

High Net Worth Individuals and Tax Evasion

Extract from NCA Intelligence Brief (Reference 0694-NECC)

Overview

Recent high profile data leaks such as the Pandora Papers and the Suisse Leaks have highlighted the extent to which tax planning is utilised by High Net Worth Individuals (HNWI), which often involves off-shore companies and trusts. Whilst the public perception of this has generally been negative, in particular where these entities are located in jurisdictions that promote privacy for beneficiaries, settlors, etc., in many instances these structures represent legitimate tax planning strategies. In contrast, tax evasion takes place when individuals or businesses deliberately fail to declare and account for the taxes they owe to a tax authority.

Definitions

HNWI

Although the UK is home to a significant number of HNWIs, there is no legal or regulatory definition of what a HNWI is. HMRC's 2020-2021 annual report notes that wealthy individuals often have complex tax affairs, covering multiple types of tax reporting obligations and defines such individuals as having "incomes above GBP200,000 or assets above GBP2 million in any of the last 3 years".

A questionnaire of some of the leading UK banking and finance institutions who participated in the work of the HNWI Tax Evasion cell has also shown that there are a variety of definitions used across the financial industry to categorise clients based on wealth. Whilst there is no agreed definition or range for HNWI, one common factor across the different participant banks was that the HNWI definition used by financial institutions may have an impact on the business segment/division that clients can be on-boarded to and also the subsequent level of due diligence that will be applied. Banks will typically apply both enhanced due diligence (EDD) 1 and a greater level of senior management scrutiny to on-boarding and maintaining HNWIs.

Tax Planning

Tax planning involves organising one's affairs in a tax efficient manner within the intent of the law and with an honest belief that it is a legal method of reducing a tax liability, with no intention of deceit.

Tax Avoidance

Tax avoidance involves bending the rules of the tax system (often utilising the services of professional tax advisors) to gain a tax advantage. Aggressive tax avoidance can involve contrived or artificial transactions that serve little or no purpose other than to produce a tax advantage which operate within the letter, but not necessarily within the spirit, of the law.

Tax Evasion

Tax evasion generally includes the deliberate concealment or misrepresentation of beneficial ownership of assets, income and gains, or otherwise fraudulent conduct, designed to divert money from the public revenue.

Risk Indicators and factors for consideration

The following are examples of risk indicators, which are further exemplified in case studies located in Appendix 1, which at a minimum, require further assessment:

1. Contradictory responses from the client when challenged on particular arrangements;
2. Residence – indications a client is resident in a location different to what they have claimed/on KYC file;
3. Circular movements of cash and /or using bank accounts as flow throughs, and where activities on the account appear to be illogical and failing to align with the purpose of the account;
4. When an account is used for a different purpose than that documented in KYC;

5. Where beneficiary/beneficiaries are identified, which are different or additional to what is documented in the KYC file and also where there is some opacity behind the motivation for certain arrangements;
6. Where a client has exposure to a jurisdiction¹⁵ considered high risk for tax evasion purposes.
7. Use of highly complex fiduciary structures, especially those which include eclectic features such as “dummy settlors” (where the settlor of record is acting as a nominee for another person who is providing the funds settled into a trust) and bearer shares.
8. Arrangements involving loans between different fiduciary structures settled or beneficially owned by unrelated persons.
9. Commercial transactions involving the use of fiduciary structures, especially in a cross-border context.
10. Use of unregulated corporate or fiduciary service providers or regulated corporate or fiduciary service providers with a poor reputation or which are subject to negative news reporting.
11. Indications that a customer has not taken professional tax advice when setting up an offshore fiduciary structure.
12. Behavioural indicators such as a customer hinting that their funds are not tax compliant or alternatively that they are seeking to conceal assets from a tax authority.

Banks and financial institutions should also be aware that potential tax evasion is likely to co-exist with other indicators of potential predicate offences and should be aware of the heightened level of risk associated with i) particular asset classes such as arts and antiques and virtual currency and ii) payment delivery channels such as the use of money service business (MSBs) or informal value transfer methods (such as hawala style transactions).

Suspicious Activity Reporting [SARs]

If you know or suspect that there has been money laundering or terrorist financing activity (including as a result of information provided to you by the NCA) and your business falls within the regulated sector, then you are reminded of the obligations to make reports to the NCA under Part 7 Proceeds of Crime Act 2002 and the Terrorism Act 2000. If you decide to make a report in this way you should adopt the usual mechanism for doing so, and it will help our analysis if you would include the reference **0634-NECC** within the text. This reference is specific to the Alerts process; where appropriate, we would ask that this is used in addition to the ongoing use of the Glossary of Terms. Guidance on making suspicious activity reports is available at www.nationalcrimeagency.gov.uk.

Data Protection Considerations

Please consider your obligations under the relevant data protection regulations and where necessary remove any related personal data from your systems securely and within a satisfactory timeframe.

Disclaimer

The Accountancy AML Supervisors' Group (AASG) accept no responsibility for any loss, damage or expense arising in connection with the use of information in this alert. Any use will be taken to signify agreement to these conditions.

APPENDIX 1: Case Studies

This section is a combination of anonymous case-studies from the cell members, from both the FIs and HMRC. All references to “banks” are relating to UK regulated banks. The case-studies are also referenced throughout the alert where they are relevant to a topic explored in more detail earlier on.

CASE STUDY 1: (themes: corporation tax evasion and transaction monitoring)

Background

- Mr D is an existing private banking client in the UK, resident in the Seychelles.
- He wanted to open a new personal account.

Potential issues

- During the account opening process, the financial crime compliance team noticed that the entire balance on Mr D's existing account has been accumulated by way of refunds from Mr D's construction company's suppliers (the company held an account with another bank);
- A review of the transaction review showed that Mr D would pay a large sum to a supplier one year and later in the same year approximately a third of the initial payment made was refunded into his UK account;
- A suspicion was formed that the client was artificially inflating cost of sales with a view to lower the company's profits and therefore evade corporation tax on the 'hidden' profit.

Themes and recommendations

- Check the background and rationale of transactional movements and whether it fits with the intended purpose of the account.
- A SAR was filed with the NCA and this followed by a consent request further to a payment instruction from the client.
- Here the bank closed all accounts.

CASE STUDY 2 (themes: understanding ultimate beneficial ownership)

Background

- A bank held a private bank account in the UK for a BVI registered personal investment company (PIC), whose sole owner was Mr A, a Nigerian national resident in the UAE;
- The bank noticed that the PIC has a very similar name to a fashion company in Nigeria, owned by Mr A's wife;
- A review of the PIC account revealed that it is frequently funded by the wife's account (via a different bank) in Nigeria. The account also made several payments to well-known fashion companies; - It was also known that Mrs A is a US passport holder.

Potential issues

- A suspicion was formed that Mrs A, is potentially the ultimate (or additional) beneficial owner of the PIC;
- Mrs A may not be fulfilling all her tax obligations in the US, which taxes citizens on a worldwide basis, regardless of where they reside;
- Additional suspicions were formed that Mrs A's business in Nigeria may not be accounting for all its transactions correctly.

Themes and recommendations

- Identify and act on information which indicates that the ultimate beneficial owners is different to what is declared on the bank or financial institution
- Be alert to transactions involving parties which are not beneficial owners and/or controllers clearly disclosed in KYC
- File a SAR

CASE STUDY 3 (themes: application of the “The Code of Practice on Taxation for Banks” (the Code))

Background

- Ms M, a private bank client was interested in a property valued at GBP 2m;
- She had an existing residential property and explained that the new property would be purchased by her daughter instead, but that she would give her daughter the deposit funds in the form of a loan (with the balance covered through a mortgage);
- Ms M also disclosed that she would spend 2 to 3 nights per week in the new property.

Potential issues

- Although Ms M's daughter would be the formal owner of the property, it appeared that Ms M herself would benefit from the purchase of the property, as a potential indirect owner;
- Although there were no direct indicators of tax evasion, the stamp duty land tax (SDLT) planning appeared to be the main motivation behind this arrangement. Individuals are expected to pay an additional 3% on top of the applicable SDLT rates if they own another residential property;
- There were also potential inheritance tax implications.

Themes and recommendations

- Understanding the main motivation behind certain arrangements, especially where there is opacity around beneficial ownership;
- The Bank in applied its obligations under the Code with regard to the GAAR, to better understand the reason behind this set up;
- To understand the purpose of the arrangements, the Bank insisted that Ms M should seek external tax advice and share this with the bank.

CASE STUDY 4 (themes: understanding the purpose of transactions)

Background

- Mr D is a UK-based wealthy sole signatory of two business current accounts, for two separate UK businesses A Ltd and B Ltd. Mr D also has a personal UK account.
- GBP750,000 transfer received from externally-held personal account, passed through his three accounts, then back out to the external originating account.
- When asked to provide a rationale for these transaction patterns, Mr D originally explained that this was a repayment of a director's loan. Mr D then provided a second explanation that this was a bridging loan from one business to the other. He then provided a third explanation that the transfer was a loan to an undisclosed third party for property investments of over GBP2m, with no fixed repayment period and ostensibly secured against those properties.
- Mr D advised he was currently on a personal 45% tax rate and B Ltd was on 20% rate so he intended to grow B Ltd to only pay 20% corporation tax vs 45% personal tax.

Potential issues

- The comment about the tax rates, whilst potentially accurate, was irrelevant in explaining the reasons behind the above transactions
- They failed to provide a sufficient rationale for the transactions.
- The above transfer and explanations provided were not consistent with expected account use, which was for receipt of rental income. The set up was illogical and excessively complicated
- In this instance, B Ltd had minimal other account activity

Themes and recommendations

- Challenge and monitor closely transactions and/or activities that appear to be illogical or do not align with the purpose of the account;
- Whilst choosing to benefit from the tax rate differential may be acceptable tax planning, in light of the other factors, i.e. a conflict with expected account activity, compared to the actual activity, will give rise to suspicions, especially where there is a discrepancy in the explanation for the transfer.
- Here a decision was made to file SARs, submission of related DAML consent requests and a decision was made to exit the relationship.

CASE STUDY 5 (themes: Common Reporting Standard (CRS) reporting / KYC inconsistency / high risk jurisdictions)

Background

- The client is a BVI entity, providing tech consultancy services, with a bank account in the UK.
- Mr B, a Russian national, is the ultimate beneficial owner (UBO) of the entity. - Mr B provided as proof of residence, a one year lease on an apartment in the UAE, with the correspondence address remaining in Russia. His main business still remained in Russia;

Potential issues

- The company's main transactional activity since onboarding consisted of cash transfers from a related party. This was not the expected activity discussed during the onboarding process. Third party transfers to and from accounts were taking place, without a reasonable explanation
- Adverse media was picked up on Mr B relating to previous prosecution in another jurisdiction for embezzlement and aiding tax evasion. Mr B stated that the charges were politically motivated and his businesses had paid all legally required taxes.
- It appeared that Mr B had planned to mask his real tax residence, by claiming to be tax resident in the UAE, although he may have been residing in Russia and failing to declare offshore earnings.
- When additional due diligence was applied, Mr B noted he received tax advice, although he was vague about his advisers and the nature of tax advice received.

Themes and recommendations

- Be vigilant to instances where client's country correspondence frequently conflicts with what is noted in the KYC file as country of residence;
- Be alert to transaction patterns and ensure they are in line with the expected transaction activity noted on the KYC file, for the whole lifetime of the client relationship
- Pay close attention to other KYC details, such as country of residence and where clients main correspondence is from (e.g. where there is a frequent inconsistency between country of residence noted on file and where the client is making phone calls from, and also where they request for postal mail to be routed to a different location etc).
- Conduct adverse media monitoring of clients and relevant connected parties (i.e. shareholders and/or controllers)
- Implement enhanced due diligence measures for high risk locations. In this instance, the UAE has no income tax and is a high risk jurisdiction for people misusing its Residence/Citizenship by Investment programme to declare themselves as tax residents - File SAR

CASE STUDY 6 (themes: Common Reporting Standard (CRS) reporting / KYC inconsistency)

Background

- Ms C is an Italian businesswoman in the jewellery business, which is her primary source of wealth, with the business mainly operating in Europe.
- Ms C declared her Certificate of Tax Residence (COTR) as UAE and provided her UAE resident card. Her address is a hotel room in Dubai, corroborated by way of a proof of stay provided by the hotel for a period of 6 months.

Potential issues

- Ms C's relationship manager (RM) appeared to receive contact mainly from her Italian telephone number;
- On the KYC file an Italian address was also noted for her bank statements.
- The client's permanent home appears to be in Italy from the information available on file and whilst she claims she lives in the UAE, as evidenced by the hotel receipt, this is not permanent accommodation.
- Mrs C appears to have no apparent connection to the UAE aside from the residency status shown on the COTR. The RM also confirmed that all contact she has had with her has only demonstrated presence in Italy, and never the UAE.

Themes and recommendations

- Potential application of EDD where clients pose risks through their jurisdiction (this includes country of tax residence; booking centre for client's account; where clients have their corporate entities/vehicles incorporated and/or operating in, etc)
- Be alert to transaction patterns and ensure they are in line with the expected transaction activity noted on the KYC, for the whole lifetime of the client relationship

- Pay close attention to other KYC details, such as country of residence and where clients main correspondence is from (e.g. where there is an inconsistency between country of residence noted on file and where the client is making phone calls from and also where they request for postal mail to be routed to a different location etc).
- Conduct adverse media monitoring of clients and relevant connected parties (i.e. shareholders and/or controllers)
- Implement enhanced due diligence measures for high risk locations. In this instance, the UAE has no income tax and is a high risk jurisdiction for people misusing its Residence/Citizenship by Investment programme to declare themselves as tax residents - File SAR

CASE STUDY 7 (themes: Common Reporting Standard (CRS) reporting / complex and opaque structures / UK property / tax evasion)

Background

- In 2010, Mx J, a UK-born and resident individual who has lived in the UK all their life, settles a trust in Jersey with their UK-resident family and Mx J as beneficiaries. They claim to the trustee that they are nonUK domiciled and that the settled funds were situated outside of the UK.
- Underneath the trust, a number of companies are incorporated in Jersey, one of which acts as a holding company together with a number of subsidiary UK property investment oriented special purpose vehicles (SPVs).
- A trust and corporate service provider (TCSP) in Jersey acts as trustee of the trust and provides directors to the Jersey companies. They charge flat fees for providing those services and an hourly rate for any other work done e.g. documenting minutes of board meetings.
- Mx J and their family set up a UK company (or partnership) and provide 'consultancy services' to the Jersey SPVs which acquire UK property.
- UK companies under Mx J's control develop property held by the Jersey SPVs.
- Mx J regularly organises the re-finance of the Jersey SPVs' property but uses UK banks. Most of this thirdparty debt is held by the Jersey holding company which it then loans to the Jersey SPVs, either at no additional interest or at a premium.
- The Jersey SPVs are paid rental income from third parties in respect of their UK property. Up until April 2020, this income was liable to Income Tax after which the income became subject to Corporation Tax.
- The Jersey SPVs filed Income Tax returns with significant interest deductions, resulting in low or no profit. The Jersey SPVs' management accounts submitted to the banks in order to support applications for finance suggest these are shareholder loans with no or commercial rates of interest, giving a different financial picture to the tax returns submitted to HMRC. The two positions cannot both be correct.
- The Jersey SPVs have bank accounts that pre-date the Common Reporting Standard. These accounts receive rental income which is paid over, indirectly, to Mx J as 'loans'. The accounts never have more than the equivalent of \$250,000 in them.
- Mx J is the principal financial beneficiary behind the structure.

Potential issues

- Although Mx J claimed to be non-UK domiciled, there are strong indicators that, irrespective of their common-law domicile, they may have been deemed UK-domiciled for Inheritance Tax at the time of settlement. The trust may therefore be subject to Inheritance Tax.
- Mx J claimed the settled funds were not UK assets. However, if the settled funds were proven to be UK assets, the trust may be subject to Inheritance Tax, irrespective of Mx J's domicile.
- Although the TCSP in Jersey provides directors and trustees, there are strong indicators that Mx J, and potentially also members of their family, manage and control the Jersey incorporated companies in the UK. The Jersey incorporated companies may therefore have failed to notify of their obligation to Corporation Tax and could be liable to chargeable gains on any property sales going back up to 20 years.
- Because Mx J settled the trust, anti-avoidance provisions such as Transfer or Assets Abroad may apply, assigning income to Mx J.
- If the loans from the Jersey holding company to the Jersey SPVs are interest bearing, the financial institutions are not being provided with an honest picture when the group obtains finance. The interest rate structure may appear to be uncommercial and represent tax evasion or avoidance which could be successfully challenged when discovered by HMRC.
- In the alternative, if the above loans are not interest bearing, the Jersey companies are evading tax by submitting inaccurate returns taking deductions for interest where none are due. - The re-financing of the Jersey SPVs' properties involving 'Reportable Accounts' will not necessarily be reportable under CRS in respect of Mx J or their family as 'controlling persons' because they are UK residents and the accounts are in the UK.

- The Jersey SPVs' bank accounts pre-dating CRS reporting may not be reportable. This is because the CRS allows jurisdictions to choose to apply a threshold such that 'Pre-existing Entity Accounts' below USD250,000 (or local currency equivalent) are not subject to review. By not allowing rental income to accrue in the accounts beyond the \$250,000, it appears there may be CRS avoidance.

Themes and recommendations

- From 31 January 2023, check any overseas legal entities owning UK property are registered on the Companies House Register of Overseas Entities 32 and that beneficial ownership information agrees with information provided for KYC purposes. Also ask to see any information about trusts submitted to Companies House (which must be submitted to the Register of Overseas Entities where a trustee is a registrable beneficial owner) and check this agrees with information provided for KYC purposes.
- Request from the customer a copy of the trust's 'proof of registration document' for the TRS. Check whether it is registered as a taxable trust and that the beneficial ownership information agrees with information provided for KYC purposes.
- Where there is a complex and opaque offshore arrangement involving a trust:
 - check what advice has been obtained on the domicile status of any UK-resident settlor
 - irrespective of the nationality/domicile of the settlor, check the source of funds of the settlement.
- Review correspondence and documents for any signs that the control appears to be with UK resident individuals. This is important where the overseas companies' directors only appear to get involved to sign documents and document board minutes as required and the UK residents appear to have unfettered authority to negotiate on behalf of the overseas companies.
- If you have concerns that an offshore structure has been put in place to avoid or evade UK tax, ask to see:
 - the UK tax returns of overseas companies if/when providing finance to ensure those returns match the financial performance as presented to the bank.
 - the underlying tax advice. If they are prepared to provide it, seek assurance from tax colleagues that it's current, agrees with the facts as you know them and is unchallengeable by HMRC.