liability offences. If there is criminal tax evasion by a taxpayer and an associated person criminally facilitated that tax evasion, the relevant body will have committed one of the corporate offences unless it can show that it had reasonable preventative procedures in place. The procedures are considered below.

What is a 'relevant body'?

Only a relevant body can commit the new CCOs (defined by s. 44 of the CFA).

A relevant body only includes incorporated bodies (typically companies) and partnerships. The corporate offences cannot be committed by individuals.

What is an 'associated person'?

A person (whether an individual or any incorporated body) 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 (s. 44(4) of the CFA). For example, a foreign tax adviser instructed by a UK financial services or accounting firm to provide tax advice to a client would be considered an associated person of the UK firm. Consequently, its advice to the client could attract liability for the UK firm.

Whether a person is performing services for or on behalf of the organisation will be determined by reference to all of the circumstances and not merely by reference to the nature of the relationship between that person and the relevant body (s. 44(5) of the CFA).

Our Practice

About Reed Smith's Accountants' Liability Practice. From litigation and regulatory defence to reputation management, data security and insurance recovery advice, Reed Smith can help protect your interests. Our lawyers act for 3 of the Big 4 accountancy firms, two-thirds of the top 20 accountancy firms and for more than half of the top 25 international networks of accountancy and business advisory firms.

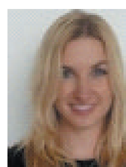
Key contacts

Jane Howard
Partner, London
+44 (0)20 3116 2895
jhoward@reedsmith.com

Charles Hewetson
Partner, London
+44 (0)20 3116 2976
chewetson@reedsmith.com

Elizabeth Mason
Associate, London
+44 (0)20 3116 2856
emason@reedsmith.com

Laura-May Scott
Associate, London
+44 (0) 20 3116 2904
lscott@reedsmith.com



Kerri Bridges
Associate, London
+44 (0)20 3116 3809
kbridges@reedsmith.com

Importantly, the associated person must commit the tax evasion facilitation offence whilst acting in the capacity of an associated person. Therefore any activity undertaken by the associated person (for example) for other relevant bodies or carried out in their 'private' capacity would not lead to liability for the relevant body.

Extra-territorial effect

The CCOs are relevant to businesses both inside and outside the UK. Specifically, s. 48 of the CFA provides that:

- The UK tax evasion facilitation offence can be committed by a relevant body as long as there has been evasion of a UK tax regardless of whether the relevant body is UK-based or established under the law of another country, or whether the associated person who performs the criminal act of facilitation is in the UK or overseas.

- The foreign tax evasion facilitation offence can be committed if the relevant body carries on business in the UK or if any conduct constituting part of the foreign tax evasion facilitation offence takes place in the UK.

What are the penalties?

The penalties for the CCOs include unlimited fines and ancillary orders (such as confiscation orders or serious crime prevention orders). A criminal conviction may also require disclosure to professional regulators both in the UK and overseas, and may prevent the relevant body being awarded public contracts. Significant reputational damage is also a likely consequence.

This is yet another mechanism likely to impact on a company's ability to engage in public procurement processes. In the context of the Modern Slavery Act 2015, the UK's Joint Select Committee on Human Rights concluded in 2017 that the government should facilitate the passage of legislation excluding obligated companies from participating in public procurement procedures where they have failed to produce a slavery and human trafficking statement.

Available defences

The CFA provides a defence to the CCOs if the relevant body can demonstrate that it had in place a system of reasonable prevention procedures which identified and mitigated its tax evasion facilitation risks or that it was unreasonable to expect it to have such procedures. The Guidance sets out what may amount to reasonable prevention procedures, which should be informed by six guiding principles:

1. Risk assessment

2. Proportionality of risk-based prevention procedures

3. Top level commitment

4. Due diligence

5. Communication (including training)

6. Monitoring and review

Notably, these are the same principles as those contained in the guidance given for what constitutes adequate procedures for the purposes of showing a defence to the corporate offence under the UK Bribery Act 2010. As with those procedures, it is not possible to

prescribe ideal procedures in the abstract. However, typical procedures will assess the risk of facilitating tax evasion from the point of view of client demographics, geography, the nature of third parties dealt with, and the practices of a particular industry.

Self-reporting

On 29 September 2017, HMRC also issued guidance on how a business can self-report its own failure to prevent the facilitation of UK tax evasion by emailing HMRC at: corporate.self-reporting@hmrc.gsi.gov.uk. Self-reporters should try to include in their email information about:

1. The reporter and relevant body
2. The tax evasion facilitation offence
3. The tax evasion offence
4. The relevant body's prevention procedures

Of course (as noted in the guidance), rapid self-reporting does not guarantee that a relevant body will not be prosecuted. It could, however, be:

- part of a relevant body's defence, if liable under the offences;
- taken into account by prosecutors when making decisions about prosecution; and
- reflected in any associated penalties, if the relevant body is convicted.

If a relevant body wishes to report a failure to prevent criminal facilitation of foreign taxes, it must report this to the SFO.

At this stage there has been no indication of the number of self-reports or investigations, although it is still early days. Businesses are, in the interim, busily implementing reasonable prevention procedures and are encouraged to review and update these procedures regularly as expected by HMRC (and noted in the Guidance). Although HMRC did not expect relevant bodies to have the prevention procedures in place by 30 September 2017, the government still expects rapid implementation with a clear timeframe and implementation plan.

Case summaries

Court of Appeal rules on duty to warn: guidance for professionals

Barker v. Baxendale Walker Solicitors (A. Firm) [2017] EWCA Civ 2056

A client sought advice from his solicitor in relation to mitigating the capital gains tax liability on the sale of his shares by creating a private unit trust. His solicitor recommended an employee benefit trust, modelled on the solicitor's interpretation of s.28 of the Inheritance Tax Act 1984: the client would gift his shares to the trust in return for capital taxation exemptions for himself and his family. The client accepted the solicitor's advice (which had not included a

warning regarding the significant risk of a different interpretation of s.28 by HMRC), gifted his shares to the trust, and sold the company. HMRC later assessed the client as liable to tax in relation to the trust.

The Court of Appeal held that the advice given by a reasonably competent solicitor would have contained not only their own view of the provision on which they were advising, but also – crucially – whether there were any contrary arguments, and the significance of such arguments. Even if a statutory interpretation is correct, advice can still be negligent if it fails to address any risk which may arise from an alternative construction.

This case serves as an important reminder that solicitors have a duty to give a balanced view of both the benefits and the risks when advising their clients. This will also apply to other professionals, especially accountants and other tax advisers such as tax counsel. Any advice should include appropriate risk warnings.

Court of Appeal addresses comparison between auditors' and bankers' duties in negligence

Singularis Holdings Ltd v. Daiwa Capital Markets Europe Ltd [2018] EWCA Civ 84

In an earlier decision, the High Court decided that a stockbroker ('D') was liable in negligence for having breached its duty of care to its customer, Singularis Holdings Ltd (in liquidation) ('S'). D was liable for having paid monies out of the client account it held for S on the instruction of a rogue director of S, who happened to be its only shareholder. S was on the verge of insolvency and D paid US$204 million of S's funds to bank accounts not in the name of S, but to related entities.

The leading authority on this point is *Barclays Bank plc v. Quincecare Ltd*, which established that a bank will be liable to its customer for damages in negligence where the bank makes a payment when it has "reasonable grounds (although not necessarily proof) for believing that the order is an attempt to misappropriate the funds of the company". This is known as the 'Quincecare duty'.

There were five grounds of appeal, all of which were dismissed. In reaching its decision, the Court of Appeal reiterated that there is no proper comparison between the duties of auditors and bankers:

"First, the duty of care owed by an auditor is of an entirely different character from the Quincecare duty owed by Daiwa to its customer, Singularis. The normal duty of an auditor is to report on the accuracy of the financial statements of the company, whereas the Quincecare duty is to "refrain from executing an order if and for as long as the banker is 'put on inquiry'".

While this ruling reinforces the fact that the duty of an auditor is different to that of a banker, it is problematic in the sense that the 'normal duty' of an auditor has been all too briefly, and thus incorrectly, stated. The auditor's duty (albeit not precisely defined in auditing standards, nor in the case law) is directly towards seeking reasonable (not absolute) assurance as to the accuracy and completeness of a set of financial statements prepared by the company. What amounts to 'reasonable' assurance is, of course, a question of judgment. What is clear, however, is that the auditor is not expected to eliminate risk, but to reduce it to an acceptable level.

Canadian Supreme Court rules on duty of care of auditors

Deloitte & Touche v. Livent Inc. (Receiver of), 2017 SCC 63

In December 2017, the Canadian Supreme Court in *Deloitte & Touche v. Livent Inc.* considered the scope of an auditor's duty of care to its corporate client.

The action was brought by the shareholders of Livent Inc. against Deloitte & Touche (Canada). As Livent's theatre properties and live entertainment business grew, so did the fraud being perpetrated by management: the executives began to falsify invoices, extend or avoid amortisation to inflate their bottom line, and enter into loan or financing agreements cloaked as asset sales in order to boost revenue.

In 1997, before the fraud came to light, Deloitte had identified irregularities in the accounting and reporting by Livent in relation to a particular transaction. Despite their concerns, Deloitte Canada issued a comfort letter/press release in 1997 that assisted the transaction in issue. Shortly thereafter, Deloitte provided a clean audit opinion.

The lower courts found that Deloitte fell below the standard of care they owed to the shareholders and awarded US$84,750,000 by way of damages.

The issues on appeal to the Supreme Court related to the duty of care and quantum. In reaching their decision, the Supreme Court clarified that a duty of care in respect of an auditor's representation or services is limited to the purpose for which the auditor undertook to provide the representation or services. The court found that Deloitte had prepared the comfort letter/press release for the purpose of assisting Livent to solicit investment; i.e., it was intended to provide comfort to investors rather than to inform Livent of its own financial position. The court concluded that no prima facie duty of care arose in respect of Livent's reliance on the comfort letter/press release and as such Deloitte was not liable for the losses arising as a result of Livent's reliance.

The Supreme Court went on to find that the auditor was nevertheless liable for Livent's losses arising from the negligently prepared clean audit opinion as Livent had relied on the audit opinion for one of its intended purposes: to enable shareholder oversight of management.

Ultimately, the damages award was revised down to US$40,425,000, having been assessed on the basis of the increase in Livent's liquidation deficit, which followed after Deloitte signed off its clean audit opinion.

Industry news

The EU tax inquiry to commence in the wake of Paradise Papers revelations

In the wake of the Paradise Papers leak, the EU parliament has voted to launch a committee (known as Taxe 3) to investigate key tax issues, including in relation to the digital economy and VAT fraud, with a view to addressing tax evasion, tax avoidance and financial crime in the EU.

Taxe 3 will review and monitor progress of EU member states in removing tax practices which allow tax to be avoided to the detriment of the single market. The committee is comprised of 45 MEPs and the inquiry has a mandate of 12 months. This follows the

investigations of the Taxe 1 and 2 committees, which examined the LuxLeaks papers of 2014, and the PANA committee, which was established after the 2016 Panama Papers leak.

SEC announces strategy for more cases on cryptocurrency coin offerings

In a recent speech at the Securities Regulation Institute, the U.S. Securities and Exchange Commission (SEC) Chairman, Jay Clayton, provided a stern message to market professionals in the initial coin offering arena, namely: "they can do better". Clayton discussed initial coin offerings and the way companies are promoting these products in a way akin to securities offerings, but then claiming they are not, in fact, securities when it suits them. This approach means that investors are not protected by U.S. securities laws. Clayton said that lawyers have failed to provide sufficient advice to companies forewarning that the products are likely to be treated as securities, with the effect that certain clients are willing to take the risk of non-compliance with securities laws.

As such, SEC staff have been placed on 'high alert' and they appear to be taking a keen interest in the way in which initial coin offerings are promoted to customers.

Change to the name of insolvency registrars

Registrars in Bankruptcy of the High Court are now named Insolvency and Companies Court Judges. Sir Geoffrey Vos, the Chancellor, has previously stated that the change in name "reflects their vital role in dealing with insolvency litigation". The change in name was effective from 26 February 2018.

In a letter to court users dated 22 February 2018, the Chancellor said that the introduction of the Insolvency Practice Direction was "imminent" and would "further expand the insolvency jurisdiction" of Insolvency and Companies Court Judges.

GDPR for accountants and insolvency practitioners: how to prepare

The GDPR will soon be in effect. From 25 May 2018, any organisation which processes personal data originating in the EU will be required to comply with the new law. Accountants and insolvency practitioners, in particular, will need to prepare for the changes to the law. The new regulation is a seismic change to European data protection laws to accommodate the use of technologies over the last 20 years, and will provide consistent EU-wide law. The GDPR will require organisations to implement and comply with a multitude of new obligations. Firms will be required to produce documentary evidence of compliance, honour new rights for individuals, and be exposed to increased sanctions of up to €20 million or 4% of worldwide annual turnover, as well as group (class) actions.

The GDPR applies to organisations "regardless of whether the processing takes place in the European Union or not", and therefore despite whether the organisation is established in Europe. The extra-territorial application of the GDPR is triggered when: (i) goods or services are offered to individuals in Europe; or (ii) the behaviour of individuals in Europe is monitored or tracked through the use of technology.

From 25 May 2018, accountants and insolvency practitioners will need to make sure that all practices, policies and processes relating to the collection and use of personal data have been assessed and brought into alignment with the requirements of the GDPR. Despite

Brexit, firms based in the UK will need to comply with the GDPR since the GDPR will be transposed into UK law.

Key dates

Reminder of key, upcoming dates:

- **25 May 2018: EU General Data Protection Regulation 2016/679 comes into effect**
  The General Data Protection Regulation introduces a seismic change to data protection laws in the EU which have extra-territorial application. Organisations which process personal data in the EU need to pay close attention.

- **26 June 2018: EU member states must establish national insolvency registers**
  EU member states must establish national insolvency registers by 26 June 2018 by virtue of the recast regulation on insolvency (see Articles 24(1) and 92(b) of the Regulation (EU) 848/2015 of the European Parliament and of the Council of 20 May 2015). An EU interconnected register is required one year later, by 26 June 2019.

- **Q2/Q3 2018: European Union (Withdrawal) Bill expected to receive Royal Assent**
  The EU Withdrawal Bill has completed its passage in the House of Commons and is with the House of Lords. It is anticipated that the Lords will conclude consideration of the Bill by May 2018, before sending any proposed amendments to the Commons.

ABU DHABI · ATHENS · BEIJING · CENTURY CITY · CHICAGO · DUBAI · FRANKFURT · HONG KONG · HOUSTON · KAZAKHSTAN · LONDON · LOS ANGELES · MIAMI · MUNICH · NEW YORK · PARIS · PHILADELPHIA · PITTSBURGH · PRINCETON · RICHMOND · SAN FRANCISCO · SHANGHAI · SILICON VALLEY · SINGAPORE · TYSONS · WASHINGTON, D.C. · WILMINGTON

Unsubscribe | Privacy Policy | Legal Notices | Forward to a friend

© 2018 Reed Smith LLP. All rights reserved.

Attorney advertising. This communication may be considered advertising under the rules of some states. Prior results described in this communication cannot and do not guarantee or predict a similar outcome with respect to any future matter that Reed Smith or any lawyer may be retained to handle. The contents of this Alert are for informational purposes only, and do not constitute legal advice.