INTERNATIONAL TAXATION

TAX HAVENS

INTRODUCTION

- Tax havens offer tax-planning opportunities for multinational groups to reduce their average worldwide tax rate.
- MN groups use tax havens to reduce and/or defer payment of tax on profits by legal means.
- Tax havens, though can be used for manufacturing activity are more usually used as locations for bank deposits and business involving mobile capital

INTRODUCTION…Cont'd

- Many tax havens are located in the Caribbean and several have historical connections with the UK.
- TH are often heavily involved in banking due to the ease of money transfer and documentation.
- However not all major banking centres are tax havens
- The Cayman Island is the largest offshore banking centre.

INTRODUCTION…Cont’d

- Most countries are, to some extent, tax havens.
- Countries want to ensure that their tax residents do not avoid tax entirely.

What is a Tax Haven

- Countries considered to be tax haven often prefer to be referred to a off-shore financial centres (OSCs).
- distinction between OSCs and THs may be difficult
- its true to say that whilst all THS are OFCs not all OFCs are THs.
- OFCs are jurisdiction in which transactions with non-residents far outweigh transactions related to the domestic economy

What is a Tax Haven…Cont'd

- **OFCs** have the following attractions; favourable

1. Tax regime
2. Legal environment
3. Regulatory system

- **Tax havens** have the following characteristics'

1. Low or nil tax
2. Secrecy: banking and/or commercial
3. Absence of exchange controls

What is a Tax Haven…Cont'd

4. Provision of off-shore banking facilities
5. Good communication facilities
6. Political stability
7. Opportunity for multilateral tax planning
8. Favourable disposition to foreign capital
9. Availability of professional advisers
10. Convenient location, good climate for communications and to attract staff.

Types of Tax Havens

- Tax havens are classified according to the functions they perform though these functions are frequently combined.

1. **Production Havens** – produce goods and services.
2. **Base Havens -** no/very low taxes on all business income
3. **Treaty Havens** – Countries with very favourable DTT networks.
4. **Concession Havens -** countries offering particular tax incentives or benefits

The Banking Sector

- Tax havens are particularly interesting to the banking sector because of the following benefits they offer;

i. No reserve requirements in respect of banking activities for non-residents

ii. Exemption for exchange controls

iii. Legal protection of confidentiality of bank records and customer information

iv. Company laws giving wide protection of the confidentiality of both financial and commercial transactions

Types of Off-shore Banking Centres

- There are three types of offshore banking centres:

1. **Fully operational** – People meet face to face and put deals together
2. **Offshore/onshore centres** - Onshore banks are allowed to set up subsidiaries with the same privileges as off-shore centres.
3. **Booking Centres -** characterised by low tax and light regulation – 'brass plate' operations.

Tax Havens and Tax Evasion

- Tax havens are used legitimately, to reduce worldwide tax liabilities which can be curbed through regulation or;
- illegitimately to evade tax by hiding assets and income – requires use of criminal sanctions.
- Use of information exchange agreements as part as DTTs or as separate agreements, TIEA (Tax Information Exchange Agreements).

Controlling Tax Haven Abuse

- Tax haven abuse can potentially be controlled by ;

1. Pressure from supranational bodies
2. Use of information gathering powers of governments
3. Amnesties
4. Exchange controls
5. Transfer pricing rules
6. Company residence rules

INTERNATIONAL TAXATION

MONEY LAUNDERING

Introduction

- Money laundering's aim is to convince the relevant authorities of the legal origin, existence and/or application of illegal sources of income
- It plays a key role in facilitating the ambition of drug traffickers, terrorists, organised crime syndicates and tax evaders.

Introduction…Cont'd

- The UN Global programme Against Money laundering defines Money laundering as; 'a process which disguises illegal profits without compromising the criminals who wish to benefit from the proceeds
- It's a dynamic three-stage process that requires;

1. Moving the funds from direct association with the crime

Introduction…Cont'd

2. Disguising the trail to foil pursuit
3. Making the money available to the criminal once again with the occupational and geographic origins hidden from view'

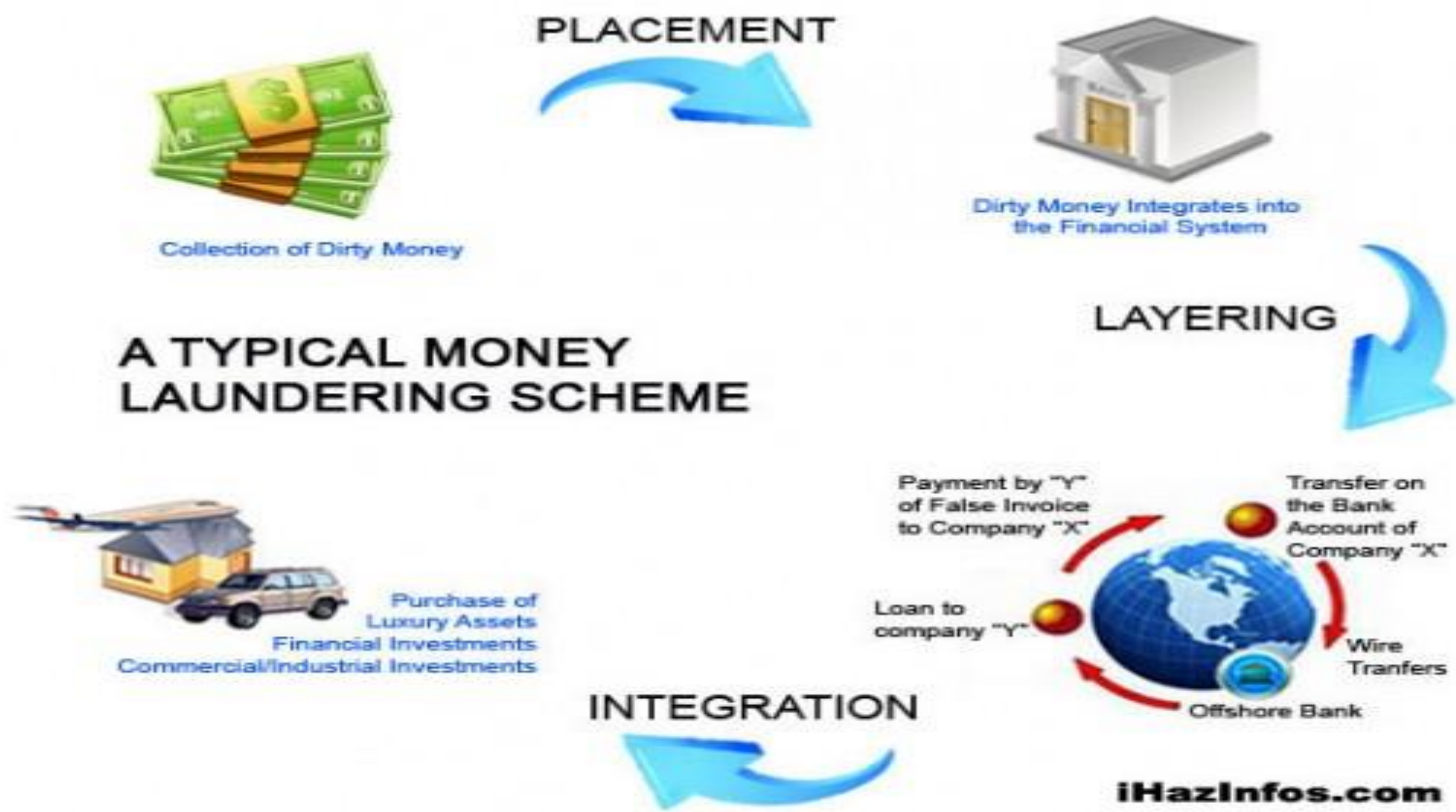
Money laundering Definitions

- Money laundering is the process by which funds derived from criminal activity ("dirty money") are given the appearance of having been legitimately obtained, through a series of transactions in which the funds are cleaned. Its purpose is to provide a legitimate cover for the source of the money
- The "washing" of criminal proceeds to disguise their illegal origin in order to legitimize them.
- It is the placing of illegal proceeds beyond the reach of asset forfeiture laws

Factors that facilitated ML Explosion

1. Globalisation of markets and financial flows with the advent of the internet – creation of a single market means that money can travel in nanoseconds.
2. Deregulation of financial market with the attendant lack of consistency or coherence in respect of anti-money laundering regulations
3. Globalisation and increased global competition meaning more competitors and greater pressure to deliver profits. People who control proceeds of crime can yield great influence over legitimate business

Stages of Money Laundering



Stages of Money Laundering…Cont'd

- There are 3 stages involved in money laundering;

1. **Placement**

- Goal - Deposit Criminal Proceeds Into **Financial System**
- Movement of cash from its source, which can sometimes be easily disguised or misrepresented
- Followed by placing it into circulation through financial institutions, casinos, shops, bureau de change and other businesses.

Stages of Money Laundering…Cont'd

2. Layering

- **Goal-** Conceal the Criminal Origin of Proceeds
- Purpose of this stage is to make it more difficult to detect and uncover a laundering activity.
- It is meant to make the trailing of illegal proceeds difficult for the law enforcement agencies
- Known methods include; converting cash into monetary instruments, material assets bought with illicit funds then sold.

Stages of Money Laundering…Cont'd

3. Integration

- **Goal -** Create an Apparent Legal Origin for Criminal Proceeds
- The movement of laundered money into the economy mainly through the banking system.
- Such monies thus appear to be normal business earnings
- It differs from layering as in this stage detection and identification of laundered funds is provided through informants
- Methods include; property dealing, front companies and false loans, false import/export invoices

Reasons for Money Laundering

- **Dilemma**: How to spend/invest large sums of money without a legitimate source without incurring the attention from relevant authorities i.e. law enforcers, tax examiners

1. **hiding wealth**: criminals can hide illegally accumulated wealth to avoid its seizure by authorities
2. **avoiding prosecution**: criminals can avoid prosecution by distancing themselves from the illegal funds
3. **increasing profits**: criminals can increase profits by reinvesting the illegal funds in businesses

Reasons for Money Laundering…Cont'd

4. **becoming legitimate**: criminals can use the laundered funds to build up a business and provide legitimacy to this business
5. **evading taxes**: criminals can evade taxes that would be imposed on earnings from the funds

Money Laundering – A Global Problem

- The IMF & World bank estimates that **3%-5% of global GDP laundered ($2.17-$3.61 trillion annually)**
- financial aspects of crime are complex due to rapidly changing advances in **technology**.
- Vast amounts of illicit money moving through the worlds' financial systems
- Tax havens and offshore centres used to launder criminal assets - due to secrecy

Money Laundering in Kenya

- Kenya is highly vulnerable to Money Laundering
- Regional trade and financial centre
- Transit point (drug trafficking, smuggling, wildlife trafficking, piracy)
- Rampant corruption.
- the country's financial system may be laundering over USD100 million each year.
- Any cases??

Negative Effects of Money Laundering

1. **Erodes financial institutions**(banks etc)- loss of integrity, public trust, instability of financial markets.
2. **reduces tax revenue** - difficult for government to collect revenue from underground economy.
3. allows the criminal to start, continue and expand activities in legitimate sectors of the economy.
4. **impairs the development of the legitimate private sector-** the supply of products priced below production cost, making it therefore difficult for legitimate activities to compete.
5. create a perception that crime pays -a stimulating effect on **youth** to start a criminal career.

Negative Effects of Money Laundering…Cont'd

6. Financing **terrorism**
7. **transfer of economic power** from the market, the government and the citizens to criminals, thus abetting crimes and corruption

International Efforts Against Money Laundering

- The first international agreement addressing money laundering is the United Nations Vienna Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (The Vienna Convention) signed in December 1988 and became effective in November 1990
- The signatories which included the G7 and European Union agreed to join together to combat the laundering of the proceeds from drug trafficking, later extended to laundering of proceeds of other serious offences.
- More members(now 36) have since joined.

International Efforts Against Money Laundering…Cont'd

- The measures included;

1. Criminalisation of money laundering
2. Enhanced international cooperation
3. Commitment to ensure that the laws of their jurisdiction bring this about

- AN international body was established to oversee the implementation of the principles of the Vienna Convention known as the Financial Action Task Force (FATF) based in Paris
- Kenya is a member of **FATF** and has signed several international instruments on combating organized crime, suppression and countering terrorism

International Efforts Against Money Laundering…Cont'd

The Financial Action Task Force (FATF) recommendations include:

1. Criminalize ML and enable authorities to confiscate proceeds.
2. Implement customer due diligence, record keeping, reporting.
3. Cooperate internationally in investigating and prosecuting ML
4. Enactment of anti-money laundering laws by many nations
5. Bilateral and multilateral agreements

Anti-Money Laundering Law in Kenya

- Before the enactment of the current Proceeds of Crime and Anti-Money Laundering Act in 2009, money laundering legislation in Kenya was weak and fragmented.
- Money laundering was primarily being dealt with under the:

1. Narcotic Drugs and Psychotropic Substances (Control) Act, 1994 (the "Narcotics Act") which only dealt with proceeds of drug trafficking
2. Central Bank of Kenya Guideline on Proceeds of Crime and Money Laundering (Prevention)(the "CBK Guideline") which only applies to banking institutions licensed under the Banking Act.

Anti-Money Laundering Law in Kenya

The **Proceeds of Crime and Anti-Money Laundering Bill, 2009** received presidential assent on the 31st December, 2009 making it law.

- the Proceeds of Crime and Anti-money Laundering (Amendment) Bill, **2012** .
- Further amended in 2017
- Kenya has signed and ratified all the UN conventions on combating Money Laundering and financing terrorism;
- United Nations Convention Against Corruption
- United Nations Convention Against Transnational Organised Crime
- United Nations Conventions for Countering Terrorism and Terrorist Finance

Anti-Money Laundering Law in Kenya…Cont'd

Definition Under the Act

- includes entering into a transaction involving property which one knows or ought to reasonably have known is or forms part of the proceeds of crime regardless of whether such transaction is legally enforceable or not and which has the effect of concealing or disguising the nature or ownership of the property or assisting a person who has committed an offence to avoid prosecution or concealing any proceeds of crime
- provide for the identification, tracing, freezing, seizure and confiscation of the proceeds of crime .
- applies to all persons whether individual or corporate and to the proceeds from any criminal activity

Anti-Money Laundering Law in Kenya…Cont'd

- **acquisition, use or possession of property** which at the time of acquisition, use or possession, one knows or ought to reasonably have known that it is or forms part of the proceeds of a crime committed by another person
- assisting someone to benefit from the proceeds of crime, malicious reporting, making false or fraudulent statement or entry and failing to report suspicion of proceeds of crime.
- Offence to fail to comply with the provisions of the Act

Penalties under the Act

- up to a **14 year** jail term and / or a maximum fine of
- KES.**5,000,000** - individual and
- KES. **25,000,000 -** for a body corporate or
- the value of the property involved in the offence whichever is higher.
- criminal forfeiture of the proceeds of crime, civil forfeiture of property including civil proceedings for recovery of property

Institutions under the Act

- **Financial Reporting Centre** - to assist in the identification of the proceeds of crime and the combating of money laundering,
- the **Anti-Money Laundering Advisory Board** - to advise the Director of the Centre on the performance of his functions under the Act(members include: PS Treasury, Attorney General, Inspector general police, Governor CBK, CEO ICPAK, chairman Kenya bankers association)
- **Assets Recovery Agency**
- **Criminal Assets Recovery Fund**

Institutions responsible for reporting under the Act

- These institutions are obliged to monitor and report to the Centre suspected money laundering activities, verify customer identity including that of existing customers, establish and maintain customer records and establish and maintain internal reporting procedures.

1. Financial institutions
2. designated non-financial businesses such as casinos, real estate agencies, dealers of precious stones and metals,
3. non-governmental organizations
4. accountants.
5. Supervisory bodies i.e. Capital Markets Authority, Retirement Benefits Authority

Money Laundering and Taxation

- Money launderers - seek to transform illegally earned income into legal income
- tax evaders- seek to conceal income, either legally or illegally earned, from detection and collection by the tax authorities
- Taking legally earned income and either hiding its very existence or disguising its nature - turns legal income into illegal

Tax Evasion and Money Laundering

- **Similarities**

1. share the **same sophisticated techniques** of fund dissimulation,
2. they mutually support each other and are often perpetrated through offshore locations.
3. Use of **tax havens**- secrecy/ anonymity

- **Differences**

1. In tax evasion funds usually move to a single location where they are sheltered from the home country's tax authorities.
2. Money Laundering - funds move rapidly through several offshore locations.

Role of Tax examiners

- Tax examiners are in a unique position to;

1. identify not only tax crimes but also money laundering because of their training
2. report unusual or suspicious transactions in accordance with domestic law and practice.
3. Report to appropriate bodies
4. Detect "dirty" money focusing primarily on unusual transactions that indicate possible money laundering.

- 'Unusual' means that a transaction differs from the norms of a certain industry or the habits of an individual, taking into account their background, normal activities or declared income.

Role of Tax examiners…Cont'd

- Deviation from normal or expected behaviour may indicate risk.
- The greater the deviation in behaviour and the more frequent the occurrence of unusual situations, the greater the risk for money laundering.

Characteristics of unusual transactions

- These include;

1. the origin of the funds is not clear;
2. the identities of the parties are not clear;
3. The transaction does not fit the person's background or legal income, and
4. there is no economic or logical explanation for the transaction.

Indicators for individuals

1. Unusual income

- No income or low income compared to normal cost of living
- Taxpayer appears to be living beyond their means

2. Unusual rise in net worth

- Inheritance from a criminal family member
- Fictitious inheritance
- Gambling and lottery gains

Indicators for individuals …Cont'd

3. Unusual possession or use of assets

- A person with low income owns or uses expensive assets (car, boat, real estate)
- A person owns assets located abroad, not declared in their tax return

4. Unusual debt

- Obtaining a loan from unidentified parties

Indicators for Companies

1. **Unusual off-balance items**

- Non-transparent ownership
- Ownership by relations/partners of criminals
- International structure with no apparent commercial, legal or tax benefits
- Purchase or sale of the companies' shares at a price far above or below estimated value
- Companies/directors registered at a foreign company service provider's address

Indicators for Companies...Cont'd

2. Unusual profit and loss items

- High rise in turnover/sales
- High rise in profit margin
- Business ratio of costs and sales not in line with industry

Indicators for Companies…Cont’d

3. Unusual transactions and parties

- Entrepreneur demonstrates poor knowledge about their business
- Transaction in goods or services not fitting company's profile
- Transaction without an evident commercial basis
- Transaction or agreements without relevant supporting documents
- Transactions with offshore companies
- Transaction with suspected criminals or their partners
- Non-transparent / non-identifiable customers, creditors or lenders

Indicators for Companies…Cont'd

4. Unusual money flows

- Payments to or from third parties who are not involved in the transaction
- Payments to or from unrelated offshore companies or accounts
- Non-transparent or non-verifiable origin of the money
- Denominations and currency not the norm in the industry
- Money flows without apparent economic reason or supporting documentation
- Unusual use of credit cards or debt instruments

Indicators in International Trade

- money laundering through trade is known as 'Trade Based Money Laundering
- key method to move and/or launder large amounts of money derived from crime

1. Over- and under-invoicing

- By making over- or under-valuations of imports or exports, capital can be moved and laundered in the form of goods or money flows.
- Over- and under valuation may take the form of adjustments to price, quantity, quality or a combination thereof.

Indicators in International Trade…Cont'd

2. False descriptions

- The goods identified on the invoice may not be the goods actually imported or exported. The documents can contain a price that corresponds to the specified goods but the actual market value of the goods imported or exported may be many times higher or lower. Physical observation is necessary in order to confirm that the goods shipped are the same as the goods invoiced.
- Goods shipped may actually be strategic goods, goods with restrictions (quotas), goods with a higher import duty or prohibited goods such as raw materials for drugs, weapons and fictitious goods.

Indicators in International Trade…Cont’d

3. Multiple Billing

- Multiple billing (or multiple invoicing) is a technique where multiple invoices are created for the same goods. This technique is used to evade import duties or to launder the proceeds of crime.

4. Fictitious transactions

- Transactions can be fictitious. The goods are never delivered or the services are never performed. Yet, with an invoice on hand, funds can be transferred or received. This serves to move money safely through corporate accounts, to falsify profits, to cover up or settle possible illegal activities.

Indicators in International Trade...Cont'd

- With current technology, it is easy to modify existing invoices or produce fictitious invoices. Information on corporations that is needed to create an invoice is readily available. It is also easy to set up a foreign corporation to deliver or receive goods or services when, in fact, they are neither delivered nor received.

5. Unusual origin or destination of goods
6. Country is not known for importing or exporting that type of goods
7. Risk countries
8. Newly formed corporations with large imports and exports

Indicators in International Trade…Cont’d

9. Volume or type of goods does not fit suppliers' or buyers' profile
10. Size or nature of goods does not fit in the method of transportation
11. Unusual description of goods
12. High costs of transportation compared to the value of the goods

Indicators on Professional Service Providers

- Professional service providers are corporations or individuals who provide specialised services
- The involvement of a professional service provider in a transaction is attractive for criminals because of:

1. The nature of the services rendered which might assist in the money laundering process;
2. The name and reputation of an industry or group of professionals which raises confidence and gives the transaction a certain appearance of legitimacy;
3. The confidentiality maintained by certain professional service providers; .

Indicators on Professional Service Providers…Cont'd

1. Unusual service provided by a professional service provider
2. Unusual professional service provider chosen for service
3. Unusual reward for a professional service provider
4. Unusual transaction, income or assets of the professional service provider

Questions?