

25 Common Questions Relating to Money Laundering and Tax Returns Answered

David Winch, May 2006

David Winch answers 25 questions on money laundering issues relating to self assessment income tax returns.

1 Does the money laundering law apply to me?

If you are an accountant, tax adviser, solicitor or anyone else assisting your clients in the preparation or submission of self-assessment income tax returns in return for a fee, yes, the legislation applies to you. Don't kid yourself that it does not because you "do not give tax advice - you just fill in the forms" or because you "are not an accountant" or because you "do not charge for completing the tax return - just for doing the accounts". None of these 'clever' excuses will be accepted in practice.

2 What do I have to do?

You have to report to your firm's money laundering reporting officer (MLRO) when you know or suspect, or you have reasonable grounds to know or suspect, that any person is engaged in money laundering. Your MLRO has to report the suspicion to the Serious Organised Crime Agency (SOCA).

3 Surely I am obliged to keep client's affairs confidential?

No, the requirement to report knowledge or suspicion of money laundering over-rides client confidentiality.

4 Completion of tax returns does not involve money laundering, does it?

Money laundering is very widely defined in the Proceeds of Crime Act 2002 (PoCA) and the Money Laundering Regulations 2003 (MLR). Tax evasion inevitably involves money laundering because when a person 'saves' tax by evasion he commits a criminal offence by making a false tax return and a money laundering offence by failing to pay the full amount of tax which is properly due.

5 So saving tax is a money laundering offence?

No, but where tax is 'saved' **by tax evasion** a money laundering offence inevitably follows.

6 So what is tax evasion?

In law, tax evasion is the dishonest under-declaration of tax liabilities. Dishonesty is an essential ingredient of tax evasion. Dishonesty distinguishes illegal tax evasion, which incorporates reportable money laundering, from honest tax avoidance, which is not reportable under PoCA / MLR.

7 So when is person dishonest?

The legal test of dishonesty was set out in the leading case of R v Ghosh in 1982. In this case it was decided that a person was dishonest when he was acting dishonestly by the standards of ordinary and decent people **and** he himself must have realised that what he was doing was, by those standards, dishonest.

So a person who deliberately fiddles his tax is being dishonest and is engaged in tax evasion which is reportable under PoCA / MLR. But a person who under-declares his income as a result of simply getting in a muddle, or failing to realise that particular income or gains ought to be declared, is not engaged in tax evasion (because their under-declaration is not deliberate), and this accidental under-declaration is not required to be reported under PoCA / MLR.

8 When ought I to suspect tax evasion?

There is no simple rule. It depends very much on your view of your client's intentions based on your knowledge of him. However where you have evidence which suggests that transactions are being deliberately omitted or mis-stated in your client's accounting records, or your client is deliberately withholding information from you, or mis-stating information to you, then you will be obliged to report your suspicions.

9 What about cash differences?

The term 'cash difference' covers a variety of situations. At one extreme, a self-employed architect, for example, may not have a petty cash system but instead may purchase cash items with his own out-of-pocket money. Some accountants will deal with this by summarising the expenditure in a cash account and may refer to the total cash expenditure as a 'cash difference' which is credited to capital introduced. This sort of cash difference does not generate money laundering concerns.

More often a 'cash difference' arises where a business receives some sales income in cash and a cash account has been prepared which includes cash income, cash banked and perhaps also cash expenditure, an opening and closing cash in hand balance and cheques received and banked. Even here a cash difference may merely represent arithmetical errors in the book-keeping which can be identified and eliminated during the preparation of accounts, or other correctable errors (such as bankings omitted from the cash book but identified from bank statements, or entries duplicated in error in the records).

Failing this, it may not be possible to pin down and correct the errors which lie behind the cash difference. In these cases consideration should be given to making a report.

If there are also other indications that records of takings or income may be understated or incomplete, for example a low gross profit percentage or a low level of cash drawings without adequate explanation, then a report should be made.

Whether or not a report is made, you should make a file note summarising the information, your decision whether or not to report, and your reasoning.

10 What if the cash difference is dealt with by an adjustment to the accounts before the tax return is submitted?

Opinions vary on this point. My own view is that a cash difference found in the preparation of accounts is likely to be made up of a number of errors or omissions occurring during the accounting period. It is likely that some of the errors or omissions will tend to cancel each other out in the cash account, so the overall cash difference is a net figure which does not fully reflect every error and omission in the records. It follows that adjusting the accounts by the amount of this overall net cash difference does not fully correct the position and the adjusted accounts still are incorrect.

In my view therefore a report should still be made even where an adjustment has been made in connection with the cash difference which has been found.

11 What if the effect of the cash difference is to increase drawings, surely this has no effect on taxable income?

Again, opinions vary but my view is that a report should be made because the overall cash difference to drawings may conceal unrecorded sales as well as unrecorded drawings.

12 On that basis wouldn't I have to report most of my clients?

If you have a lot of clients involved in cash businesses who have inadequate records it may well be the case that you will need to report large numbers of your clients. However each case must be considered individually on its merits.

13 What about other irregularities?

Wherever you suspect that a client's tax return understates the client's taxable income as a result of deliberate errors or omissions by the taxpayer, the matter is reportable. This will apply, for example, where a self-employed client deliberately understates the proportion of telephone or motoring expenses which are private and therefore not eligible for deduction from taxable profits, or an individual deliberately omits certain taxable investment income from his return.

14 What about VAT implications?

Where there are under-declarations of VAT as a result of evasion these are also reportable. Where both income tax and VAT are being evaded both matters can be dealt with in a single report to SOCA.

15 How do I make a report?

Initially you should report the matter to your firm's MLRO in writing. You should include all relevant information. It would be sensible to attach a copy of the file note referred to in question 9 above and your files to the report.

16 I am the MLRO - what should I do?

If you are the MLRO, or you are a sole practitioner working alone who has no MLRO, you should consider the case and, if you believe there are reasonable grounds to suspect tax evasion, you should report the matter to SOCA (not to the Inland Revenue). You can make your report online or by post or fax. You are not required to use the report forms issued by SOCA, but you may find them helpful.

17 Where can I get the SOCA forms?

You can download them from the SOCA website at <http://www.soca.gov.uk/financialIntel/index.html>.

18 Can I use the Limited Intelligence Value (LIV) report form?

The LIV report form is for use when the authorities already have all the relevant information concerning suspected money laundering. It is not appropriate to use the LIV form in connection with the submission of a tax return.

19 Do I need to ask for consent from SOCA before submitting a tax return which I suspect includes false or incomplete figures?

No. Providing you submit a report to SOCA shortly after submission of the return you will have done sufficient to satisfy the authorities.

20 How quickly do I have to make the report?

The legislation requires that the report be made as soon as practicable. Where a report is submitted within 30 days of the day on which the tax 'saving' arises this is likely to be regarded as acceptable. In connection with a 2006 tax return the tax saving is likely to arise on submission of the return where this generates a refund and on 31 January 2007 in other cases.

21 What could happen to me if I do not report my suspicions?

Failure to report is itself a criminal offence punishable by a fine or imprisonment. You may also find yourself criticised by your professional body, if you are a member of one, if it comes to light that you have failed to report when you had reasonable grounds for suspicion.

22 Should I tell the client that I have reported him to SOCA?

No, you must not tell the client that you have reported him, nor should you tell anyone else about the report if this might interfere with any subsequent action by the authorities. Such a disclosure is 'tipping off' which is itself a criminal offence punishable by imprisonment.

23 What do SOCA do with the reports?

Information from reports related to tax evasion is passed to the HM Revenue and Customs. Since the Money Laundering Regulations 2003 came into force in March 2004 reports under the new legislation have led to numerous new inquiries being opened by HM Revenue and Customs.

24 Hasn't the legislation been amended so that accountants are no longer required to report suspicions?

The Proceeds of Crime Act 2002 and the Money Laundering Regulations 2003 have been amended by subsequent legislation, including the Serious Organised Crime and Police Act 2005 and the Proceeds of Crime Act 2002 and Money Laundering Regulations (Amendment) Order 2006. Further amendments to the law are anticipated as a consequence of the introduction of the requirements of the EU Third Money Laundering Directive into UK legislation before the end of 2007.

However in practice these changes are expected to have little impact on accountants who will still be required to report suspected tax evasion and other crimes in most cases.

25 Where can I get help?

You can get confidential one-to-one email support, information and free monthly NewsAlerts from my MLRO Support website www.mlrosupport.co.uk.

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