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The Proceeds of Crime Act: Statutory v. Contractual Obligations

A recent High Court decision in *Shah and another v HSBC Private Bank (UK) Ltd* will provide some much needed comfort to entities having to comply with The Money Laundering Regulations 2007 as to the interplay between their statutory obligations under the Part 7 of the Proceeds of Crime Act 2002 ("POCA") and other contractual obligations owed to their clients.

The claimants were account holders with the defendant bank. They issued four separate instructions for money to be transferred to third parties. The bank suspected that the claimants were involved in money laundering activities and so the transfers were delayed as authorised disclosure was made to the relevant authorities and it waited for the appropriate consent under POCA. The bank told the claimants that the delay was caused by compliance with their UK statutory obligations. The claimants informed their creditor (an ex-employee) of the reason for the delay and soon rumours began to spread in Harare (where the claimants were resident) that the claimants were under investigation for money laundering in the UK. The Zimbabwean authorities themselves became suspicious and firstly froze and then seized the claimants' investments. The claimants issued proceedings in England alleging that the bank's failure to carry out their payment instructions had caused them substantial losses.

The Court held that:

- Suspicion under POCA was a purely subjective matter. It did not matter whether or not there were reasonable grounds for the suspicion provided that it was genuinely held.
- Because the bank had a suspicion that the requested transfers involved funds that were criminal property, it was compelled to make a disclosure under POCA. The authorised disclosure did not constitute a breach of contract for failing to execute its customers' payment instructions. On the other hand, a failure to report a suspicion could have led to a liability under POCA.
- The bank was not in breach of any duty to disclose information to the claimants. To have done so would have put the bank at risk of committing a "tipping off" offence under POCA.

On the facts of the case, the bank made the authorised disclosures promptly and transferred the money within a reasonable time once the appropriate consent had been given. The Court did however suggest that there may be possible breaches of duty in circumstances where there was found to be unreasonable delay on the part of a bank.

This decision makes it clear that accountancy firms must comply with their obligations under Part 7 of POCA, even if doing so runs contrary to any duties owed to their clients. The court will not impose a liability in law if the alleged breach was caused by compliance with Part 7 of POCA, even if a suspicion (as long as it is genuinely held) turns out to be unfounded.

Unfair Prejudice of Shareholders under the Companies Act 2006

A recent case, *Oak Investments Partners XII Limited Partnership v Boughtwood & Others*, has highlighted the fact that where a company is a quasi-partnership and the relationship between the 'partners' irrevocably breaks down as a result of the conduct of one of the 'partners', that can amount to unfairly prejudicial conduct.

In this case, the petitioner was a Venture Capital Fund that had invested in a company founded by an entrepreneur. Under the terms of the investment, the entrepreneur was to have a limited management role (dealing with Research & Development and Intellectual Property matters) and the Fund was to appoint a new Chief Executive Officer and Chief Operating Officer. Relationships broke down because the entrepreneur could not accept his reduced management role and he sought to take control of the Board. The Fund brought an action for unfair prejudice (under S994 Companies Act 2006).

As stated above, the Court held that the attempt to wrest control amounted to unfair prejudice. The Court went on to hold that:

- mismanagement of a company's affairs may amount to unfairly prejudicial conduct. However, such conduct must be more than conduct which at the time was reasonable, but which subsequently turns out not to have been in the company's best interests;
- a significant shareholder who improperly asserts rights of control over the practical management of the affairs of the company may be acting in an unfairly prejudicial manner. Further, this improper exercise of management functions need not be as a director; acting as a senior manager may be enough;
- in this case, the failure of the entrepreneur to adhere to his agreed management role; his failure to accept decisions of the board of directors as to expenditure; his failure to give consideration to further financing options for the company, and his improper attempts to wrest control of the company, amounted to unfairly prejudicial conduct.

In the event of a successful petition for unfair prejudice the Court will usually order that the wrongdoer purchase the petitioner's shareholding. In this case however, the court ordered that the entrepreneur had to sell his shares to the petitioner. This decision is welcome, particularly in situations where the wrongdoer is unlikely to be able to afford to buy the shares (especially if they are valued as at the date prior to the breakdown in the relationship, rather than the date of the petition or the date of the purchase).

Final Opportunity for Retrospective Claims for Overpaid and Underclaimed VAT

The window for making retrospective claims of VAT finally closes on 31st March 2009. Any late claims will be automatically rejected.

HMRC Business Brief 7/2008 announced that claims can be made for overdeclared output tax in periods ending before 4 December 1996, as well as to underclaimed input tax in accounting periods ending before 1 May 1997. Claims can go back as far as 1 April 1973, or the date of VAT registration if later.

Any business may be affected if either output VAT was overpaid or input VAT was underclaimed. The following points should be noted:

- It is no longer necessary to prove that there had been an intention to make a claim.
- It is possible to base a claim on a valid and reasonable estimate if original accounting documents no longer exist.
- Claims can include a request for simple interest and compound interest.

The following list includes areas which have already resulted in some significant claims for repayment paid by HMRC:

- Manufacturer discounts
- Sales of input tax blocked goods, e.g. cars
- Mileage costs paid to employees.
- Staff expenses
- Business and staff entertaining/subsistence
- Recovery of VAT on imports
- Gaming machines – where VAT has been accounted for on takings

- Reviewing previous repayments/voluntary disclosures
- Costs relating to foreign exchange transactions
- Costs related to share or bond issues

Paid Cheques

The ICAEW Audit & Assurance Facility has issued a Technical Release, AAF 01/09, dealing with obtaining and examining paid cheques based on current banking practice. It gives guidance, rather than being an auditing standard, and replaces the guidance previously given in an ICAEW Technical Release, FRAG 27/93, in 1993.

Many companies now make some, but not necessarily all, payments electronically. This, together with improvements in practice relating to cheques paid to “*a/c payee only*” means that the inspection of paid cheques as an audit technique has become the exception rather than the rule. However, there may be occasions when the auditors’ assessment of internal control and risk causes them to decide to review paid cheques for evidence that payments recorded were made to the person named and for the amount shown in the accounting records. In addition, the Solicitors’ Accounts Rules (“SAR”) still require testing of paid cheques (or digital images of their front and back).

Banks do not have a standard or common procedure for storing, retrieving or returning paid cheques to customers. If paid cheques are required then either the auditor or the client should discuss with the bank how paid cheques are to be obtained. The charges that a bank might levy for returning paid cheques are the subject of a contractual agreement between the bank and the client and can be negotiated and minimised as part of this discussion.

The Money Laundering Regulations 2007 require the banks to retain paid cheques for at least 5 years; but they are only required to keep them in original form for 1 year and thereafter they may keep them in the form of legally admissible copies.

Banks may have a preference for one of the options set out below for obtaining returned cheques and AAF 01/09 gives guidance on how to streamline the procedures for obtaining them under each of these options:

- To return all paid cheques to the customer;
- To provide a pre-arranged number of paid cheques direct to the auditor, the selection being left to the bank. This option may not be appropriate for SAR reporting engagements, where the selection of a sample is often part of a risk assessment, and may be linked to other procedures;
- To provide photocopies or digital scans of paid cheques;
- To extract paid cheques before they are stored, for despatch direct to the auditor;
- To provide specific paid cheques at the auditor’s request.

AAF 01/09 points out that truncation, which is the process whereby cheques can be retained at a processing centre rather than an individual branch, does not preclude the obtaining of paid cheques and the procedures outlined above can still be used.

AAF 01/09 includes an appendix giving the suggested form of authority from the client to their bankers where paid cheques are to be sent to an auditor. Rather than a separate authority it could be included in the existing Authority for the bank to disclose information.

Investment Trusts Statement of Recommended Practice (“SORP”)

In January 2009 the Association of Investment Companies issued its revised SORP on the financial statements of investment trust companies and venture capital trusts.

How to check whether a VAT Number is valid

The validity of EU VAT numbers can be checked from http://ec.europa.eu/taxation_customs/vies/vieshome.do

If you do not have internet access the validity of UK VAT numbers can be checked by checking the check digits in the number. UK VAT numbers all comprise 9 digits in blocks of 3, 4 and 2. The last two numbers are a check digit and are generated by the following algorithm. For the purposes of explaining this, the number 831 4958 16 will be used.

The first 7 digits of the VAT number are assigned a multiplier beginning with 8 for the first digit and reducing to 2 for the 7th digit:

8	3	1	4	9	5	8	(The first 7 digits)
8	7	6	5	4	3	2	(The multiplier)
64	21	6	20	36	15	10	(The results)

The results are totalled to give 178 (64+21+6+20+36+15+10)

97 is subtracted as many times as necessary until a negative number is produced. This negative number is the last 2 digits of the VAT number

178 – 97 = 81
81 – 97 = -16

16 is the check digit and the last 2 digits of the VAT number.

If the first negative number was, say, -2, the check digit would be 02

Paid Holiday While on Sick Leave

The European Court of Justice (“ECJ”) has recently ruled on *Stringer and others v HMRC*. The case will now return to the House of Lords. The ECJ decision, which clarifies the conflict between sick pay and holiday pay, is that workers on long-term sick leave do accrue paid statutory holiday. Where workers cannot take their statutory holiday entitlement because they have been on sick leave for the whole or part of the leave year, the right to annual leave is not lost at the end of the leave year and annual leave can therefore be carried over to the next leave year. If the worker is not able to exercise the right to annual leave before the termination of the employment relationship, s/he are entitled to a payment in lieu of outstanding statutory holiday entitlement.

This decision could have serious cost implications and could lead to employers changing their approach to managing sickness absence and progress to termination faster than they might otherwise have done (although care needs to be taken to ensure that the dismissal is not unfair and does not amount to disability discrimination). Long term sickness policies should be reviewed in the light of this decision.

Subscription Periods for Rights Issues

From 10 February 2009, the minimum rights issue subscription period is reduced to 10 days from 21 days under the London Stock Exchange Listing Rules and AIM Rules.

Companies can conduct their rights issues over longer periods if they want to.

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