

NORTHERN IRELAND OFFICE

CONSULTATIVE PAPER

TERRORIST EXPLOITATION

OF THE CONSTRUCTION INDUSTRY

IN NORTHERN IRELAND

RESPONSIBILITIES FOR CONSTRUCTION EMPLOYERS
RESPONSIBILITIES FOR CONSTRUCTION WORKERS
CONSTRUCTION INDUSTRY INSPECTORATE
SANCTIONS

IMPORTANT :- RESPONSES TO
THIS DOCUMENT ARE REQUIRED
BY FRIDAY 5 MARCH 1993

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- In response to the long-term campaign of violence in Northern Ireland, the major criminal organisations require millions of pounds which they derive from a multitude of rackets, crimes and frauds. The response of Government to this situation can be seen as falling into three areas:-
- (i) The establishment by the Royal Ulster Constabulary in 1982 of a squad tasked exclusively to combat racketeering. This is the first of its kind in the world.
 - (ii) The introduction of new legislation to combat racketeering.

INTRODUCTION

1. This paper outlines for discussion some possible proposals to combat terrorist exploitation of the construction industry in Northern Ireland. The vast majority of businessmen and workers refuse to become involved in abuses, but there remain dishonest workers and unscrupulous employers who cheat their own staff, the taxpayer and their competitors; and the terrorists take advantage of this situation by organising and assisting the frauds to enrich their organisations and themselves. The Government therefore believes it is worth considering equipping the industry with a new legislative and administrative framework which will help to eradicate exploitation.
2. Informal discussions have taken place about the Government's proposals. They have been encouraging, but some respondents have reservations about the proposals and are concerned about their practicability. It has been decided to publish the proposals and circulate them selectively. The issues raised are wide-ranging and significant, and the Government would welcome comment on any aspect of the proposals, including the costs of compliance. It would also welcome proposals for other action which Government or the construction industry itself might take to tackle terrorist exploitation of the industry. A checklist of issues is attached.

RACKETEERING

3. To wage their campaign of violence in Northern Ireland, the terrorists require millions of pounds which they derive from a multitude of rackets, crimes and frauds. The response of Government to this situation can be seen as falling into 3 broad areas:-
 - i) The establishment by the Royal Ulster Constabulary in 1982 of a squad tasked exclusively to combat racketeering. This is the first of its kind in the

United Kingdom, and it has had considerable success tackling overt criminal activity, for example, video piracy and extortion. The squad has also achieved notable success in decreasing the flow of funds to the terrorists from registered clubs and freeing clubs from their control and influence.

- ii) The establishment within the Northern Ireland Office in 1989 of a multi-disciplinary financial investigation Unit staffed by experienced financial investigators and researchers. The Unit is tasked with researching and promoting effective counter-measures to long established rackets and frauds; informing Government departments and agencies of terrorist fundraising in their areas of responsibility; undertaking detailed financial investigations into terrorists and their businesses (including money laundering activities); and providing professional, financial expertise to the RUC's anti-racketeering squad which has primacy in investigating terrorist financial crime.
- iii) The enactment of legislation directed at terrorist finances, notably Part III of the Northern Ireland (Emergency Provisions) Act 1987 dealing with the private security industry; the financial offences provisions in the Prevention of Terrorism (Temporary Provisions) Act 1989; and most recently the confiscation and financial investigation measures in the Northern Ireland (Emergency Provisions) Act 1991. Effective use is being made of these legislative provisions.

EXPLOITATION OF THE CONSTRUCTION INDUSTRY

4. It is widely accepted that the Government's measures are biting, and that the terrorists are finding it steadily harder to raise funds. But there is a significant exception. The construction industry continues to be an important source of

funds and influence for both Republican and Loyalist terrorists. It is possible to list some of the ways in which terrorists exploit the industry.

(i) Extortion

5. Terrorists offer "protection" to contractors. Failure to accept such services results in damage to equipment and work in progress, delays and strikes, harassment of the workforce, etc. Sometimes even less sophisticated methods are employed - simply "pay up or else". Groups of workers, or individuals, are threatened with violence (against themselves or their families) if they fail to make contributions. Alternatively honest workers may be intimidated off the site and replaced with more compliant workers. On some building sites, extortion payments have increased costs by as much as 10%, and this is reflected in inflated tenders.

(ii) Social Security Fraud

6. The construction industry provides many possibilities for "doing the double", that is working (often under a false name) while at the same time claiming social security benefits. Wages are paid in cash and no tax or National Insurance deductions are made. Terrorists and other criminals organise groups of workers in "doing the double" frauds and exact a levy from their wages. The racketeers may effectively control the employment of the workers. Terrorist racketeers can therefore convert fraud opportunities in the construction industry into status, prestige and economic power.

(iii) Inland Revenue Fraud

7. Most of the frauds perpetrated result in income or corporation tax evasion. The nature of the industry - cash payments and casual, peripatetic employment - enables labour only subcontractors in particular to remain wholly unknown to the

Inland Revenue or to declare only a part of their receipts. To combat this, there is a special tax regime in the industry, and only subcontractors who satisfy certain basic conditions may be paid without having an amount to cover tax and NIC deducted by the contractor. Subcontractors prove they are exempt from deduction by producing a tax exemption certificate (TEC). Contractors making gross payments to exempt subcontractors are required to send to the Inland Revenue the vouchers detailing the subcontractor's name and amount paid. The Revenue uses these vouchers to check on tax returns and accounts. However, vouchers are not always provided by the subcontractor to the contractor, and there is a ready trade in forged and stolen documents, enabling subcontractors to understate their takings or hide their true identities. Similarly, some contractors use incorrect documents to cover bogus payments. Such manipulation of the special tax regime occurs throughout the United Kingdom construction industry, but has been seized upon and exploited by the terrorist organisations in Northern Ireland.

(iv) VAT Fraud

8. Construction work on commercial buildings and the repair of domestic premises attracts Value Added Tax (VAT) at the standard rate (currently 17½%). Other construction work, including the first time construction of domestic premises, is zero rated. A builder who is liable to pay VAT submits a return to HM Customs & Excise, setting out the VAT received from customers and the VAT paid to suppliers of goods and services. The builder pays the net VAT due, or reclaims VAT overpaid from HM Customs & Excise. This accounting exercise provides the opportunity for a variety of frauds including omitting to record or mis-recording as zero-rated in the VAT return a particular contract on which VAT has been charged, and the reclaiming of VAT in respect of purchases which were never made.

Extent of Terrorist Involvement

9. In the early 1970's, terrorists in Northern Ireland realised that construction industry frauds could be a reliable and substantial source of funds. Since then, there has been regular media, judicial and parliamentary comment on the nature and extent of terrorist exploitation of the industry. The RUC and other agencies have reliable intelligence that terrorists continue to play a major role in, and derive substantial funds from, construction industry frauds in Northern Ireland. In some cases, terrorists organise frauds which may simultaneously exploit the tax, VAT and social security systems; in other, they confine their role to trafficking in stolen documents which are used to perpetrate frauds. In addition, terrorist organisers and traffickers derive substantial personal benefits from TEC and social security frauds.

DEFICIENCIES OF EXISTING ARRANGEMENTS

10. The RUC has well-established arrangements to deal with intimidation and extortion. When demands are brought to their attention, their policy is to invite the potential victim to talk, in confidence, to their specialist anti-racketeering squad. In 1991, the Chief Constable launched a new initiative: a direct help-line is manned round the clock by experienced police officers who provide immediate assistance to any victim of extortion who calls. The RUC's approach has resulted in many successful prosecutions.

11. Fraud poses greater problems for all enforcement agencies. The direct and indirect tax systems are designed for the cost effective and efficient collection of revenue. Even if it were practicable to do so, making such systems proof against fraud would be very expensive, and would impose disproportionate and unacceptable burdens on the vast majority of honest VAT and tax payers. Similar arguments apply in respect of the social security system.

12. At present, all the enforcement agencies attempt to deal with fraud by investigation and prosecution, but that approach has limitations. First, assembling the evidence to prosecute a case of fraud is a laborious process, requiring considerable expertise and taking significant time. For example, in the investigation of social security fraud, frequently inadequate personnel records are maintained (if any are held at all) and fraud investigators have to rely on "observing" suspects working on building sites in order to prove fraud. This type of surveillance work is difficult at the best of times, and in some locations impossible. The lack of supporting payroll evidence often severely weakens the prosecution case.
13. Second, it is generally accepted that fraud is among the most difficult of crimes to prosecute, for example, requiring the cogent explanation of complex matters to a jury, and proof to criminal standards that a person has suffered loss, and that evidence exists and has been obtained lawfully.
14. Third, recovery of revenue can be a problem. A distinctive problem with fraud in Northern Ireland is the land boundary, between Northern Ireland and the Republic of Ireland, inviting the exporting and thus concealment of the proceeds of fraud. Tax evaders use "front" men and firms, leave the country before assessments can be raised or move assets on so that there is nothing left to pay outstanding tax bills. Terrorists have utilised all these methods to cheat the Inland Revenue. In such cases, even when prosecution has been successful, civil action can fail to recoup the money due.
15. Fourth, a construction industry fraud may involve breach of Department of Health and Social Services regulations, and incur VAT and Revenue (PAYE and TEC) debts simultaneously. Government agencies are handicapped in confronting such multiple fraud as each organisation has a limited jurisdiction and the fragmentation of responsibility, coupled with statutory constraints on the exchange of information, creates

difficulties of planning and co-ordination. Conversely, where a fraud operates against a single Government department, a monitoring visit by any other organisation may not uncover that fraud.

16. The limitations which attach to the investigation and prosecution of construction industry fraud in general apply just as much when that approach is directed specifically against terrorist controlled fraud. Despite those limitations, the RUC's Anti-Racketeering Squad regularly obtains convictions in major fraud cases. But it has considerable difficulty in distinguishing terrorist connected fraud from other criminal fraud in the construction industry. Nor do its successes appear to be deterring terrorists from their activities. The traditional approach of investigation and prosecution cannot by itself end or even significantly curb terrorist fundraising from the construction industry.

OUTLINE PROPOSALS

17. Terrorists and other criminals currently have available a range of opportunities for fraud in the construction industry. They take advantage in a variety of ways, ranging from straightforward abuses to combinations of different types of fraud. If the problem is to be tackled successfully, the solution will have to address each opportunity for abuse, and so provide a defence against more complicated frauds. The relationships between what the terrorists and other fraudsters currently do and the proposals are outlined in simplified form in the tables on pages 9 and 10. While certain of the proposals will be of considerable assistance in preventing and discouraging extortion, they are aimed primarily at fraud.
18. What is proposed is a regulatory framework designed specifically to prevent terrorist organised fraud, and a separate, dedicated enforcement agency. The proposals are set out in more detail in the four annexes to this Paper, but the essential features of the proposed scheme are as follows:-

- a) all employers involved directly in construction industry work in Northern Ireland would be required to apply to the Secretary of State to be licensed; all employees of such employers and independent building tradesmen would be required to apply to the Secretary of State for registration;
- b) licensed employers would have duties to employ and subcontract work only to registered workers and other licensed employers; to maintain a nominated bank or similar account in Northern Ireland for receipt of all construction industry earnings; to pay earnings only by electronic transfer; to keep specified records and make returns in respect of payments to employees and sub contractors, including third party payments on their behalf; and to afford access to the nominated account and business records;
- c) registration would bring certain obligations, in particular the obligation to carry a card while working on building sites; to maintain a nominated bank or similar account and accept payment by electronic transfer; and to retain copies of statements relating to the nominated account;
- d) the registration and licensing schemes would be underpinned by new criminal offences;
- e) there would be provision for persons convicted of offences to be disqualified from registration and licensing; and
- f) there would be an inspectorate appointed by the Secretary of State, which would have investigative and enforcement powers.

PROPOSALS

PROPOSALS

SOCIAL SECURITY
FRAUDS

NATURE OF TERRORIST
NATURE INVOLVEMENT

MECHANICS OF CRIMES

Terrorists, directly or working through other criminals

- organise "off record" labour at low wages, topped up by social security
- collect VAT from other construction firms and customers and fail to account for it or take a 'cut' of gross wages of "off record" labour

- individuals present false names on site

use false VAT numbers,
fail to register for VAT,
incorrect type of work
undertaken

- individuals are paid in cash or untraceable cheques
- individuals claim benefits under their true identities

- individuals to be registered by Government
- individuals to carry registration cards on site and produce card for inspection by construction inspectorate
- individuals to accept payment only by electronic transfer
- social security authorities to be advised of employment

TAX EVASION

Terrorists, directly or working through other criminals

- obtain tax exemption documents unlawfully by theft, intimidation, corruption
- if detected, escape prosecution
- forge documents
- traffick in stolen and forged documents
- use such documents to disguise "off record" labour and to offset tax liabilities

- persons submit returns to Inland Revenue falsely naming bona fide firms as subcontractors

evidence difficult to obtain for
fraud offences difficult to prove

- fraudulent subcontractors use false tax identities

- firms pay fraudulent subcontractors in cash or untraceable cheques

- keep no or inadequate records

move assets on or conceal true ownership

- employers to be identified and licensed by Government
- regular returns to construction inspectorate of payments to subcontractors and individuals
- Inland Revenue to be advised of subcontractors receipts
- requirement to pay and receive earnings in NI only by electronic transfer to deal with terrorist involvement
- prescribed records to be kept and subject to inspection
- confiscation (and imprisonment for default) under Emergency Provisions Act

NATURE OF TERRORIST INVOLVEMENT	MECHANICS OF CRIMES	PROPOSALS
VAT FRAUDS	<p>Terrorists, directly or working through other criminals</p> <ul style="list-style-type: none">. falsely reclaim VAT from Customs & Excise. collect VAT from other construction firms and customers and fail to account for it to Customs & Excise. use false VAT numbers;. fail to register for VAT;. misdescribe types of work undertaken	<ul style="list-style-type: none">. Customs and Excise to be advised of VAT trading. prescribed records to be kept and subject to inspection. On site inspection
INVESTIGATION AND PROSECUTION	<p>Terrorists</p> <ul style="list-style-type: none">. escape detection. if detected, escape prosecution. if prosecuted, not convicted as terrorist. retain proceeds of crimes. if convicted, return to criminal activities in construction industry. <p>possible frauds (by returns)</p> <ul style="list-style-type: none">. establish "front" businesses and organise/ facilitate frauds by other criminals. evidence difficult to obtain and fraud offences difficult to explain and prove. outwith scope of current anti-terrorist offences. move assets on or conceal true ownership. inadequate barriers to returning to construction industry	<ul style="list-style-type: none">. scheme prevents fraud and "front" businesses. dedicated inspectorate. new simple criminal offences. provision for scheduling of offences to deal with terrorist involvement. confiscation (and imprisonment for default) under Emergency Provisions Act. disqualification for serious breaches of scheme

EFFECTS

19. If adopted, such a scheme would have the following effects:
- a) no individual on a building site could pass himself off under a false name, either to his employer, main or subcontractor or to a regulation scheme inspector; coupled with the disclosure of information to the relevant bodies, that should make social security and tax exemption certificate fraud much more difficult to commit;
 - b) the licensing of employers would draw them in to a regime of specified records and regular returns, so the inspectorate would be alerted at an early stage to possible frauds (by returns) and would be able to collect admissible evidence (from records); that should prevent tax evasion and VAT fraud;
 - c) the prohibition of cash transactions and replacement by electronic transfer, coupled with the abolition of false names for individuals and companies would ensure that all payments within the construction industry could be traced to their recipients, making the detection of frauds and extortion relatively easy;
 - d) the absence of cash on building sites and the need to keep records would make payment of protection money more difficult, and provide a basis and justification for resisting extortion demands.
20. The scheme should prevent frauds taking place - thus preventing exploitation by terrorists; deter persons from attempting frauds; and ensure that any person or employer convicted of a serious offence under the legislation would be banished from the construction industry for a significant period of time. Prevention and deterrence are particularly important: at present, prosecution after the event, even when successful, have

does not necessarily lead to the recovery of lost revenue. The scheme should also help in deterring and preventing extortion. The regime is practical, and would have the overall effect of protecting the construction industry from the parasitic activities of terrorists and other criminals.

IMPLICATIONS

21. One consequence of the enactment of such a scheme would be a significant sacrifice of privacy by individuals and companies in the construction industry in Northern Ireland. For example, the inspectorate would be able to require sight of registration cards on building sites. Some, both within the industry and beyond, would be concerned at this apparent erosion of civil liberties. Others would be apprehensive that the scheme could act as a disincentive to investment in Northern Ireland. A further worry would be that the cost of compliance with the scheme might reduce the competitiveness of local construction firms when they seek contracts outside the Province.
22. There could be legislative safeguards to ensure that the sacrifices demanded by the scheme would be sought only while Parliament was convinced of the need for them. More importantly, taken together and implemented resolutely, these proposals would put a stop to fraud in the construction industry in Northern Ireland, and so would prevent terrorist exploitation of the industry. They would hinder significantly terrorist organised extortion. It is against this substantial benefit to those involved in the industry, and to society more widely, that the sacrifices required for the proposals to work must be balanced.
23. The industry continues to be at risk of exploitation by terrorist racketeers and gangsters, and all the people in Northern Ireland suffer the consequences of the industry's problems. Individual workers and their representatives, and employers, contractors and their representative groups all have

much to gain by supporting and participating in a concerted attack on racketeering and corruption in the construction industry.

RESOURCE IMPLICATIONS

24. The need for rigorous enforcement of registration and licensing requirements would give rise to substantial financial and human resource implications. The proposed scheme would require a full time inspectorate, probably of some 75 staff, of whom about half would be involved in inspections on site, with the remainder undertaking the processing of applications for licences and registration and the maintaining of the data base. There would thus be substantial public sector costs. Since the proposed scheme would eradicate practically all fraud in the construction industry in Northern Ireland, the public sector costs should be more than recovered by savings on existing losses through tax evasion and social security frauds. In any case, depriving the terrorists of the substantial amounts they currently obtain from construction industry abuses is sufficiently important in itself to justify additional public sector costs, even without compensating financial benefits.

WAY FORWARD

25. If the proposals meet with approval, there would be a need for legislation. The regulatory scheme would be set out in an explicitly anti-terrorist Bill. The Government recognises that its proposals represent a radical approach which would benefit from the thorough debate which characterises the Parliamentary process. In any case, the proposals could not be carried out under the Order in Council procedure because they would fall under the heading of "Special powers and other provisions for dealing with terrorism and subversion", as described in paragraph 14 of Schedule 2 to the Northern Ireland Constitution Act 1973, and so require the authority of an Act of

Parliament. While some details would be relegated to subordinate legislation, the intention would be that as much as possible of the proposed regulatory scheme should appear in primary legislation.

CONCLUSION

26. The Government is committed to early and effective progress on the development of a policy on terrorist exploitation of the construction industry. Accordingly, interested parties are invited to forward written comments on this Consultative Paper by 5 March 1993 to

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