Money Laundering 1/8/2018

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The scope of activity expected from organisations in terms of anti-money laundering and counter-terrorist financing (AML/CTF) no longer comes as a surprise, unlike a year ago. The lack of statutory measures in organisations now increasingly indicates wilful non-compliance with, rather than ignorance of, statutory requirements. To ensure that the measures in place are properly implemented and achieve their goals, organisations need an understanding of the forms money laundering can take.

After the adoption of the AML/CTF rules, continuing the business relationship with a particular customer depends on the characteristics of their transactions. This assessment is based on a customer due diligence review or the organisation's understanding, i.e. whether they believe a transaction might involve money laundering. This decision drives not only the organisation's future income source but also potential statutory liability. The AML/CTF rules are not aimed at stopping every creative approach to optimising corporate operations but should prevent any scheme that lacks a legitimate business purpose and is not consistent with the law.

There is still a lack of common understanding among organisations about their obligations to take active steps when they become aware that their customers are involved in transactions designed for tax evasion or fraud. Money laundering is often thought to involve only obvious crimes, while transactions aimed at illegally reducing tax liabilities go unnoticed.

Money laundering means activities associated with transferring illegally obtained funds in order to conceal their criminal origin and later channel them back into legitimate business. The recent adoption of the EU fourth AML directive clearly lists gross tax violations as crimes in the context of money laundering[1]. The current European and global approach is that the legal framework for fighting money laundering plays a key role in minimising tax evasion.

Is your customer evading taxes?

Recent years have blurred the line between legitimate tax avoidance and illegal tax evasion. Some cases are obvious, especially if there is evidence of fraud (such as preparation of false accounting documents). Yet most cases are not so obvious and make it difficult for organisations governed by AML/CTF legislation to report suspicious and unusual transactions.

In the process of monitoring transactions the responsible person should consider not only the characteristics listed in the legislation but also any indications and typologies seen in practice. The Anti-Money Laundering Service's website regularly updates the typologies of money laundering and terrorist financing, where characteristics of evading payment of taxes and similar payments are listed as a top priority.

Organisations often carry out cross-border transactions with companies and various legal arrangements registered in tax havens or the EU. Assessing those transactions is not facilitated by the fact that the different statutory requirements have ranked the Netherlands, the UK and Cyprus among the most popular EU jurisdictions for registering shell companies[2].

And then there are increasingly aggressive tax planning methods that take advantage of technical discrepancies between national tax laws and provide for entering into transactions which may initially appear suspicious and unusual but typically do not amount to a crime.

Tools for monitoring

To facilitate the monitoring of those transactions, reduce ways of evading taxes, and help governments achieve their financial goals, countries should set up and maintain registers of beneficial owners, as well as providing the relevant government agencies with more resources and powers they need to perform their tasks more efficiently. The global standard on automatic exchange of information and the US Foreign Account Tax Compliance Act as well as the common reporting standard for automatic exchange of financial account information and other OECD initiatives will become even more important, along with global efforts to prevent tax avoidance and evasion.

Given privacy rights and data protection issues, it is clear that the new rules of the game are inextricably linked with business compliance and transparency. Given the new information exchange requirements, is the obligation placed on organisations governed by AML/CTF legislation to scrutinise customers and their transactions likely to be alleviated? Probably not. These requirements merely add to the existing measures to minimise money laundering. Since tax law violations are among the most common causes of money laundering, still more support is expected from the organisations governed by AML/CTF legislation in monitoring their customers. It is up to each organisation to individually determine what resources they will assign for improving their understanding of customer transactions, depending on how important it is for the organisation to continue the business relationship with a particular customer.

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[1] Article 3(4)(f) of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing in conjunction with section 218 of the Latvian Criminal Code

[2] Extensive comments on factors driving effective fight against money laundering in the EU are offered in the report of 16 November 2017 on the inquiry into money laundering, tax avoidance and tax evasion by the EU Parliamentary Committee of Inquiry to investigate alleged contraventions and maladministration in the application of Union law in relation to money laundering, tax avoidance and tax evasion, which contains the main findings about information obtained in the scandal surrounding Panama Papers here.