HMRC CRIMINAL INVESTIGATION AND PROSECUTION POLICY

HMRC have two distinct tracks in dealing with serious fraud. Whilst neither process is particularly pleasant for the person suspected of serious tax fraud, the choice of which one HMRC use has potentially devastating consequences for the individual concerned.

The two tracks, basically, are:

(i) The issuance of Code of Practice 9 (COP 9); and
(ii) Criminal investigation with a view to prosecution.

Before the merger with HMCE in 2005, the Inland Revenue had long had a selective prosecution policy. This was most clearly set out in their evidence to the Committee on Enforcement Powers of the Revenue Departments under the Chairmanship of Lord Keith (The Keith Report) in 1983. HMRC retains a selective criminal investigation policy as regards serious fraud. It is certainly the case that tax evaders who fail to avail themselves of the opportunity to contact HMRC and make a full disclosure face the risk of prosecution. However, as I discuss below, I have doubts that the current policy of selectivity is applied fairly or transparently.

CODE OF PRACTICE 9

COP 9, which of course used to be known as Hansard, has of course changed over the years but its essence remains the same. As is well known, at the initial meeting (at which the taxpayer and his advisers will attend), HMRC will tell the taxpayer that he is suspected of serious fraud and then challenge him to make a full disclosure of taxation irregularities. An outline disclosure (usually followed by a substantial payment on account) is expected to be made at that meeting, and a detailed report submitted in six months. During the process, HMRC will not reveal the grounds of their suspicions (other than possibly, and only to some extent, through a later “scoping meeting”). The tax to be collected can go back twenty years, the penalty can typically represent 30 - 40 per cent of the
tax arrears, and the interest will often be immense. There is no prosecution for the “predicate” alleged tax fraud offence.

Until 2005, if a full disclosure was not made, the predicate tax offence could still be prosecuted. Post-2005, and the changes which had to be made COP 9 due to R v Gill v Gill¹, if a full disclosure was not made, the Revenue reserved the right to prosecute for the making of a false declaration as part of the COP 9 enquiry. This is particularly important at the moment as HMRC would clearly like us to know that generally they have greater sources of information available to them now than they have had in the past. One source of information which they currently apparently have is the contents of a list of account holders and amounts which list was stolen from his employer by a former employee of HSBC in Geneva.

When the COP 9 process is completed, as is well known, a statement of assets has to be submitted, and a certificate of full disclosure signed. It is bound to be the case that HMRC are methodically working through the HSBC list, and checking to see that the alleged account holders at HSBC in fact declared those accounts in any statement of assets they previously submitted as part of a previous COP 9 or other enquiry. If they did not, then a criminal investigation is likely to follow.

**CRIMINAL INVESTIGATION WITH A VIEW TO PROSECUTION**

The second track, of course, is criminal investigation leading to possible prosecution. Many present today probably have little experience of prosecutions in practice. However there need be no doubt that for their clients, outside of ill health, it may be the most stressful experience they ever have to go through.

A few years ago when powers between the old Inland Revenue and HMCE were aligned, fairly typically, despite the protestations of the ICAEW², the powers were increased to the highest common denominator. Accordingly, HMRC, when investigating direct tax fraud, were given the power of arrest. They already had the power to obtain a search warrant from the Court if they suspected evidence of serious tax fraud would be found on premises (be it in the form of documents or material on a computer).

Now, ancillary to their powers of arrest under the Police and Criminal Evidence Act 1984 (PACE), they can also search premises without a search warrant. If a suspect has proper tax fraud specialist legal representation, arrest can sometimes be effected by arrangement. Alternatively it may be possible to persuade HMRC not to arrest at all when they conduct the interview under caution. However, on occasion, arrests will take without any notice whatsoever, at the time of the search.

¹ R v Gill & Gill [2003] EWCA Crim 2256
HMRC will often be accompanied by the police. The suspect and his family may have to stand by in their pyjamas while his domestic premises are searched, and documents, diaries, and computers are removed. This may take place either before or after he is taken, under arrest, to the police station. Other searches will often be happening simultaneously at the office premises, and at those of anyone else suspected of being involved in the alleged tax fraud. There may even be a search at the premises of his accountants, although, usually, relevant material from there will be extracted by means of a production order.

And that is just the start of it.

Arrest on the day will usually be followed by interviews under caution at the police station. The unqualified right to silence during such interviews has long been removed - the Conservative Government in 1994 (when Michael Howard was Home Secretary) by “virtue” of the Criminal Justice and Police Act (CJPOA) 1994 removed the right to silence. Interviews under caution are a potent weapon in the armoury of law enforcement, and of course are much loved by HMRC criminal investigators. False denials of otherwise provable facts, as well as admission of facts, can be massively damaging to a defendant later, as can silence itself.

Typically in tax fraud cases, the investigation may take a very long time. If the suspect has been subject to an interview under caution on the day of the raid, he is likely to be interviewed at least once more, once HMRC have had time to analyse any documents seized in the execution of the search warrants (or obtained by virtue of any production order; or following a request for mutual legal assistance to the competent authorities of another state).

The recent “re-alignment of powers” also gave HMRC the right to intercept telephone communications in serious cases. Customs previously had this right of course in VAT fraud cases. The material or “product” obtained cannot be used in Court, and indeed, under current rules, it must remain absolutely secret. Even mentioning the existence of specific material may be an offence under RIPA 2002. Nonetheless, many people have surmised that it is routinely used in carousel fraud investigations, and it is by no means fanciful to suggest that it is being used, or may be used in the future, in complex direct tax evasion cases - particularly if HMRC perceive the suspected criminality to be a “wholesale attack” on the system.

Once the criminal investigation is completed, and once the decision to prosecute has been made by the CPS, the suspect will face charge or summons, and the trial process will commence. Naturally, sentences of imprisonment can be severe. The freezing of assets by way of a crown court restraint order, followed by confiscation after conviction, is also a grave concern for the defendant.

Clearly in a criminal tax fraud investigation there is a need for specialist tax fraud advice from a solicitor at the earliest opportunity. Frankly, after the interview is too late. If specialist representation
is not obtained on the day, a duty solicitor may be assigned. The rates paid by the duty solicitor scheme are so low that under the legal aid system, the solicitors firm instructed may send only partially qualified staff with little or no experience of fraud (let alone tax fraud) prosecutions. Even the average specialist fraud solicitor will have very little knowledge of direct tax fraud (although he or she may know something of that endemic blight on the economy known as “carousel” or “MTIC” fraud, which has got little to do with the sort of matters which are the subject of direct tax fraud criminal investigations). The upshot of the above is that if there should be a raid on, and arrest of, one of your clients, the arrangement of immediate tax fraud specialist legal representation at the custody suite (at a time when the client is in custody so cannot arrange it himself) may be the best thing that you ever do for your client.

**AVOIDANCE v EVASION**

Recently HMRC have been putting particular resource into the criminal investigation of what might be termed very aggressive tax avoidance schemes. The policy of the Inland Revenue as from the late 70s was, as many will know, to deal with such schemes by way of what was known as the Ramsey\(^3\) or Furniss v Dawson\(^4\) doctrine of looking at the substance, rather than form of a pre-ordained series of transactions, one or more of which was inserted for a tax avoidance purpose. Alternatively schemes would be dealt with by specific anti-avoidance legislation. That really meant that the worst that was probably going to happen was that the scheme would not work, and the tax would be payable plus penalties and interest; and that was so even in the most artificial schemes.

A culture of tax avoidance specialists, therefore, built up, with some schemes very “aggressive” indeed. This even continued after the introduction of the Disclosure of Tax Avoidance Schemes (DOTAS) Rules on 1 August 2004. What sometimes happened in those cases is that the promoters of certain schemes resorted to describing them as something other than tax avoidance schemes - such as investment schemes for example. I strongly suspect that some of them did this (and resorted to concealment of the fact that there was a scheme in the first place) not because they thought the scheme did not work; but rather because they thought the scheme did work, and if HMRC knew about it, they would do whatever they could to close the “loophole” which was being exploited. HMRC criminal investigators have often simply interpreted such scenarios as deliberate concealment of the true facts, because of alleged knowledge on the part of the promoters that the scheme did not work. Clearly in such criminal investigations, if it can be shown that the scheme did work as no tax was payable, that would result in the dismissal of any prosecution (eg; R v Hanson and Thompson\(^5\)).

It is worth noting that there appear to be ongoing at least four investigations/prosecutions which deal with what might arguably be described as tax avoidance schemes. These cases will certainly bring

\(^3\) W. T. Ramsay Ltd. v. Inland Revenue Commissioners, Eilbeck (Inspector of Taxes) v. Rawling [1982] A.C. 300
\(^4\) Furniss v Dawson [1984] A.C. 474
\(^5\) Regina v Hanson and Thompson [2006] EWCA Crim 2849
into focus the clash of culture between the tax avoidance world and the criminal justice system, but it remains to be seen how matters will transpire; and whether first and foremost, as in every fraud prosecution, the Crown will be able to prove (1) a tax loss and (2) dishonesty on the part of the defendants.

**THE CRITERIA OF SELECTION FOR CRIMINAL INVESTIGATIONS AND PROSECUTION, AND THEIR APPLICATION IN PRACTICE**

As I have stated there is a selective criminal investigation policy. By and large, once an investigation is criminal, if HMRC can gather admissible evidence to the appropriate standard, there will be a prosecution.

The prosecution has to consider and apply the Code for Crown Prosecutors, which provides that, before there can be prosecution:

1. There has to be a realistic prospect of conviction - in fact over 51% (although this definition often appears to be overlooked or forgotten by prosecutors); and
2. Prosecution must be in the public interest.

The decision to prosecute used to be made, and the prosecution itself conducted, by the Revenue and Customs Prosecution Office (RCPO). Before that was established in 2005 (at the same time as merger), the Inland Revenue’s own Solicitors Office used to prosecute on direct tax matters. The RCPO themselves did not unfortunately have a good reputation, as can be seen, for example, in *R v Uddin & Others*[^6] where its conduct in the non-disclosure of certain key material casting doubt on the veracity of their own witnesses was such that the prosecution of a huge £110m alleged carousel fraud was stopped as an abuse of process by a High Court Judge. The matter was even raised in Parliament, following which the Independent Police Complaints Commission (IPCC) were given special powers to investigate the RCPO. (The IPCC previously could only investigate the police.)

But then, almost unnoticed, on 1 January 2010, the RCPO was abolished and its function slipped into the CPS.

Whilst there are for the moment still said to be specialist revenue prosecutors within the CPS, the takeover of the RCPO by the CPS is surely bound to mean that the prosecution’s knowledge of tax fraud, technical tax issues, and also how the Revenue can deal with tax fraud without using prosecution, will dissipate. In the past, when RCPO prosecuted, in my experience there was at least a chance that, when considering the public interest test, RCPO would (i) consider the wider interests of HMRC; (ii) be aware that HMRC have two tracks for dealing with serious fraud, and that the vast majority of serious tax fraud are dealt with using COP 9; and (iii) thus perhaps be open to persuasion

[^6]: Operation Venison (*R v Uddin & Others*) [2005] EWCA Crim 1788
that the public interest would best be served by the issuance of COP 9 rather than by a prosecution. However, one would have thought that very few CPS prosecutors will ever have heard of COP 9, or have any sense of how many very serious tax fraud cases are in fact dealt with by HMRC civilly under COP 9, rather than by prosecution. A CPS prosecutor, when considering an individual serious tax fraud case, and a submission that the case should not in fact be prosecuted, is arguably far less likely than the RCPO would have been to compare the case with a COP 9 case and come to a view not to prosecute. On the contrary, one would have thought that he would be more likely to compare such a tax fraud case with other serious non-tax fraud cases – which, as a matter of course, are routinely prosecuted. (This is despite the slight shift in this regard by the Serious Fraud Office, following the appointment in 2008 as Director of the SFO of former Inland Revenue Special Compliance Office Director/former Head of HMRC Special Civil Investigations, Richard Alderman – particularly in relation to overseas corruption – outside the scope of this paper.)

In these circumstances, once a tax fraud criminal investigation is sufficiently complete for a report to be submitted to the CPS, it may just about be worth the specialist solicitor trying to convince the CPS that the matter shouldn’t be prosecuted – for example, perhaps because the suspected tax fraud does not fall within the HMRC’s criminal investigation policy. Certainly, it would be appropriate in certain cases for the solicitor to make a formal submission that the evidential test has not been satisfied, if he has been allowed to see the evidence (which sometimes happens, and which can be pushed for…). However, as I have said, submissions based on policy grounds, or based on an argument that the published HMRC criminal investigation policy has not been properly complied with, or is unfair, are unlikely to be successful. Instead, the responsibility for who will ultimately be prosecuted where there is evidence of tax fraud falls squarely on HMRC; and if a prosecution is to be prevented because of unfairness, or a submission that the tax is not properly due, it is HMRC and not the CPS, who should be engaged at the earliest possible opportunity. Everything depends on the facts of a case, but that opportunity may very well be much earlier on, and well before the criminal investigation is completed.

The issue of fairness is particularly important as I believe the criminal investigation policy which is supposed to be fair is not in fact properly applied; and in fact the criteria for selectivity for criminal investigations in practice are anything but fair. (Note: this particular subject matter is also outside of the scope of this paper. I have previously written about it in detail - please see my chapter on direct tax fraud in the Lexis Nexis Butterworths publication entitled ‘Fraud: Law, Practice & Procedure’).

Suffice it to say HMRC has always been supposed to select the most serious cases for criminal investigation and possible prosecution. These categories used to be known as the “categories of heinousness”; but my own view is that they have been watered down to such an extent that HMRC have given themselves the widest possible leeway on whom they investigate criminally. (This has been done without any published objective outside scrutiny of their policy; it has been a long time since the Keith Committee Report, and current criminal investigation policy, both in theory and in practice, is very different to what it was then).
HMRC are of course conscious that from time to time they have been criticised by one public body or another for not prosecuting enough cases, e.g. the National Audit Office Report dated 26 February 2003, which stated that the Inland Revenue should increase the number of prosecutions they conducted.

Although they will not say it (and they steadfastly refuse to publish meaningful figures), their response in my view has been to inflate the prosecution figures by prosecuting a whole range of smaller or objectively less serious frauds; whilst dealing with the vast majority of larger or objectively more serious frauds by issuing COP 9. From around 2001, in other words the time when the Grabiner offence (fraudulent evasion of income tax contrary to Finance Act 2000, s 144) was introduced, I have therefore regarded revenue criminal investigation/prosecution policy in practice as being both unfair and lacking in transparency. Indeed, the policy’s lack of transparency, in my view, is precisely because it is not fair.

PREDICTIONS FOR AREAS HMRC WILL INVESTIGATE CRIMINALLY

Despite the criticisms I have made above about fairness, there are some predictions that can fairly confidently be made.

The world, and phase, we are in at the moment is one of tax “amnesties”. Over the last few years, as we have seen, we have had general amnesties e.g. the Offshore Disclosure Facility introduced on 17 April 2007 (ODF) and the 2009 New Disclosure Opportunity (NDO)\(^7\); and a specific amnesty for a particular group i.e. the Tax Health Plan (THP) (and the rumours are that others are to follow). We have also had a specific amnesty (namely the Liechtenstein Disclosure Facility (LDF)), which, on closer examination, turns out to be general amnesty for those that bother, or have the good sense, to take the appropriate specialist advice to bring themselves within its terms.

HMRC know that amnesties only work if those targeted think that if they do not participate, they will face very serious penalties and even prosecution. Indeed, in November 2009, Permanent Secretary Dave Hartnett stated that some individuals with offshore funds would “end up in tears because they are just not going to have thought we would be as tough as we’re going to be.” So I would certainly have thought that there will now be a certain number of prosecutions in major tax fraud cases, especially where people have had the chance to avail themselves of the possibility of making a voluntary disclosure and have spurned that chance.

HMRC have recently announced that they will be increasing prosecutions five-fold. It remains to be seen whether, if they do that, they will select the most serious cases, or whether they will again, in my

\(^7\) In an article in Accountancy Age dated 28 July 2009, the NDO was described by Permanent Secretary Dave Hartnett as “the final opportunity for taxpayers with unpaid tax to voluntarily disclose under the favourable penalty structure”
view, subvert their published criminal investigation policy, and fail to apply fair criteria of selectivity. But even if they do improve their figures by criminally investigating smaller or objectively less serious cases, they are surely bound to criminally investigate some at least of the most serious cases. And those cases, if the evidence is there, surely will be prosecuted.

**OTHER ISSUES**

1. **THE USE OF MATERIAL FROM THE STOLEN LIST OF THE HSBC EMPLOYEE.**

In a sense, specialist tax fraud defence lawyers would relish HMRC seeking to prosecute using this material. The issue of whether illegally obtained material can be used as admissible evidence in criminal prosecutions has long been a legal chestnut in the criminal courts. There are strong arguments that the evidence is inadmissible, even if, for example, the Revenue criminal investigator himself had obtained it “lawfully” - for example by means of the mutual exchange of information pursuant to a treaty with another state. I strongly suspect that prosecutors will shy away from it; but I do think that criminal investigators will try to obtain the material from other sources. This may include using it to know how to direct their information powers. However, even trying to obtain the material in this way is in my view arguably a use of illegally obtained material and may not be lawful.

There is a further point. Arguably in using the information, HMRC are themselves committing a money laundering offence. Section 328 of the Proceeds of Crime Act 2002 (POCA) criminalises anyone who “enters into or becomes concerned” in an arrangement which he “knows or suspects” facilities (“by whatever means”) the use of criminal property “by or on behalf of another person”. POCA section 340 defines criminal property as property that represents in whole or in part directly or indirectly the benefits of a person’s criminal conduct, as long as the person “knows or suspects that it constitutes or represents such a benefit”. Arguably, therefore, the HSBC list of names is “criminal property” and the use of it by the Revenue - even to apply for a production order - is an arrangement whereby the Revenue know or suspect its use is being facilitated. Section 329 of the Proceeds of Crime Act 2002 is also relevant and may criminalise HMRC’s conduct.

Even if there is no technical offence on the part of HMRC, in my view there are clearly admissibility issues in both criminal and civil proceedings. This is a complicated area, a detailed analysis of which law is outside the scope of this paper. But clearly there are issues which should be explored.

2. **IS IT LAWFUL FOR THOSE THAT HAVE BEEN ISSUED WITH COP 9 TO BE DENIED THE AVAILABILITY OF LDF?**

There is currently a conflict between the material published by HMRC on LDF. The Memorandum of Understanding says that “any person already under investigation by HMRC as of the date of signing this Memorandum of Understanding cannot participate in the disclosure facility”. That would mean for
example that if you were served with a COP 9 last week, you could apply for and be registered for the LDF this week, as long as you had qualifying property and fulfilled the other criteria.

Answers to “Frequently Asked Questions” (FAQs) were published a few months ago to try to “clarify” this. The answer to question 1(13) of the latest version of this document (published 3.11.10) says that “If, at any time prior to registering for the LDF, you are notified that you are under investigation …you will not qualify for the terms of the LDF.” That would mean of course that if you were served with COP 9 last week, you could not apply for and be registered for the LDF this week, because you had already been notified that you were under investigation.

The difference of course can be massive. Under LDF the tax collected only goes back 10 years, the penalties are only 10% and the composite rate option can also save a lot of tax. Overall the difference between the amount payable under LDF and COP 9 may amount to many hundreds of thousands of pounds.

As I have said, the answers to the FAQ’s are supposed to “clarify” the MOU; which, however, is surely clear in any event and not in need of clarification (although perhaps not to HMRC’s liking).

In these circumstances, the question of which takes precedence - the clear statement in the published MOU or the answers to the FAQs - is not an easy matter, and involves issues of constitutional law, legitimate expectation in the context of judicial review, and the relationship between private rights and public international law in the form of bilateral treaties between states. Issues of fairness also come into it. (Why should someone with Liechtenstein property, or for that matter a medical practitioner, be treated any differently from anyone else?) Both of these issues are outside the scope of this paper, but scope for a paper in itself.

Harry Travers
BCL Burton Copeland
16 November 2010