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Challenges in Anti Money laundering Regulations in Taxation

Madina G. albekova, PhD Candidate, University of Karaganda "Buketov"

CHALLENGES IN AML REGULATION IN TAXATION

M.G. Albekova, PhD Candidate, Karaganda Buketov University

Abstract

This article examines the interconnected challenges of money laundering and tax crime in the current global context. The paper highlights the connection between corruption, illegal entrepreneurship and the use of offshore companies and emphasizes the far-reaching impact of these activities on economies worldwide. The article emphasizes the shortcomings of existing tax crime and money laundering prevention systems, which allow them to persist and undermine important tax revenues for jurisdictions. Significantly, the article traces the development of international efforts, particularly the recognition of tax evasion as a money laundering offense by the Financial Action Task Force. It also looks at the role of organizations such as the OECD and the International Monetary Fund in providing frameworks and recommendations to strengthen jurisdictions in combating tax crime and improving tax compliance.

Keywords: money laundering, tax crimes, offshore, beneficial owners, AML framework, compliance monitoring

Introduction

In modern conditions, the world community has intensified its efforts to combat money laundering everywhere. Money laundering is closely linked to phenomena such as corruption, illegal entrepreneurship, capital flight and the use of offshore companies and banks to conceal profits and evade taxes.

Money laundering and related tax crimes are global problems that affect the economies of all countries. Systems designed to prevent tax crimes and related money laundering have weaknesses and loopholes that allow them to persist and deprive jurisdictions of important tax revenue.

Based on the Country report, in the Republic of Kazakhstan, tax evasion, shadow economy, corruption, Ponzi schemes, cybercrime and drug trafficking are the main sources of illicit proceeds that criminals seek to launder [1]. And it should be noted that tax evasion occupies a primary role in a number of predicate offences in the country.

Money laundering and tax crimes are often committed at the same time and use similar methods. Successive leaks such as the Swiss Leaks, Panama Papers, Paradise Papers, FinCEN Files, Pandora Papers and most recently the Suisse Leaks illustrate well that the methods of money launderers and tax criminals are often the same.

In 2012, the FATF (Financial Action Tax Force) changed its recommendations and included tax evasion as a money laundering offense [2]. Following the FATF guidelines, this principle was incorporated into the 4th Money Laundering Directive in 2015 by adding tax offenses as predicate offenses to money laundering [3].

The FATF's goal was clear: recognizing tax evasion as a predicate offense to money laundering increases the number of tools available to regulators to combat tax crime. Ultimately, successful tax evasion pursues the same goal as money laundering: the introduction of dirty money into the legal financial system.

Since 2011, the OECD has published a number of documents on tax crime, including the Ten Global Principles for Combating Tax Crime, which support the provision of a range of practical tools, guidance, training and other capacity-building initiatives for jurisdictions to help combat it support tax crime. Furthermore, in 2017, the OECD published its report entitled "Combating Tax Crime: Ten Global Principles", in which Principle 1 explicitly states: "Jurisdictions should have a legal framework that ensures that violations of tax laws are punishable and effective Sanctions are imposed in practice" [4].

In a paper published in April 2023, the International Monetary Fund called on jurisdictions to adopt anti-money laundering measures to improve tax compliance, combat tax crime and, in turn, promote domestic revenue mobilization [5].

Results and Discussion

There are many types of illicit financial flows, but all of them involve taxation in one way or another. These activities include manipulating commercial invoices, transfer pricing and shifting profits to or through low-tax offshore jurisdictions, resulting in governments around the world missing out on large amounts of tax revenue.

Tax crimes can be committed both domestically and internationally. Due to the large domestic shadow economy and the prevalence of cash-based financial transactions, domestic tax crimes occur in the form of tax evasion, while internationally there is an increase in corporate and offshore income from private individuals' financial assets.

Issuing fictitious invoices is one of the main methods of tax evasion. In cases involving the issuance of fictitious invoices, the damage amounted to 138.1 billion tenge (around 300 million euros), with an average of 133.7 million tenge (around 300,000 euros) per crime. Overall, the loss from tax evasion amounted to 226.3 billion tenge (around 300 million euros), with an average of 424.6 million tenge (around 900,000 euros) per crime.

Article 245 of the Criminal Code of the Republic of Kazakhstan provides for liability for evasion of taxes and other obligatory payments to the budget from organizations on a large scale in excess of 50,000 MCI (about 400,000 euros). Under article 245 of the Criminal Code of the Republic of Kazakhstan, 32 cases were registered for 11 months in the current year, 93 cases in 2022 and 97 cases in 2021. [6].

As for external indicators, according to experts, Kazakhstan withdraws $3-6 billion dollars annually due to offshore. So, in January-September 2021, the largest amount of investments fell on the Cayman Islands: $637.5 million - almost 3 times more compared to the same period in 2020, followed by Seychelles ($176.6 million).

AML typologies related to tax crimes can pose particular challenges for national tax authorities, law enforcement authorities and financial investigation authorities to detect, analyze and investigate due to their complexity. Such schemes are typically transnational in nature, utilize complex legal structures involving the use of legal entities and agreements as well as nominee shareholders and/or directors, and involve experienced professionals who create such schemes and facilitate transactions to further the criminal activities of their clients to support. Due to technological advances, such actors have direct access to the global financial system in multiple jurisdictions, including legal entities, systems and bank accounts, as well as more complex financial services, making identifying the stages of money laundering particularly challenging.

Complex tax evasion systems therefore rely on professional expertise in the design and implementation of a range of complex, often cross-border, commercial, accounting and legal systems [7].

Offshore

Offshore companies play an important role in financial crime. A good example of this is the Panama Papers, which showed that money laundering and tax evasion are important issues that often accompany the abuse of offshore products (companies and bank accounts) and nominee services.

According to various estimates, state governments lose a total of $500 to $600 billion per year in lost corporate tax revenues due to tax havens through legal and not-so-legal means [8]."The Panama Papers and the Luxembourg Leaks revealed the tax havens were often used for illegal purposes and increased calls for change. In response, the Organization for Economic Cooperation and Development (OECD) has launched two major projects. One is the Common Reporting Standard (CRS), a system for the automatic exchange of financial information between countries to help tax authorities track their taxpayers' offshore holdings.

In July 2019, the OECD estimated that 90 countries had provided information on 47 million accounts worth €4.9 trillion; bank deposits in tax havens were around 20 fell -25 percent; and the voluntary disclosure prior to the implementation of the standard had brought additional tax revenue of 95 billion euros to the OECD member states and the G20, which also includes large emerging countries. [9].

Beneficial owners

Identifying the owners of companies and other legal entities such as trusts is another way to combat illicit financial flows. A study by Damgaard, Elkiar and Johannessen (2018) found that $12 trillion – nearly 40 percent of all foreign direct investment – flows through shell companies that are not connected to real economic activity. Although not all of these flows are illegal, the lack of information about the actual person who actually owns, controls and benefits from these structures – the so-called beneficial owner – can be used to conceal dubious transactions. [10]

The International Anti-Money Laundering Standard adopted by the FATF contains specific recommendations to improve the transparency of legal entities and their beneficial ownership. Basic information normally stored in business registers, such as company name, type of incorporation, legal status, address and list of directors, should be publicly available. Beneficial ownership information should always be available to competent authorities, whether stored in the register, at financial institutions or at the companies themselves [2].

In September 2023, the Financial Monitoring Agency (a body of the FIU of the Republic of Kazakhstan) approved the Rules for maintaining the Register of Beneficial Owners of Legal Entities [11]. In accordance with these rules, access to the register has a limited range of subjects. Users of the register are state authorities of the RK, carrying out within their competence control over observance by subjects of financial monitoring of the RK legislation on AML (except for the authorized body - FMA), special state and law enforcement authorities, and also subjects of financial monitoring, which have access to the register and possibility to enter in the register the information on supposed beneficial owners of legal entities of clients and controlled subjects.

Information from the register may be provided to other authorities on the basis of a joint act on exchange of information between the commissioner and law enforcement agencies, special state authorities.

Public access has many advantages. It makes it easier for financial institutions to perform customer due diligence. It also allows the public to track and analyze government procurement of goods and services (e.g. to establish links between contractors and officials), review financial reports submitted by officials, and ensure the accuracy and timeliness of information stored in registries check.

Shell companies

The problem of using shell companies to avoid taxes and obtain the proceeds of crime is often used by criminals. Such companies exist for a relatively short period of time, but during the short period of their existence, quite large amounts of money can be withdrawn through them. At first glance, one-day companies do not differ from ordinary, other, quite reliable companies. However, there are a number of signs that, after analyzing them, you can immediately distinguish from the general spectrum of such "gray" companies. As a rule, such companies have a so-called "gray" registration address: addresses where a large number of companies are registered are referred to as "gray". In addition, the "gray" company is usually not located at the specified legal address and does not have its own fixed assets and premises. In addition, such companies do not pay taxes or submit regulated reports to regulators.

Compliance monitoring

Particular attention should be paid to a customer due diligence program, as an effective identification program is the best way to prevent money laundering and terrorist financing. The more a financial monitoring entity knows about its customers, the more successful it will be in

preventing money laundering abuse. Know Your Customer due diligence or Counterparty Due Diligence procedures are usually quite effective in identifying potential risks. Unfortunately, many companies do not pay due attention to this system, and sometimes do not implement it in their operations.

The identification of the customer (his representative) and the beneficial owner consists in carrying out measures to establish and verify the reliability of information about the customer (his representative), identifying the beneficial owner and establishing information about him within the framework of financial monitoring, defining and establishing the purpose of a business relationship or a one-time operation (transaction), as well as obtaining and determining other information about the customer (its representative) and the beneficial owner specified in the requirements.

In Kazakhstan, the Law on Combating Money Laundering and Financing of Terrorism and the Law on Countering Corruption are applied in the area of compliance.

Employees of the compliance control unit can generally be categorized into the following types:
- Compliance/Legal Compliance, involved in the processes of identifying deficiencies and violations of the requirements of the legislation of the Republic of Kazakhstan and internal documents of the organization;
- AML/CFT, involved in AML/CFT processes;
- Ethics/Anti-Corruption, involved in the processes of maintaining ethics of the organization at a sufficient level, as well as combating corruption [12].

The introduction of risk-based supervision will ensure improved monitoring of dubious transactions by customers of financial institutions, their activities and business models, as well as assessment of the effectiveness of AML measures by financial monitoring authorities. These measures will make it possible to focus on customers and operations that may be involved in AML systems to take preventive measures to minimize AML risks.

Confidentiality

Restrictions on confidentiality and professional secrecy are usually accompanied by restrictions on the transfer of information. Financial and banking secrecy has its limits in the area of combating money laundering. There are clear exceptions provided for in national legislation and international standards, as well as in numerous national and international case laws on this issue. For example, FATF Recommendation 9 states: "Countries should ensure that financial institution secrecy laws do not impede the implementation of the FATF Recommendations" [2].

Authorities should consider including clear enabling provisions and exemptions in laws and guidance that can improve the ability of tax and law enforcement authorities to access AML information in the performance of their duties.

International cooperation

AML authorities have access to information valuable for managing taxes, including detecting violations. In particular, FIUs have access to a number of valuable sources of information that can help detect tax crimes and verify tax debts. FIUs are the central hubs for financial information in their countries and are tasked with obtaining, analyzing and disseminating appropriate information to relevant authorities, including tax authorities [13].

IMF experts propose giving tax authorities access to the databases of anti-money laundering agencies and expanding their use of customer due diligence checks, which include the collection and storage of extensive databases on company directors, their agents and business beneficiaries, activities, Business structure etc. include affiliates and transactions. In addition, tax authorities' tools can be expanded through methods such as covert operations, access to private information systems, and broader asset freezes and seizures.

In this context, it is very important that the AML framework is sufficiently comprehensive and that affected entities are subject to effective supervisory and enforcement frameworks.

In July 2020, the Egmont Group published best practices on AML/CFT and tax cooperation [14]. The best practices highlight the importance of promoting effective cooperation between FIUs and tax authorities, developing national anti-money laundering strategies and ensuring international cooperation between FIUs in combating money laundering arising from serious tax offenses.

Conclusions

The difficulty of identifying criminally derived funds in the global financial system has given the world's developed nations the idea of the need for collective action to combat money laundering, including in the tax area.

They are complex legal structures with companies and trusts often spanning multiple jurisdictions, a common feature of tax offenses and related money laundering schemes. The transparency of the beneficial ownership of legal entities and legal agreements is intended to identify criminals using these structures and to provide intelligence to the relevant authorities as part of their analyzes and investigations.

The legal instruments adopted at international level form the international legal basis for international cooperation in combating money and property laundering. At the same time, the issues related to improving economic and legal institutions to combat money laundering need to be further explored.

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