The Money Laundering Regulations 2003 - IIT Guidance Note, May 2004

This Guidance Note has been issued by the Institute of Indirect Taxation as an aid to its members (including students) in the scope and application of the Money Laundering Regulations 2003 .
It does not replace familiarisation with the text of the ML Regs. themselves or associated legislation to which members are referred.

Introduction

The main parts of the Money Laundering Regulations SI 2003/3075 (the ML Regs.) came into force on 1st March 2004, to comply with a European Directive, and have a significant affect on all members of the Institute, in particular those engaged in private practice.

They introduce a strict new anti-money laundering reporting regime. Any relevant business, as defined, is now required to have in place client identification, staff training and record keeping systems.

Legal Framework

The ML Regs. arise out of the European Union fight against money laundering: Directive 2001/97/EC of December 2001 updates the scope of the earlier Directive 91/308/EEC of June 1991 on money laundering in financial services industry.

The 2001 Directive notes in its preamble that the controls and reporting requirements imposed by the 1991 Directive for the financial sector led money launderers to find alternative outlets. These non-financial businesses became vulnerable to being misused for money laundering, especially when advising on financial or corporate transactions, including advice.

The key part of the Directive is customer identification and reporting using a threshold for transactions of €15,000 or more (about £10,000 at current exchange rates). This transaction value is important as the money laundering requirements are not based on the value of the professional fee charged but on the size of the underlying tax-related transaction with the customer. Although necessary for fighting money laundering this has the result ,for practising members of the Institute, of bringing a large proportion or even all of the tax work they do within the scope of the new rules.

Relevant Business
The ML Regs. apply to any member working for any "relevant business", but not including a government department . So members working for Customs & Excise are not directly covered, although they will need to be aware of the Regulations.

For members in private practise, whether working for others or themselves, the scope of "relevant business" under reg.2(2) is very wide and includes:

- Tax advice (corporate, unincorporated or personal)
- Accountancy services
- Auditing (under the Companies Act 1989)
- Legal services (involving financial or real property transactions)
- Company or trust work (formation, operation or management)
- Insolvency work (under the Insolvency Act 1986)

So all aspects of tax advice, together with commonly associated work, come within the definition of relevant business. The complete list also covers dealing in investments, bureaux de change, estate agents, casinos and cash dealing in goods over €15,000.

It is important to note that "relevant business" is determined by the service provided to the customer, not the legal form of the business providing it. So members working for a "relevant business" are covered regardless of whether that is a corporation, unincorporated business or sole proprietorship.

Preventing Money Laundering
Under reg.3(1) every person, including members, carrying on a relevant business, as defined above, must comply with procedures under the ML Regs for:

- Client identification
- Record-keeping
- Reporting.

In addition the business has to put in place other procedures as appropriate for forestalling and preventing money laundering.

"Relevant employees" must be made aware of the money laundering parts of the Proceeds of Crime Act (POCA) 2002 and the Terrorism Act (TA) 2000. Details of these requirements are discussed below. Such staff must also be trained in how to recognise and deal with transactions which may be related to money laundering.

Although not directly defined "relevant employees" can be taken to include any whose work in any way involves "relevant business" as defined above.

Members should make sure that their employers are aware of and comply with their duty to instruct and train them as appropriate. Given the extensive record-keeping requirements of the ML Regs. it would be prudent for members to ensure that they have a record of training provided. The requirements include sole practitioners, who will thus have to make sure they comply themselves.

It is a criminal offence not to comply with the ML Regs. The penalties are severe: on conviction following an indictment up to two years in prison, a fine or both and on summary conviction a fine not exceeding the statutory maximum.

In considering whether an offence has been committed the court must look at whether the defendant followed any relevant guidance, issued by a supervisory or appropriate body (such as a professional body or institute) which has been approved and published by the Treasury. Even in the absence of Treasury approved guidance it will be relevant to any investigation, prosecution or conviction whether appropriate guidelines were or were not followed.

This is important as it is a defence to criminal charge that all reasonable steps were taken and due diligence exercised to avoid committing an offence. Although these terms amount to a matter of fact for each case, so that no firm definitions can be given, the key is whether the practitioner can point to what steps were actually taken to comply and if anything more could practically have been done. Accordingly this Guidance Note has been issued to assist members in complying with their duty under the ML Regs.

Identification Procedures

The identification procedures for clients are contained in reg.4 and in many ways are the most significant part of the ML Regs. for members. Where the relevant business, known as "A" in the regulation, forms or even agrees to form a business relationship with another party, called "B" (the client or customer), then A must obtain evidence of B's identity in two sets of circumstances.

The first is where a one-off transaction involves payment of €15,000 or more to or by B. Smaller but linked transactions are added together for the €15,000 limit to stop items being artificially split down. The second situation is where A knows or suspects that the transaction involves money laundering, regardless of the amount involved. In either case the procedures for A to identify B must be followed.

As mentioned above the €15,000 threshold relates to the underlying transaction by the customer, not the professional charge or fee payable. Thus for tax the transaction value would relate back to the amount payable by or to the customer B, whether an assessment, repayment or possible liability.

If the transaction is covered then B, the customer, has to produce to A, the relevant business, satisfactory evidence of their identity as soon as reasonably practicable after first contact is made between A and B. If B does not do this then A has to take measures specified in A's identification procedures to establish B's identity.

The initial burden on B as the client to produce evidence of their identity may seem odd for a professional relationship, but in the context of fighting money laundering it is understandable. Although some clients may be inconvenienced at having to produce evidence of their identity the requirement has been around for some time in the financial sector and as the ML Regs. become more widely known hopefully most regular clients will become used to it.

If B does not produce evidence of their identity themselves then A has to have a procedure in place to establish it. This might apply where B is an existing customer who has previously produced evidence of their identity. It is a matter of reasonable judgment in each case how much the relevant business may need, if at all, to have B update their identification evidence. If B is an existing client who recently produced satisfactory evidence of their identity it may be reasonable to just get them to confirm that it still applies. Where the interval between them having originally identified themselves and the present is longer then some, perhaps all, of the identification evidence may need to be updated.

The requirements for identification are more stringent where B is not physically present as account needs to be taken of the greater risk of money laundering. Thus where the A-B relationship is not conducted face to face, as a great many are not, the evidence threshold is raised.

What amounts to satisfactory evidence of identity is defined broadly as evidence which might reasonably establish that B is who they claim to be and then in fact reasonably does satisfy A. Hence the test for satisfactory evidence is in two parts: the initial objective test of what is reasonable and secondly the objective test of whether A is actually satisfied. This is an important safeguard for members in practise. It is not enough for the customer B to claim that the evidence produced may have satisfied a third party, the duty is on A to satisfy themselves.

Identification Evidence

The type of evidence that would be objectively reasonable varies with the individual circumstances and this Guidance Note does not seek to replace individual professional judgment.

Examples of what may or may not be acceptable evidence for different types of client are set out below. Certain documents such as a passport are valuable and if not produced at a face to face meeting, for a copy to be taken, then the

originals should not be sent as they may be lost in transit, instead the client should provide copies of the original documents(s) certified by member of a professional body (such as a lawyer, accountant, doctor, or engineer) giving their contact details for verification.

Individual
For proof of name and date of birth alongside a photograph:

- Passport
- Identity card
- Driving licence
- Birth or marriage certificate (only if none of the above are available, with an explanation as to why, and then only if supported by a photograph certified as above)

For proof of address a recent:

- Utility bill
- Bank statement

Company
There needs to be evidence that the company exists.
For a publicly quoted company this can be a simple check that the company is:
- Currently listed in the share section of a newspaper
- Listed by a recognised stock exchange

For a private company existence can be checked by:
- Evidence from Companies House

In addition, whether public or private, there needs to be evidence that the individual(s) representing the company have authority to act, such as:
- Listing as current director
- For staff a letter of introduction
- Up to date listing by a professional body

Where it is an overseas company the amount of evidence required would likely be greater.

For a company where it is known or suspected that the directors or other staff are nominees, for example an offshore company, then details of any trust and of who really controls the company should be obtained.

Unincorporated Body, Partnership or Trust
Evidence that the body:
- Exists
- Those acting for it are authorised to do so

Local Authority
Evidence that a local authority exists should be straightforward but it is also necessary to have proof that those acting for it are authorised to do so.

Client Acting for a Third Party
If the client B acts or appears to act for a third party, such as a professional client acting for a lay client, then under reg.4(3)(d) reasonable measures must also be taken to establish the identity of the third party. This look through requirement stops money launderers intervening B to hide their identity. It also places a positive duty on A, and any member to also obtain evidence of the lay client's identity. It is not allowable to act for B on the basis that their lay client remains anonymous.

Doubtful Evidence
Members must be alert to the fact that organized crime and terrorism is often associated with forged identification documents. This must be borne in mind when assessing identification evidence produced and is especially so when the member is presented with a form or version of evidence which they do not recognize and/or cannot reasonably verify is genuine. It also reinforces the need for the recipient of the evidence to be satisfied by it themselves.

No firm guidance can be given about doubtful identification evidence but members should be wary of accepting the following:

- Mobile telephone records
- Electoral register
- Personal references (unless the referee is already known to the member and the reference is checked)

Lack of Identification Evidence
If, for whatever reason, satisfactory evidence of identity cannot be obtained then reg.4(3)(c) is quite clear - the business relationship "must not proceed any further". The law is absolute on this, the A-B relationship must stop. Failure to comply is a criminal offence.

It should be noted that there are limited exceptions to the identification procedures, mainly concerned with where the client B is an authorised person within the financial services sector. members should check an up to date version of the ML Regs. if the client B claims that an exception applies.

Record-keeping
Once evidence of identification is obtained there is a requirement to keep records of that. This can consist of:

- A copy of the evidence itself (perhaps scanned to save on paper files) and information as to where a copy of it can be obtained (reference to a file, off-site storage or another organization) or
- Information enabling the identity evidence to be re-obtained where the above two cannot be complied with.

Where A has as its client B another regulated business which acts for a third party or lay client then even though B should have carried out its own checks A, and the Institute member working for them, should nonetheless insist on obtaining their own evidence of the identity of both B and the third party.

A has to keep records of all transactions carried out in the course of the relevant business with B. Records must be kept for five years, which provides an audit trail of both identity evidence and what business has been conducted. This also gives the authorities a valuable and necessary resource for fighting money laundering. It also makes the member and their records the first step in stopping money laundering so it can be expected that, from time to time, their records may well be subject to inspection by the appropriate authorities in the course of an investigation.

Reporting Officer and NCIS

An organization also has to have in place an internal procedure for reporting matters should an irregularity arise. This means that a "nominated officer" must be appointed to receive disclosures under the ML Regs. For the sole proprietor again this is a function they must fulfil themselves. The job of the nominated officer is to receive disclosures from other staff in the organization where those persons know or suspect that someone is engaged in money laundering. This has to be done as soon as possible. The nominated officer then has to consider the information and determine for themselves, for the purposes of money laundering, whether it gives rise to:

- Knowledge
- Suspicion
- Reasonable grounds for knowledge or suspicion

The regulations are broad and there is a two part test with subjective knowledge and suspicion being backed up by the objective test of reasonable grounds. So the nominated officer has to ask themselves not just how the information appears to them but what another person would reasonably make of it.

If the nominated officer, or sole practitioner, does determine that there are grounds for disclosure then this must be provided to the National Criminal Intelligence Service (NCIS). There is protection for professional legal privilege but this does not apply where the information was given by the client with the intention of furthering a criminal purpose.

In the event of a report being made to NCIS then they have specified disclosure report forms which need to be used.

High Value Cash Transactions
The ML Regs. include further obligations requirements on persons running a money service (such as a bureaux de change) or who deal in high value goods (accepting cash for transactions of €15,000 or more). As these types of business are especially open to abuse from money laundering they have an additional requirement to be registered with Customs & Excise and are liable to related inspection and penalties.

Proceeds of Crime and Terrorism Acts
It is also a requirement that business make relevant employees aware of the money laundering parts of POCA 2002, ss.327 to 340. A person commits an offence, punishable by up to 14 years imprisonment, if amongst other things they conceal, disguise, convert, transfer, acquire, use, possess or arrange for any of the foregoing in relation to criminal property. Protection is given under s.338 if an authorised disclosure is made and made in the prescribed form.

Similarly the ML Regs. also refer to ss.18 and 21A of TA 2000. These make it a money laundering offence to become concerned in an arrangement in connection with terrorist property. It is also an offence when knowing of or suspecting an offence in relation to terrorist property to fail to report it.

Conclusion
Although the ML Regs. add to the administrative burden on businesses they are an important and necessary part of the fight against money laundering and international terrorism. The affect on practising members is to make them, their identification procedures and records the first line of defence against money laundering.

Members should also be careful to ensure proper data protection for identification evidence obtained from clients.

These notes are intended as a guide only. Members should ensure they make themselves aware of the law in respect of money laundering and any future changes thereto. The Institute of Indirect Taxation does not accept responsibility for any loss or damage suffered by a person as a result of them acting or not acting as a result of anything contained/not contained in these notes. If you are a member of another professional body which has issued guidance on money laundering you should also refer to that guidance. NICIS may in limited circumstances be willing to provide advice, such advice will not necessarily constitute a defence at law.

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