

MONEY LAUNDERING AND TAX EVASION – THE BANKER’S DILEMMA

Alan Binnington

Background

Jersey has had anti-money laundering legislation since the 1980’s but it was only on July 1st, 1999, with the implementation of the Proceeds of Crime (Jersey) Law 1999 (“the 1999 Law”) that the money laundering offences which had been created by legislation such as the Drug Trafficking Offences (Jersey) Law 1988 were extended to cover other forms of serious criminal conduct. The 1999 Law was based largely on section 93 of the UK’s Criminal Justice Act 1988 (“the 1988 Act”) as amended by the Criminal Justice Act 1993 which, in turn, was intended to implement the EU Council Directive of June 10th, 1991 on the Prevention of the Use of the Financial System for the Purpose of Money Laundering[1]. The EU Directive required member states to legislate to prohibit money laundering in connection with the proceeds of criminal activity, such activity being defined by reference to the crimes specified in Article 3(1)(a) of the Vienna Convention of 1988 which was directed against illicit traffic in narcotic drugs and psychotropic substances, together with such other criminal activity designated as such for the purposes of the Directive by each member state. Interestingly, the Directive did not require Member States actually to criminalise money laundering nor did it specifically refer to criminal activity in the field of tax evasion.

When the 1988 Act was amended it is widely believed that the UK Treasury did not think that tax evasion was included in the Act’s definition of criminal conduct. Indeed, the Parliamentary debate on the amendments to the 1988 Act[2] focused on the evils of drug trafficking and organised crime with no mention of the Act’s possible use in the field of tax evasion. However within two years the UK Government was making clear that it regarded tax evasion as an issue which was just as serious as that of drug trafficking. In October 1995, at the Commonwealth Finance Ministers’ Meeting held in Jamaica, the Chancellor of the Exchequer stated that:

“we must recognise that money laundering is associated with all types of crime – from fraud to extortion, arms smuggling to kidnapping. It is quite artificial to draw a distinction between drug related crimes and other crimes. In Britain we have responded to the shifting threat by passing legislation to cover the proceeds of all indictable offences. There is no moral difference between drug trafficking and other serious offences, the risks from both are great, and this applies as much to fiscal offences as any other crime. All crimes should mean ALL crimes. Who is the victim is irrelevant. Tax crimes make the law abiding suffer. It is they who make up the shortfall caused by those who cheat”. [3]

How then did a statute which, at the time it was debated, did not appear to apply to tax offences, come to be applied to such offences? The answer lies in the way in which “criminal conduct” is defined, not by reference to a list of particular offences but by reference to the mode of trial of offences.

The problem of definition

The money laundering offences created by the 1988 Act, as amended, create liability where the accused has in some way dealt with a person's "proceeds of criminal conduct" with a specified degree of knowledge of that person's criminal activity. "Criminal conduct" is defined as "conduct which constitutes 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) Scotland".^[4] By virtue of Section 71 of the 1988 Act, as amended, Part 6 of the Act applies to offences which are listed in Schedule 4 to the Act or, if not so listed, which are indictable offences, other than drug trafficking offences or offences under Part 3 of the Prevention of Terrorism (Temporary Provisions) Act 1989. Broadly speaking, therefore, "proceeds of criminal conduct" refers to the proceeds of indictable offences. As far as fiscal offences are concerned, under English law tax evasion is dealt with not by means of trial on indictment but by means of proceedings for a penalty before the Commissioners of the Inland Revenue. On the face of it therefore the English legislation would not appear to apply to tax evasion. This may well be the reason why, when the Act was debated, no reference was made to its application to fiscal offences. However, tax evasion will usually, in addition, involve some other form of criminal activity which is triable on indictment such as forgery or false accounting. There is, of course, also the common law offence of cheating the public revenue which was expressly preserved by Section 32(2) of the Theft Act 1968. This offence comprises any form of fraudulent conduct which results in diverting money from the Revenue and thus requires no positive act of deception^[5]. Failure to make a tax return could therefore constitute the offence of cheating.

Although it is now clear that offences committed within the context of tax evasion will fall within the definition of criminal conduct for the purposes of the 1988 Act there are nevertheless difficulties in applying the Act to such offences, these difficulties arising as a result of the definition of "proceeds", difficulties which also arise under the Jersey legislation discussed below.

The Jersey legislation

The 1999 Law follows a similar pattern to the 1988 Act. Thus it creates three principal money laundering offences, namely assisting another to retain the benefit of criminal conduct^[6], acquiring possessing or using the proceeds of criminal conduct^[7] and concealing or transferring the proceeds of criminal conduct^[8]. For the purposes of the 1999 Law "criminal conduct" is defined, in Article 32(7), as "conduct which constitutes an offence to which this Law applies or would constitute such an offence if that conduct had occurred in the Island". By virtue of the First Schedule to the Law, offences to which the Law applies are "any offence for which a person is liable on conviction to imprisonment for a term of one or more years (whether or not he is also liable to any other penalty)".

Under the Income Tax (Jersey) Law 1961 the penalty for fraudulently or negligently making incorrect statements in connection with a tax return is a fine rather than a sentence of imprisonment^[9]. Accordingly, as in the UK, tax evasion *per se* does not constitute criminal conduct for the purpose of the 1999 Law. However, again as in the UK, tax evasion may involve other offences, such as forgery, false accounting or common law fraud, all of which are punishable by a sentence of one or more years' imprisonment and thus fall within the definition of criminal conduct.

Cheating the revenue authorities in Jersey

The position in relation to cheating may however be different. There does not appear to be a common law offence in Jersey of cheating the public revenue. This is perhaps not particularly surprising given that Jersey was described, in 1847, as an Island in which the taxes “are so light that the Island is generally looked upon as free from taxes”^[10]. The position is not wholly free from doubt but it would seem strange if the Royal Court could suddenly discover an offence which does not appear to have been charged in this jurisdiction and which depends upon the distinction, under English law, between two forms of cheating. Under English common law cheating was only an offence if it involved physical interference with the property of another against the will of its owner. It was not an offence simply to trick someone into parting with his ownership of money or other property. In the words of Holt C.J.^[11]: “Shall we indict one for making a fool of another?”. Where the cheating was directed against the public as a whole the common law recognised the offence where any particular member of the public suffered by it. The acts complained of did however have to include the use of a misleading device in a permanent form rather than simply the making of a false statement. Thus in *R v Jones*^[12] the court stated that the cheat was “not indictable unless he came with false tokens; playing with false dice is, for that is such a cheat as a person of ordinary capacity cannot discover”. In *R v Hudson*^[13] which concerned the submission of false statements to the Inland Revenue, Goddard L.C.J. delivering the judgment of the Court of Criminal Appeal, reviewed the earlier authorities, noting that if one subject merely cheats another by telling him lies, that is not indictable whereas if the false representation is used to defraud the Crown it is indictable as a fraud on the public. The court went on to hold that “all frauds affecting the Crown and public at large are indictable as cheats at common law”. In the circumstances of *R v Hudson*^[14] it was not necessary for the court to consider whether there was any difference between an act or an omission for these purposes, as the taxpayer in that case had made a false representation.

The distinction between an act and an omission fell to be considered some 30 years later by the English Court of Appeal in *R v Mavji*^[15]. The case concerned the failure by a director of a company to file value added tax returns on behalf of the company in respect of gold which it had sold and on which it had charged the tax. The court noted that neither in *R v Hudson*^[16] nor in the earlier authorities was the distinction between ‘deceit’ involving an act and ‘non deceit’ involving no more than an omission canvassed or regarded as vital or indeed relevant. The court stated that: “The distinction has always been and in our view remains between ‘frauds affecting the Crown and public at large’, to repeat the words of Hawkins, and those which affect only individuals”.

The Jersey position

The position under Jersey law would appear to be different. Cheating the revenue does not appear to have been charged as such in Jersey. It is more likely to be charged as fraud or false accounting. Furthermore, having conducted a comprehensive review of Jersey case law the Court of Appeal, in *Foster v Att.Gen*^[17], concluded that whilst it is not easy to draw a general rule from local cases of criminal fraud the cases “justify the proposition that to establish criminal fraud it is necessary to show that the defendant deliberately made a false representation with intention of causing thereby – and with the result in fact of causing thereby – actual prejudice to someone and actual benefit to himself or somebody else”. This would seem to suggest that a deliberate act is required rather than an omission. This would certainly be consistent with the Jersey authorities referred to in the Court of Appeal’s

judgement. The one exception referred to in that judgment would appear to be the case of *Attorney General v O'Brien*^[18] which arose from the Out of Work Donations granted by the States after the First World War to demobilised soldiers until they found employment. The two defendants had both had a few days paid employment whilst receiving the allowance, but had not informed the Out of Work Donations Committee. They were convicted of having “*commis une fraude au préjudice des Etats*”. The judgment is silent as to whether there was any form of representation and as the defendants admitted the facts the matter was not argued. The difficulty with such cases is that, as the Court of Appeal itself stated in *Foster*, “it is not easy to draw a general rule from local cases with criminal fraud because it is very rare to find in the records any reasons for the court’s decision”.^[19] Notwithstanding the O’Brien decision the position would seem to be in Jersey that a positive act is required rather than an omission. On this basis the failure to file a tax return would not constitute fraud whereas the filing of a false return would. This distinction may not be particularly problematical from the point of view of criminal law generally but, as will be seen, may pose difficulties in relation to the reporting requirements under the 1999 Law.

The problem of “Proceeds”

The difficulties of applying the 1999 Law to fiscal offences do not end with the definition of criminal conduct. Article 1(1) of the 1999 Law provides that ““proceeds of criminal conduct” in relation to any person who has benefited from criminal conduct, means that benefit”. Article 1(2) then provides that “where a person derives a pecuniary advantage as a result of or in connection with the commission of an offence or with criminal conduct, he is to be treated as if he had obtained as a result of or in connection with the commission of that offence, or that conduct, a sum of money equal to the value of the pecuniary advantage.

Where a person commits, for example, a robbery it is fairly easy to identify the proceeds of his criminal conduct. However in the case of tax evasion, which usually results in the taxpayer simply paying less tax than he should, it is likely to be difficult to identify the proceeds. Although Article 1(2) provides, in effect, that the tax evader is to be treated as if he had obtained a sum of money equal to the amount of the tax that he has saved, the 1999 Law provides no guidance as to where that sum is to be found. In the case of the robber it is relatively easy to identify the amount taken from say, a bank, and then to trace its progress through the money laundering process. Although its character may be changed as a result of the laundering operation one is likely to be able to follow an audit trail and identify the ultimate destination of the funds. However in the case of the tax evader it is not possible to do this. Tax is not usually payable out of a specific fund. This difficulty in identifying “proceeds” in the case of fiscal offences is however a difficulty both for the prosecution and for the defence.

An illustration

One can illustrate the difficulties by reference to Article 32 of the 1999 Law which deals with the offence of assisting another to retain the benefit of criminal conduct. Article 32 provides:

“(1) Subject to paragraph (3), if a person enters into or is otherwise concerned in an arrangement whereby -

(a) the retention or control by or on behalf of another (in this Article referred to as “A”) of A’s proceeds of criminal conduct is facilitated (whether by concealment, removal from the jurisdiction, transfer to nominees or otherwise); or

(b) A’s proceeds of criminal conduct –

(i) are used to secure that funds are placed at A’s disposal; or

(ii) are used for A’s benefit to acquire property by way of investment, knowing or suspecting that A is a person who is or has been engaged in criminal conduct or has benefited from criminal conduct, he is guilty of an offence.”

The prosecution therefore have to prove (1) the defendant’s participation in an arrangement which assists in the retention or control of A’s proceeds of criminal conduct; and (2) that the defendant knew or suspected that A is a person who is or has been engaged in criminal conduct or has benefited from criminal conduct. In a fiscal case the prosecution may be in some difficulty in proving that the particular funds being dealt with by the arrangement are the proceeds of criminal conduct for the reasons referred to above. However the defendant is not in a position to rely on that difficulty when it comes to proof of his knowledge or suspicion, as the knowledge or suspicion relates not to the question as to whether or not the funds are the proceeds of criminal conduct but as to whether or not A is a person ‘who is or has been engaged in criminal conduct’. Accordingly the defendant may not suspect that the particular funds are the proceeds of a fiscal offence but if he suspected that A had previously engaged in any form of criminal conduct he could be found guilty if it turns out that the funds were the proceeds of entirely different criminal conduct, namely a fiscal offence. Article 32(4) does however provide a defence if the defendant can prove that “he did not know or suspect that the arrangement related to any person’s proceeds of criminal conduct”. However the burden of proof is then on the defendant and if the court is satisfied that the proceeds were in fact the proceeds of a fiscal offence academic arguments as to the difficulties of identifying proceeds in fiscal cases are unlikely to advance the matter much further.

The problem of suspicion

The difficulty of identifying “proceeds” in fiscal offences also presents a practical problem as a result of the indirect requirement imposed by the 1999 Law to report suspicious transactions.

Each of the principal money laundering offences provides, as a defence, that if the defendant carries out the act complained of with the consent of a police officer having disclosed his suspicion or belief that property is derived from or used in connection with criminal conduct then the offence is not committed. Thus although the 1999 Law does not impose a positive obligation to report it provides a substantial incentive, in the form of a potential defence, for doing so^[20]. In the case of non fiscal offences, deciding whether or not there is knowledge or suspicion may well be relatively straight forward, albeit that there may be difficulties depending on whether the offence in question requires the application of an objective or a subjective test. However in the case of fiscal offences the problem is more acute. In the absence of decided cases on the point it would be unsafe to assume that merely because there are difficulties in identifying the proceeds of a fiscal offence one does not have to report a person who one suspects of evading tax. Some comfort may perhaps be drawn from the fact that if the offence of cheating the public revenue is unknown to Jersey law some positive act

will be required over and above a mere failure to pay tax, which act is likely to arouse suspicion and thus trigger the desire to report. Until a case comes before the courts the debate will continue as to how much information about a taxpayer's affairs will lead to suspicion of fiscal criminal conduct.

Difficulties may also arise where there is a suspicion that the client is evading tax in his home country but for reasons which, whilst they involve illegality, are nevertheless understandable. The obvious example is where the client is resident in a country where corruption is endemic and where those responsible for tax collection routinely pass information to criminal groups who then kidnap a member of the taxpayer's family in the hope of extracting a large ransom. Whilst one may have every sympathy with the taxpayer in those circumstances, from a moral point of view, the strict legal position is that if an offence such as fraud is involved then one is dealing with criminal conduct and failing to disclose a suspicion renders one liable for an offence in the event that either the prosecutor or the court decides to take the strict, rather than the moral, view.

Conclusion

The history of the EU Council Directive and the 1988 Act, which are the sources of Jersey's 1999 Law suggest that in the drafting process little thought was given to the difficulties of applying this legislation to fiscal offences. For those who might one day find themselves charged with a money laundering offence relating to fiscal matters some comfort may be drawn from the fact that some of the difficulties may hinder the prosecutor in securing a conviction. However from the point of view of the operation of a financial services business, such as a bank, these difficulties of application will frequently pose significant problems given the indirect requirement to report suspicious transactions. Reporting one's customer to the police on the basis that one suspects him of having engaged in criminal conduct is a drastic step. On the other hand, failing to report a suspicious transaction and, as a result, being convicted of a money laundering offence, which carries with it a potential sentence of imprisonment of up to 14 years, is an extremely serious matter. For understandable reasons neither government nor prosecutors wish to give greater guidance as to the application of all crimes money laundering legislation to fiscal offences. This is an unsatisfactory state of affairs but it would seem that we shall have to wait for the first test case before the matter is clarified.

Alan Binnington is an advocate of the Royal Court and is a partner in Messrs Mourant du Feu & Jeune, 22 Grenville Street, St Helier, Jersey, JE4 8PX.

[1] EC Directive 91/308

[2] Hansard, April 4th, 1993

[3] HM Treasury Press Notice No 132/95 October 5th, 1995

[4] Section 93A (7)

[5] *R v Mavji* [1987] 2 All ER 759

[6] Article 32

[7] Article 33

[8] Article 34

[9] See Article 137

[10] Evidence of Mr Peter Le Sueur, Advocate, at para 2018 of the 1847 *Report of the Commissioners appointed to inquire into the criminal law of the Channel Islands*

[11] In *R v Jones* (1703) 2 Ld.Raym.1013

[12] *Supra*

[13] [1956] 1 All ER 814

[14] *Supra*

[15] *Supra*

[16] *Supra*

[17] 1992 JLR 6

[18] (1919) 27 PC106

[19] 1992 JLR 6 at 26

[20] This can be contrasted with Article 18A of the Drug Trafficking Offences (Jersey) Law 1988 where failure to disclose a suspicion relating to drug money laundering is a specific offence.