

Money Laundering, Tax Evasion and Accountants

David Winch, May 2006

The Money Laundering Regulations 2003 have been in force for more than 2 years in the UK and the identification of new clients has become just another routine part of an accountant's life. But the full impact of the requirements has not yet filtered through in many accountancy firms.

Because accountants, generally speaking, are not involved with their clients' funds and transactions in the way that banks and solicitors are, accountants are not in the greatest danger of direct involvement in money laundering related to serious crime or terrorism.

But accountants do examine their clients' business and financial affairs in great depth. Greater depth than bankers or other professional advisers. So what is reportable and what is not?

Most frequent risk area

The area of risk which most accountants will encounter most frequently relates to taxation. An accountant must report to his Money Laundering Reporting Officer (MLRO) or to the Serious Organised Crime Agency (SOCA) where, in the course of the provision of accountancy services or taxation advice, he receives information or other matter which causes him to know or suspect, or gives reasonable grounds for knowledge or suspicion of, money laundering by anyone.

Money laundering will occur whenever a crime is committed by which someone benefits.

Tax evasion

Tax evasion is a crime by which someone benefits. Tax avoidance is not a crime. Getting in a muddle is not a crime.

Tax evasion involves dishonesty. In law dishonesty means that someone behaves in a way that by generally accepted standards is dishonest and that the dishonest person realises that he is behaving dishonestly by those standards.

So something that happens accidentally or unintentionally is not tax evasion. Tax evasion requires deliberate wrongdoing or deliberate failure to do something which one is required to do (such as notifying the tax authorities of the commencement of trading).

Providing legitimate tax planning advice is not a crime (even if one is required to notify H M Revenue and Customs of the advice). Similarly following that advice, or pursuing a course of action which one genuinely believes to be correct in law, is not a crime (even if, at the end of the day, a different view prevails). Very often the firm's Money Laundering Reporting Officer (MLRO) is torn between respecting client confidentiality and requirements to report suspicions to SOCA.

Understandable confusion

Understandable confusion arises because accountants know that their clients may be subject to penalties for negligent omissions or mis-statements and the accountant may believe this to be reportable. Negligence alone is not reportable. Reports are required in relation to deliberate wrongdoing or deliberate failure only. Although the client is subject to a penalty this does not mean that he has committed a criminal offence. Without a criminal offence there can be no money laundering.

Another confusion is caused by the accountant's knowledge and experience which tells him that H M Revenue and Customs rarely bring criminal prosecutions against taxpayers even in cases where deliberate wrongdoing has been admitted. The accountant needs to recognise that where there has been deliberate tax evasion a report to SOCA must be made. This is the case whether or not the full facts are being disclosed to H M Revenue and Customs and even though prosecution is not being considered.

Yet another confusion arises from the need to report not just based on what the accountant knows, but also on the basis of that which he does not know, but which he suspects.

Some examples

Let's take some examples to dispel some of the fog!

You are Mr D's accountant. Mr D's income tax affairs are under investigation by his local tax office. It comes to light that Mr D has been careless in his book-keeping. Some of his purchase and expenses invoices cannot be found and there are deposits into his personal bank account for which he can produce no documentary evidence.

The inspector proposes a settlement involving an addition to profit each year over several years and suggests a round sum payment to cover tax, interest and penalties. After discussing the matter with you, and the costs of continuing to challenge the inspector, Mr D agrees to settle on this basis.

Is this a case in which a report should be made, or should have been made, to SOCA?

First, let's discard the irrelevancies. It is irrelevant that Mr D has agreed to pay a penalty. It is irrelevant that full information has been submitted to the inspector. It is irrelevant that agreement has now been reached to the satisfaction of the tax authority. It is irrelevant when the under-declarations of income took place or what period of time they related to.

The relevant question is this “Do you know or suspect that Mr D deliberately dishonestly evaded tax?”

If you suspect that, for example, the bankings into Mr D's personal bank account were a deliberate attempt by him to cause taxable income to go unrecognised and undeclared then you must report this to SOCA (if you have not already done so).

On the other hand, if you have no reasonable grounds for suspicion that Mr D intended any under-declaration of income, then you need not report the matter to SOCA.

Unrecorded cash transactions

Let's take another example.

Your client Mr M is a builder. He admits to you that he does 'cash jobs' which he does not put through his books. Although he has not previously told you, he now admits that he has been doing this since the commencement of his business and that he has always known this was a wrong thing to do. Past tax returns submitted for him by your firm have therefore been incorrect.

Mr M asks you what the chances are of this being discovered by the authorities.

This must be reported to SOCA. You know or suspect that Mr M has been engaged in deliberate dishonest tax evasion.

The matter must be reported to SOCA whether or not Mr M instructs you to make a full disclosure to HM Revenue and Customs. The nature of the report which you make to SOCA will reflect Mr M's instructions to you, but that is outside the scope of this article.

Cash differences in a retail business

One more example.

You prepare accounts and tax returns for Mr F who runs a public house and lives on the premises. There is a cash difference which cannot be explained. Mr F's gross profit percentage is lower than other similar businesses. Mr F takes little cash drawings but his returns do reflect private consumption and personal accommodation expenses. Mr F explains that his life is his work and he has little need of cash drawings.

Do you need to report Mr F to SOCA?

The relevant question

Again the relevant question is this “Do you know or suspect that the taxpayer is deliberately dishonestly evading tax?”

Your answer will depend, no doubt, on the nature of the records and the cash difference and your view of Mr F's character. Do you consider him to be fundamentally honest in his tax affairs? Or do you suspect he may be 'skimming' cash from the takings? If you suspect Mr F of tax evasion the matter will not be resolved by adding whatever cash difference you have found to the recorded takings or drawings. The cash difference will almost certainly be a net figure resulting from an amalgam of plusses and minuses.

If you do report Mr F to SOCA the likelihood is that the information in your report will be passed to H M Revenue and Customs and Mr F will be subject to an investigation of some sort. However this should not be a factor in your decision.

Whenever a question such as this arises the accountant would be well advised to make a full file note to document his consideration of the money laundering reporting issues. This file note should not be seen by the client or anyone else outside the firm (except, where appropriate the firm's legal advisers or the authorities).

Where the matter is in doubt you should discuss the position with your firm's Money Laundering Reporting Officer - and keep a file note of the discussion. If you decide to make a report to the MLRO you should always make that report formally and in writing.

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