The Anti-Money Laundering Disclosure Regime and the Collection of Revenue in the United Kingdom

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Abstract

This article reviews the application of the anti-money laundering (AML) legislation to show that the disclosure regime is being used by the UK Government to increase the collection of revenue under the tax system. The article explains how the deployment of the AML disclosure regime as a revenue-gathering tool was not an unintended consequence of the enhanced reporting requirements imposed in the wake of the terrorist attack on September 11, 2001. Rather, the UK Government has used the AML disclosure regime to cajole the financial sector into making disclosures in revenue cases where no underlying criminal activity is involved by taking advantage of the ambiguity which hovers over the line between lawful tax avoidance and dishonest tax evasion.

Introduction

Although tax avoidance does not constitute "criminal conduct" for the purposes of the AML disclosure regime, information concerning tax avoidance frequently forms the subject of financial disclosures made to the Serious Organised Crime Agency (SOCA) due to the fine lines which exist between tax evasion, tax avoidance, failed tax avoidance and tax mitigation. When considering whether to make such a financial disclosure, professional guidance for the financial sector operates to discourage professionals from making a determination whether lawful tax avoidance or unlawful tax evasion is involved. Where information relating to lawful tax avoidance or unlawful tax evasion is impressed with legal privilege it will be immune from disclosure in the hands of a solicitor, barrister or overseas legal adviser, but notwithstanding the change in the law to extend the application of legal privilege in the money laundering context to certain other professional advisers, the number of cases affected by the privilege exemption is small.[1] Having come into possession of relevant information through the operation of the AML disclosure regime, HMRC are able to open an investigation which results in civil settlement. Civil settlements are often reached in Code of Practice 9 (CoP 9) cases where the conduct is more akin to failed tax avoidance than tax fraud.[2] Unlike other areas where the application of the AML disclosure regime is perceived as ineffective and a costly weapon in the fight against financial crime, the position is different in revenue cases. The amount of tax revenue gathered as a result of the AML

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[1] The legal privilege aspect is more fully dealt with in the sections below headed **The anti-money laundering disclosure regime**: *Legal privilege* and **Processing financial disclosures**: *Legal privilege*.

[2] CoP 9 is available at *http://www.hmrc.gov.uk/leaflets/cop9-2009.htm* [Accessed February 26, 2010].

disclosure regime is significant relative to the costs of HMRC's investigation, and unless there is a change in the approach to the making of financial disclosures in revenue cases, the AML disclosure regime will prove an increasingly valuable revenue gathering tool. In practice, this serves to enhance HMRC's ability to detect tax avoidance as well as criminal tax evasion in the coming years.

The anti-money laundering disclosure regime

When the financial reporting requirement was first introduced in 1986 as part of the UK's anti-money laundering law, it applied only to the proceeds of drug trafficking. The regime was extended in 1993 to cover not only the proceeds of drug trafficking but also the proceeds of other serious criminal conduct such as theft, false accounting and conspiracy to defraud. The anti-money laundering offences were comprehensively revised in Part 7 of the Proceeds of Crime Act 2002 (POCA) when the distinction between handling the proceeds of drug trafficking and other criminal conduct was abolished.[3]

The principal money laundering offences

Today there are three principal money laundering offences. First, under section 327(1) of POCA a person is guilty of a criminal offence if he conceals, disguises, converts, transfers or removes what is described as "criminal property" from the jurisdiction. Secondly, section 328(1) penalises a person where he enters into or becomes concerned in an arrangement which he knows or suspects facilitates (by whatever means) the acquisition, retention, use or control of "criminal property" by or on behalf of another person. Thirdly, section 329(1) prohibits a person from acquiring, using or possessing "criminal property". Each offence is punishable by a maximum sentence of 14 years imprisonment and an unlimited fine.[4] The common denominator between these offences is the notion of "criminal property" which is defined in section 340(3) to mean "a person's benefit from criminal conduct" or where it "represents such a benefit (in whole or part and whether directly or indirectly) and the alleged offender knows or suspects that it constitutes or represents such a benefit". However, a person will not commit a criminal offence under any of these sections where he makes an authorised disclosure to SOCA under section 338 and, if the disclosure is made before the prohibited act is done, the person has "appropriate consent" within the meaning of section 335. A person is deemed to have "appropriate consent" where he makes a disclosure and he has not received a notice from SOCA refusing consent within seven working days starting with the first working day after the person makes the disclosure.[5]

Failing-to-report offences

In addition to the three principal money laundering offences, there are three free-standing criminal offences of failing to report. These secondary offences are contained in sections 330, 331 and 332 of POCA. Section 330 provides that a person commits a criminal offence where:

[3] The POCA offences came into force on February 24, 2003.
[4] POCA s.334(1)(b).
[5] POCA s.335(2)(a), (3) and (5).

(1) he fails to make a financial disclosure to SOCA in circumstances where he knows or suspects or has reasonable grounds for knowing or suspecting that another person is engaged in money laundering;[6]

(2) the information on which his knowledge or suspicion or reasonable grounds for such knowledge or suspicion came to him in the course of a business in the "regulated sector";[7] and

(3) he can identify the person engaged in money laundering or the whereabouts of any of the laundered property, or he believes (or it is reasonable to expect him to believe) that the information will or may assist in identifying the money launderer or the whereabouts of the laundered property.[8]

The offence is punishable by a maximum sentence of five years imprisonment and an unlimited fine.[9] The "regulated sector" is defined in Schedule 9 to POCA as amended[10] to include all those working in the financial sector such as banks and building societies, estate agents, insolvency practitioners, tax advisers, accountants, auditors, solicitors and barristers, and those involved in the provision of company or trust formation or management. The offences in sections 331 and 332 are similarly worded. Section 331 applies to a person who is nominated to receive internal disclosures from members of a firm or business operating in the "regulated sector".[11] The offence is committed where the nominated officer fails to make a financial disclosure of information contained in an internal report which gives rise to reasonable grounds for suspicion. Section 332 casts its net wider in that it catches a person who has received an internal report which leads him to suspect that another person is engaged in money laundering in circumstances where the firm is not operating within the regulated sector.[12] A criminal offence will be committed if no financial disclosure is made to SOCA in these circumstances. Both offences are punishable by a maximum sentence of five years imprisonment and an unlimited fine.[13] For the purposes of determining whether a person knows or suspects or whether there are reasonable grounds for suspecting that a person is engaged in money laundering, section 340(11) defines "money laundering" as conduct which contravenes one of the principal money laundering offences, or which constitutes an attempt, conspiracy or incitement to commit one of these offences, or which constitutes aiding, abetting, counselling or procuring the commission of one of these offences.

Suspicion

The effect of the legislation is to make "suspicion" the central mental ingredient for the principal money laundering offences and "reasonable grounds for suspicion" the equivalent ingredient for the failing to report offences. The suspicion, or reasonable grounds for suspicion, is referable

[6] POCA s.330(2).
[7] POCA s.330(3).
[8] POCA s.330(3A).
[9] POCA s.334(2).
[10] POCA Sch. 9 was amended by the Proceeds of Crime Act 2002 (Business in the Regulated Sector and Supervisory Authorities) Order 2003 (SI 2003/3074) art.2.
[11] POCA s.331(1).
[12] POCA s.332(1).
[13] POCA s.334(2).

to whether the person obliged to make a financial disclosure suspects that the proceeds of crime are involved, or in the case of the failure to report offences, whether there are reasonable grounds for suspecting that another person is engaged in money laundering. Noting that the meaning of "suspicion" was not defined in POCA, the Court of Appeal (Criminal Division) indicated in *R v Da Silva (Da Silva)* that "the essential element in the word "suspect" and its affiliates, in this context, is that the defendant must think that there is a possibility, which is more than fanciful, that the relevant facts exist".[14] The Court also noted that a judge trying a case involving an allegation of money laundering could not be criticised if he declined to define the word "suspecting" further and confined himself to directing a jury that they should apply their own understanding of the word.[15] The Court in *Da Silva* was concerned to make clear that, although suspicion did not need to be clear or firmly grounded and targeted on specific facts, a vague feeling of unease would not suffice.[16] The Court of Appeal (Civil Division) subsequently confirmed that the definition of "suspicion" put forward in *Da Silva* also applies in money laundering cases arising in the civil courts.[17] In reality, this definition of "suspicion" is not helpful since the assessment of whether a possibility is fanciful involves a value judgment and circumstances will vary from case to case. This is particularly true in a case where there is an issue about tax avoidance since the possibility of tax evasion can sometimes be difficult to exclude.

The difficulties for a person working in the regulated sector seeking to make an assessment about the possible criminal origin of funds are compounded by the fluid definition of "dishonesty" applied by the criminal courts in cases where financial crime is involved. In cases where fraud is suspected as the predicate activity, criminal liability frequently depends upon a jury's assessment of the defendant's state of mental awareness and whether he was acting dishonestly when he committed the conduct in question. The classical test for dishonesty in criminal cases was established by the Court of Appeal (Criminal Division) in *R v Ghosh*.[18] The Court of Appeal said that the test of dishonesty was both subjective and objective; it is subjective in that it is the state of mind of the accused not his conduct which must be considered. It is objective in that the standard of honesty to be applied is not that of the accused, but that of the reasonable and honest man. Halpin believes the lack of moral consensus in the application of the second limb of the test renders the test unworkable.[19] On any view, the twofold nature of the test makes prediction of a jury's decision rather hazardous. An alternative formulation of the notion of "suspicion" was put forward by the Privy Council in *Hussein v Chong Fook Kam*.[20] The case concerned the circumstances in which the power of arrest may be exercised, and during the course of giving the Privy Council's Opinion Lord Devlin famously said that:

> "Suspicion in its ordinary meaning is a state of conjecture or surmise where proof is lacking. 'I suspect but I cannot prove'. Suspicion arises at or near the starting-point of an investigation of which the obtaining of prima facie proof is the end."[21]

[14] *R v Da Silva* [2006] EWCA (Crim) 1654; [2007] 1 WLR 303 per Longmore LJ [16].
[15] *Da Silva*, above fn.14, [2007] 1 WLR 303 [12].
[16] *Da Silva*, above fn.14, [2007] 1 WLR 303 [16].
[17] *K Ltd v National Westminister Bank plc* [2006] EWCA Civ 1039; [2007] 1 WLR 311.
[18] *R v Ghosh* [1982] QB 1053.
[19] Andrew Halpin, "The Test for Dishonesty" [1996] Cr L R 283, 294.
[20] *Hussein v Chong Fook Kam (Hussein)* [1970] AC 942.
[21] *Hussein*, above fn.20, [1970] AC 942, 948B.

The Court of Appeal subsequently affirmed Lord Devlin's words in an extensive line of cases[22] culminating in *Al-Fayed v Commissioner of Police for the Metropolis*.[23] Applying Lord Devlin's definition in *N2J Ltd v Cater Allen*,[24] which was a money laundering case, Nelson J noted that:

> "Suspicion does not have to have a long history of misdoing before it arises. It may arise in an otherwise seamless period of good conduct from one important piece of new information."[25]

Notwithstanding how the test of suspicion may be formulated, two things are very clear. First, the threshold for the forming of suspicion in the UK's AML disclosure regime is extremely low indeed. Secondly, the low threshold for suspicion has the potential to create severe challenges when the AML disclosure regime has to be applied in a case where legitimate tax avoidance appears to be involved but the possibility of criminal tax evasion cannot be entirely discounted.

Reasonable grounds for suspicion

Whilst the test of criminal liability under the principal money laundering offences in sections 327 to 329 of POCA is subjective and depends upon whether the defendant suspected the proceeds of criminal conduct were involved, the test of criminal liability under the secondary failure to report offences in sections 330 and 331 of POCA is an objective one. As the UK Government explained in the Consultation Document on the draft Proceeds of Crime Bill published in March 2001, the imposition of a negligence test was necessary to act as a deterrent against those in the financial sector and other relevant sectors who failed to act competently and responsibly where information before them ought to make them suspect that another person is engaged in money laundering.[26] The Government declared that the standards of competent and responsible action would form the subject of guidance issued by professional bodies for those operating in the financial sector, and sections 330(8) and 331(4) of POCA made clear that a Court must take into account any relevant guidance issued by a professional body which has been approved by HM Treasury for this purpose. Guidance for the UK financial sector has been issued by the Joint Money Laundering Steering Group (JMLSG) which is a body operating under the auspices of the British Bankers Association. The most recent version was published in November 2007[27] and approved by HM Treasury one month later.[28] Guidance has also been issued by the Consultative Committee of Accountancy Bodies (CCAB) and this too has been approved by HM Treasury. Together with HMRC's guidance for those businesses it supervises, it is generally

[22] See, for example, *Holtham v The Commissioner of Police for the Metropolis*, unreported, Independent, November 26, 1987; *Castorina v Chief Constable of Surrey*, unreported, Independent, June 16, 1988 ; *Parker v Chief Constable of Hampshire* [1999] All ER (D) 676.
[23] *Al-Fayed v Commissioner of Police for the Metropolis* [2004] EWCA Civ 1579.
[24] *N2J Ltd v Cater Allen (N2J)* [2006] EWHC B10 (QB).
[25] *N2J*, above fn.24, [2006] EWHC B10 (QB) [35].
[26] Cm 5066 [8.6] available at *http://www.archive.official-documents.co.uk/document/cm50/5066/5066.htm* [Accessed February 26, 2010].
[27] Available at: *http://www.jmlsg.org.uk* [Accessed February 26, 2010].
[28] Letter from the Chancellor of the Exchequer to the JMLSG dated December 18, 2007, available at: *http://www.jmlsg.org.uk*.

recognised that the JMLSG and CCAB guidance set compliance standards for the whole of the financial sector.

The JMLSG Guidance indicates that the test is likely to be met:

> "When there are demonstrated to be facts or circumstances, known to the member of staff, from which a reasonable person engaged in a business … would have inferred knowledge, or formed the suspicion, that another person was engaged in money laundering …"[29]

Persons operating in the regulated sector must make their decision based upon information obtained during the customer due diligence procedures required to be undertaken under The Money Laundering Regulations 2007 (MLR 2007)[30] which replaced The Money Laundering Regulations 2003 (MLR 2003), which had been in force since March 1, 2003.[31] This is the origin of the "know-your-client" (KYC) compliance requirement. The terms of the JMLSG Guidance accord with the requirement contained in Article 6(1) of the European Directive on Money Laundering of 1991 (the 1991 AML Directive) for Member States to ensure that financial institutions co-operate fully with the authorities responsible for combating money laundering by informing those authorities on their own initiative "of *any* fact which *might* be an *indication* of money laundering" (emphasis added).[32] The requirement to report *any* fact which *might* be an *indication* of money laundering necessarily posits the possibility that on occasion lawful commercial activity will form the subject-matter of a financial disclosure. Lawful commercial activity and "a fact which *might* be an *indication* of money laundering" are not mutually exclusive concepts, for the scope of the reporting obligation is sufficiently wide to embrace conduct which, following investigation by the authorities, is confirmed as lawful. The terms of the disclosure requirement were not altered by the Second European Directive on Money Laundering (the Second AML Directive),[33] although the wording was changed in Article 22(1) of the Third European Directive on Money Laundering in 2005 (the Third AML Directive).[34]

Proving the principal money laundering offences

Although the financial disclosure requirement stipulated in the European Directives is triggered by a suspicion of involvement in possible money laundering, the commission of the principal money laundering offences set out in sections 327 to 329 of POCA will be proved only where the existence of "criminal property" can be established. The essence of the principal money laundering offences is the handling of monies which represent the proceeds of criminal conduct. The House of Lords in *R v Montila*[35] clarified that in order to commit a money laundering offence under the pre-POCA law it was necessary for the prosecution to prove that the property derived

[29] JMLSG Guidance, above fn.27 [6.13].
[30] SI 2007/2157. The MLR 2007 came into force on December 15, 2007.
[31] SI 2003/3075.
[32] Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering.
[33] Directive 2001/97/EC amending Directive 91/308/EEC, above fn.32, on prevention of the use of the financial system for the purpose of money laundering.
[34] Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.
[35] *R v Montila* [2004] UKHL 50; [2004] 1 WLR 3141.

from the proceeds of drug-trafficking or the proceeds of some other form of serious criminal conduct.

Proving the failure-to-report offences

According to the recent ruling of the High Court of Justiciary in *Ahmad v HM Advocate (Ahmad)*[36] the situation is different when proving the commission of criminal offences contrary to sections 330 to 332 of POCA (failure-to-report). The Court decided in *Ahmad* that it is sufficient for the prosecution to establish the existence of reasonable grounds for suspicion which a person in the regulated sector ought to have disclosed to SOCA, irrespective of whether or not the monies represent the proceeds of another person's criminal activity. In other words, the offences under section 330 to 332 can be committed in circumstances where a person suspected, or ought to have suspected, the existence of "criminal property" and failed to report the existence of this suspicion to SOCA even though, as it turned out, no criminal property actually existed. The absence of any requirement to prove the existence of "criminal property" for the purposes of sections 330 to 332 of POCA resonates loudly in cases where tax issues are involved because the line between legitimate tax avoidance and criminal tax evasion is sometimes so difficult to discern. There are many cases in practice where the use of offshore structures in a commercial transaction appears consistent with legitimate tax avoidance activity but where the possibility of criminal tax evasion cannot be discounted as fanciful. In the majority of these cases, the activities of the participants will be entirely lawful and proceeds of criminal conduct will not be involved. Yet, applying the decision in *Ahmad*, the law requires an AML disclosure to be made, even though it may subsequently become apparent that proceeds of crime are not involved.

Legal privilege

Legal privilege has been recognised by English Courts in the last two hundred years as playing a pivotal role in a civilised society governed by the Rule of Law. In *Bowman v Fels (Bowman)*[37] Brooke LJ described access to private and confidential legal advice as "a fundamental principle not lightly to be interfered with",[38] and as Lord Taylor CJ explained in *R v Derby Magistrates' Court, ex p B*,[39] it is axiomatic that "a man must be able to consult his lawyer in confidence, since otherwise he might hold back half the truth". Accordingly, and consistently with the common law approach to legally privileged information, section 330(6) of POCA provides that a person who is a professional legal adviser or relevant professional adviser[40] does not commit a criminal offence if he fails to make a financial disclosure of information which has been communicated to him in legally privileged circumstances.[41]

[36] *Ahmad v HM Advocate* [2009] HCJAC 60. A recitation of the arguments is beyond the scope of this article but *en passant* (and *pace* the view expressed by William Blair QC and Richard Brent, *Banks and Financial Crime* (Oxford: OUP, 2008) 195 [7.92]) the author records his view that *Ahmad* was wrongly decided.
[37] *Bowman v Fels* [2005] EWCA Civ 226 [2005] 1 WLR 3083 (CA).
[38] See *Bowman*, above fn.37, [2005] 1 WLR 3083 [74], per Brooke LJ.
[39] *R v Derby Magistrates' Court, ex p B* [1996] AC 487 (HL).
[40] POCA s.330(6)(b), as amended: Subs.(6)(c) words "or (7B)" inserted by The Proceeds of Crime Act 2002 and Money Laundering Regulations 2003 (Amendment) Order 2006 (the 2006 Amendment Order)(SI 2006/308) art.2(1), (3). Date in force: February 21, 2006: see the 2006 Amendment Order art.1.
[41] See POCA s.330(6)(b)) amended as described in fn.40.

When POCA was first enacted, the legal privilege exemption applied only to information coming into the possession of a lawyer. However, the law was amended in 2006 to extend the AML exemption to certain other professional advisers who had come into possession of information in legally privileged circumstances.[42] The rationale for extending the exemption was rooted in the concern that members of the tax and accountancy professions should not be placed at a competitive disadvantage with the legal profession when involved in advisory and litigious work. In 2001 the Office of Fair Trading (OFT) noted that "there [was] a case on either efficiency or competition grounds for a reduction in the scope of the privilege of legal advisers or a limited extension of privilege to others in order to remove the distortion of competition that favours the lawyer".[43] After considerable reflection, the Government opted to extend the application of the exemption to other professionals. The Government's decision represented a significant U-turn, since, when POCA had been debated in the House of Lords in May 2002, Lord Rooker had argued on the Government's behalf that the legal privilege exemption should not be applied to accountants and tax advisers on grounds of commercial equivalence because "accountants and tax advisers are in no way regulated in the same way as lawyers in this country, so it may prove difficult to determine exactly to whom the professional privilege exemptions may apply".[44]

In the event, it was difficult for Parliament to determine exactly to whom the legal privilege exemptions should apply. In the initial version of section 330(6) of POCA, Parliament had limited the exemption to a "professional legal adviser", without offering a definition of this phrase. But the absence of a definition has not proved problematic since there is general recognition that the term embraces solicitors, their non-solicitor partners and their employees, barristers and in-house lawyers.[45] As for the definition of other relevant professional advisers, the following provision was inserted into section 330(14) of POCA by statutory instrument in 2006:

> "A relevant professional adviser is an accountant, auditor or tax adviser who is a member of a professional body which is established for accountants, auditors or tax advisers (as the case may be) and which makes provision for-
> (a) testing the competence of those seeking admission to membership of such a body as a condition for such admission; and
> (b) imposing and maintaining professional and ethical standards for its members, as well as imposing sanctions for non-compliance with those standards."[46]

This definition includes members of the Institute of Chartered Accountants of England and Wales (ICAEW), the Association of Certified Chartered Accountants (ACCA) and the Chartered Institute of Taxation (CIOT). Furthermore, section 330(7B) of POCA makes clear that legal privilege also captures the situation where information is not communicated directly to a professionally

[42] See the 2006 Amendment Order, above fn.40.
[43] *Office of Fair Trading, Competition in Professions: A report by the Director General of Fair Trading* (2001), [47], available at *http://www.oft.gov.uk/shared_oft/reports/professional_bodies/oft328.pdf* [Accessed February 26, 2010].
[44] *Hansard*, HL Deb, Vol. 635, col.1081 (May 27, 2002), available at *http://www.publications.parliament.uk/pa/ld200102/ldhansrd/vo020527/text/20527-10.htm* [Accessed February 26, 2010].
[45] See Law Society, *Anti-money laundering practice note*, October 29, 2009, Ch.6, available at: *http://www.lawsociety.org.uk* [Accessed February 26, 2010].
[46] POCA s.330(14) inserted by the 2006 Amendment Order, above fn.40, art.2(5).

qualified person but to a person employed by, or in partnership with, a relevant professional adviser.

In contrast to the position in section 330(6) of POCA, there is no reference to the legal privilege exemption in sections 327 to 329, and until the seminal decision of the Court of Appeal (Civil Division) in *Bowman*[47] there was considerable uncertainty as to the position. Interestingly, the Court in *Bowman* re-affirmed the fundamental principle that information passed to a solicitor or barrister for the purposes of obtaining legal advice or during the course of litigation was protected by legal privilege and therefore immune from disclosure under the AML disclosure regime. Applying traditional canons of statutory construction the Court ruled that sections 327 to 329 of POCA did not operate to override either expressly or by implication the fundamental principle of legal privilege at common law. In this way, the Court of Appeal ensured that the AML disclosure regime had no application to information communicated to a solicitor or a barrister in legally privileged circumstances, whether the financial disclosure obligation arose under sections 327 to 329 or section 330 of POCA. The Financial Times reported the judgment in *Bowman* under the following headline: “Lawyers welcome ruling on money laundering”.[48]

Unfortunately, the position of other relevant professional advisers under sections 327 to 329 of POCA was not addressed by the Court of Appeal, no doubt because the Court’s decision pre-dated the legislative amendment made to section 330(6) which came into force on the February 21, 2006. Certainly there are compelling arguments in favour of extending the application of the *Bowman*[49] ruling to tax and accountancy professional advisers who fall within the statutory definition set out in section 330(14). After all, the impact of extending the defence in section 330(6) to a “relevant professional adviser” would be rendered nugatory if the adviser remained obliged to make a financial disclosure under section 328. Once it is established that a relevant professional adviser has equivalence for the purposes of section 330(6), on what rationally defensible criteria could a Court exclude equivalence with the legal profession under sections 327 to 329? In this context, it is right to remember that Recital (18) to the Second AML Directive[50] stipulates that directly comparable services ought to be treated in the same manner when practised by any of the professionals covered by the Directive.

Tax offences and the AML disclosure regime

Tax offences as predicate crimes

Since the essence of money laundering involves the handling of another person’s proceeds of crime, it is self-evident that a predicate criminal offence must have been committed. Where the proceeds of drug-trafficking or some other form of organised criminal activity are laundered, it is not difficult to identify the nature of the predicate criminal offence. The position with the proceeds of tax evasion, however, is rather different. In some cases, for example where a taxpayer obtains a tax rebate from the revenue authority by making a false declaration, the predicate criminal offence is easy to establish. The taxpayer will have committed the offence of false

[47] *Bowman*, above fn.37, [2005] 1 WLR 3083.
[48] Nikki Tait, *Financial Times*, March 9, 2005.
[49] *Bowman*, above fn.37, [2005] 1 WLR 3083.
[50] Above fn.33.

accounting contrary to section 17(1) of the Theft Act 1968 and also an offence of obtaining by making a false representation under section 1(2)(a) of the Fraud Act 2006. On any view, he will have obtained money from the revenue authority in a criminal manner. In other cases, perhaps where a company presents false accounts to the revenue authority in order to minimise the profits on which corporation tax should be paid, the position is rather different. Although the criminal offence of false accounting will have been committed, in this situation the criminal conduct will not have caused the taxpayer to obtain any money which he did not already have. The fraudulent conduct has enabled the taxpayer to reduce his company's tax liabilities by retaining more of its money than it would have been entitled to retain if it had honestly declared its income, but it cannot be said that any monies have been acquired as a result of the crime. What is more, the retained monies will almost certainly represent the proceeds of the company's lawful commercial activity. There will not be anything criminal about the way in which the monies were obtained. Accordingly, for the purposes of the money laundering legislation, there is a conceptual obstacle to the recognition of a tax offence as a predicate crime where the underlying conduct involves the retention of monies lawfully obtained. There are other arguments advanced against treating tax offences as predicate crimes for the purposes of the AML disclosure regime. Money laundering has an international dimension, as the 1991 AML Directive recognised at the outset when it declared that:

> "money laundering shall be regarded as such even where the activities which generated the property to be laundered were perpetrated in the territory of another Member State or in that of a third country."[51]

The notion of a tax offence constituting predicate criminal activity does not sit easily with this international dimension.[52]

European Directives

Certainly it was not envisaged by the 1991 AML Directive or the Second AML Directive (agreed in 2001)[53] that Member States would treat revenue fraud as a predicate offence for the purposes of the money laundering legislation. The 1991 AML Directive defined criminal activity by reference to the Vienna Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances adopted in 1988.[54] The definition was extended by the Second AML Directive to cover the activities of criminal organisations, fraud on the European Union, corruption and offences "which may generate substantial proceeds".[55] On any plain reading of the Second AML

[51] See the 1991 AML Directive, above fn.32, art.1.
[52] For an interesting discussion on the designation of tax evasion as a predicate offence, see the exchanges between Lord Hannay and Professor Alldridge during the course of the latter's evidence given on April 1, 2009 to the House of Lords European Committee on *Money Laundering and the Financing of Terrorism*, see the 19th Report, session 2008–9, (Q343 and Q344) available at *http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeucom/132/132ii.pdf* [Accessed February 26, 2010].
[53] Above fn.33.
[54] See the 1991 AML Directive, above fn.32, art.1. See also, United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances 1988 art.3(1)(a), available at:*http://www.unodc.org* [Accessed February 26, 2010].
[55] See the Second AML Directive, above fn.33, art.1(E).

Directive, a tax offender who dishonestly retained monies could not be said to have "generated substantial proceeds" within the meaning of this phrase. It was only in 2005 that the range of predicate offences was dramatically increased in Article 3(4) of the Third AML Directive[56] to include "any kind of criminal involvement in the commission of serious crime". Pursuant to Article 3(5), this definition added to the existing list of predicate offences any offence linked with terrorist activity, corruption and all offences punishable by deprivation of liberty or a detention order for a maximum of more than one year.[57] Plainly this placed the position beyond doubt, because if dishonest retention of monies owed to a revenue authority constituted a criminal offence punishable by more than one year's imprisonment, it would be classified as a serious crime for the purposes of this definition. However, long before the Third AML Directive had been agreed in November 2005, the UK Government ensured that a tax offence constituted a predicate offence for the purposes of the UK's AML disclosure regime, irrespective of the niceties of any legal arguments which could be advanced to the contrary.

The 1993 legislation

When the AML reporting requirement was first introduced in 1986, it applied only to the proceeds of drug trafficking. Notwithstanding loud protests from the banking community, section 24 of the Drug Trafficking Offences Act 1986 created an offence of assisting another to retain the benefit of drug trafficking, with a statutory defence where a person disclosed to the authorities that he suspected or believed that the monies were derived from drug trafficking.[58] The AML disclosure regime for drug-trafficking offences was extended in 1993 when section 18 of the Criminal Justice Act 1993 (CJA 1993) added section 26B of the Drug Trafficking Offences Act 1986. This was the first free-standing offence involving a failure to disclose. Although the offence applied only to the proceeds of drug-trafficking, it was the progenitor of the current failure to report offences contained in sections 330 to 332 of POCA. The drug trafficking legislation was consolidated in the Drug Trafficking Act 1994, with the failure to report offence set out in section 52 of that Act.[59] At the same time as the free-standing failure to disclose offence for drug trafficking was introduced, the CJA 1993 also introduced money laundering offences to cover handling the proceeds of other forms of serious criminal conduct such as theft, false accounting and conspiracy to defraud. Sections 29 to 31 of the CJA 1993 inserted three money laundering offences into section 93 of the Criminal Justice Act 1988 as it then was: as it stands following that amendment it is referred to below as "CJA 1988 as amended".[60] In each case, by virtue of section 93A(7) of the CJA 1988 as amended, the money laundering offence applied to the proceeds of criminal conduct:

[56] Above fn.34.
[57] The definition of serious crime in art.3(4) follows Recommendation 1 of the revised Forty Recommendations put forward by the FATF, available for download via: *http://www.fatfgafi.org* [Accessed February 27, 2010].
[58] See Jonathan Fisher, "Drug Trafficking Offences Act" [1986] JIBL 124.
[59] The provisions relating to the proceeds of drug trafficking remained in force until Pt 7 of POCA was implemented on February 24, 2003 by The Proceeds of Crime Act 2002 (Commencement No.4, Transitional Provisions and Savings) Order 2003 (SI 2003/120) (the 2003 Commencement and Savings Order) art.3.
[60] CJA 1988 as amended ss.93A, 93B and 93C.

> "which constituted an offence to which this Part of this Act applies or would constitute such an offence if it had occurred in England and Wales or (as the case may be) in Scotland."

The effect of this subsection was to refer back to section 71(9)(c) of the CJA 1988 as amended which specified that Part VI of the CJA 1988 applied to all indictable offences (with the exception of drug trafficking and terrorism offences, which were the subject of other legislation) and the offences listed in Schedule 4 to the CJA 1988, such as copyright and social security offences. Although the UK Government was not required at this time to bring tax offences within the ambit of the AML disclosure regime in order to comply with its European obligations under the 1991 AML Directive,[61] there is no doubt that the amendments introduced by the CJA 1993 operated to have this effect. Since the AML disclosure regime bites where conduct committed abroad would constitute an offence in any part of the United Kingdom if it had occurred there, the evasion of foreign taxes also constitutes a predicate crime for the purposes of the legislation.[62]

UK Government intention

This was precisely the result the UK Government wanted to achieve, and when the Labour Party swept into office in 1997 it is clear that it regarded the ability to deploy the AML disclosure regime as an important weapon in the battle against harmful tax practices as an opportunity which was too good to miss. Almost exactly one year after coming into office the UK Government hosted a meeting of the G-7 Finance Ministers in London[63] which was chaired by the former Chancellor of the Exchequer (Gordon Brown). The next day HM Treasury issued a Press Release (Crown copyright material reproduced with the permission of the Controller of HMSO and the Queen's Printer for Scotland):

> **"G-7 INITIATIVE ON HARMFUL TAX COMPETITION**
>
> A major new initiative to tackle harmful tax competition was agreed by G-7 Finance Ministers today at a meeting in London chaired by Chancellor of the Exchequer Gordon Brown.
>
> The G-7 agreement paves the way for more international exchange of tax information to curb international tax evasion and avoidance through tax havens and preferential tax regimes. It reinforces the recommendations of the OECD Report for curbing harmful tax competition and the complementary EU Code of Conduct on business taxation.
>
> It also commits the G-7 to leading international action on tax related crime by gathering more intelligence through money laundering systems and providing for it to be shared internationally by tax authorities.
>
> Announcing the UK inspired initiative, Mr Brown said;

[61] Above fn.32.
[62] POCA s.340(2)(b). See Jonathan Fisher and Jane Bewsey, "Laundering the proceeds of fiscal crime" [2000] JIBL 2000 11–21; Peter Alldridge, "Are Tax Evasion Offences Predicate Offences for Money Laundering Offences" [2001] JMLC 350; Aileen Barry, "Examining Tax Evasion and Money Laundering" [1999] JMLC 326.
[63] Conclusions of Finance Meeting held on May 8–9, 1998 issued by the G-7, available at: *http://www.g7.utoronto.ca/finance/fj980509.htm* [Accessed February 27, 2010].

> 'Our agreement today represents a major breakthrough in tackling the growing problems caused by harmful tax competition, and the tax evasion and avoidance it generates. This reinforces the OECD's vital work to curb the damaging effects of tax havens and preferential tax regimes.
>
> We are determined to put in place strong and practical measures to tackle the growing threat of international tax crime and evasion through tax havens and preferential tax regimes. The globalisation of business and finance makes this an increasingly pressing issue.
>
> This initiative paves the way for co-ordinated international action to allow information to be passed to tax authorities, so that honest citizens and business do not have to pay the price of the activities of tax fraudsters. We in the G-7 are committed to building practical co-operation at every level to counter these threats.'
>
> The G-7 agreement;
>
> i) reinforces the OECD's Report which provides a platform for tackling harmful tax competition, and for obtaining more information about transactions in tax havens and preferential tax regimes. This complements and mutually reinforces the EU Code of Conduct on Business Taxation;
>
> ii) addresses a potential weakness in international anti-money laundering systems by ensuring that financial institutions report suspicions about the movement of criminal assets regardless of whether they believe that the criminality involved is tax related. This is partly motivated by growing evidence that criminals can evade anti money laundering systems by presenting their affairs as tax related to reassure their bankers, brokers and professional advisers;
>
> iii) provides an important new source of intelligence to tax authorities by making it possible for suspicious transaction reports received by law enforcement agencies to be made accessible to those investigating tax related crimes domestically or overseas.
>
> To advance this agenda the UK will attach an officer of the Inland Revenue's Special Compliance Office to the Economic Crimes Unit of the National Criminal Intelligence Service (NCIS), which is responsible for analysing and allocating reports of suspected money laundering. These arrangements will allow domestic and international money laundering intelligence to flow to the Inland Revenue for the first time."[64]

The text of the Press Release is highly instructive in a number of significant respects. The Press Release makes abundantly clear the UK Government's perception that tax crime is to be treated as a predicate offence for the purposes of the UK's AML disclosure regime. It also demonstrates a clear intention on the part of the UK Government to deploy the AML disclosure regime as a mechanism for channelling more information to the Inland Revenue (now HMRC). But the real significance of these sentiments lies in the context in which they have been expressed. The Finance Ministers of the G-7 countries had met not to discuss the problems caused by international

[64] HM Treasury News Release, 71/98, May 9, 1998, available at: *http://www.hm-treasury.gov.uk/press_71_98.htm* [Accessed February 26, 2010].

tax evasion, but the much broader issue of harmful tax competition. The G-7 countries were concerned to tackle the levels of tax avoidance as well as tax evasion, and whilst it is true that the body of the Press Release distinguishes between the operation of the AML disclosure regime in tax evasion cases and the need for more extensive international exchange of information in tax avoidance cases, the all-important line between tax avoidance and tax evasion becomes blurred in the second action point agreed by the G-7 countries since this posits the use of the AML disclosure regime to compel financial disclosures in circumstances where complicated financial arrangements are presented to bankers and professional advisers as tax related. Of course there will be cases where criminals who have obtained monies illegally seek to evade anti-money laundering systems by presenting their affairs as tax related; however, more often than not when arrangements appear to be tax related the monies will have been legitimately earned through business in the commercial sector. The phrase "tax related" is used in this context as a euphemism for tax avoidance which, in contrast to the malign activities of tax evaders, is a perfectly legitimate activity in which businessmen and high net worth individuals frequently indulge. Stripped of its linguistic niceties, the agreed action point carries with it the connotation that AML legislation requires a financial disclosure to be made where tax avoidance arrangements have been put in place because the possibility of money laundering cannot be excluded. Then, in furtherance of the third action point, this important new source of intelligence obtained through the operation of the AML disclosure regime can be passed to the law enforcement agencies for investigation.

International context

The move towards eliding tax avoidance and tax evasion reverberates in the wider international context, where the battle against harmful tax practices adopted by large multinational enterprises rages at its fiercest. The scale of international tax avoidance has led such arrangements to acquire a pejorative connotation; and the problem cannot be under-estimated. As a report published by the Tax Justice Network Project in September 2005 commented, "the role played by tax havens in encouraging and profiteering from tax avoidance, tax evasion and capital flight from developed and developing countries is a scandal of gigantic proportions". The Project recorded that one per cent of the world's population hold more than 57 per cent of total global wealth, and that approximately US $255 billion annually was involved in using offshore havens to escape taxation, an amount which would more than plug the financing gap to achieve the Millennium Development Goal of halving world poverty by 2015.[65] As trans-national organisations increasingly utilise a myriad of offshore structures to effect their complex—and strictly lawful—tax avoidance arrangements, it is perhaps unsurprising that law enforcement agencies should begin to confuse their activities with those of the criminals. Oxfam noted in its report on tax havens published in June 2000 that:

[65] *Tax Us If You Can* September 2005, 78, available at: *http://www.taxjustice.net*. See also reports by Christian Aid, *Shirts Off Their Backs*, September 2005, available at: *http://www.christianaid.org.uk/images/the_shirts_off_their_backs.pdf* and *Death and Taxes*, May 2008, available at: *http://www.christianaid.org.uk/images/deathandtaxes.pdf* [Each accessed February 26, 2010].

> "The tools used [by the criminals] are often the same as those used for tax avoidance: offshore bank accounts and company registrations protected by secrecy laws; offshore trusts; transfer pricing and intra-firm property transactions."[66]

As the line between legitimate and illegal uses of offshore structures is blurred, it becomes increasingly difficult for persons working in the financial sector to distinguish between those involved in lawful business activity and those seeking to hide their illicitly obtained proceeds from the eyes of the law enforcers.

SOCA noted in its Threat Assessment for 2009–10 that tax avoidance, whether of direct or indirect taxes, is estimated to cost HM Treasury billions of pounds a year and commented:

> "Although tax avoidance itself is not illegal, some avoidance schemes can include fraudulent elements, particularly in the way that the scheme is implemented. In recent years, there has been a significant growth in schemes that are wholly or in part fraudulent… Tax avoidance schemes are sold to companies and high income earners in the UK who seek to reduce their tax liabilities."[67]

SOCA had expressed similar sentiments in its Threat Assessment for 2009–10.

Money laundering indicators

The inexorable problem for the regulated sector is that mechanisms involving offshore companies and trusts are equally popular with tax avoiders and money launderers alike. As the OECD noted in its seminal report *Behind the Corporate Veil* published in May 2001, almost every economic crime involves the misuse of corporate entities:

> "[M]oney launderers exploit cash-based businesses and other legal vehicles to disguise the source of their illicit gains, bribe-givers and recipients conduct their illicit transactions through bank accounts opened under the names of corporations and foundations, and individuals hide or shield their wealth from tax authorities and other creditors through trusts and partnerships, to name but a few examples."[68]

Guidance issued by the regulatory and supervisory bodies has alighted upon the use of offshore companies and trusts as classic indicators of suspicious conduct. Since the introduction of the MLR 2007[69] a plethora of guidance on the application of the AML disclosure has been published. However, as already noted, the guidance issued by the JMLSG and that issued by the CCAB dominate the field, in large part because of their wide application across the financial,[70] tax and accounting sectors but also because in both cases the guidance has been approved by HM Treasury under section 330(8) of POCA. Solicitors are obliged to apply the anti-money laundering guidance

[66] Oxfam, *Tax Havens*, June 2000, 16, available at: *http://publications.oxfam.org.uk* [Accessed February 26, 2010].
[67] SOCA, *Threat Assessment 2009–10* [365]–[366], available at: *http://www.soca.gov.uk* [Accessed February 27, 2010].
[68] OECD, *Behind The Corporate Veil: Using Corporate Entities for Illicit Purposes*, 3, available at: *http://www.oecd.org/dataoecd/0/3/43703185.pdf* [Accessed February 26, 2009].
[69] Above fn.30.
[70] The guidance is addressed to all those working in the financial services industry. JMLSG Guidance, above fn.27 [14]–[16].

set out in the Law Society's *Anti-money laundering practice note*, and where a solicitor is authorised and regulated by the Financial Services Authority, the Law Society's Guidance makes clear that the JMLSG Guidance must be considered as well.[71] Finally, in this connection the guidance issued by HMRC should not be overlooked.[72] This guidance is addressed to money service businesses, high value dealers, and trust or company services providers, in respect of whom HMRC are the supervisory authority pursuant to Part 4 of the MLR 2007.

Turning first to consider the position for those working in the financial services industry, the JMLSG state that:

> "Illustrations of the type of situation that may be unusual, and which in certain circumstances might give rise to reasonable grounds for suspicion, are:
> - transactions which have no apparent purpose, or which make no obvious economic sense (including where a person makes a loss against tax), or which involve apparently unnecessary complexity;
> - the use of non-resident accounts, companies or structures in circumstances where the customer's needs do not appear to support such economic requirements;
> - where the transaction being requested by the customer, or the size or pattern of transactions, is, without reasonable explanation, out of the ordinary range of services normally requested or is inconsistent with the experience of the firm in relation to the particular customer;
> - dealing with customers not normally expected in that part of the business;
> - transfers to and from high-risk jurisdictions, without reasonable explanation, which are not consistent with the customer's declared foreign business dealings or interests;
> - where a series of transactions are structured just below a regulatory threshold;
> - where a customer who has entered into a business relationship with the firm uses the relationship for a single transaction or for only a very short period of time;
> - unnecessary routing of funds through third party accounts;
> - unusual investment transactions without an apparently discernible profitable motive."[73]

Similarly, the CCAB Guidance advises tax and accountancy professionals to be cautious where an activity is so unusual or lacking in normal commercial rationale.[74]

In light of these money laundering indicators, sector guidance developed by the regulatory bodies has the effect of steering persons working in the regulated sector towards making a disclosure in cases where an issue relating to tax is involved. The Law Society's *Anti-money laundering practice note* reminds solicitors that financial disclosures need to be made in circumstances where they do not know the exact nature of the criminal offence or that particular

[71] The Law Society, *Anti-money laundering practice note*, October 29, 2009 [1.5], available at: *http://www.lawsociety.org.uk/productsandservices/practicenotes/aml.page* [Accessed February 26, 2010].
[72] Notice MLR 8, *Preventing money laundering and terrorist financing*, available at: *http://www.hmrc.gov.uk* [Accessed February 26, 2010].
[73] See JMLSG guidance, above fn.27 [7.26]: [4.16] is also relevant.
[74] CCAB, *Anti-Money Laundering Guidance for the Accountancy Sector* [6.27], available at: *http://www.ccab.org.uk/PDFs/070612%20CCAB%20Guidance%20Clean.pdf*.

funds were definitely those arising from the crime. A solicitor does not need to have evidence that money laundering is taking place to have suspicion.[75] The Royal Institution of Chartered Surveyors also issued guidance to its members in almost identical terms.[76] The CCAB guidance indicates that tax and accountancy professionals must give consideration to whether individuals or businesses have engaged, or intend to engage, in conduct which *could* constitute a money laundering offence.[77] In its guidance to tax practitioners the CCAB correctly makes the point that in the tax environment there are many circumstances in which the tax authorities have a long and established practice of dealing with matters on a civil basis. However, the practices or anticipated practices of HMRC are irrelevant to the reporting obligations under POCA. If a tax practitioner suspects that a criminal offence *may* have been committed, and there *may* be or *may* have been proceeds, whether actual or prospective proceeds, then, unless the legal privilege exemption applies, he is obliged to report to SOCA irrespective of the fact that a criminal prosecution "may in the member's view be highly unlikely in practice".[78] In a similar vein, HMRC's guidance directs businesses under their supervisory control to scrutinise "unusual transactions and any other activity that is regarded as particularly likely by its nature to be related to money laundering which could result in suspicion" with a view to making a financial disclosure.[79] In a later section of HMRC's guidance directed at trust and company service providers, the reference to suspected tax irregularities is more overt. Factors increasing the risk of money laundering include use of complex trust or company ownership structures that *could* be used to hide the identity of the underlying beneficial owners, the movement of money across international borders and divergence from the type, volume or frequency of transactions expected in the course of the business relationship.[80] In the event that a company or trust service provider may not have appreciated this steer, the final section of the guidance is more explicit, concluding that factors such as "the purchase of companies that have no obvious commercial purpose, subsidiaries having no apparent purpose, companies which continuously make substantial losses", or the existence of "uneconomic group structures for tax purposes" *could* result in grounds for suspicion.[81]

The spectre of imprisonment for a lengthy period or the initiation of professional disciplinary proceedings operates as a considerable incentive for the professional community to err on the side of caution when deciding whether or not to make a financial disclosure. In the few cases which have come before the criminal courts, the sentencing Judges have dealt savagely with defendants who have failed to make a financial disclosure in accordance with the requirements

[75] The Law Society, above fn.71 [5.3.2].
[76] Royal Institution of Chartered Surveyors, *Suspicion and Reporting Suspicions*, February 2004, available at: *http://leasehold-outrage.com/docs/legislation/RICS_MoneyLaundering_reporting_suspicions.pdf* [Accessed February 27, 2010].
[77] CCAB, above fn.74.
[78] CIOT, *Supplementary Anti-Money Laundering Guidance for the Tax Practitioner*, June 25, 2009 [6.3.1] to [6.3.3], available at: *http://www.tax.org.uk*.
[79] HMRC, MLR 8, above fn.72 [10.2].
[80] HMRC, MLR 8, above fn.72 [21.3].
[81] HMRC, MLR 8, above fn.72 [21.8].

of the AML disclosure regime.[82] Against this background, the practice of defensive reporting is wholly understandable.

Tax avoidance and tax evasion

It has been a cornerstone of English law that a taxpayer is entitled to arrange his affairs so as to reduce his liability to tax, and the fact that the motive for a transaction is to avoid tax does not invalidate it unless a particular enactment so provides.[83] However, if the arrangement is to be effective it is essential that the transaction has some economic or commercial substance. For as Lord Goff explained in *Ensign Tankers (Leasing) Ltd v Stokes*:

> "Unacceptable tax avoidance typically involves the creation of complex artificial structures by which, as though by the wave of a magic wand, the taxpayer conjures out of the air a loss, or a gain, or expenditure, or whatever it may be, which otherwise would never have existed. These structures are designed to achieve an adventitious tax benefit for the taxpayer, and in truth are no more than raids on the public funds at the expense of the general body of taxpayers, and as such are unacceptable."[84]

The problem for those working in the financial sector when applying the AML disclosure regime is that at first blush "unacceptable tax avoidance", to use Lord Goff's phrase, can often present to those working in the financial sector as suspected criminal tax evasion. Inevitably this is the case, since the central hallmark of unacceptable tax avoidance (namely, artificial transactions lacking in commercial substance) has been identified by the regulatory and supervisory bodies as one of the classic indicators giving rise to a suspicion that criminal activity has occurred. The point is neatly demonstrated by a consideration of the House of Lords judgment in *Barclays Mercantile Business Finance Ltd v Mawson (Barclays Mercantile)*.[85] Although the decision has been regarded as representing a narrowing of judicial approach towards tax avoidance with a renewed focus on a strict application of statutory construction,[86] the clarity of language used by the House of Lords when describing the central feature of unacceptable tax avoidance conveys an unambiguous message to those working in the financial sector when determining whether or not there are reasonable grounds for suspecting criminal tax evasion in the circumstances of a particular case.

In *Barclays Mercantile*, the House of Lords was required to determine whether a taxpayer was entitled to claim capital allowances under the Capital Allowances Act 1990 after it had acquired a gas pipeline under a purchase and lease back arrangement. Attention focused on the payment of the deposit which was partly used to discharge the liability for rent under the lease

[82] See the cases reported in Spike Charlwood et al (eds), *Cordery on Solicitors* (London: LexisNexis Butterworths), loose leaf, Section 5, F, Criminal Prosecutions [915] to [920].
[83] *Duke of Westminster v IRC* (1935) 19 TC 490, per Lord Tomlin, 520; *W T Ramsay Ltd v IRC* [1981] STC 174 (HL), per Lord Wilberforce, 180a; and *IRC v Willoughby* [1997] STC 995, per Lord Nolan, 1003h.
[84] *Ensign Tankers (Leasing) Ltd v Stokes* [1992] STC 226 (HL), per Lord Goff of Chieveley, 244j.
[85] *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51; [2005] STC 1.
[86] For further discussion on *Barclays Mercantile* and its relevance to the debate on the approach to statutory construction in tax avoidance cases, see John Tiley, *Revenue Law*, 6th ed (Oxford: Hart Publishing, 2008), 111–128 [5.6]; Judith Freedman, "Interpreting Tax Statutes, Tax Avoidance and the Intention of Parliament" [2007] LQR 53; Malcolm Gammie, "Sham and Reality: The Taxation of Composite Transactions" [2006] BTR 294.

and partly for the benefit of the seller. HMRC attacked the arrangement on the ground that it was part of a coordinated scheme which had no commercial purpose. The House of Lords saw the matter differently, deciding that even if this was correct it did not affect the reality of the taxpayer's expenditure and its acquisition of the pipeline for the purposes of its finance leasing trade. But in drawing a distinction between earlier cases where tax avoidance arrangements failed because they lacked any business or commercial purpose, the House of Lords noted that:

> "it [was] characteristic of … composite transactions that they will include elements which have been inserted without any business or commercial purpose but are intended to have the effect of removing the transaction from the scope of the charge."[87]

The language used by the House is strikingly similar to the language used by the regulatory and supervisory bodies when identifying indicators of money laundering.

The tension between unacceptable tax avoidance and suspicions of money laundering arising from criminal tax evasion is more acute when the notion of a "sham" arrangement is introduced into the equation. An arrangement designated a sham will fail for tax avoidance purposes since tax falls to be levied on actual legal rights created and not legal rights which appear to have been created. However, for those working in the regulated sector there is an additional aspect which needs to be considered when an arrangement is vulnerable to attack as a sham, namely, whether there are reasonable grounds for suspecting that the taxpayer intended the arrangement to give a false appearance with the dishonest intention of depriving HMRC of tax to which it would otherwise be entitled. Applying the indicators of money laundering identified by the regulatory and supervisory bodies, the approach adopted by the Court of Appeal in *Hitch v Stone* forces those working in the regulated sector to make an AML disclosure whenever a concern about possible sham arises.[88] Having determined in *Snook v London and West Riding Investments Ltd*[89] that a sham is defined as a transaction in which acts done were intended to give the appearance of creating legal rights different from those which were actually created, the Court of Appeal elaborated in *Hitch v Stone* on the meaning of a sham, making clear that the test of common intention was subjective. It follows that an arrangement which lacks commercial purpose is not necessarily a sham; the status of the arrangement will depend upon whether the parties intended the arrangement to lack commercial purpose, which is a different matter.[90] The logical consequence for those working in the financial sector is that, where there are reasonable grounds for suspecting that the parties formed this intention dishonestly in so far as any potential liability to HMRC was concerned, an AML disclosure report will need to be made. A person working in the regulated sector will conclude more readily that he is required to make an AML disclosure where there are reasonable grounds to suspect that an arrangement is a sham than where the arrangement is not sham but there are reasonable grounds to suspect that the arrangement lacks any commercial purpose.

[87] *Barclays Mercantile*, above fn.85, [2005] STC 1 [34]–[35].
[88] *Hitch and others v Stone* [2001] EWCA Civ 63; [2001] STC 214.
[89] *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786.
[90] For a comprehensive discussion of the approach of the Courts towards sham trusts, see Matthew Conaglen, "Sham trusts" [2008] CLJ 176.

Striking a different note, the number of AML disclosures generated in tax related cases is unlikely to increase following domestic application of the abuse of rights doctrine developed by the European Court of Justice, now the Court of Justice (ECJ) in recent years. The decision of the ECJ in *Halifax plc and others v CC&E* (C-255/02)[91] (*Halifax*) represents the high water mark in terms of judicial rulings at an appellate level, where the ECJ held that the abuse of rights doctrine was applicable in the context of value added tax (VAT) where a group of companies carried out a transaction with the sole intention of obtaining a tax advantage by avoiding or reducing VAT liability which would otherwise have been payable. In order for the doctrine to apply, the transaction must result in a tax advantage contrary to the purpose of the Sixth Directive on VAT,[92] and also the transaction must have been made with the sole aim of obtaining a tax advantage. The *Halifax* principles were applied with significant effect by the Court of Appeal in *WHA Ltd v HMRC*[93] when upholding a decision by HMRC to disallow a claim for input VAT on the ground that the taxpayer had entered into an arrangement which amounted to an abuse of rights. The Court of Appeal was clear that the sole purpose of the arrangement was to secure a tax advantage and considering the various steps in the arrangement as a totality, it concluded that the overall effect was abusive. There were aspects of the scheme which were artificial and lacked any commercial purpose.

Initial experience amongst practitioners suggested that HMRC was relying on the doctrine at almost every opportunity, not just on substantive issues but also in the course of interim proceedings to obtain disclosure of information from traders.[94] This precipitated considerable discussion about whether the doctrine could be deployed more broadly by HMRC as a weapon in the domestic context. Dixon and Cannon adopted a bullish stance, expressing their view that although the doctrine of abuse is a creature of European law and therefore has no direct effect in domestic tax law, "it is worth remembering that Member States must exercise their competence over domestic taxation in a way that is consistent with Community law".[95] More recently, the High Court in *HMRC v Weald Leasing Ltd*[96] (*Weald Leasing*) applied a brake to any expansive ambitions that HMRC may have harboured, making clear at the heart of its decision that in order to invoke the abuse of rights doctrine HMRC needed to do more than merely establish that the arrangement was outside of the taxpayer's "normal commercial operations", or was artificial and not "at arm's length". There is an additional element which has to be shown which involves satisfying the Court that, in the circumstances of the particular case, the grant of the tax advantage would be contrary to the purposes of the relevant European Directive and the national legislation transposing it. Assuming that the High Court's approach in *Weald Leasing* is maintained, viewed from the perspective of a person working in the financial sector seeking to discharge his AML disclosure obligations, the emergence of the abuse of rights doctrine is unlikely to influence him one way or the other when focusing on the paramount consideration of whether or not the arrangement has an apparent commercial or economic purpose as highlighted by the money

[91] *Halifax plc and others v CC&E* (C-255/02) [2006] ECR I-1609; [2006] STC 919.
[92] Directive 77/388/EEC on the harmonisation of the laws of the Member States relating to turnover taxes.
[93] *WHA Ltd and another v HMRC* [2007] EWCA Civ 728; [2007] STC 1695.
[94] See Hui L. McCarthy, "Abuse of Rights: The effect of the doctrine on VAT planning" [2007] BTR 160.
[95] Dennis Dixon and Patrick Cannon, "Halifax and Ramsay" *Tax Journal*, Issue 876 (March 12, 2007), 11.
[96] *HMRC v Weald Leasing Ltd* [2008] EWHC 30 (Ch); [2008] STC 1601. For a case comment, see Rita de la Feria, "HMRC v Weald Leasing Ltd" [2008] BTR 548.

laundering indicators. To this extent, the domestic application of the abuse of rights doctrine adds nothing to the considerations a person working in the financial sector must take into account.

Similarly, the introduction of the disclosure of tax avoidance schemes (DOTAS) legislation[97] requiring prior notification to HMRC of the existence of certain schemes is unlikely to impact upon the number of AML financial disclosures made in tax-related cases. This is because the fact of notification deprives the arrangement of an undue level of secrecy which is another of the significant money laundering indicators identified by the supervisory and regulatory bodies. In this situation, a person working in the financial sector would swiftly reach the conclusion that the risk of criminal tax evasion is remote in circumstances where the existence of the tax avoidance scheme has already been disclosed to HMRC under the DOTAS scheme.

In English law, unacceptable tax avoidance is a different species from criminal tax evasion which occurs when a taxpayer performs any form of fraudulent conduct which has the purpose and effect of depriving HMRC of money due to them.[98] Typically, fraudulent intent on the part of a taxpayer is demonstrated where there is evidence of collusion between the taxpayer and others, or there is evidence that documents have been forged with intent to deceive HMRC.[99] Failure to make complete disclosure during the course of a tax investigation, and evidence that a taxpayer's previous dealings with HMRC have been characterised by a lack of co-operation, are also significant factors. False invoices typically characterise cases of tax evasion involving the creation of complex artificial structures such as offshore companies and trusts, but it is only the dishonest state of the taxpayer's mind which converts a case from one of failed tax avoidance to criminal tax evasion. Ormerod excoriates the distinction between tax avoidance and tax evasion, noting that "the difficulty in distinguishing between shades of avoidance and evasion means that it is always possible for the revenue authorities to prosecute a taxpayer with the criminal offence of cheating in respect of a scheme which is alleged to be dishonest evasion but which the (non) taxpayer believes to be, at worst, an ineffective avoidance scheme."[100] Ormerod explains that "even a professional tax adviser cannot state the difference between the two with precision and confidence. In reality such schemes lie along a spectrum, with the legitimate ordering of affairs at one end and the deliberate evasion, which should no doubt be charged as an offence, at the other. The critical point along the spectrum lies between schemes classified as ineffective or unsuccessful tax avoidance where revenue law declares that tax is payable, and those classified as illegal evasion."[101]

During the last fifteen years a number of tax evasion cases have been prosecuted where the nub of the criminal allegation has focused on the sham nature of an arrangement or lack of commercial purpose underlying a transaction. In *R v Hunt*[102] the defendant was convicted of criminal tax evasion after he introduced false invoices into company accounts in order to reduce

[97] FA 2007 Pt 4.
[98] *R v Less and Depala*, March 2, 1993 (CA), unreported, but cited with approval by Stuart-Smith LJ in *R v Hunt* [1994] STC 819 (CA); also *R v Dimsey* (CA) [1999] STC 846, per Laws LJ, 758A.
[99] See the "badges of heinousness" applied by the Inland Revenue in the formulation of its prosecution policy before the merger with HMRC, described in the *Report of the Committee on Enforcement Powers of the Revenue Departments* (Cmnd 8822) (the Keith Report) [22.1.7].
[100] David Ormerod, "Cheating the Public Revenue" [1998] Crim LR 627.
[101] Ormerod, above fn.100, 636.
[102] *R v Hunt*, above fn.98, [1994] STC 819.

the level of profits on which corporation tax would be levied. A central feature of the charge alleged that the invoices were misleading, false or deceptive because they purported to show commercial transactions made in good faith. A more subtle arrangement came before a criminal court in *R (on the application of IRC) v The Crown Court at Kingston, John (interested party)*[103] where a defendant was indicted following his association with a scheme involving the purchase of English companies by companies controlled by a Swiss resident. The assets held by the English companies consisted primarily of cash and each of the companies had substantial liabilities to corporation tax. Steps were subsequently taken to eliminate these tax liabilities. Although the case was dismissed in the Crown Court because there was insufficient evidence from which a jury could safely infer that the defendant had been acting dishonestly, it is important to note that the prosecution had founded its case on an allegation that the transactions involved in the scheme were fictions or shams. The prosecuting authority had greater success the following year in *R v Stannard*[104] (*Stannard*) when the defendant was convicted for his role in a variant of the scheme, under which a company would be targeted for acquisition where it had an unpaid corporation tax liability and funds available to meet that liability. Steps were taken to reduce the corporation tax liability by the issue of debenture documents which purported to show that debentures in substantial sums had been issued and interest paid in advance. There was supporting documentation and money flows to substantiate the existence of the debentures but in the face of an allegation that the scheme was dishonest the defendant was convicted by a jury. The conviction was upheld on appeal, and reciting the prosecution case Buxton LJ noted the allegation that "the interest payments had no substance" and "the debentures were a sham".

Absence of commerciality also formed the foundation for the prosecution of the defendants in *R v Webb and Simpson*[105] where, similar to *Stannard*, there were actual money transfers supported by entries in the company's accounting records. The defendants contended that they were operating a tax avoidance arrangement under which ownership of copyright in learning courses had been purchased by a Bahamian company. The learning courses were sold by an English company and royalty payments were made to the Bahamian company in respect of each sale. The royalty payments were variously described in the accounts as franchise fees, royalty payments and "costs of course fees". The effect of making the royalty payments was to reduce the profits of the English company on which corporation tax would be levied. Unsurprisingly, the tax avoidance scheme failed to achieve its objective and to compound matters with the revenue authorities no tax was withheld by the English company on the royalty payments in accordance with the requirements of sections 349 and 536 of the Income and Corporation Taxes Act 1988. In the eyes of the prosecution, this was not simply a case of a failed attempt at legitimate tax avoidance. Rather, it was a dishonest enterprise to cheat the public revenue of tax to which it was entitled since even if the Bahamian company had owned the copyright, the prosecution alleged that in reality the payments made by the English company were extractions and not royalty payments. The Court of Appeal found no difficulty in upholding the convictions; the

[103] *R (on the application of IRC v The Crown Court at Kingston, John (interested party)* [2001] EWHC Admin 581; sub nomine *R (on the application of IRC) v Crown Court at Kingston* [2001] STC 1615 (Admin Div).
[104] *R v Stannard* [2005] EWCA Crim 2717; [2005] All ER (D) 14 (Nov).
[105] *R v Webb and Simpson* [2000] EWCA Crim 56 October 23, 2000, unreported, (CA).

movement of monies was real, but there was no genuine underlying commerciality to support them.[106]

Unquestionably, the nature of the allegations made in these cases, focusing upon actual movements of monies supported by business invoices and accounting entries, serve as a catalyst for those working in the financial sector to make an AML disclosure report in any case where parties have entered into transactions for the purposes of tax avoidance and there is scope for a challenge by HMRC that the transactions lack genuine commercial purpose.

Processing financial disclosures

SOCA

Upon receipt of a financial disclosure SOCA records the details on its computer database (called ELMER) and analyses the information contained in the financial disclosure and any associated financial disclosures already held on the computer database in order to extract strategic and tactical intelligence. In appropriate cases, SOCA subsequently makes the financial disclosure available to a law enforcement authority (LEA) for investigation. Each financial disclosure report is analysed and those with potential tax implications are passed to the HMRC officers on secondment to SOCA. Although the implementation of a statutory prescribed form for making a financial disclosure continues to be awaited,[107] SOCA encourages a person making a disclosure to identify the nature of suspected criminal activity when identifying the reasons for suspicion. In relation to revenue offences, there are five categories—Benefit fraud (XXF1XX); Excise fraud (XXF2XX); Corporate tax evasion (XXF3XX); Personal tax evasion (XXF4XX); and VAT fraud (XXF5XX).[108] Accordingly, it is possible for SOCA to identify the tax cases with relative ease. Where SOCA officers identify significant potential tax implications, a report is made for transmission to HMRC. Every report is "sanitised", with irrelevant and unnecessary information excised. There are restrictions on the use of information recorded in a Memorandum of Understanding between the National Criminal Intelligence Service (NCIS) and the Inland Revenue which SOCA and HMRC have inherited.[109] This provides that information/intelligence passing from SOCA to HMRC may not be disseminated to other parties or agencies without the agreement of SOCA. Intelligence from financial disclosures passed from SOCA to HMRC can be used only by HMRC for the purposes of a fraud investigation. As a means of ensuring that these restrictions are complied with, there are arrangements within HMRC for all review papers which relate to intelligence received from HMRC to be filed separately from other papers, and

[106] For two further prosecutions where absence of genuine commerciality was the central issue in the case, see *R v Charlton* [1996] STC 1418 (CA) and *R v Leaf* [2008] 1 Cr App R (S) 3.

[107] POCA s.339 contains the power for Parliament to introduce a prescribed statutory form for the purpose of making financial disclosures. See also Home Office Consultation Document, *Tackling Money Laundering - Suspicious Activity Reports: Prescribed Form and Manner 2007*, available at: *http://www.homeoffice.gov.uk* [Accessed February 28, 2010].

[108] SOCA, *Glossary of Terms*, available at: *http://www.soca.gov.uk* [Accessed February 28, 2010].

[109] Pursuant to the Commissioners of Revenue and Customs Act 2005, HM Customs and Excise merged with the Inland Revenue to form the Commissioners for Her Majesty's Revenue and Customs (HMRC) on April 7, 2005. For the commencement date, see the Commissioners for Revenue and Customs Act 2005 (Commencement) Order 2005, SI 2005/1126.

to be given the appropriate level of additional security. The reports cannot be used directly as evidence in the HMRC investigation. Their purpose is to provide the background intelligence, which can help HMRC know where to look.[110] In addition to the dissemination of sanitised financial disclosures by SOCA to HMRC, SOCA permits HMRC to make a search request for existing intelligence reports in relation to an individual or a company where serious tax fraud is suspected.

HMRC

When HMRC has received information from a financial disclosure which identifies the taxpayer and the nature of the suspicious information, HMRC can choose how it wishes to proceed. Typically, in a case where good quality information is received HMRC commences an investigation under CoP 9 (2005) entitled *Civil Investigation into Cases of Suspected Serious Fraud*.[111] The procedure is known by its acronym "CIF" and replaced the "*Hansard*" procedure and HM Customs & Excise's (HMCE) civil evasion procedures on September 1, 2005. As a general rule, where HMRC decide to investigate using CIF it will not seek a prosecution for the tax fraud which is the subject of the investigation. Instead, the taxpayer will be given an opportunity to make a full and complete disclosure of all irregularities in their tax affairs and a civil settlement will be reached. HMRC's operating manual indicates that CIF is used in cases where the tax loss exceeds £500,000 and in cases where there are complex or sensitive issues.[112] Under CIF, a taxpayer is warned that HMRC may exercise its statutory information powers to obtain information: "If you do not make a disclosure we will undertake our own investigation, using statutory information powers (including to third parties) if necessary."[113] These powers are extensive and can be exercised without the taxpayer's knowledge.[114]

At the stage where information from a financial disclosure is passed to HMRC and a CIF begun, it may not be apparent whether the case involves a complex but lawful tax avoidance arrangement or a flagrantly dishonest act of criminal tax evasion. CIF applies where there is a case involving "*suspected* serious tax fraud" (emphasis added). Either way, there is no doubt that HMRC are entitled to investigate the taxpayer's affairs under this procedure when information has been received following a financial disclosure made by a third party pursuant to the AML disclosure regime. As CoP 9 makes clear, HMRC conduct the investigation "with a view to the imposition of a civil penalty for fraudulent conduct, if our suspicions are confirmed",[115] but at all times HMRC undertake to "keep an open mind to the possibility that there may be an innocent explanation for the suspected irregularities".[116] If the investigation finds nothing wrong with the

[110] See OECD *Access for Tax Authorities to Information Gathered by Anti-Money Laundering Authorities*, (Country Practices), (Paris: OECD, 2002) [23], [116]–[122] and [144]–[156], available at: *http://www.oecd.org* [Accessed February 28, 2010]. See also, *An Anti-Money Laundering Strategy for the Inland Revenue*, which has been adopted by HMRC, [4.2], available at: *http://www.hmrc.gov.uk/specialist/antimoneylaunder-strat.pdf* [Accessed February 28, 2010].
[111] HMRC, CoP 9, above fn.2, available at: *http://www.hmrc.gov.uk* (Accessed February 28, 2010).
[112] HMRC, "Special civil investigations guidance" "Civil Investigation of Fraud (Code 9 2005)": [Manual, *Suspected Serious Fraud Code of Practice 9*], available at: *http://www.hmrc.gov.uk*.
[113] HMRC, CoP 9, above fn.2, "If you do not make a disclosure".
[114] HMRC, CoP 9, above fn.2, "Making a statement you know to be false may render you liable to prosecution".
[115] HMRC, CoP 9, above fn.2, "Outline".
[116] HMRC, CoP 9, above fn.2, "Introduction".

taxpayer's affairs, the investigation is concluded and no action is taken. More commonly, however, "Once we have agreed the nature and extent of any irregularities, the procedures for concluding the investigation and paying amounts due are slightly different for direct and indirect taxes".[117] HMRC will write to the taxpayer to try and reach an agreed figure to cover the amount of outstanding tax, interest and penalties. If agreement cannot be reached, HMRC will formally determine the outstanding liability. For both direct and indirect taxes, the taxpayer appeals to the First-tier Tribunal (Tax Chamber) or the Upper Tribunal.

In this connection, the language used in the CoP 9 warning merits careful attention. Significantly, the procedures for paying amounts of tax due are not restricted to the situation where HMRC have found evidence of serious tax fraud but have nevertheless decided to offer a civil settlement as an alternative to prosecution. Instead, the procedures for concluding a CoP 9 investigation and paying amounts due will be triggered in any case where "irregularities" have been established. It is trite to point out that the reference to "irregularities" embraces an extremely wide spectrum, ranging from cases involving serious tax evasion to other cases where tax avoidance arrangements have been made in good faith but—for one reason or another—are deemed by HMRC to have failed. Ultimately the point is a simple one. There is no restriction whatsoever to prevent HMRC from agreeing a tax settlement which includes interest and penalties under CoP 9 in a case where a financial disclosure has been made pursuant to the AML disclosure regime and no criminal conduct is involved. In recent times HMRC have been keen publicly to assert the existence of a rigid division between its civil and criminal investigative processes, in support of its efforts to obtain more extensive and invasive powers when conducting a criminal investigation. Parliament is more likely to acquiesce in HMRC's accretion of criminal investigative powers if it is confident that information obtained during a criminal investigation will not be surreptitiously used in support of civil proceedings. Therefore, arguing in March 2007 in favour of further integration and modernisation of its criminal investigation powers HMRC asserted that a complete separation of criminal and civil investigations had been achieved.[118]

In HMRC, responsibility for external criminal investigation is now vested in two directorates responsible only for criminal investigation. These are the Criminal Investigation Directorate, which has responsibility for criminal investigation of tax and related matters, and the Detection Directorate which has responsibility for frontiers protection. Criminal investigation of internal frauds is dealt with by a separate unit responsible to the Solicitor of HMRC, following advice that this work should be kept separate. The former Special Compliance Office in the Inland Revenue combined criminal and civil investigation functions, but a complete separation has now been achieved. Civil enquiries are undertaken by a number of units including Local Compliance, Serious Civil Investigation, Complex Personal Returns and the Large Business Service. The management of criminal and civil activity within HMRC only comes together at Director General level and decisions that spanned both activities are the responsibility of HMRC's Executive Committee (ExCom).[119] Whilst it may be true that HMRC have successfully established a clear

[117] HMRC, CoP 9, above fn.2, "Reaching an agreement".
[118] HMRC, *Modernising Powers, Deterrents and Safeguards - Criminal Investigation Powers: Publication of draft clauses and explanatory notes - Responses to the August 2006 consultation document*, January 17, 2007 [3.3], obtainable via *http://www.hmrc.gov.uk/about/review-powers-con-docs.htm* [Accessed February 28, 2010].
[119] HMRC *Modernising Powers, Deterrents and Safeguards - Criminal Investigation Powers*, above fn.118 [3.3].

division between the use of evidence where a case moves from civil investigation to criminal and vice versa, this division is vulnerable to being undermined by the operation of the AML disclosure regime. Information contained in a financial disclosure should come into HMRC's hands pursuant to the AML disclosure regime only where there are reasonable grounds for suspecting that another person is engaged in money laundering. The requirements triggering the making of a financial disclosure are rooted in criminal process, yet the information may be used to initiate an investigation under CoP 9 resulting in a civil settlement for a tax irregularity in circumstances where the taxpayer's conduct falls far short of criminal conduct.

Legal privilege

Although the application of the legal privilege exemption has been extended to apply to accountants, tax advisers and other professionals falling within the parameters of section 330(14) of POCA, the number of cases affected by this exemption is relatively small. There are two explanations. First, the legal privilege exemption applies to a limited category of professional advisers when compared with other persons carrying on business in the regulated sector. Certainly it is true that lawyers and other professional advisers such as tax advisers and accountants are best informed to make a determination as to whether there is a possibility (more than fanciful) that legitimate tax avoidance or unlawful tax evasion is involved, but this is not the case where the person making the financial disclosure falls into another category of person working in the regulated sector. Secondly, on the occasions where information giving rise to reasonable grounds for suspicion comes into the possession of a professional legal adviser or some other relevant professional adviser falling within the terms of section 330(14), the scope of the legal privilege exemption is remarkably narrow. Under section 330(10), information comes to a legal professional adviser or a relevant professional adviser in privileged circumstances only:

> "[W]here it is communicated or given to him —
> (a) by (or by a representative of) a client of his in connection with the giving by the adviser of legal advice to his client,
> (b) by (or by a representative of) a person seeking legal advice from the adviser, or
> (c) by a person in connection with legal proceedings or contemplated legal proceedings".

Although the statutory language is not identical to the delineation of legal privilege at common law, the same significant question arises in practice with reference to section 330(10)(a) and (b) as to whether information is communicated to a professional person "in connection with the giving by the adviser of legal advice" or for the purposes of "seeking legal advice".

The parameters of "legal advice" are surprisingly narrow.[120] The Law Society's *Anti-money laundering practice note* warns solicitors that legal privilege "does not extend to everything lawyers have a duty to keep confidential" but rather "protects only those confidential communications falling under either of the two heads of privilege — advice privilege or litigation privilege".[121] The practice note adds that "[t]he protection applies only to those communications

[120] See *Three Rivers District Council and others v Bank of England* [2004] UKHL 48; [2005] 1 AC 610.
[121] The Law Society, above fn.71 [6.4.1].

which directly seek or provide advice or which are given in a legal context, that involve the lawyer using his legal skills and which are directly related to the performance of the lawyer's professional duties".[122] To similar effect, when the legal privilege exemption was extended to cover accountants and tax advisers, the Institute of Chartered Accountants in England and Wales (ICAEW) informed its members that it was important for them to consider the application of the exemption since "a relevant professional adviser may be providing a variety of services to a client, not all of which may create privileged circumstances for this purpose".[123] In particular, with regard to audit work, the ICAEW noted that this work "[did] not of itself give rise to privileged circumstances for this purpose, as the relevant professional adviser is neither providing legal advice, nor is he instructed in respect of litigation".[124] The steer given by the regulatory guidance is entirely consistent with the expectations articulated in Parliament at the time when the legal privilege exemption was extended. As the Order was laid before Parliament, Baroness Scotland (speaking for the Government) indicated that "the equal treatment between [the] professions … [would] apply only to the very limited extent that they [were] carrying out effectively the same functions in relation to legal advice. The exemption from the obligation to report money laundering to the appropriate authorities is therefore a narrow one which should only apply in specified and appropriate circumstances".[125]

Impact of financial disclosures

In the year ending September 30, 2009, 228,834 financial disclosures were received by SOCA, as compared with 210,524 during the same period in 2007–8.[126] As at March 2009, there were approximately 1.5 million financial disclosures held on the ELMER computer data base.[127] The financial disclosures were made primarily by banks (75 per cent), but also by accountants (2.7 per cent) and solicitors (2 per cent).[128] The majority of financial disclosures by banks were made ex post facto, in contrast to the situation with solicitors who requested consent to proceed with the transaction in the majority (63.7 per cent) of cases in which consent requests were received at the time when the SAR was made.[129] A similar pattern had emerged in the previous year, with the vast majority of financial disclosures emanating from the banks, building societies and those involved in the processing of electronic payments.[130]

[122] The Law Society, above fn.71 [6.4.1].
[123] ICAEW, Tech 02/06, February 2006, *Guidance on changes to the money laundering reporting requirements: The exemption from reporting knowledge or suspicion of money laundering formed in privileged circumstances* [7], available at: *http://www.icaew.com* [Accessed February 28, 2010].
[124] See ICAEW, Tech 02/06, February 2006, above fn.123 [13].
[125] *Hansard*, HL, Vol 675, col. WS133 (November 22, 2005), available at: *http://www.publications.parliament.uk/pa/ld200506/ldhansrd/vo051122/text/51122-37.htm#51122-37_head0*. [Accessed February 28, 2010].
[126] SOCA, "Suspicious Activity Reports Regime Annual Review 2009", 45 (Annex B), available for download at: *http://www.soca.gov.uk/news/151-suspicious-activity-reports-regime-annual-report-2009* [Accessed June 3, 2010].
[127] House of Lords European Union Committee, *Money Laundering and the Financing of Terrorism*, 19th Report of Session 2008–9, Evidence March 18, 2009, 93 (Q 193). Available via *http://www.parliament.uk/hleuf/* [Accessed March 1, 2010].
[128] SOCA, "Suspicious Activity Reports Regime: Annual Review 2009", above fn.126, 45 (Annex B).
[129] SOCA, "Suspicious Activity Reports Regime: Annual Review 2009", above fn.126, 46.
[130] SOCA, "Suspicious Activity Reports Regime: Annual Review 2008" November 20, 2008, 40 (Annex B), available at: *http://www.soca.gov.uk*.

Efficacy of financial disclosures

In its role as the UK's primary financial intelligence unit, SOCA presents an impression to the regulated sector and the public at large that the AML disclosure regime is an extremely important weapon in the fight against financial crime. Financial disclosures are described as "a vital weapon in the UK's armoury to prevent and detect crime and to protect the integrity and reputation of the UK financial system".[131] However, there are many in business and academia who vehemently contest the UK Government's assertions about the efficacy of the AML financial disclosure regime. In a report published by the Corporation of London published in June 2005,[132] the costs of complying with the AML disclosure regime were considered to be unduly high and disproportionate to the gain obtained in terms of law enforcement. The report noted that AML disclosure regime costs in the UK were significantly higher as a proportion of national GDP than in other major jurisdictions, and that the proportion of compliance costs versus GDP was almost one quarter higher in the UK than in the USA, over double that in Germany and almost three times that in France and Italy. Amongst the themes to emerge from the study, it was felt that whilst the UK was perceived as being more heavily regulated than other major financial centres, the UK's AML disclosure regime was not perceived as being more effective at detecting and deterring criminal conduct than the regulations in other jurisdictions. There were very similar perceptions about the level of effectiveness of the AML disclosure regime from UK respondents and international respondents.[133]

Limited case-specific feedback from SOCA fosters an aura of cynicism amongst those working in the financial sector as to whether AML disclosures truly assist HMRC in its fight against those who dishonestly evade their tax liabilities. Moreover, in terms of cost/benefit analysis, there is considerable doubt about whether the width of the reporting burden placed on the financial sector, with the attendant risks of making AML disclosures in cases where a taxpayer's commercial arrangements engage the money laundering indicators, can be truly justified. In this connection, the House of Lords European Union Committee recently recommended that SOCA should provide increased levels of case by case feedback in an effort to persuade the financial sector of the value of the efforts it puts into operating the AML disclosure regime.[134] The House of Lords European Union Committee also considered that it was vital for SOCA to make a serious attempt to calculate the cost/benefit of the AML disclosure regime. At the present time, no

[131] SOCA, Frequently Asked Questions, "What is a SAR?" available at: *http://www.soca.gov.uk* [Accessed April 26, 2010].

[132] Corporation of London, "Anti-Money Laundering Requirements: Costs, Benefits and Perceptions" City Research Series Number Six, June 6, 2005, available at: *http://www.cityoflondon.gov.uk/NR/rdonlyres/3A40A89E-27CF-407E-8B3B-0317020F1559/0/BC_RS_AMLRFULL_FR.pdf* [Accessed February 28, 2010].

[133] In November 2004 HM Crown Prosecution Service Inspectorate (HMICA) reported that many opportunities for asset recovery were being routinely missed. See HMICA, *Payback time, Joint Review of Asset Recovery since the Proceeds of Crime Act 2002*, (November 2004) [5.3], available at *http://www.hmica.gov.uk/files/Full.pdf* [Accessed March 1, 2010]. A *Panorama* programme, *Crime Pays*, broadcast by the BBC on March 24, 2009 came to a similar conclusion. David Blunkett, the then Home Secretary who introduced the legislation, was quoted as saying: "We've failed — we've failed on the ambition of bankrupting those who had made enormous amounts of money, out of criminal behaviour". See also Peter Sproat: "To what extent is the UK's anti-money laundering and asset recovery regime used against organised crime?" [2009] JMLC 134.

[134] House of Lords European Union Committee, above fn.127 [122].

cost/benefit analysis has been carried out by any body at any level: not by the FATF, not by the EU, and not by any department or agency within the UK Government.[135]

Financial disclosures and tax

From SOCA's perspective

SOCA estimates that since the new AML disclosure regime was brought into effect by POCA on February 24, 2003[136] and MLR 2003 on March 1, 2004,[137] approximately one quarter of financial disclosures lead to new enquiries into taxation matters.[138] The Commissioners of Customs and Excise and the Inland Revenue (IR) were the second and third largest authorities respectively to which financial disclosures were allocated for investigation in both 2003 and 2004.[139] Of the financial disclosures disseminated to law enforcement authorities (LEA), 55.3 per cent were copied to HMCE and 11.4 per cent to the IR.[140] Without doubt, therefore, the newly conjoined HMRC[141] are a major stakeholder in the AML disclosure regime. HMRC used to have a team of 15 staff working with the Financial Intelligence Unit at the National Criminal Intelligence Service (NCIS).[142] The IR were one of eight LEAs which piloted the remote ELMER computer system at NCIS in 2005.[143] SOCA highlights the value of financial disclosures in the effort to maximise the level of tax collected in the UK, and in its Suspicious Activity Reports Regime Annual Report 2007 it carries a quotation from HMRC's Head of Criminal and Enforcement Policy which explains that financial disclosures are a "vital and valuable source of intelligence for a diverse range of its activities" and that this resource enables HMRC "to inform and focus enforcement and compliance intervention activity from money laundering investigations to the full cross section of taxes and duties it administers".[144]

Further evidence of the linkage between the AML disclosure regime and the collection of tax in the UK is established by remarks made by Mike Wells, Director Risk & Intelligence Service at HMRC, quoted in the Suspicious Activity Reports Regime Annual Review 2008. Mr Wells indicated that "SARs have proven to be a valuable information resource across the entire range of HMRC's enforcement effort, from identifying and addressing serious tax compliance issues, to the highest level criminal investigations of organised crime networks". The resonance of Mr Wells' references to "the entire range of HMRC's enforcement effort" and the addressing of

[135] House of Lords European Union Committee, above fn.127 [124] and Sproat, above fn.133 [128].
[136] See the 2003 Commencement and Savings Order, above fn.59.
[137] See MLR 2003, reg.1(2)(d) and fn.31 and associated text.
[138] SOCA, "Suspicious Activity Reports (SARs) Frequently asked questions", 17, available at: *http://www.soca.gov.uk* [Accessed April 26, 2010].
[139] Matthew H. Fleming, *UK Law Enforcement Agency Use and Management of Suspicious Activity Reports: Towards Determining the Value of the Regime* (London: UCL, 2005), 22, available at *http://www.jdi.ucl.ac.uk/downloads/publications/research_reports/Fleming_LEA_Use_and_Mgmt_of_SARs_June2005.pdf* [Accessed March 1, 2010].
[140] See Fleming, above fn.139 [50].
[141] Regarding the establishment of HMRC, see fn.109.
[142] SOCA, "Suspicious Activity Reports Regime Annual Review 2007", (London: SOCA, 2007) [83].
[143] See Fleming, above fn.139, 7, fn.9.
[144] See SOCA, "Suspicious Activity Reports Regime Annual Review 2007", above fn.142, 20.

"serious tax compliance issues" is to be noted.[145] The notion of tax compliance is far wider than criminal evasion activity, for as HMRC's Tax Compliance Risk Management Guidance records, "a tax compliance risk may be an identified tax issue, where HMRC and the customer may not agree about a particular tax analysis set out in a return or declaration. Or it may be a less specific uncertainty about whether tax returns and declarations are correct which may lead to an issue being identified".[146] On any view, a tax compliance issue falls a long way short of suspected criminal activity which should properly form the subject matter of a financial disclosure under the AML disclosure regime.

From HMRC's perspective

Covert disclosure of information about potential tax irregularities is the lifeblood of revenue investigators. Historically, there have been many occasions when revenue authorities have been willing to pay insiders large sums of money for information about tax irregularities committed by those with whom they have associated, the most recent example occurring in the case of Heinrich Kieber, a former Liechtenstein banker, to whom HMRC paid £100,000 for details of secret offshore bank accounts.[147] With the receipt of inside information having traditionally played such an important role in the refinement of tax investigation techniques, the extension of the UK's AML disclosure regime to all forms of criminal conduct which included tax offences was a golden opportunity which the UK revenue authorities were not going to miss. Neatly coinciding with the Chancellor of the Exchequer's chairing of the G-7 meeting of Finance Ministers in May 1998, the Inland Revenue developed links at that time with NCIS to raise the profile of tax fraud and improve the quality and quantity of financial intelligence. The enterprise was highly successful, and the National Audit Office (NAO) noted in 2003 that "the impact of new intelligence sources has led to a reassessment and reorganisation of Special Compliance Office intelligence capabilities and approach, and the establishment in 2001 of a single dedicated intelligence unit". The NAO added that "intelligence has proved valuable as a source of referrals for fraud investigation and in providing effective early warning of significant tax fraud and avoidance issues".[148] The association between "significant tax fraud" and "avoidance" issues is noted. The IR indicated to the NAO that it expected POCA's implementation to lead to "a large increase in the number of tax fraud related disclosures, including in relation to the use of the offshore accounts and structures".[149] It is axiomatic to point out that offshore structure cases are the most difficult to determine in terms of deciding whether the line between tax evasion and tax avoidance has been crossed. HMRC and the NAO have yet to publish figures revealing the

[145] SOCA, "Suspicious Activity Reports Regime Annual Review 2008" published on November 20, 2008, above fn.130, 29.

[146] HMRC, *Tax Compliance Risk Management: Guidance for Large Business Service (LBS) customers and staff*, December 2007, s.2. This version of the guidance has now been replaced by a Manual on the Tax Compliance Risk Management Process available at *http://www.hmrc.gov.uk/large-business/risk-framework-guidance.htm* [Accessed June 4, 2010].

[147] Jonathan Fisher,"Money talks in pursuit of tax evaders," *Daily Telegraph*, March 19, 2008, available at: *http://www.telegraph.co.uk* [Accessed March 1, 2010].

[148] National Audit Office, *Tackling Fraud against the Inland Revenue, Report by the Comptroller and Auditor General*, HC 429 (Session 2002–2003), February 28, 2003, [2.34] available at *http://www.nao.org.uk* [Accessed March 1, 2010].

[149] National Audit Office, *Tackling Fraud against the Inland Revenue*, above fn.148 [2.35].

number of financial disclosures made under the AML disclosure regime which involve offshore structure cases since April 2004. There is, however, good evidence testifying to the value of the AML disclosure regime in combating tax irregularities relating to the hidden economy. The hidden economy is usually taken to mean any undeclared economic activity, typically casual moonlighting and work paid cash in hand, and certainly many people will unquestionably commit tax offences since it is their plain intention to operate below the radar and side-step the obligation to pay tax on the income they earn. In this respect, the substance of a financial disclosure founded on a suspicion that a person is working in the hidden economy is likely to fall towards the tax evasion end of the spectrum. In these circumstances, it is perhaps unsurprising that the NAO should have reported recently that the AML disclosure regime made a significant impact in the collection of tax in this area. In the period April 2004 to the end of March 2007, HMRC completed 7,150 investigations triggered by financial disclosures made under the AML disclosure regime. Over £27 million in tax was recovered, representing around £3,800 in each case. Based on current levels of success, HMRC indicated to the NAO that it expected over the next two years to raise a further £51 million from investigations involving the hidden economy triggered by financial disclosures made under the AML reporting regime.[150]

Moving away from the secret workings of the hidden economy to the concern about the disclosure of information relating more to tax avoidance issues than tax evasion in the context of the use of offshore structures, amongst the data scrutinised in the study of the AML disclosure regime undertaken by UCL's Jill Dando Institute of Crime Science there were papers relating to a case involving the use of offshore companies in a tax haven. The study noted that "[financial disclosures submitted in this case] had led to the investigation of a large UK business (with a turnover of billions of GBP). Through NCIS, an LEA had been provided with a volume of information that detailed the ownership and nature of transactions going through offshore companies. The UK companies would buy materials from connected tax haven companies and the UK group was reporting large losses. The offshore arrangements were never static and during the course of enquiries the LEA became aware of over 40 offshore companies. There were myriad issues including company residence, transfer pricing, branch/agency, and trust legislation and employee remuneration arrangements. Ultimately the case was settled for more than £6 million".[151] The LEA in question was almost certainly the IR (now HMRC), and noting that the case resulted not in criminal prosecution but civil settlement, this study neatly supports the contention that the AML disclosure regime is indeed being deployed by the UK Government as a means of discovering information relating to failed tax avoidance arrangements falling short of the commission of any criminal offence involving tax evasion.

Conclusion

The paradox is enormous: instead of making extensive in-roads into the detection and criminal prosecution of organised crime, the AML disclosure regime has shown itself to be remarkably effective in the area of tax collection, and it is responsible for triggering a significant proportion

[150] National Audit Office, *Tackling the Hidden Economy*, HC 341 Session 2007–2008, April 3, 2008, [3.14], available at *http://www.nao.org.uk*. [Accessed March 1, 2010].
[151] See Fleming, above fn.139 at 80.

of tax investigations taking place. These investigations rarely give rise to criminal prosecution since under the CIF procedure civil settlement is HMRC's primary goal. The fragile line dividing legitimate tax avoidance from criminal tax evasion causes the AML disclosure regime to capture many financial disclosures relating to tax avoidance arrangements rather than criminal evasion, and by deploying the AML disclosure regime in this way the UK Government is able to intensify its battle on those who arrange their commercial affairs to avoid tax in a legitimate way.

The statutory language of the AML disclosure regime is criminal, the architecture of the enforcement process is criminal, and the statutory intention is to capture the proceeds of criminal activity. Therefore if the distinction between tax avoidance and tax evasion is to remain extant in English law, further emphasis needs to be placed on the legal requirement that the prosecution must prove the existence of criminal property before a money laundering offence under Part 7 of POCA can be made out. Moreover, it is imperative to appreciate in a case where there is a tax issue that the threshold for making a financial disclosure is not triggered merely by the existence of offshore company and trust structures. Financial disclosures should not be filed on the strength of a hypothesis which is equally consistent with tax avoidance as with tax evasion; indicators of criminality over and above the use of complex offshore company and trust structures are required. In the vast majority of cases the use of complex offshore structures is more likely to be consistent with legitimate tax avoidance activity than the concealing of criminally obtained funds, and in the absence of factors indicating that criminality is involved, the regulated sector should not be compelled to bring instances of legitimate tax avoidance activity to HMRC's attention in this way.

Disclosure; Money laundering; Reports; Tax administration; Tax avoidance; Tax evasion