Jeffrey Owens and Rick McDonell and Riël Franzsen and Jude Thaddeus Amos

Inter-agency Cooperation and Good Tax Governance in Africa

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Inter-agency Cooperation and Good Tax Governance in Africa

Edited by
Jeffrey Owens, Rick McDonell, Riël Franzsen and Jude Amos

WU (Vienna University of Economics and Business) and University of Pretoria

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2017
Inter-agency Cooperation and Good Tax Governance in Africa

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PREFACE

In 2015, the Vienna University of Economics and Business (WU) and the African Tax Institute at the University of Pretoria launched a project to identify the links between corruption, money laundering and tax crimes in Africa. The project promotes the concepts of good tax governance and the importance to economic development of a tax system that is transparent and free of corruption. The project explores how law enforcement agencies and tax authorities can best cooperate to counter corruption and bribery. The project was initially aimed at three focus countries, namely, Ghana, Nigeria and South Africa, but soon was extended to other African countries. This is a joint initiative with the United Nations Office on Drugs and Crime (UNODC) and is also supported by the World Bank.

This book brings together a series of background papers prepared for the Conference on Inter-Agency Co-operation and Good Tax Governance in Africa held at the University of Pretoria in July 2016. After a rigorous double peer-review process, the papers were revised by the authors. We express our gratitude to and acknowledge the services of the following peer reviewers: Tom Balco; Carika Fritz; Leon Gerber; Willem Jacobs; Benjamin Kujinga; Thabo Legwaila; Annet Oguttu; Dirk Scholtz; David Solomon; and Xeniya Yeroshenko.

Finally, we express our sincere gratitude to all the research and administrative assistants who contributed to the Good Tax Governance in Africa Project. This book pays tribute to their efforts.

Jeffrey Owens, Rick McDonell, Riël Franzsen and Jude Amos
Vienna and Pretoria
November 2017
FOREWORD

Over the past three years, the Institute for Austrian and International Tax Law at the Vienna University of Economics and Business (WU) was engaged in a partnership with the African Tax Institute (ATI) at the University of Pretoria. With the support of the United Nations Office on Drugs and Crime (UNODC), the partners engaged in a project that brought together officials, business, academics, as well as international and regional organisations to discuss and identify solutions to illicit financial outflows from Africa.

The project has involved research, workshops, training seminars and conferences, all aimed at providing practical solutions which the participating countries can use to counter such outflows. It has also helped to develop a core of young researchers that can carry on this work, providing African governments with the analyses and facts to confront this problem.

It has been a privilege for the Institute for Austrian and International Tax Law and the United Nations Office on Drugs and Crime to be associated with this initiative. WU is the largest business school in Europe, and the Institute is one of the leading global centres in the area of international taxation, with over 60 researchers and professors from more than 40 countries, including many from Africa. UNODC has decades-long experience in assisting United Nations member states to prevent economic crimes and combat money laundering and the financing of terrorism, and has had the privilege of working with governments and competent authorities dealing with Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) in most African countries to improve the effective implementation of national and international AML/CFT laws and policies. It also assists regionally through African Financial Action Task Force (FATF)-style regional bodies. In assisting African countries to strengthen institutions, legal frameworks and operational capacities, it helps them to prevent and disrupt economic crimes, to identify and counter illegal activities and to confiscate and dispose of stolen assets.

We are pleased that this book brings together a number of papers that were prepared by post-graduate researchers as background papers for a major conference held in Pretoria, South Africa, in July 2016 and which was opened by the Honourable Pravin Gordhan, the then Minister of Finance of South Africa. This publication will enable a wider audience to benefit from the discussions on key issues and hopefully will contribute to the ongoing debate on illicit financial flows and good tax governance.

Michael Lang
Head of the Institute for Austrian and International Tax Law Vienna University of Economics and Business (WU)

Jean Luc Lemahieu
Director, Division for Policy Analysis and Public Information, UN Office on Drugs and Crime, Vienna

November 2017
EDITORS

**Jude Amos**

Jude Amos is manager of the Tax and Good Governance Project at the Institute for Austrian and International Tax Law, Vienna University of Economics and Business (WU). Before taking over the management of this initiative, he worked in various capacities as a tax and investment law researcher, writer, editor, advisor and consultant in The Netherlands, Luxembourg and France. He holds a Bachelor of Laws (LLB) degree from the University of Ghana; a Master of Laws (LLM) degree from McGill University; a second Master of Laws (LLM) degree from the University of British Columbia; and a PhD degree from the University of Sydney.

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Riël Franzsen occupies the South African Research Chair in Tax Policy and Governance and is the director of the African Tax Institute in the Faculty of Economic and Management Sciences at the University of Pretoria, South Africa.

Riël specialises in land and property taxation and regularly acts as a policy advisor for the International Monetary Fund (IMF), United Nations (UN), World Bank, and other entities. He has worked in this capacity in Africa, Asia, the Caribbean and Europe. He has acted as an instructor for the IMF, the Lincoln Institute of Land Policy, the Network of Associations of Local Authorities of South-East Europe, and The Hague Academy for Local Governance. He serves on the Board of Advisors of the International Property Tax Institute, and has authored and co-authored numerous journal articles and book chapters on land and property taxation. He is co-editor and co-author of *Property tax in Africa – Status, challenges and prospects*, published by the Lincoln Institute of Land Policy in May 2017.

**Rick McDonell**

Rick McDonell currently is the co-director at WU of the Tax and Good Governance project in Africa. He also provides workshops to researchers and students in relation to tax and crime topics and acts as an advisor to LLM and PhD students in preparing their theses. Until the end of 2015, he was the executive secretary of the Financial Action Task Force (FATF) and the founder of the Asia/Pacific Group on Money Laundering.

Rick was also previously chief of the UN Global Programme against money laundering. He has vast experience in legal policy, investigations and prosecutions.

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Jeffrey Owens is the Director of the WU Global Tax Policy Centre at the Institute for Austrian and International Tax Law, WU. He has focused his attention on questions of tax policy and tax administration, with particular emphasis on international taxation and related domestic issues. His earlier
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Clement Migai is a research associate at the Institute for Austrian and International Tax Law at the Vienna University of Economics and Business (WU), where he is also pursuing a doctoral programme in Business Law. Prior to this, he was an Assistant Manager at the Kenya Revenue Authority (KRA) responsible for co-ordinating its input into the review of the regulatory and fiscal frameworks and capacity building for mining, oil and gas tax administration. He joined KRA as graduate trainee in 2005 and acquired diverse experience in tax dispute resolution by representing the Large Taxpayers Office in disputes with taxpayers at the various tax appellate tribunals and representing the KRA in courts at the Legal Services Division.

Clement is an Advocate of the High Court of Kenya, a Certified Public Secretary and a Certified Public Accountant. He holds an LLM degree in International Commercial Law (with distinction) from Robert Gordon University, Aberdeen, and a Bachelor of Laws (LLB) degree from Moi
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Lindelwa Ngwenya has been engaged in public policy research, including tax policy, since 2012. She has worked as a researcher and a legal drafter for the Southern Africa Development Community (SADC) Centre for Land Related, Regional and Development Law and Policy, an academic associate in the Department of Mercantile Law of the University of Pretoria, a researcher for the Centre of Excellence in Food Security and a lecturer at the African Tax Institute of the University of Pretoria. She has worked on several research projects, including projects commissioned by the Department of Agriculture, Forestry and Fisheries (South Africa), Norad’s Evaluation Department (Norway), and the African Tax Institute (including the Tax and Good Governance Project of the African Tax Institute and Global Tax Policy Centre of the Vienna University of Economics and Business). Her areas of research expertise include international tax, corporate tax (with a specific interest in corporate financing). She holds a Master of Laws in Mercantile Law, Master of Philosophy: Taxation (both from the University of Pretoria) and an Advance Diploma in Corporate Taxation (International Institute of Tax and Finance). She is currently enrolled as a PhD student at the University of New South Wales where her area of focus is the combatting of aggressive tax planning through the abuse of securitisation structures.

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Attiya Waris is an advocate, arbitrator and senior lecturer at the Law School, University of Nairobi in Kenya where she has been teaching for over 12 years. She researches on the linkages between tax revenue and tax spending with reference to the development of the state. She analyses this through the lens of human rights, development and poverty alleviation as well as the movement of wealth across borders and the impact it has on a developing state. Her current research interests include work on transfer pricing, global wealth chains, health financing as well as the linkages between gender and taxation and Islamic finance and taxation. She has published on international and African regional issues as well as domestic tax issues in Kenya, Rwanda, South Africa, Somalia and Bangladesh. Attiya is both author and co-author of several taxation books, including Tax and development: Solving Kenya’s fiscal crisis through human rights, and has authored numerous articles globally. Currently she is the Tax Member of the Technical Committee on Banking and Finance, National Treasury, Kenya; was a 2016 nominee as UN Special Rapporteur on the Right to Development; spearheaded the first memorandum of understanding between the Kenya Revenue Authority and an academic institution, the University of Nairobi. She also chairs the Working Group of Fiscal Studies, Law School, University of Nairobi, Kenya.
1 Introduction

This book examines the linkages between money laundering, bribery, corruption and tax evasion in Africa, and how to counter these illicit financial flows (IFFs) requires a whole government approach and a reassessment of existing international instruments. To fully understand the issues discussed by the various authors, it is essential to understand recent developments in the international environment.

The period from the 1980s to the mid-1990s was marked by the progressive liberalisation and deregulation of international trade, investment and financial flows. Increasingly dense networks of cross-border economic relationships resulted, as financial centres were forced to compete with each other to attract international financial flows. With the decline of non-tax barriers to the mobility of capital, the significance of low or preferential tax regimes as a factor in making investment decisions increased. In 1996 the heads of the G-7 states sought to bring these developments to a head. In their final Communiqué issued following the Lyon Summit, they acknowledged:

Globalisation is creating new challenges in the field of tax policy. Tax schemes aimed at attracting financial and other geographically mobile activities can create harmful tax competition between states, carrying the risk of distorting trade and investment [and] leading to the erosion of national tax bases. We strongly urge the [Organisation for Economic Co-operation and Development (OECD)] to vigorously pursue its work in this field, aimed at establishing a multilateral approach under which countries could operate individually and collectively to limit the extent of these practices.


2 See G7 Communiqué, Lyon 21 July 1996 (See AP Archive).
2 OECD harmful tax competition initiative

The Organisation for Economic Co-operation and Development (OECD) responded to the call by the G-7 for a return to the status quo ante through its ‘harmful tax competition’ project, which called for the development of measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases. In 1998, the OECD published its first report entitled ‘Harmful Tax Competition: An Emerging Global Issue’. The report identified two primary contributors to the harmful tax competition developing between states – the so-called ‘tax haven’ jurisdictions and preferential tax regimes. The latter predominantly were phenomena of OECD member states, and were to be dealt with internally by a process of domestic and peer review, while secrecy jurisdictions were subject to a more confrontational and interventionist approach. The report announced the creation of the Forum on Harmful Tax Practices, which was tasked with identifying non-OECD member jurisdictions that met the criteria for designation as a secrecy jurisdiction. A follow-up report published in 2000 identified 35 such jurisdictions, which were to be identified in a future ‘List of uncooperative tax havens’ unless they made a commitment to eliminating harmful tax practices by 2005. Any jurisdiction that failed

5 ‘Tax havens’ are characterised in the OECD 1998 Report by four main factors: (i) imposing no, or only nominal tax; (ii) a lack of effective exchange of information with other countries; (iii) a lack of transparency; and (iv) investment with no substantial activities. The application of the term ‘tax haven’ remains controversial and contested. It is often conflated with the term ‘offshore financial centre’ – itself an equally amorphous term that, from the perspective of land-locked ‘onshore’ jurisdictions such as Switzerland and Lichtenstein, usefully glosses over the fact that everywhere is ‘offshore’ of everywhere else. Accordingly, this article adopts the Tax Justice Network’s preferred terminology of ‘secrecy jurisdiction’, where the more pertinent distinction is one between ‘here’ and ‘elsewhere’.
6 ‘Preferential tax regimes’ are characterised in the OECD 1998 Report by four main factors: (i) the regime imposes low or no taxes on the relevant income (from geographically mobile financial and other service activities); (ii) the regime is ring-fenced; (iii) the regime lacks transparency, eg the details of the regime or its application are not apparent, or there is inadequate regulatory supervision or financial disclosure; and (iv) there is no effective exchange of information with respect to the regime. Note that ring-fencing occurs when a tax regime is partially or fully isolated from the domestic markets of the country providing the regime. It may take a number of forms, including excluding resident taxpayers from taking advantage of its benefits; and/or excluding enterprises that benefit from the regime from operating in the domestic market.
to comply would be liable to the application of co-ordinated defensive measures by OECD member states.8

However, Switzerland and Luxembourg had vocally abstained from endorsing both the 1998 and 2000 reports,9 arguing that they represented a partial and imbalanced approach that resulted in the unacceptable protection of countries with high levels of taxation, while the incoming United States (US) Treasury Secretary had expressed concern to the G-7 Finance Ministers.

The intervention by the US reflected ideological unease with the OECD’s increasing encroachment upon fiscal sovereignty. Traditionally, taxation was seen as an inherent or essential component of sovereign status, and any infringement of a state’s right to self-determination concerning its system of taxation would be regarded as an infringement on sovereignty itself.10 Instead, the US sought to align the work being done by the OECD on harmful tax practices with the work being done by the Financial Action Task Force (FATF) and others on anti-money-laundering and counter-terrorism financing (AML/CFT). This shifted the focus of the project towards transparency and information exchange as mechanisms to be used in the detection and prevention of illicit financial flows.

3 Emphasis on misuse of corporate vehicles

In February 2000, the FATF had undertaken a review of the rules and practices that impaired the effectiveness of money laundering prevention and detection systems, and concluded:

Shell corporations and nominees are widely used mechanisms to launder the proceeds from crime, particularly bribery (e.g. to build up slush funds). The ability for competent authorities to obtain and share information regarding the identification of companies and their beneficial owner(s) is therefore essential for all the relevant authorities responsible for preventing and punishing money laundering.11

8 Interestingly, the Report only envisaged the application of defensive measures against non-cooperative secrecy jurisdictions; no corresponding provision was made for similar measures to be invoked against non-cooperative OECD member states with preferential tax regimes. See R Woodward ‘The OECD’s harmful tax competition initiative and offshore financial centres in the Caribbean Basin’ in R Ramsaran (ed) The fiscal experience in the Caribbean: Emerging issues and problems (University of the West Indies: St Augustine, Trinidad 2004) 623-625.


11 Cited in FATF ‘The misuse of corporate vehicles, including trust and company service providers’ 13 October 2006.
In April 2000, the Financial Stability Forum (FSF) had also highlighted a number of prudential and market integrity concerns arising from their review of what they termed ‘problematic’ secrecy jurisdictions. They specifically expressed concern at the ease with which corporate vehicles – such as companies, trusts, foundations, partnerships, and other types of legal persons and arrangements12 – could be created and dissolved in these jurisdictions, and the lack of availability of timely information on their beneficial ownership.13 The FSF subsequently issued a formal request to the OECD to examine the vulnerability of corporate vehicles to misuse for illicit purposes, and stressed the importance of ensuring that the authorities in each jurisdiction had the ability to obtain and share information on the beneficial ownership and control of corporate vehicles established in their jurisdictions.

In May 2001, the OECD issued its Report on the Misuse of Corporate Vehicles for Illicit Purposes to the G-7 Finance Ministers and the Financial Stability Forum (FSF).14 The report found that almost all economic crimes involve the misuse of corporate vehicles: Money launderers exploit cash-based ‘front’ businesses and other legal entities to disguise the source of their illicit gains; corrupt officials conduct transactions through bank accounts opened under the names of corporations and foundations; and individuals hide or shield their wealth from tax authorities and other creditors through trusts and partnerships.15 In order to successfully combat and prevent the misuse of corporate vehicles for these purposes, the report concluded that it was essential that all jurisdictions establish effective mechanisms enabling their authorities to obtain, on a timely basis, information on the beneficial ownership and control of corporate vehicles established in their own jurisdictions, and that such information must be capable of being shared with other authorities both domestically and internationally.16

12 The term ‘legal arrangements’ refers to express trusts or other similar legal arrangements (eg fiducie, treuhand and fideicomiso, while ‘legal persons’ refers to any entities other than natural persons that can establish a permanent customer relationship with a financial institution or otherwise own property (eg companies, bodies corporate, foundations, anstalt, partnerships, or associations and other relevantly similar entities). See FATF ‘Glossary of the FATF Recommendations’ October 2012.
15 As above.
16 OECD (n 13 above) 7-8.
The OECD report was followed by a succession of others exploring similar policy concerns, ensuring that the issue of corporate vehicle misuse and financial transparency remained firmly on the public agenda.17

4 Improving the legal framework for information exchange: Article 26 of the OECD Model Tax Convention

In 2005, significant amendments were made to article 26 of the OECD Model Tax Convention on Income and Capital to enable the broader exchange of information and prevent bank secrecy. Previously, article 26(1) provided for the exchange of ‘information as is necessary for carrying out the provisions of [the Convention] or of the domestic laws concerning taxes of every kind and description imposed on behalf of the contracting states’.18 The revisions to paragraph 1 of article 26 substituted the right to request and the obligation to provide tax information when it becomes ‘foreseeably relevant’, rather than only when ‘necessary’. A new paragraph 5 was also added to article 26, which made it clear that jurisdictions could not decline to provide information solely because it was held by banks, financial institutions, nominees, agents or fiduciaries, or solely because it was information relating to ownership. The most significant consequence of the change was that domestic bank secrecy rules, by themselves, no longer could be used as a basis for declining to provide information.

5 Global responses to the financial crisis

The global financial crises of 2008-2009 brought secrecy jurisdictions back to the centre of the conversation around illicit financial flows and the need for greater transparency. Countries around the world were confronted with damaging combinations of large bailout costs and diminishing corporate tax receipts, and politicians and bureaucrats were acutely aware of the need to find additional revenue streams. Spurred on by contemporaneous media reports and prosecutions arising out of the Swiss UBS bank scandal19 and the Liechtenstein tax data leak,20 issues of tax evasion and

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17 In 2002 the International Trade and Investment Organisation (ITIO) and the Society of Trust and Estate Practitioners (STEP) commissioned the report ‘Towards a Level Playing Field: Regulating Corporate Vehicles in Cross-Border Transactions’. In 2006 the FATF issued its paper on ‘The misuse of corporate vehicles’, and in 2010 the Caribbean FATF published ‘Money laundering using trust and company service providers’.
18 Our emphasis.
19 During US senate hearings, a Geneva-based whistle-blower from UBS bank, which at the time was partly owned by the Swiss government, disclosed that UBS was sending bank officials to US cities to promote the use of its services by high-net-worth Americans. These officials told the Americans that they could successfully hide their monies offshore where the monies would remain undetected and untaxed by US tax
tax avoidance\textsuperscript{21} suddenly found themselves high on the public agenda as attention turned towards the massive amounts of unreported private financial wealth concealed in the world’s secrecy jurisdictions.\textsuperscript{22}

5.1 How big is the problem of hidden wealth?\textsuperscript{23}

The most frequently-cited estimate on the global extent of all illicit financial flows comes from the International Monetary Fund (IMF) in the mid-1990s, which provided a ‘consensus range’ of between 2 and 5 per cent of global gross domestic product (GDP) – or between USD1.47 and USD3.69 trillion (based on a global GDP of USD73.9 trillion in 2015).\textsuperscript{24}

These figures were endorsed in a recent meta-analysis conducted by the United Nations Office on Drugs and Crime (UNODC), which estimated the total illicit financial flows at 3.6 per cent of global GDP or around USD2.7 trillion (adjusted) annually, of which 2.7 per cent or USD2 trillion was available for laundering through the international authorities. The US government successfully forced the disclosure of roughly 4,450 account identities of US taxpayers, leading to a host of penalties and prosecutions as well as a USD780 million fine payable by UBS to the US government. See AJ Cockfield ‘Big data and tax haven secrecy’ (2016) 18 Florida Tax Review 483 508-509.

The 2008 Lichtenstein tax affair originated when a bank employee surreptitiously copied bank records listing over 1,400 customers with anonymous bank accounts. A compact disc with this bank account information was purchased by the German government for €4.2 million, and eventually was transferred to governments and tax authorities throughout the world, leading to audits and prosecutions of non-compliant taxpayers. See Cockfield (n 18 above) 507; M Esterl, G.R. Simpson & D Crawford ‘Stolen data spur tax probes’ The Wall Street Journal 19 February 2008.

According to the European Commission, ‘tax evasion’ generally comprises illegal arrangements where tax liability is hidden or ignored, that is, the taxpayer pays less tax than he or she is supposed to pay under the law by hiding income or information from the tax authorities. ‘Tax avoidance’ is defined as acting within the law, sometimes at the edge of legality, to minimise or eliminate tax that would otherwise be legally owed. It often involves exploiting the strict letter of the law, loopholes and mismatches to obtain a tax advantage that was not originally intended by the legislation.

Quantitative estimates suffer from a number of methodological shortcomings, which are exacerbated by inconsistencies in defining predicate offences (eg legality or otherwise of ‘facilitation payments’ – given to induce foreign public officials to perform an act or exercise a function); terminological uncertainty; and legal grey areas (eg not all jurisdictions agree on the dividing lines between ‘tax evasion’, ‘tax avoidance’ and ‘tax fraud’). Accordingly, the figures cited are imperfect estimates and based on a combination of inferences from macro-economic data and direct information collected by law enforcement agencies, financial intelligence units, and taxation and customs authorities.

financial system – around the midpoint of the earlier International Monetary Fund (IMF) consensus range.25

Of course, not all illicit financial flows are hidden within, or routed through, secrecy jurisdictions. Of the amounts identified above, the Tax Justice Network estimates the total amount of private wealth held in secrecy jurisdictions at somewhere between USD24 to USD36 trillion.26 Other models, based on differing data sets and utilising narrower assumptions, place the total much lower, at around USD7.6 trillion (roughly 8 per cent of global GDP). Even following the most conservative estimates, this results in a global ‘tax gap’ – the difference between tax actually collected and that which is theoretically due and payable – of USD190 billion per year.27

While illicit financial flows and the hidden wealth phenomena are global issues, their impacts are felt disproportionately in the developing world. It is estimated that developing countries lose USD1 trillion each year as a result of corrupt or illegal cross-border deals, many of which involve anonymous companies.28 An Oxfam analysis shows that in Africa alone, approximately 30 per cent of all financial wealth – a total of USD500 billion – is held in secrecy jurisdictions. This is estimated to cost African countries USD14 billion a year in lost tax revenues; enough money to pay for healthcare that could save the lives of 4 million children, and to employ enough teachers for every African child to receive an education.29

At the April 2009 London Summit, G-20 member states again committed to taking action against non-cooperative secrecy jurisdictions. Announcing their capacity and willingness to ‘deploy sanctions to protect our public finances and financial systems’, the G-20 successfully pressured each of the jurisdictions identified by the OECD as being non-compliant with existing international standards on tax transparency to enter into a range of bilateral tax information exchange agreements (TIEAs).30 The Summit was hailed as a watershed moment for global financial transparency, with the G-20 leaders declaring at the conclusion of the

25 UNODC ‘Estimated illicit financial flows’; figures in US dollars (USD) extrapolated from GDP figures and adjusted according to World Bank data as at 2015; see n 23 above.
30 TIEAs were promoted by the OECD as a means for countries to administer and enforce their tax and criminal laws by facilitating the exchange of foreign tax information that can then be used in an examination of a taxpayer.
Overview

Summit that ‘the era of banking secrecy is over’. While arguably premature in light of subsequent critiques of the effectiveness of TIEAs, the G-20’s call for jurisdictions to adopt high standards of transparency and information exchange in tax matters led to the restructuring of the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes and, ultimately, to amendments being made to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, which laid the foundations for the global shift towards Automatic Exchange of Information (AEoI).

6 Political response to the offshore leaks disclosures

Another significant turning point in the global push for financial transparency came in April 2013, when the International Consortium of Investigative Journalists (ICIJ) released the first of what would prove to be several leaks involving vast quantities of financial data taken from within secrecy jurisdictions. The cache of documents comprising the initial ‘offshore secrets’ leaks contained more than 2.5 million records, which revealed the previously secret dealings of over 120,000 offshore companies and private trusts, implicating more than 70,000 people from 170 countries and territories. The leaked data provided a unique insight into the methods by which individuals were using networks of shell and shelf companies in tax havens to criminally evade taxes, launder illegal earnings, and finance cross-border terrorism, and provided objective evidence for the severity of the crimes and abusive practices that could be successfully perpetrated by taking advantage of both a globalised financial system and incomplete and fragmented national tax and financial transparency frameworks.

A lack of knowledge about who ultimately controls, owns and profits from companies and legal arrangements, including trusts, not only assists those who seek to evade tax, but also those who seek to launder the proceeds of crime, often across borders. Shell companies can be misused to facilitate illicit financial flows stemming from corruption, tax evasion

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33 Previously known as the ‘Forum on Harmful Tax Practices’.
34 Measured at 260 gigabytes, the total size of the leaked files obtained by the ICIJ was more than 160 times larger than the leak of US State Department documents by WikiLeaks in 2010. See G Ryle et al ‘Secret files expose offshore’s global impact’ ICIJ, http://www.icij.org/offshore/secret-files-expose-offshores-global-impact (accessed 19 October 2017).
35 As above.
36 See Cockfield (n 18 above) at 485.
and money laundering. The misuse of shell companies can be a severe impediment to sustainable economic growth and sound governance. We will make a concerted and collective effort to tackle this issue and improve the transparency of companies and legal arrangements. Improving transparency will also improve the investment climate, ease the security of doing business and tackle corruption and bribery. It will support law enforcement’s efforts to pursue criminal networks, enforce sanctions, and identify and recover stolen assets.37

The G-8 subsequently committed to taking concrete action, based on a number of principles considered fundamental to the transparency of ownership and control of companies and legal arrangements. These principles later were largely reiterated by the G-20 in adopting the High-Level Principles of Beneficial Ownership at the Brisbane Summit in November 2014.

6.1 G-8/G-20 principles of beneficial ownership

- Beneficial ownership is defined in a way that captures the natural person(s) who ultimately owns or controls the legal person or legal arrangement.
- Legal persons obtain and hold their beneficial ownership and basic information onshore, and that this information is adequate, accurate, and current.
- Trustees of express trusts (and other similar legal arrangements) maintain adequate, accurate and current beneficial ownership information, including information of settlors, the protector (if any) trustees and beneficiaries.
- Relevant authorities have timely access to adequate, accurate and current beneficial ownership information.
- Authorities understand the risks to which their AML/CFT regime is exposed and implement effective and proportionate measures to target those risks.
- The misuse of financial instruments and of certain shareholding structures that may obstruct transparency, such as bearer shares and nominee shareholders and directors, is prevented.
- Financial institutions and designated non-financial businesses and professions (DNFBPs) are subject to effective AML/CFT obligations to identify and verify the beneficial ownership of their customers.
- Effective, proportionate and dissuasive sanctions are available for regulated businesses that do not comply with their obligations.

• National authorities cooperate effectively domestically and internationally to combat the abuse of companies and legal arrangements for illicit activity.

In practice, these principles broadly reiterate requirements regarding the transparency of ownership and control of companies and legal arrangements that already had been in place for many years under the FATF standards. Nonetheless, the commitment to action demonstrated collective buy-in to these issues at the highest political level, and paved the way for further strengthening of regulatory frameworks.

The European Commission sought to capitalise on this momentum, passing the Fourth Anti-Money Laundering Directive (4th AMLD) in December 2014. The new Directive brought the EU framework into line with the revised 2012 FATF Recommendations by extending the scope of the existing regime and strengthening obligations in a number of areas, including the risk-based approach, ongoing monitoring requirements, beneficial ownership identification and record keeping requirements, politically-exposed persons (PEPs), the scope of predicate offences, and third party equivalence. Controversially, the 4th AMLD also included express requirements for EU member states to keep central registries of accurate and current information on the ultimate beneficial owners of legal entities. This requirement went beyond the wording of the final G-8 and G-20 Communiqués, which noted only that central registries were a possible means of achieving compliance, rather than a necessary one. It is unclear at this point how many jurisdictions will follow the lead of the EU in mandating central registries for beneficial ownership information, or how many will choose to make them publicly accessible. The UK and Ukraine already have implemented public registries, while France, The Netherlands, South Africa, Nigeria, Afghanistan, Kenya, Ghana and Denmark have stated their intention to do so. Ireland, Australia, New Zealand, Indonesia, Jordan, Norway and Georgia reportedly are

38 The FATF Standards comprise the FATF Recommendations, their Interpretive Notes and applicable definitions in the Glossary. The FATF Recommendations set out a comprehensive and consistent framework of measures that countries should implement in order to combat money laundering and terrorist financing, as well as the financing of proliferation of weapons of mass destruction. The first iteration of the FATF Recommendations was published in 1990 (‘Forty Recommendations’), and subsequently amended in 2001 to incorporate standards dealing with the issue of terrorism financing (‘Eight Special Recommendations’). In 2003/04, the FATF made revisions to the existing Recommendations, and added a Ninth Special Recommendation (‘40+9 Recommendations’). A comprehensive review was again conducted in 2012, and the Recommendations were expanded to deal with the financing of proliferation of weapons of mass destruction, and to be clearer on transparency and tougher on corruption.

considering doing the same.\textsuperscript{39} The 4th AMLD entered into force on 26 June 2017.

Meanwhile, in July 2016, the European Commission subsequently published further proposed amendments to reinforce the Directive (unofficially termed the 5th AMLD), which \textit{inter alia} will extend the scope of the central registries to include trusts and other forms of legal arrangements and enable public access on the basis of a demonstrated ‘legitimate interest’ (which is to be defined by each member state).\textsuperscript{40} Member states may also choose to grant wider public access at their discretion although, should they do so, they must have due regard to the balance between the public interest to combat money laundering and terrorist-financing (ML/TF) and the protection of the fundamental rights of individuals, in particular the right to privacy and the protection of personal data.

However, these proposals have been strongly criticised in a February 2017 opinion issued by the European Data Protection Supervisor (EDPS), which found that they

significantly broaden access to beneficial ownership information by both competent authorities and the public, as a policy tool to facilitate and optimise enforcement of tax obligations. We see, in the way such solution is implemented, a lack of proportionality, with significant and unnecessary risks for the individual rights to privacy and data protection.\textsuperscript{41}

The principle of proportionality requires that limitations to personal rights and freedoms may only be made if they (i) are necessary; and (ii) genuinely meet objectives of general interest (in this instance, as determined by the EU) or the need to protect the rights and freedoms of others. Accordingly, the EDPS has recommended that access to beneficial ownership information be limited only to those entities in charge of enforcing the law. The proposed amendments remain under review, with both the European Commission and European Council waiting for parliamentarians to agree on their final negotiating positions.

7 Fall-out from the Panama and Paradise Papers disclosures

On 3 April 2016, journalists from 107 media organisations in more than 80 countries released the first wave of stories reporting on 2.6 terabytes of confidential information leaked to the German newspaper Süddeutsche Zeitung from the database of Mossack Fonseca, the world’s fourth biggest offshore law firm. The Panama Papers leak contained 11.5 million documents, representing more data than the US diplomatic cables released by WikiLeaks in 2010; the Offshore Leaks in 2013; the Luxembourg tax files in 2014; and the HSBC files in 2015 combined. The files contained the confidential records of over 214,000 companies, trusts and foundations set up across the 21 secrecy jurisdictions where Mossack Fonseca operates, and detailed the involvement of over 14,000 intermediaries (such as lawyers and tax advisors) who directed their clients to use the firm’s services. These records revealed details of the previously-hidden financial dealings of 12 current and former heads of state; 61 associates of current or former heads of state; and 128 current and former political and public officials.

The political pressure was increased by the recent revelations, by what came to be known as the Paradise Papers, which once again highlighted the need to know who the ultimate owners of opaque vehicles are. There were over seven million documents that were analysed by the International Consortium of Journalists, suggesting that there was more than USD350 billion lost every year by countries in illicit flows. It is still too early to see how governments will deal with the latest revelation.

7.1 G-20 call for action on tax and beneficial ownership transparency

At their meeting on 13 April 2016 in Washington DC, the G-20 Finance Ministers and Central Bank governors called on the FATF and the Global Forum to consider ways of improving the implementation of the international standards on transparency, including on the availability of beneficial ownership information and its international exchange. In September/October 2016, the FATF and the Global Forum outlined their initial proposals:

- Greater emphasis must be placed on beneficial ownership in follow-up processes to both the FATF mutual evaluations and the peer reviews conducted by the OECD Global Forum.
- The Global Forum recently agreed upon new Terms of Reference (ToR) for the second round of peer reviews of the Exchange of Information Rules (EoIR) Standard. The new ToR require that all jurisdictions have access to information regarding the beneficial ownership of entities and
legal arrangements operating in their jurisdictions (as defined by the FATF), and allow for its international exchange for tax compliance purposes.

- This new round of reviews, which has just commenced, therefore will include the assessment of the effectiveness of the implementation of the beneficial ownership standard and should drive forward improvements in implementation.

- Enhanced cooperation between the FATF and the Global Forum to further ensure coherence and mutual reinforcement to ensure work is mutually supportive, and promote clear and consistent recommendations to improve implementation.

- Although the scope of FATF and Global Forum assessments differ, some practical challenges recur in the context of different legal and administrative systems, for instance how to ensure the accuracy of ownership information held in a company registry, or how to enable ownership information to be exchanged between fiscal and law enforcement authorities, in both directions. For this reason, it is important to ensure that countries receive clear and consistent recommendations on how to improve their implementation of the international standards on beneficial ownership for AML/CFT and tax purposes. This minimises confusion on the part of assessed countries about what steps they need to take to improve implementation. The FATF Secretariat and Global Forum Secretariat will map where the respective standards and assessment processes coincide, and consider ways to promote clear and consistent recommendations to countries.

- Engage with relevant bodies to compile and disseminate examples of effective implementation for ensuring the availability, timely access to and exchange of accurate and reliable legal and beneficial ownership information for tax purposes.

The OECD has also indicated its willingness to the G-20 Finance Ministers and Central Bank governors to undertake further work in the tax area relating to beneficial ownership information for legal entities and arrangements. Specifically, the OECD’s contribution, which is designed to complement the FATF and Global Forum’s proposals, would focus on the following components, with progress reported to the G-20 in 2017: 42

- **Gap analysis:** Conduct an analysis to determine whether there are gaps between tax compliance needs (both civil and criminal) for beneficial ownership information, and the relevant FATF standards for AML and, where gaps are identified, suggest possible solutions taking cost benefit considerations into account;

- **Designing structured and electronically searchable data sets of ownership information:** Review the existing data structures and formats used for the US Foreign Account Tax Compliance Act (FATCA) and the Common Reporting Standard (CRS), referred to as ‘FATCA/CRS’, and explore the benefits, costs and issues involved in the wider adoption of the

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42 OECD Secretary-General’s tax report to G20 Finance Ministers, October 2016.
existing FATCA/CRS common structure and related formats for possible use by other repositories of ownership information such as registries, designated non-financial businesses and professions.

- **Domestic access to beneficial ownership information:** Map the current state of play with respect to the legal ability to countries and jurisdictions to share or access beneficial ownership information amongst different agencies domestically, including information received from a treaty party. With the results of this mapping exercise, explore the possibility of improving the sharing of beneficial ownership information between competent authorities as well as other authorities, including tax authorities in their 'civil' tax capacity.

- **Improving international access to beneficial ownership information:** Map the current state of play concerning the legal rules with respect to the ability to obtain beneficial ownership information both in the FATF and tax domains, and evaluating the practical issues associated with the existing framework with the goal of improving international access.

## 8 Conclusion

This is the background against which the chapters in this volume should be read. This publication focuses on the experience of African countries in counteracting illicit financial flows, which include bribery, money laundering, tax evasion and other criminal activities. These studies are part of a broader project on tax and good governance which were undertaken over a three-year period.43

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Numerous papers have been published on illicit financial flows. This includes not only academic papers but policies and reports from international as well as continental and regional organisations and institutions globally. The issue of illicit flows thus are being raised not only at the academic, civil society and public level, but is also discussed by political leaders. There is a growing body of work surrounding the definition of the concept and how much is being transferred which remains disputed. There is also some research into what is being transferred and how it is being moved. This includes research on the global wealth and value chains involved and the methods of transfer through the political, economic, legal and accounting processes in order to facilitate cross-border financial flows. This research has also successfully been made accessible to the general public. Although globally there remains a lack of clarity on certain issues, African states collectively and separately have taken certain steps, first and foremost, building consensus by producing a joint UNECA/AU High Level Panel Report on Illicit Financial Flows (HLP Report). This report reflects the political consensus aimed for by heads of state on the continent. The next almost inevitable step would be to examine how to implement the HLP Report by tracking, controlling and stopping illicit financial flows. The beginning of a meeting of minds between the social, economic, legal, accounting and political domains was a necessity in order to place the issue high enough on a political agenda to release the HLP Report. However, it is now incumbent upon the very same actors and to push for the realisation of legislative, regulation, policy and practical changes.

In light of all the information now available to countries globally and regionally, the issues this chapter deals with are the changes that are actually taking place on the ground in countries to track, control and stop illicit financial flows (IFFs). Some of the key areas that play a part in illicit financial flows include, but are not limited to, anti-money laundering, banking; taxation and corruption. This chapter, however, will be limited to the actions taken in Africa at the international, continental, regional and domestic levels from a treaty, legislative, regulatory, policy and practical perspective on illicit financial flows to establish whether indeed there is change on the continent. Part 1 introduces the issue of illicit financial flows. Part 2 analyses the recommendations made by the HLP Report and
critiques it. Part 3 analyses whether the continent, regions or countries are moving in the direction of countering IFFs based on the recommendations of the HLP Report; what direction is being taken; what steps being considered and implemented and whether they reflect the HLP Report. Part 4 proposes recommendations based on current developments globally on what other alternative or additional steps could be considered by African governments to counter IFFs and Part 5 contains the conclusion.

1 Introduction

Illicit financial flows (IFFs) have been brought onto the international agenda through the reports of think-tanks and civil society organisations in an attempt to understand why countries that are rich in resources remain in a cycle of poverty with growing inequalities.\(^1\) Figures reported are as high as in the trillions of US dollars from developing countries and broken down to 50 to 70 billion US dollars annually from Africa alone.\(^2\) This data has been correlated to public spending and the Millennium Development Goals (MDGs) to show how these losses could have improved living standards if it had been tracked, controlled or stopped.\(^3\) Much of the data that has been released globally has also been with reference to specific cases and information on IFFs and the interconnections in one way or another with many countries globally, and often involve African countries either singly or in groups. The result is that there have been calls to effect changes on the ground.\(^4\)

In addition to the large figures involved and the type of acts undertaken, the stakeholders are also wide-ranging and across the world and it may be said that every single person in the world to one extent or another is included. This includes the users or beneficiaries and the enablers. Beneficiaries of IFFs include, first, the criminals who receive money in exchange for the crime committed and, second, those seeking to merely protect their money due to volatility in their home countries (legally or illegally earned) and, third, those who explore loopholes in the laws and regulations. The enablers include the finance professionals (for example, lawyers, bankers and accountants) involved in the process;

government officials that allow and fail to enforce; and those who deliberately break the law. As a result, concerns raised related to IFFs tend to involve multiple issues, but may be broken down into the act: criminal and non-criminal. Criminal activities involved in IFFs are linked to smuggling (children, arms, narcotics, cash, slavery, stolen art, amongst others); money laundering; corruption; and bribery and tax evasion. Non-criminal activities include the use of loopholes in poorly-crafted or absent laws, regulations and policies.

Smuggling and other criminal activities have been a long-term concern in IFF circles and there are treaties in place as well as diverse organisations and government agencies working on different parts of the issue. However, the financial area has not been addressed as effectively. The non-criminal concerns remain completely ignored. As a result, initially, tax administrations reacted swiftly across the continent with the realisation of the necessity of cross-border tax audits which had never before taken place in neighbouring countries. However, IFFs cannot be a silo placed into one department or one part of a government but, rather, concerns all sectors of government and governance.

While this research and public activism have been ongoing, it has also reached the politicians and policy makers, globally and in Africa. Since 2012, the African Commission on Human and Peoples’ Rights (African Commission), the African Union (AU) and the United Nations Economic Commission for Africa (UNECA) have continued to raise the issue of IFFs to the level of the heads of state of the continent, first through a series of resolutions, then at the Tana Forum in 2012, then through a joint audit

6 FATF, Egmont Group, OECD, WB, IMF, UN, StAR, among others.
9 Action Aid Calling time on tax avoidance (2010).
of several tax agencies on the continent\textsuperscript{12} and, most recently, in 2015 through the release of the report of the High-Level Panel on Illicit Financial Flows (HLP Report).\textsuperscript{13}

The HLP Report breaks new ground, not only for the African continent, but also for other developing countries and the world. It has made strong recommendations and taken a clear stand on the issue of IFFs that has globally caused ripples. However, enforcement continues to be a weak point. This chapter will reflect on the HLP Report; take stock of the recommendations made in the HLP Report and critique it; and analyse the changes that have taken place since the release of the report in 2015 to establish the level of enforcement that has taken place on the continent as a result of the HLP Report.\textsuperscript{14}

2 Unpacking the magnitude of illicit financial flows in Africa and the HLP Report

The HLP Report used figures from several authors to set out the magnitude of the problem. Global financial integrity was its main point of reference on the magnitude of IFFs. It supported its approach by quoting Global Financial Integrity’s (GFI) data that between 2005 and 2014, IFFs from the south were 4.6 to 7.2 per cent of developing countries’ total trade, while such inflows were 9.5 to 16.8 per cent, with about 3.3 per cent of IFFs over this period being attributed to fraudulent trade mis-invoicing or ‘transfer pricing’. They state that since 2012, emerging and developing countries have lost over a trillion dollars yearly that could have been invested productively in industry, agriculture, healthcare, education or infrastructure. The breakdown of where these IFFs are most prevalent in developing countries is as follows: transnational criminal activities (counterfeiting (USD923 million to USD1.13 billion)); drug trafficking (USD426 billion to USD652 billion); illegal logging (USD52 billion to USD1.13 billion)).


\textsuperscript{13} Within regional groups of countries, a joint audit was conducted of SAB Miller, a UK multinational corporation (MNC) by the tax officials of South Africa, Ghana, Zambia, Tanzania and Mauritius. Action Aid, ‘SABMiller to face tax audit in five African Countries’ ActionAid UK.

\textsuperscript{14} AU/UNECA ‘Report of the High-Level Panel on Illicit Financial Flows from Africa’.

\textsuperscript{14} As above.
USD157 billion); human trafficking (USD150.2 billion); illegal mining (USD12 billion to USD48 billion); illegal fishing (USD15.5 billion to USD36.4 billion); illegal wildlife trade (USD5 billion to USD23 billion); crude oil theft (USD5.2 billion to USD11.9 billion); small arms and light weapons trafficking (USD1.7 billion to USD3.5 billion); organ trafficking (USD840 million to USD1.7 billion); trafficking in cultural property (USD1.2 billion to USD1.6 billion); thus totaling somewhere between USD1.6 trillion and USD2.2 trillion. The GFI report estimates that developing countries lost between USD620 billion and USD970 billion in illicit outflows in 2014. IFFs from the south are estimated at 4.2 to 6.6 per cent of total developing country trade for 2014, while inflows were 9.5 to 17.4 per cent. Total IFFs of all developing countries in 2014 were estimated at USD2.01 to USD3.507 trillion.15

GFI estimates have been criticised, for instance, for making unrealistic assumptions about trade-related transport costs and ignoring other explanations for 'errors'. For example, estimated GFI outflows include IFFs and trade mis-invoicing estimated from inconsistencies in trade data. Despite these weaknesses in data, there are other general concerns that further limit the validity of the data and will more likely result in them being higher than is being stated. IFFs can only be calculated correctly if all the figures are passing through formal institutions such as banking institutions, or customs databases where they may be documented. Globally, however, cash payments are still prevalent and in Africa as well as other developing countries it is not merely cash but barter trade in the micro, small, medium and/or large-scale, depending on the individual transaction. For example, the exchange of ivory for small arms is a well-known transaction on the African continent.16 As a result, no exact figures on IFFs in reality are available to measure the true extent of IFFs. The GFI figures set out above that are now infamous are those of the billions and trillions. However, these are limited in different ways to trade mis-invoicing mis-pricing or even customs data. Criminal activities and their financing remain undetermined.

When it comes to actual state-collected data, many African countries, notwithstanding, do not release their actual books of accounts or budgets. The reasons given include that, because loan terms are so heavy, the state is attempting to retain more money for development; hiding corruption; or even a failure to keep proper records. In 2016, the Zimbabwean Commissioner-General for Taxation was suspended and investigated

15 GFI Illicit financial flows to and from developing countries: 2005-2014.
regarding issues of corruption.\textsuperscript{17} He later resigned in 2017.\textsuperscript{18} Countries in conflict or those that have in the past had sanctions may not have accounted at all for certain periods. A recent publication on African data analysis excluded Zimbabwe and Somalia: Zimbabwe due to a lack of access to data for the period when they were subjected to sanctions; and Somalia also lacked access as they were and still are involved in a civil war.\textsuperscript{19}

There is no data at all on treaty-shopping and abuse for the following reasons: First, no cost benefit analyses have to date been carried out by African countries to actually assess this before a treaty is signed or even periodically after signature to ensure continued relevance and validity of the treaty and the effect of the abuses and shopping. However, Tanzania recently passed a law requiring that this be carried out in future not only before exemptions are granted, but also for capital expenditure separately in the mining sector.\textsuperscript{20} However, since tax havens or secrecy jurisdictions do not allow access to beneficial owners, one cannot ascertain the true owner of a corporation and its structure in order to do a more detailed analysis. The unpacking of this data continues to occur only through the work of leaks and global scandals, such as LuxLeaks;\textsuperscript{21} Swiss Leaks;\textsuperscript{22} WikiLeaks;\textsuperscript{23} the Panama Papers;\textsuperscript{24} and, more recently, the Apple-Ireland case\textsuperscript{25} and the Paradise Papers.\textsuperscript{26} The HLP Report uses this type of data as this is all that is currently available, but one must remain fully aware that the figures, while at best only estimates, seem to be estimates only of one part of the entire amount of IFFs flowing into and out of the African continent.

With this background in mind, the AU tasked a high-level panel, chaired by Thabo Mbeki, to examine IFFs and their impact on Africa’s

\textsuperscript{17} ‘#Zimbabwe Revenue Authority (ZIMRA) Commissioner General, Mr Gershom Pasi Suspended’ Zimbabwe Today (blog), 6 May 2016, https://zimbabwe-today.com/zimra-commissioner-general-suspended/ (accessed 14 December 2017).


\textsuperscript{19} Waris and Kohonen (n 3 above).

\textsuperscript{20} N Woodroffe et al Tanzania’s new natural resources legislation: What will change (2017) 6.


\textsuperscript{24} ICJ ‘The Panama Papers’,


The mandate of the panel was to determine the nature and patterns of IFFs from Africa; to establish the level of IFFs from the continent; to assess the complex and long-term implications of IFFs for development; to raise awareness among African governments, citizens and international development partners of the scale and effect of such financial outflows on development; and to propose policies and mobilise support for practices that would reverse such illicit financial outflows.

The report recommended that there should be a unified global architecture on the issue of IFFs in the form of a UN declaration on the issue of IFFs; that IFFs are to be included in the post-2015 Development Agenda; and that Africa should initiate steps for the UN to adopt a unified policy instrument on IFFs. On the issue of the methodology to achieve the recommendations, the report suggested that, in order to control and stop IFFs out of the country, with specific reference to multi-national enterprises (MNEs), mis-invoicing, the arm’s length principle and transfer pricing needed to be addressed. This effectively ties in with the international debates on base erosion and profit shifting (BEPS) that includes both the legal and illegal activities that MNEs are engaged in.

One of the immediate results of the HLP Report was that the AU raised the issue of IFFs to the presidential level and tasked itself, with the support of UNECA, to begin to work on the issues and the impact it was having on the continent as well as recommending changes required in law and policy. UNECA subsequently released a report by reassessing the data and recalculated the figures using its own methodology. It also began unpacking the IFF data available to set out the region most affected, the countries with the weakest fiscal systems and the sectors with the highest number of IFFs.

Since the release of the HLP Report, there have been attempts to assess the figures by UNECA as well as the United Nations Conference on Trade and Development (UNCTAD). The conclusion currently is that the IFFs from the African continent annually comes to between USD50 and USD70 billion per annum.

3 HLP definition of IFFs and priority areas of IFF losses

The definition of IFF remains contentious globally. The most common definition in the literature is the legalistic interpretation of IFFs, which suggests that IFFs refers to money that is earned, transferred or used in

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contravention of existing laws. In some cases, this money is earned illegally, such as through organised crime; money laundering; drug trafficking to embezzlement; terrorist financing; and bribery. In other cases, the money could have been earned legally but transferred out of the country illegally by circumventing currency controls or customs control. An example of customs fraud is trade mis-invoicing involving buyers and sellers presenting fraudulent documentation to customs officials. These persons falsify the value of their trade by under or over-invoicing their trade documents so as to be less or more than the actual market value in order to circumvent the payment of customs duties. In other cases, money could have been earned legally, but the tax on the same is evaded through illegal means of not complying with countries’ tax laws, for instance, by deliberately falsifying tax returns and books of account. Criminal prosecution is required to apprehend the perpetrators of the above illegal activities.

In terms of the legal interpretation of IFFs, tax evasion, which is illegal, forms part of IFFs. However, tax avoidance is considered not to fall under IFFs, since tax literature defines it as involving the arrangement of one’s affairs to pay less tax by utilising loopholes in tax laws and exploiting these within legal parameters. This interpretation is backed up by earlier British court decisions, such as *Duke of Westminster* that held the view that ‘every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be’, and that no legal or moral obligation rests upon a taxpayer to pay higher taxes than he or she is legally bound to under the law.

An alternative approach used by many analysts of IFFs is to define these more broadly, based on the understanding that ‘illicit’ does not refer only to the illegal. Indeed, the *Oxford English dictionary* defines illicit as ‘not authorised or allowed; improper, irregular; esp not sanctioned by law, rule, or custom; unlawful, forbidden’, which is much broader than only the

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29 RW Baker, *Capitalism’s achilles heel: Dirty money and how to renew the free-market system* (John Wiley & Sons, 2005). Raymond Baker has witnessed the free-market system operating illicitly and corruptly, with devastating consequences. In Capitalism’s Achilles Heel, Baker takes readers on a fascinating journey through the global free-market system and reveals how dirty money, poverty, and inequality are inextricably intertwined. Readers will discover how small illicit transactions lead to massive illegalities and how staggering global income disparities are worsened by the illegalities that permeate international capitalism. Drawing on his experiences, Baker shows how Western banks and businesses use secret transactions and ignore laws while handling some $1 trillion in illicit proceeds each year. He also illustrates how businesspeople, criminals, and kleptocrats perfect the same techniques to shift funds and how these tactics negatively affect individuals, institutions, and countries.


illegal. According to this view, excessive tax avoidance practices should be seen as improper and/or not sanctioned by custom, especially given the backlash against such practices illustrated by the public outrage against illegitimate but legal commercial activities in the wake of the 2008/2009 global financial crisis, when non-governmental organisations (NGOs) raised concerns about companies paying little or no corporation tax in the countries where they do business. This prompted investigations by the United Kingdom on corporations such as Google, Amazon, Starbucks, Thames Water, Vodafone and Cadbury (before the takeover by Kraft), which revealed how these companies used aggressive tax avoidance schemes to shift profits to low-tax countries. This was seen as a failure to live up to the expectations of societal norms. In line with this second definition of ‘illicit’ above, aggressive tax avoidance practices by a multinational enterprise (MNE) would thus be deemed illegitimate and falling under the broad interpretation of IFFs.

The HLP Report brought consensus from an African perspective by defining illicit financial flows as

money that is illegally earned, transferred or utilised. These funds typically originate from three sources: commercial tax evasion, trade misinvoicing and abusive transfer pricing; criminal activities, including the drug trade, human trafficking, illegal arms dealing, and smuggling of contraband; and bribery and theft by corrupt government officials.

This broader definition of IFFs seems to be truer to the meaning of ‘illicit’. An even more powerful argument for including aggressive tax avoidance in illicit financial flows is that it should be considered as harmful and, therefore, illicit, due to the negative impact that it has on development. Therefore, it needs to be measured, tracked and stopped. From a practical point of view, given that tax avoidance and tax evasion both result from weak tax laws (that are difficult to interpret and enforce in the case of tax evasion), it would seem important to measure tax avoidance along with tax avoidance in order to give a full appreciation of a country’s losses due to weaknesses in its tax system. In addition, in many cases it is impossible for the researcher to tell, with the data currently publicly available, whether a particular flow represents tax evasion or tax avoidance, which is another argument for measuring them together.

However, the reason that this broader definition was not only chosen by the HLP Report, but why it continues to be relevant and important is

35 Christian Aid ‘Death and taxes’ (London: Christian Aid, 2008).
made clearer through the information emerging in the past two years. Research conducted, for example, on transfer pricing in Africa reveals that only 18 countries have transfer pricing legislation. This would mean that there is no law regulating transfer pricing in the remaining 36 countries of the continent. Based on this alone, it would mean that the IFFs out of African countries that are not at all documented would be any type of transfer pricing arrangement carried out in these 36 countries where it is neither legal nor illegal: Tax planning thus comes in to take advantage of this weakness in the law in structuring companies to either reduce their tax burden or to whiten their black money through corporate structures. 37 This single example, coupled with barter trade as well as cash movements across the continent, highlights why inclusion of tax avoidance in the discussion on IFFs becomes so crucial for the definition of IFF and the need to develop regulatory systems on the African continent.

4 African measures countering illicit financial flows

The HLP Report identified three fields of reform at different geographical levels. This chapter, accordingly, will assess what changes have taken place in anti-money laundering (AML); taxation and corruption in the past two years during and after the release of the report at several levels: globally, continentally, regionally and domestic where possible in their relationship with IFFs.

Without specific reference to African involvement, there already has been some actions taken globally. The United Nations Office on Drugs and Crime (UNODC), after producing a report, 38 passed a resolution titled ‘Strengthening international co-operation’ in preventing and combating illicit financial flows linked to drug trafficking, from the anti-money laundering perspective. 39 There also has been much activity at the level of the UN Tax Committee as well as at the OECD. However, at the level of corruption globally, there has been no clear global approach or activity with the actions being undertaken being part of other actions, such as anti-money laundering or tax evasion and avoidance. It has been limited mainly to domestic activity of states and practitioners in conferences with

38 Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes (Vienna 2011).
calls for action, but no specific conventions or policy and, on the other hand, groupings of states like the G20 and G30 (through the OECD).

4.1 Global level recommendations

The global recommendations of the HLP Report were two-pronged. The first was to guide Africa on what stand it should take at international fora and actions they ought to spearhead. The second was with reference to the approach African states should take in their bilateral and multilateral relations with non-African states and their global partners. As a result, this section is divided into these two sub-sections in order to unpack the status of the recommended measures.

4.2 African action on the global level

The HLP Report called for a UN declaration on the issue of IFFs in Africa and that it should initiate steps for the UN to adopt a unified policy instrument on IFFs. However, to date this has not taken place and there has been no action from African states to draft either a declaration or policy instrument to be taken forward to the UN. However, in February 2016 the High-Level Panel on Illicit Financial Flows (HLPIFF) discussed its findings with UN member states at a special briefing of the UN Economic and Social Council (ECOSOC).40

In June 2015, after the release of the HLP Report, the AU passed a special resolution on IFFs,41 where it asked UNECA, the African Development Bank and regional economic communities (RECs) to submit annual reports on the progress of the counter-measures to IFFs.42 These reports, however, have as yet not been released and should have been available after June 2016. However, despite several attempts to inquire into the status of this report, nothing has as yet been released.43 The same resolution also called for the AU, UNECA and the African Capacity Building Foundation and other development partners to build capacities of AU member states and institutions, particularly in contract negotiation, tax management, regulatory and legal frameworks, policies, money laundering, asset recovery and repatriation, and resource governance for effective and optimal management and governance of African natural

42 African Union (n 33 above) para 4.
43 The author contacted the AU in late 2006 and was told that once it was ready, the report would be online, but the website accessed on 30 October 2017 showed no report release.
resources. The negotiations here seem to be ongoing, but there has been no official statement on the progress.

The same AU resolution also reiterated that the issue of international cooperation on IFFs be raised in the post-2015 Development Agenda. This was done and, although the Addis Ababa report of 2015 does make reference to IFFs, African states failed to achieve the creation of a UN tax body which could have taken the form of an upgrade of the UN Tax Committee. Interestingly, the countries that broke the deadlock in Addis Ababa included South Africa and Ethiopia, reflecting the fact that, despite the passing of the AU resolution, the actual coherence of a single African standpoint seems out of reach as domestic and possibly regional concerns continue to trump the continental concerns. However, despite this setback, the Addis Ababa tax initiative was set up to build capacity, and African countries that joined include Ethiopia, Liberia, Sierra Leone and Malawi.44

The report also recommended that the international community eliminate secrecy jurisdictions, introduce transparency in financial transfers and crack down on money laundering, and that there be stronger collaboration between Africa and the US, EU, G8 and G20 for greater transparency in international banking and the UN, the International Monetary Fund (IMF) and World Bank to play a more coherent and visible role in tackling IFFs. This seems not to have taken place as yet, although negotiations seem to be ongoing.

### 4.3 Bilateral relations between African and non-African countries and institutions

In the bilateral relations between African and non-African countries and institutions, several specific recommendations were made by the HLP Report. In addition, several other activities continued to take place. These recommendations are a combination of banking and taxation with criminal implications. A series of technical recommendations were made in the HLP Report, some of which already were being implemented.

#### 4.3.1 Mis-invoicing and the Bank for International Settlements

In the case of mis-invoicing, the HLP Report requested that the Bank for International Settlements (BIS) publish the data it holds on international

banking assets by country of origin and destination in a matrix format, along the lines of the data published by the IMF for bilateral trade; foreign direct investment (FDI) and portfolio investment, so that it can inform the analysis of IFFs from Africa.\textsuperscript{45} It remains unclear whether any attempts have been made to contact the BIS requesting a change to its data matrices. However, a brief analysis of their website in June 2017 revealed that the data still was not available according to the parameters outlined in the HLP Report.

\textbf{4.3.2 Arm’s length principle and free access to comparables databases}

In order to resolve issues of the arm’s length principle availability of comparable pricing data on goods and services, national and multilateral agencies are to make fully and freely available, and in a timely manner, data on the pricing of goods and services in international transactions, according to accepted coding categories. This remains unresolved. However, several African countries have purchased access to pan-European databases. Kenya in 2011 purchased the database on comparables, and the initial use was regarded as successful,\textsuperscript{46} South Africa since 2012 also has had access to a comparable database.\textsuperscript{47} The only other countries that currently have access in Africa are Algeria\textsuperscript{48} and Uganda.\textsuperscript{49} The African Tax Administration Forum (ATAF), however, currently is investigating the possibility of the purchase of a database for collective use.\textsuperscript{50}

The use of the information from the pan-European databases continues to be contested and, despite this recommendation, it remains unconvincing whether the databases really are of any long-term use at all.\textsuperscript{51} Examples of the use of the database in Kenya seem to be providing

\begin{itemize}
\item \textsuperscript{50} As above.
\end{itemize}
mixed results.\textsuperscript{52} However, there is a need to build local databases, but it remains unclear as to which actions are being taken in this regard.

### 4.3.3 Publicly-available disaggregated MNC financial information

In relation to states outside Africa, the report recommended that partners should require: publicly-available disaggregated financial information on their MNCs; require beneficial ownership information for incorporation; elaborate a global governance framework for asset freezing, management and repatriation. Thus far, this is being discussed in the Base Erosion and Profit Shifting (BEPS) project at the OECD and the UN Tax Committee and the actions vary based on whether there is an existing agreement with the partner country for the exchange of information.

In the case of Kenya, a request for information provided a positive response from the UK but a negative response from Germany.\textsuperscript{53} This illustrates that there is a lack of clarity on the types of information that may be requested and how to make a request, as each country still follows a different domestic law-governed process. However, it identified the need to have a coherent and single approach to access to information and more work on transparency from an African perspective on what all companies working with African states ought to do. Perhaps a template on the exchange of information from an African perspective would be one way of resolving this and bring certainty into the discussions. A global endeavour to counter some issues related to this includes the development of a rule on country-by-country reporting. However, despite this, the recent Kenyan experience shows that even in EU states there is no coherent understanding of what information should be shared despite the OECD having standard forms.

### 4.3.4 Transparency and public debt audits

An interesting development on the side of lenders is the Norwegian government’s plan for an independent audit of all its bilateral debts owed by seven developing countries.\textsuperscript{54} Norway has been in the forefront of efforts to address issues of odious debt. The countries whose debts to Norway will be audited include Egypt, Somalia, Sudan and Zimbabwe. The aims of the audit are to promote financial transparency and to test the new UN Principles on Responsible Lending and Borrowing, which were launched by the United Nations Conference on Trade and Development (UNCTAD) in 2012.

53 As above.
54 IH Kvangraven ‘Exportable’ in How to make the Norwegian debt audit transferable to other countries. Oslo, Norway: The Norwegian Coalition for Debt Cancellation (SLUG) (2012).
5 Continental and regional level multilateral agreements

Continental-level conventions offer a framework to work towards the harmonisation and co-ordination of national initiatives. The most comprehensive existing framework is the African Union Convention on Preventing and Combating Corruption. A further area in which regional groupings could take a lead in cooperating is in the use of customs data. First, by sharing trade price data, countries automatically expand the data set against which they can judge and identify abnormal pricing – and this can be done in real time. Second, in the Open Government Guide ‘follow-the-money’ partnerships, working with major trading partners to identify abusive pricing happening at each end of the same transactions. Starting such a process on a regional basis could in its own right be powerful, and also provide a demonstration to other trade partners of the value of cooperation. Joint audits, as are being spearheaded by the ATAF, also need to continue through the sharing of technology and databases at the regional and continental levels, and the automatic exchange of tax information among African countries. This is partially being dealt with by the ATAF.

5.1 Domestic level recommendations

At the domestic level, the HLP Report made several recommendations. This section will not only canvass the recommendations made by BEPS and the HLP Report, but also additional attempts that are being made by African countries. The section is divided into two: the technical issues that need reform and the administrative reforms.

5.1.1 Technical legal and policy reforms

There have been several reforms of law and policy that have been clearly identified as crucial to reduce and prevent IFFs. These include transfer pricing; beneficial ownership; country-by-country reform; and the review of tax treaties.

First, each African country should establish a transfer pricing laws and policy. Currently, only 18 African countries have transfer pricing laws in their domestic frameworks. This means that whether or not there is a double taxation agreement (DTA) in place on a cross-border tax issue, there still is no possibility of monitoring issues of transfer pricing without

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a clear legislative framework in place. The reform of this law with its required regulations will mean that African states should require multinational corporations operating in their countries to provide the revenue authority and/or their transfer pricing units with a comprehensive report showing their disaggregated financial reporting on a country-by-country or subsidiary-by-subsidiary basis. African governments could also consider developing a format for this reporting that would be acceptable to multiple African revenue authorities, which would allow for the cross-border assessment of the growing African owned multinational enterprises (MNEs). An Angolan transfer pricing regime was introduced by Presidential Decree 147/13 on 1 October 2013, applying to all domestic and cross-border commercial transactions entered into between qualifying taxpayers and related entities from 1 January 2013. Order 599/14 of 24 March 2014 sets out a list of ‘major taxpayers’ and their requirements to prepare a transfer pricing report. The transfer pricing rules present a number of challenges for affected taxpayers, including a requirement that transfer pricing documentation should be prepared in Portuguese.

Second, intentional or inaccurate stating of price quantity, quality or other aspects of trade in goods and services to manipulate or evade taxation should be made illegal. This could take the form of strengthening the general anti-avoidance rule (GAAR) in a country. However, there should also be high penalties for the failure to do so as well as criminal sanctions on chief executive officers, directors and their accountants, auditors and lawyers. National legislations not always agree on what is considered a prosecutable financial offence, and this opens avenues for agents to evade taxes, to move money illegally across borders and launder it in banking systems. For example, a case study on Botswana, Tanzania and Zambia found that, while Zambia recognises abusive transfer pricing as a crime, the other two countries do not. The harmonisation of legislation across countries is necessary to close avenues for ‘criminal arbitrage’ across national boundaries.

Third, the registry of companies should be bolstered and digitised and there should be a clear register of companies for tax purposes where domestically-registered companies and their foreign-related party data ought to be accessible.

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56 The Tanzanian Regulations allow for unilateral, bilateral and multilateral APAs, which are valid for a maximum period of five years, subject to annual compliance requirements.


Fourth, customs should use available databases to compare prices. This currently is not in place, and the assessment remains based on an *ad hoc* and often case by case basis relying on documentation like receipts, although the customs officials in some countries check online prices in making an assessment of goods. The World Customs organisation have a role to play in this, which to date remains unoccupied as no institutions have come forward to take up this role as yet at a global level.

Fifth, states ought to start collecting trade transaction data. National and multilateral agencies ought to make fully and freely available, and in a timely manner, data on the pricing of goods and services in international transactions. It is not clear whether any countries are specifically doing this. However, the open data revolution currently taking place has opened up much information that still leaves out much transactional data. Since banks already do this through the central bank clearing centre, extending this should not be difficult to enforce with joining of the databases of the central bank and with the revenue authority to triangulate the issue.

Sixth, automatic exchange of tax information globally, subject to national capacity and attention to necessary confidentiality. In several African countries there have been steps to pass freedom of information legislation which would allow the revenue authority (RA) in principle to access the necessary data domestically. However, this remains untested. In addition, there are discussions on the global accessibility of information to which African states have added their call internationally, but no similar issue has been raised domestically. This possibly is as a result of there being a presumption that African countries mainly will be the recipients of information. However, in reality, several African countries, including Egypt, Nigeria, Algeria, South Africa and Tunisia, will be suppliers of information as they also house home-grown MNEs.

Seventh, beneficial ownership information should be provided when companies are incorporated or trusts and foundations are registered. The current status in most African countries is that the companies’ registries are not updated and the digitisation is not complete. In some countries, such as Kenya, this process has been pending for almost 20 years. The result is that the issue of a repository that is reliable, up to date and easily accessible, becomes a problem and, with the added nuance of a beneficial ownership registry, the structures remain uncrystallised and laws enabling the collection of this data in most cases have not even been drafted.

Eighth, thus far there seems to have been discussions on country-by-country reporting in the ATAF and, as a result of the Davis Committee recommendations, South Africa has commenced with the implementation of the Country by Country (CbC) Reporting Standard by the South African
Revenue Service (SARS) will come into effect through regulations this year.\(^6^0\)

Ninth, the review of current and prospective double taxation conventions, particularly those in place with jurisdictions that are significant destinations of IFFs, to ensure that they do not provide opportunities for abuse. Since the discussion on treaty review came to the forefront, Mauritius has reviewed its treaty with India. Rwanda revoked its treaty with Mauritius and subsequently signed a revised version which allowed for the taxation of management services in Rwanda before the repatriation of the amount to Mauritius. In Mozambique, the government ceased to sign tax treaties and has started reviewing old treaties, starting with the treaty with the tax haven of Mauritius. In Nigeria, the Senate and National Assembly raised queries regarding tax incentives and the granting of pioneer status to companies, and one of the nation’s anti-corruption agencies took a special interest in the processes for granting incentives. Nigeria’s National Assembly issued a directive that the new tax treaties should go to parliament for review.

Tenth, regional integration arrangements to introduce accepted standards for tax incentives to prevent harmful competition in the effort to attract foreign direct investment should be used. Currently there are discussions in the separate regional blocs of the East African Community (EAC), Southern African Development Corporation (SADC), Economic Community for West African States (ECOWAS), the Magreb as well as Common Market for East and Southern Africa (COMESA) to set up the joint sharing of data as well as a shared model double taxation agreement (DTA) developed in the East African Community (EAC). Many countries also are members of ATAF. The harmonisation of legislation across countries is necessary to close avenues for ‘criminal arbitrage’ across national boundaries.

Eleventh, policy activities, such as a national action plan to counter IFFs, should be developed. Thus far, in Africa the only countries to develop a plan include Burkina Faso, Kenya, Liberia, Mauritius, Niger, Senegal and Sierra Leone. In addition, these countries are part of the Partnership on Illicit Finance that include Burkina-Faso, Kenya, Liberia, Mauritius, Niger, Senegal, Sierra Leone and the US.\(^6^1\)

Finally, join such initiatives as FATF and EITI Institutional support for these measures. Most African countries already are members of the regional bodies under the FATF, including Eastern and Southern Africa.


Anti-Money Laundering Group (ESAAMLG), Middle East and North Africa Financial Action Task Force (MENAFATF), Inter-Governmental Action Group Against Money Laundering in West Africa (GIABA) and Task Force on Money Laundering in Central Africa (GABAC). Only 17 countries are Extractive Industry Transparency Initiative (EITI) compliant with four in the process of implementation and one suspended.

5.1.2 Administrative reforms

The HLP Report listed out in detail that there was a need to establish or strengthen the independent institutions and agencies of government responsible for preventing IFFs. Included (but not limited to) are financial intelligence units; anti-fraud agencies; customs and border agencies; revenue agencies; anti-corruption agencies; and financial crime agencies. All these agencies should render regular reports on their activities and findings to national legislatures. Methods should be created for effective information sharing and co-ordination among various institutions and agencies. Robust mechanisms should be put in place for supervision of banks and financial institutions.

First, setting up the institutions and then putting them in close co-ordination with each other is crucial. The effectiveness of national initiatives in combating financial crimes often is hampered by inadequate co-ordination, harmonisation, and cooperation across African countries. Such discrepancies are widespread across the continent. The framework of collaboration needs to be among anti-corruption agencies, anti-money laundering agencies, financial intelligence units, and specialised offices across other branches of government, including the central bank, the police, customs services, immigration services, mining and trade ministries and company registries. They also need to equip their foreign missions (embassies and official representations at multinational institutions) to operate as centres for collection and dissemination of information on financial crime. This cross-agency co-ordination needs to be organised along the entire length of the ‘information value chain’, from the detection of suspicious activity to investigation, all the way to prosecution. At present, efficiency often is hampered by rigid specialisation and the compartmentalisation of responsibilities and agency mandates. For example, it often is not clear whether the role of the tax authorities is restricted to investigating the offence of tax evasion, or whether it extends to the investigation of associated crimes such as money laundering and the predicate offences that generated the funds. This lack of clarity on the institutional mandate hampers effective deterrence and prosecution of financial crime. In Swaziland, Shanmuga Rethenam, the director of the defunct iron ore mine, Salgaocar Swaziland, is wanted for a series of crimes, including fraud, tax evasion and theft of close to E1 billion, and has

62 This was the purpose of the July 2016 conference in Pretoria.
been charged by the Deputy Public Prosecutor.63 In South Africa, tax
amnesties were being granted to South African nationals with illicit
finances abroad. The first offshore exchange control and income tax
amnesty appeared in 2003, and a second similar amnesty followed in 2010,
with a third announced in the 2016 budget speech. However, in April 2016
the national bank announced that South Africans with illicit offshore
portfolios are not likely to get another amnesty.64

Second, a section focused on international tax issues as well as transfer
pricing should be created. Only nine African countries have transfer
pricing units, with the remaining countries, such as Rwanda, opting not to
have one as they are not adequately staffed to collect tax generally.
Transfer pricing units should as a matter of extreme urgency be situated in
revenue authorities and should be well equipped in accordance with global
best practices. Establishing transfer pricing units may entail the training of
a selection of existing revenue officers in this specialised area. However, as
pointed out, after an initial windfall it remains unclear whether the training
will provide any additional revenue. Despite this, there remains a necessity
for revenue authority staff to have a thorough understanding of the transfer
pricing in order to remain vigilant.65

Third is the employment and building capacity of more staff dealing in
these key sectors. While African countries have undertaken a number of
efforts to combat corruption, money laundering, tax evasion and illicit
financial flows, the scope of these efforts and their degree of effectiveness
remains uneven. Even where relevant agencies have been established, they
often face serious financial, technical and human capacity constraints.
Recently South Africa collaborated with Kenya, Malawi and Rwanda on
different types of capacity-building initiatives.66 Moreover, efforts often

64 IOL Reporter ‘No more breaks for tax dodgers | IOL Business Report’ 18 April 2016, http://www.iol.co.za/business/news/no-more-breaks-for-tax-dodgers-2010949 (accessed 18 August 2017). Where the owner wants the funds to remain offshore, there is a 10% penalty on funds that are in breach of exchange control regulations. If the funds are remitted back to South Africa, only a 5% penalty is payable. These penalties must be paid from the offshore funds and where there is a lack of available offshore cash, such as for property holdings, the penalty can be paid from rand-based sources, but an extra 2% additional penalty is added. ‘There are, of course, also tax implications, with National Treasury advising that 50 per cent of taxes owing would be due and payable for the last five tax years. This is a point on which some clients may need professional tax opinion as there has been no detail given as to how this 50 percent would be computed.’ ‘Interest would be charged on outstanding taxes, but no penalties would be levied. It is presumed that applicants would need to re-open previous assessments on their SARS E-filing profile and resubmit tax returns for these periods,’ he notes. This amnesty application period ran for six months from 1 October 2016.
are spread too thinly across a multitude of agencies, with little systematic co-ordination and few synergies among them.67

Finally, improving governance. Ultimately, mechanisms for combating financial crimes must be part of the broader agenda for improving economic and political governance on the continent. The effectiveness of mechanisms for combating financial crime is contingent on the quality of information and the capacity to generate and manage this information. Such capacity is in short supply in the majority of African countries. Most countries lack an adequate stock of qualified forensic statisticians, investigators and financial crime prosecutors. They also lack adequate supply of specialised technology and equipment for collecting, processing, and storing specialised information on financial crime. African governments, therefore, need to invest in capacity building in the investigation and prosecution of financial crime. African countries recognise the importance of tackling IFFs, especially money laundering. Various countries have taken steps to establish legislation and tighten existing laws and create anti-IFF mechanisms. African countries have membership of the Inter-Governmental Action Group against money laundering in the sub-regions; the Financial Action Task Force; the Financial Crimes Enforcement Network; and the Egmont Group of Financial Intelligence Units.

However, despite action with regard to the issue of IFFs, Egypt still is unable to recover an estimated USD11 billion believed to have been transferred illicitly from the public purse during the era of the former President Hosni Mubarak to Switzerland as well as other countries in the European Union (EU) and the US.68 However, there are encouraging signs and some successes: Nigeria, leading on the IFF share, is also credited as representing the single most successful case of asset recovery by a state: USD2.3 billion illicitly transferred by Abacha has been recovered. However, even this recovery took 10 to 16 years for the two countries to finalise and, thus, while the money may have been returned, it should never in the first place have been accepted, and the earnings the banks made from the money should also be returned to the countries whose

67 A Ennouri ‘Tunisian President Moncef Marzouki refuses to increase investment in IMF’ Tunisia Live 28 June 2012.
money it was. The ‘know-your-client’ principle the banks are supposed to use seems to have little or no weight in these types of scenarios. No bankers have been charged for any illegal acts despite the return of the money.

More recently, the Tunisian government has challenged the legitimacy of debts inherited from the Zine el-Abidine Ben Ali regime. In 2012, President Marzouki refused to endorse a proposal for an increase in Tunisia’s quota share in the IMF (by about USD370 million), pending the passage of a Bill to audit the debts incurred under the Ben Ali regime. The Bill would authorise an investigation to determine whether these debts were used in the interests of the country or as an ‘instrument of dictatorship and repression’, in the words of the new President. If Tunisia follows through with an audit of the Ben Ali debts, this will set a historic precedent for Africa.

6 Other piecemeal reforms

In addition to the reforms identified by the HLP Report as being crucial, additional reforms and actions being undertaken in different countries include changes in mining in several African mineral-rich countries as well as VAT reform in order to catch the resources using a different form of taxation.

6.1 Mining reform in Zambia

In Zambia, the Mines and Mineral Act of 2008 was amended to include some progressive clauses that aims at closing tax loopholes, and the government is in the process of reviewing the Zambia Development Agency Act to ensure that administration of the tax incentive is effective and transparent. In Malawi, the government is reviewing the Mines and Mineral Act which addresses the regulation of tax incentives and tax avoidance.


70 Y Wong Sovereign finance and the poverty of nations: Odious debt in international law (2012).

6.2 VAT and tax-incentive reform in Tanzania

The Tanzanian Parliament enacted a new Value Added Tax Act 2014 and Tax Administration Act 2014, which entered into law in February 2015. These new laws contain provisions according to which all multinationals now have to pay value-added tax (VAT). Furthermore, the discretionary powers of ministers in granting tax incentives were removed, tax incentives for multinationals will be reviewed to ensure compliance with legal tax requirements, no multinationals will be granted harmful incentives going forward since a cost-benefit analysis will first have to be conducted, and all tax incentives will first undergo parliamentary scrutiny. Civil society has played a positive role in these changes to the law. After the elections, the increased political will of the new government has seen the restructuring of the revenue authority leadership. Investigations have begun against those involved in suspected corruption and theft as well as those involved in deals that led to the non-payment of taxes and duties by multinational companies to the revenue authority at the port of entry. These measures have already resulted in government increasing tax collection from various sources from 900 billion Tanzanian shillings to 1.7 trillion Tanzanian shillings in a few months’ time. At the same time, the budget towards education increased from 3.465 billion Tanzanian shillings (2014/15 FY) to 3.870 billion Tanzanian shillings (2015/16 FY), an increase of about 5 per cent.

7 Recommendations

There are additional recommendations that may be useful on a piecemeal basis, but have not been discussed in the HLP Report and would provide additional and complementary steps to the already existing measures against IFFs, most importantly in recognition of the immense differences that exist in and between African countries, both regionally and across the continent. The levels of development of fiscal systems, and how they stand in relation to each other as well as globally, should be mapped. This mapping must go hand in hand with a strategic approach of not just ranking countries, but also outlining according to a timeline the steps that must be put in place to get these countries to reach the levels of their neighbours and as well as the African standard.

Other recommendations include: first, increasing the remuneration of civil servants; second, providing clear documentation of incentives and subsidies and placing these in line in the national budget; third, preparing publicly available cost benefit analyses of companies before allowing them to invest in a country; fourth, using smart technology to triangulate data by updating company registries and triangulation of their digitised contents with the tax databases as well as the land registries; fifth, changing procurement practices to allow only those not at all related to government
to win tenders which will also allow for a clearer separation of state and business; and sixth, following the Scandinavian concept of placing a politician’s companies in trust for the duration of his or her political term and disallowing it from engaging in any government business.

8 Conclusion

The listing and discussion of all the endeavours recommended and those being put into effect show a lack of coherence between the continental recommendations and those being implemented in individual countries. Some heterogeneity is understandable as independent fiscal states must by their very nature first address the problems that are of greatest concern to them. However, some of the important recommendations of the HLP Report presently exist merely on paper in the African context.

The international fiscal crisis began to unfold as early as 2004 and the ripple effect is being felt globally. It is crucial that for countries, such as those in Africa, that reforms be put in place to give a helping hand to not only recently-emerging and conflict states like South Sudan, but also to those struggling to understand the complicated nuances of complex technical issues, such as South Africa and Kenya, while at the same time being cognisant of the diverse types of mineral-rich economies like the Democratic Republic of the Congo (DRC) and Mozambique as well as Zambia.
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Abstract

The growing macro-economic policy malaise with illicit financial flows is indicative of the undesirable consequences in which these flows result. In an effort to identify an appropriate policy in response to this phenomenon, it is imperative that the impact of illicit financial flows be considered. This chapter, through a literature review, illustrates that this phenomenon not only has adverse economic and social effects, but also has the potential to threaten the stability of governments. Although the adverse impacts are significant, it is illustrated that some positive impacts can emanate from illicit financial flows. The impact of these flows cannot be illustrated without defining what they are. Thus, the appropriate point of departure is the provision of a definition adopted in this chapter.

1 Introduction

Illicit financial flows (IFFs) are believed to have grown exponentially in the age of globalised financial markets. Although the exact magnitude of IFFs cannot be determined with precision, it is estimated that the value of IFFs, in the developing region, is worth more than development assistance received from Organisation for Economic Co-operation and Development (OECD) countries. There is a dearth of literature that has sought to quantitatively determine the impact of IFFs on economies, and even fewer attempts to quantitatively determine the impact of this phenomenon on developing economies. However, there are some studies that have determined the impact of a specific form of illicit flows in the context of developed and developing countries. The objective of the chapter is to

* The author would especially like to thank Jeffrey Owens for the constructive and thoughtful comments.
enumerate and provide a brief discussion of the consequences of IFFs that already have been determined in literature and to determine areas of further research. This is done in an effort to inform policy choices in response to IFFs. While studying IFFs with reference to their consequences may elicit the inception of ‘asymptomatic’ macro-economic policies, rather than panaceas for the underlying institutional causes of the phenomenon, it is imperative that the implications be considered in an effort to emphasise the gravitas of IFFs. This study constitutes a literature review of research conducted on the impact of IFFs. The study provides a synopsis not only of the findings made in the literature reviewed, but also of the methodology employed in order to unearth the respective findings. It is imperative that the methodology be made explicit as it is of relevance from a policy perspective. The appropriate point of departure is to provide a concise definition of the term ‘IFF’.

2 Definition of illicit financial flows

The term ‘IFF’ gained popularity in the 1990s. In literature, the term is commonly used to refer to money and capital flows sourced or attributable to illegal activities or transferred and used in an illegal manner. This definition suggests that the term IFF is wide enough to encompass illicit capital flows (ICFs). However, it is imperative that the distinction between ICFs and IFFs be provided. This is because literature suggests that the nature the financial flow assumes will determine its impact.

IFFs can be divided into three categories, namely, criminal, corrupt and commercial forms. Criminal forms of ICFs are capital flows emanating from criminal or deviant activities. Corrupt capital flows are capital flows resulting from the bribery of or theft by public officials; and commercial ICFs emanate from statutorily-prohibited commercial activities such as falsified asset swaps, the abuse of transfer pricing and tax evasion. Commercial ICFs are said to amount to two-thirds of all IFFs.

In traditional economic literature, capital flows refer to flows specifically allotted for the acquisition of capital stock. ICFs are defined as unrecorded and untaxed ‘illicit leakage of capital and resources out of a

4 RW Baker Capitalism’s Achilles heel: Dirty money and how to renew the free market system (2005) 6.
Spill-overs of illicit financial flows

ICFs amount to the appropriation of domestic wealth where such appropriation puts the wealth out of the reach of domestic authorities.

It is suggested that not all forms of ICFs have a negative impact on economic growth or the political settlement of a jurisdiction. The notion that all forms of ICFs have a negative impact finds its origin in the premise that when all capital flight is retained domestically it will yield a higher social rate of return. This premise does not consider the possibility that some forms of ICFs may have positive or neutral effects. An example of such a flow would be a flow that is rendered illegal or illicit as a result of ill-considered laws aimed at protecting domestic monopolies.

Furthermore, the impact of ICFs can be direct or indirect in nature. The direct consequences of ICFs have an immediate impact on a country's economic development through a reduction in revenue or a reduction in private domestic investment. The indirect consequences of ICFs include effects on the social and political structures in existence in the country in which the illicit capital flows are observed.

For purposes of this chapter, IFFs are defined as all financial flows with negative effects on economic growth, whether indirect or direct, and where such consequences are borne by the political settlement in a country. This definition does not include all forms of ICFs, but only those with a negative effect on economic growth.

Common to all forms of IFFs is the concealment of the illicit nature of these flows and their conversion into usable assets through money laundering. Money laundering is defined as the act of obscuring the illicit nature of proceeds of illicit activities, and in itself an illicit activity. Seemingly the definition implies that not only is money laundering in itself an IFF, but it is predicated by illicit activities resulting in illicit flows. Significant strides have been made, in literature, to determine the impact of money laundering. The discussion of the impact of IFFs thus commences with a synopsis of the impact of money laundering.

9 Blankenburg & Khan (n 3 above) 63.
10 Blankenburg & Khan 23.
11 Blankenburg & Khan 26.
3 Impact of illicit financial flows

A literature review by Unger illustrates the effect of money laundering on society and the economy. The author, from an observation of literature, identifies the consequences of money laundering as including:

- distortions on consumption;
- distortions on investment and savings;
- artificial increases in prices;
- unfair competition;
- changes in imports and exports;
- negative and positive effects on growth rates;
- effects on output, income and employment;
- lower revenues for the public sector;
- the compromise of privatisation;
- changes in demand of money and exchange rates and interest;
- distortion on capital flows;
- risk to financial sector stability;¹³
- distortion of economic statistics;
- increased crime such as corruption and bribery;
- increase in crime; and
- a compromise of political institutions.¹⁴

Despite the nexus between money laundering and IFFs, it would be imprudent to impute the consequences of money laundering onto all forms of IFFs. This is because, as discussed above, not all forms of IFFs, particularly ICFs, have a direct or indirect negative effect on economic growth. However, due to the relationship between money laundering and IFFs, an analysis of the effects of money laundering provides a good indication of the potential effects of IFFs.

3.1 Negative spill-overs of illicit financial flows

3.1.1 Economic impacts

Employment

The nexus between IFFs and money laundering has been explained above. The laundering of illicit proceeds has adverse effects on job creation. This is because such laundering does not require labour-intensive activity but produces what is referred to as ‘sterile assets’.\textsuperscript{15} This is in accordance to a study by Bartlett which seeks to determine the impact of money laundering on economic development in developing economies by the imputing findings observed from an economic literature review. The study begins by describing the three stages of money laundering, which are the placement stage; the layering stage; and the integration stage. It proceeds to differentiate between forms of money-laundering flows innate to developing countries, which include domestic flows; returning flows; inbound flows; outbound flows; and flow-through funds. Domestic flows are defined as the laundering of the proceeds of crime in the jurisdiction in which the funds arose. Returning flows are defined as funds that arose from illicit activities in the jurisdiction to which they return subsequent to being laundered abroad. Inbound flows are defined as the proceeds of criminal activities carried out in a different jurisdiction but which are ultimately integrated into a country separate to the one where the predicate offence took place. Outbound flows are defined as funds that are essentially comprised of illicit capital flight, and flow-through funds are defined as funds that are laundered domestically but are redirected to a separate jurisdiction following such laundering, thus having little to no impact on the economy.\textsuperscript{16} The study considers the effect of money laundering across three different sectors, namely, the financial sector; the real sector; and the external sector. Of relevance to employment is the effect of money laundering on the real sector.\textsuperscript{17}

The author suggests that money laundering has the most direct effect on the real sector. The author asserts that money that is not laundered through the financial sector is laundered through less productive activities.\textsuperscript{18} In an effort to justify this assertion, the author makes reference to a study prepared for the Australian Transactions Reports and Analysis Centre which applies an input-output model in an effort to determine the lost economic activity as a result of money laundering. The study infers

\textsuperscript{16} Bartlett (n 16 above) 3.
\textsuperscript{17} Bartlett 4.
\textsuperscript{18} Bartlett 17.
that the loss of employment is depicted in the difference between the level of real estate purchases as a result of legitimate expenditure and the purchase of real estate as a result of money laundering. The assumption made in the study is that legitimate purchases often are made across all types of property, while properties purchased through money laundering usually are residential in nature. The study finds that money laundering results in a loss of jobs due to the acquisition of ‘sterile’ assets, such as residential properties. It is worth noting that the acquisition of commercial property is likely to generate economic productivity, whereas the acquisition of residential property increases individual wealth. This may have an indirect positive economic impact as the owner’s purchasing power is increased. However, it exacerbates unequal wealth distribution in addition to the negative impact it has on job creation. Furthermore, Bartlett makes the observation that the adverse effect on job creation not only is a result of the purchasing of sterile assets, but also a result of the lack of economic development due to increased corruption and crime.

**Economic stability**

The financial sector has been identified as an area of the economy where IFFs take place. Unsecured loans, money laundering, stock market manipulation and forgery were identified as activities occurring in the financial sector to which illicit outflows may be attributed. In addition to this, the significance of the role of the financial sector in base erosion and profit shifting is evident in the Base Erosion and Profit Shifting Actions 4, 8, 9 and 10 of the OECD, which are actions targeted towards the countering of base erosion and profit shifting that occurs in this sector. Furthermore, the Financial Action Task Force has identified the need to ensure adequate regulation and supervision of the financial sector in an effort to ensure that the banking sector is not used as a money-laundering apparatus. The ability to combat financial crimes and the minimisation of IFFs are at the centre of the maintenance of financial integrity. Financial integrity is imperative to the maintenance of economic stability.

The laundering of IFFs results in the perversion of the financial system and the integrity of the financial system is seen as the basic requirement for economic development. This is particularly true for immature developing financial systems innate to most developing economies. Cross-border IFFs are believed to distort foreign exchange markets and stimulate the underground exchange market. In addition to this, due to the illusive nature of IFFs, they result in a distortion of national accounts. A study by Allridge does well to articulate the distortion money laundering has on

economic stability. In this study, Allridge employs a literature review, in order to justify the criminalisation of money laundering by elucidating the economic ramifications caused by money laundering.

The author makes the observation that money laundering causes inefficiencies in the financial market. These inefficiencies are believed to be as a result of the distortion caused by money laundering on investment decisions. Money laundering encourages the allocation of money to destinations where the ease of capital control circumvention is the highest, as opposed to the destination with the most favourable expected rate of return. This further permeates the inefficient allocation of the world’s resources.\textsuperscript{21} It is imperative that the importance of the efficient distribution of resources be explained. The allocation of most concern is the distribution of property and the entitlements associated with such property. This is because property rights enable market participation since, in the absence of such rights, or in the inefficient distribution of such rights, a segment of society is excluded from market participation. Financial markets concern themselves with the efficient allocation of resources (that is, the allocation of property rights that enable economic participation) and a distortion in financial markets manifests as a distortion in allocation efficiency. The theory of efficiency in markets presupposes the existence of perfect information. However, in the absence of perfect information, market failures manifest. In a perfectly competitive market, scarce resources would be allocated as efficiently as possible in order to satisfy the demands of consumers. However, where markets are imperfect, government intervention, such as the criminalisation of money laundering, is permitted in order to rectify these market failures and enable the efficient allocation of property rights.

Aside from the gross inequity caused by the inefficient allocation of resources, there is a growing school of thought that attributes the existence of the informal sector to non-inclusive property rights systems. It acknowledges a nexus between the informal sector and property rights system and denotes the informal sector as a representation of ‘[t]he people’s struggle to acquire private property rights’.\textsuperscript{22} In turn, IFFs are believed to be impacted by the size of the informal sector or underground economy. In a study by Global Financial Integrity titled ‘Russia: Illicit financial flows and the role of the underground economy’,\textsuperscript{23} the authors use the size of the underground economy as a proxy for governance and suggest the existence of a link between the size of the underground economy and IFFs. In this study the authors employ a least squares regression model and identify a positive correlation between the size of the underground economy and IFFs. The authors suggest that, according to

\textsuperscript{21} As above.
\textsuperscript{22} H de Soto \textit{The other path: The invisible revolution in the Third World} (1989) 55.
their model, a 1 per cent increase in the size of the underground economy was correlated with a 7 per cent increase in the size of cross-border transmitted illicit capital in the period between 1994 and 2011.24

In addition to the obscured allocation of property rights, IFFs pose a systemic risk to the financial sector. This is particularly true in the case of money laundering. Money laundering creates a nexus between the formal and informal economy by enabling the flow of resources between the two economies.25 The flow of proceeds of illicit activity into the formal financial system distorts the integrity of both domestic and global financial systems.26

Market failures caused by IFFs not only are evident in the inefficient allocation of resources and the systemic risk to which the financial system is exposed, but also are evident in the distortion of exchange rates and interest rates. IFFs cause an artificial fluctuation in capital inflows and outflows. Prima facie robust capital imports lead to the appreciation and depreciation of exchange rates, and this has the potential of having an adverse impact on legitimate exports and domestic prices. Furthermore, it creates a distortion in policy choices due to the fact that such policies are espoused on the volatility of exchange and interest rates as a result of artificial capital inflows and outflows.27

Competition

The neo-classical model of competition recognises that in a perfectly competitive market, scarce resources would be allocated as efficiently as possible in order to satisfy the demands of consumers.28 This is also referred to as technical efficiency. However, where the market is imperfect, inefficiencies result. IFFs are believed to impair fair competition and thus lead to inefficiency. This is because factors that influence the decisions concerning the manner in which IFFs are laundered do not concern themselves with ascertaining the greatest rate of return through production, but rather with the circumvention of the cost of capital. In an effort to convert illicit proceeds into usable assets, money launderers engage in a significant number of purchases at prices that do not always reflect the market value for the acquired assets. Furthermore, their primary interest is not in the asset itself but, rather, in the level of concealment

27 Aluko & Bagheri (n 26 above) 445.
provided by the acquisition of the particular asset. As a result of this, they are likely to purchase the asset for more than its market value. This creates an artificial inflation in the price of the assets which may exclude a certain group of society from the legitimate acquisition of the product. This creates non-competitive markets.\textsuperscript{29} Non-competitive markets, which usually take the form of oligopolies or monopolies, not only result in the minimisation of individual choices as a result of the inflation of prices,\textsuperscript{30} but also create barriers to entry into a particular market, and allow for the abuse of dominance by way of price manipulation and other practices that may be considered abusive to consumers.

It must be noted that, unlike market competition, tax competition is likely to result in an inefficient allocation of resources. This is because resource allocation is likely to be motivated by the after tax rate of return on capital rather than on factors of production. Some scholars are of the view that the migration of capital into low tax jurisdictions (or tax havens) increases productivity in high-tax jurisdictions and, implicitly, the competitiveness of markets. This position suggests that the ability to relocate taxable profits into low-tax jurisdictions, which results in a reduced user cost (or pre-tax marginal product of capital) does not divert activity from non-havens but, instead, prompts investors into increasing their activity in high-tax jurisdictions.\textsuperscript{31} However, this position is speculative and is premised on the observation that the demand for low-tax jurisdictions increases where multinationals conduct activity in high-tax jurisdictions.\textsuperscript{32} Furthermore, criticism suggests that the arguments proffered in favour of low-tax jurisdictions are premised on the undesirability of imposing taxes on elastic inputs such as capital and remiss espoused policy choices.\textsuperscript{33}

**Economic growth**

The impact of illicit flows on economic development may be observed from a study by Ndikumana. The author endeavours to determine the impact of capital flight on economic development. While the term ‘capital flight’ implies the migration of more than just illicit capital, the author equates capital flight to IFFs. This is because the author contends that a significant degree of capital flight is spurred by illicit motives, and alleges

\textsuperscript{30} It should be noted that specific practices to which IFFs may be attributes, such as trade mis-invoicing, may result in the distortion of a consumer’s choice between imported goods and locally-produced goods due to the circumvention of import duties.
\textsuperscript{31} MA Desai et al ‘Do tax havens divert economic activity?’ (2005) 90 Economic Letters 222.
that there is an absence of sufficient empirical evidence supporting the
notion that capital flight is premised on legitimate portfolio choices. In
traditional economic literature, capital flight refers to ‘abnormal capital
outflows … propelled from a country … by any one or more complex list
of fears or suspicion’. Ndikumana’s research seeks to determine the
impacts of capital flight (IFFs) and tax havens on economic development.
Pursuant to this, the author employs an econometric model to analyse the
impact of capital flight domestic investment, and then applies a simulation
model in order to determine the gains that would have been derived from
the investment but for the capital flight. The author places significance on
investment as investment is recognised as the most pivotal factor
contributing to long-term economic growth. Capital flight is said to have
an impact on investment because it diminishes the amount of public and
private domestic savings which, in turn, results in a reduction of capital
creation. Furthermore, it creates macro-economic uncertainty due to the
fact that it erodes trust in a specific country’s macro-economic policies.
Trust in economic policies, particularly those governing the financial
system, is imperative for the attraction of foreign direct investment
(FDI).

The author makes the finding that capital flight has a negative effect on
domestic investment and that this imposes an opportunity cost on African
economies that has resulted in the forfeiture of an estimated additional 3
per cent growth in the gross domestic product of the African countries in
question. A study by Nkurunziza examines the nexus between IFFs and
poverty in Africa. The author defines illicit flows as outflows resulting
from theft, corruption, the mismanagement of public resources and
transfer mispricing. In order to determine the effect of IFFs on poverty,
the author applied two simulation models. The first model was constructed
on the basis of the capital-output ratio which establishes the number of
units of investment needed to produce a unit of output. The basis for this
simulation is the presumption that IFFs result in reduced investment, as
illustrated above. The second simulation incorporates capital stock instead
of investment as a determinant of capital flight. The author makes
the finding that in the absence of IFFs, in the period between 2000 and

34 C Kindleberger International short-term capital movements (1938) 33 Journal of the
American Statistical Association 296.
35 L Ndikumana ‘Capital flight and tax havens: Impact on investment and growth in
Africa’ Conference Paper: European Development Network Conference on Finance
36 Yikona et al (n 20 above) 12.
37 The author estimates that the GDP of African countries would have grown by an
additional 3% between the period 2000 and 2010. Ndikumana (n 35 above) 19.
38 JH Nkurunziza ‘Illicit financial flows: A constraint on poverty reduction in Africa’
concernedafricanscholars.org (accessed 17 May 2016).
39 The capital stock is determined on the perpetual inventory method.
2008, poverty would have been reduced by an additional four to six percentage points.  

3.1.2 Social impacts

Crime

Money laundering is said to be a catalyst for increased criminal activity. In addition to this, money laundering is believed to increase the occurrence of corruption and other illicit crimes. This is because money laundering allows criminals to mask wealth derived from the performance of illicit activities. It allows criminals to remain active through the avoidance of criminal justice sanctions and equips criminals with seemingly legitimate financial resources required for the further advancement of criminal activity. It is alleged that a symbiosis relationship exists between money laundering and corruption. Not only do they occur in tandem, but often enrich each other. It is submitted that a positive correlation is observed from the existence of perception of corruption and the size of the informal sector. IFFs are aggravated by smuggling. Smuggling is said to be the result of the disparity in the manner in which certain goods are treated between jurisdictions. This disparate legal treatment, whether as a result of incongruous policies or a lack of enforcement, is believed to incite the illegal import or exportation of the specific good to which the law applies.

Equality and distribution

The forfeiture of revenue as a result of IFFs leads to the hampering of the redistribution of wealth; impedes on the curbing of socially-undesirable conduct (excises); and also causes rent seeking and impedes on the principles of democracy. Rent seeking refers to the attainment of an undue benefit, particularly where the law is structured in such a manner that a group of persons is able to attain a benefit whilst the cost of such benefit is borne by other fractions of society. Rent seeking further exasperates social inequity or unfairness. The term ‘fairness’ is a normative concept. Aristotle regarded fairness as a component of justice. According to

40 In addition to this, the author observes a distinction in the hypothetical poverty reduction between resource-rich and non-resource-rich countries. Poverty reduction in oil-rich countries surpasses that in non-resource-rich countries. The author does not provide a rationale for this distinction. Nkurunziza (n 38 above) 15.
44 OECD (n 43 above) 5.
Aristotle, justice exists in three facets, namely, distributive justice; rectificatory justice; and political justice. Distributive justice manifests in distributions of honour or resources that fall to be divided amongst those who have a share in the constitution; rectificatory justice seeks to rectify the consequences ensuing as a result of voluntary or involuntary transactions between man and man and political or legal justice which seeks to treat those who are equal, equally and those who are unequal, differently. Horizontal equity is closely linked with Aristotle’s notion of legal justice. Therefore, the construction of legal justice requires that tax laws be adjusted taking into account the nature of the taxpayers in an effort to attain horizontal equity.46 Conversely, vertical equity is closely linked to Aristotle’s summations of distributive justice which concerns itself with redistribution. It is important to take note of these concepts of justice because a good legal system is one that conforms to the notions of justice and morality. In the absence of such conformity, the legal system may be construed as a fallacious one.47 Rent seeking is undesirable as it bestows a benefit on a section of society while imposing the burden associated with this benefit on a different fraction of society, exasperating inequity and further heightening the poor distribution of resources.

In a study by Baker aimed at determining the effects of capitalism on society by considering the impact of ‘dirty money’, which Baker considers a resultant corollary of capitalism, ‘dirty money’ is defined as ‘illegally earned, illegally transferred or illegally utilised’ money. The author deconstructs dirty money into money that crosses borders and money that does not.48 Additionally, Baker identifies three forms of dirty money that cross borders. These forms include proceeds of crime, corruption and commerce. Proceeds of crime are defined as proceeds emanating from conduct that is criminal in nature, such as racketeering, trafficking, embezzlement, securities fraud, credit fraud, and so forth. Proceeds of corruption are afforded separate recognition to proceeds of crime and are said to include proceeds derived from the bribery of officials or theft by government officials. Commercial proceeds are defined with reference to their characteristics. The first characteristic is that the proceeds usually result in the evasion of tax. This implies that the conduct to which the proceeds may be attributed is a predicate to tax evasion. The second characteristic is an absence of records reflecting the proceeds in the country of origin.49 The varying methods in which the proceeds are derived include transfer mispricing; fraud; the use of shell companies; transfers to tax havens; the use of trusts and flee clauses; and the use of other intricate structures that make use of subterfuge.50 The definition afforded to dirty

46 As above.
47 H Hart The concept of law (1961) 206.
48 This is implicit in the recognition of dirty money that crosses borders.
49 RW Baker ‘Playing the game’ in RW Baker Capitalism’s Achilles heel: Dirty money and how to renew the free-market system (2005) 23.
50 RW Baker ‘Dirty money at work’ in Baker (n 49 above) 136.
money is synonymous to the definition of IFFs provided in section 2 of this article.

In an effort to determine the impact of dirty money on equality, Baker reviews statistics from a range of sources to determine income distribution. Baker refers to World Bank country statistics providing information concerning gross domestic product (GDP) and quintile shares of gross domestic product, purchasing power parity and the country rankings of the United Nations (UN). From an inspection of the statistics, Baker makes the observation that the gap in income distribution is increasing. Baker continues to illustrate how poor income distribution results in inequality by explaining the ‘Gini coefficient’, and goes on to review studies that have sought to determine income distribution and inequality through the use of the statistics synopsised. Baker concludes that dirty money leads to poor income distribution and causes the largest income inequality in developing countries.  

A similar observation is made by Yikona et al in a study on behalf of the World Bank which seeks to determine the effects of regulation aimed at curbing ‘ill-gotten’ money on Malawi and Namibia’s economy. The primary objective of Yikona’s study is to determine the effects of anti-money-laundering regulation on economic development. Pursuant to this, the study endeavours to determine the relationship between and the effects of the proceeds of crime on economic development. The study adopts a qualitative approach which encompasses a literature review, anecdotal evidence of the perceptions of experts in Malawi and Namibia, and conclusions derived from an observation of secondary data.

The study defines the term ‘ill-gotten money’ with reference to the sources from which the ill-gotten money is derived. These sources are said to include corruption; tax evasion (including transfer mispricing); organised crimes; and illicit resource dealings. The authors conclude that tax evasion and corruption have the most significant impact on development as they encroach upon the government’s tax base and this ultimately exacerbates the poverty alleviation plight. Inequity in a country has the potential to instigate the disruption of the social and political fabric of a country.

3.1.3 Undermine of democracy

It is imperative that the positive correlation between political stability and economic productivity be noted. IFFs damage the integrity of society and
undermine democracy and the rule of law. The rule of law is imperative as it is used as a measure of institutional quality. The term ‘institution’ is understood as encompassing a wider scope than its original meaning. The term is often used to describe an organisation formed for a particular social purpose. The definition we are concerned with in this study is the understanding of institutions as humanly-devised constraints, such as law and societal norms that influence human interactions. The question arises as to which specific institutions are of relevance where the address of the IFFs is concerned. It is often proposed that the institution of relevance in this instance is the government and its ability to allocate secured property rights.

Well-functioning institutions are believed to be institutions that are able enforce incepted policies and facilitate the allocation of property rights. Corruption, in particular, predicates the abuse of government resources by redirecting those resources from the provision of public goods and services. Furthermore, corruption is implicit in the failure to uphold the rule of law and, thus, is indicative of weak institutions. It is believed IFFs are negatively impacted by the perceptions of a transparent electoral process; a belief in government’s ability to form and implement policies; a confidence in government’s ability to govern; and the allocation of secured property rights. IFFs are considered a direct challenge to government’s authority as they result in the undermining of the enforcement of laws and the corruption of government. A failure to enforce coercive laws, such as anti-money-laundering legislation and laws targeted at curbing tax evasion, results in the usurpation of the authority and, thus, the legitimacy of governments.

Cognisance must be taken of the Report of the High-Level Panel on Illicit Financial Flows from Africa. Although the primary objective of the report is to analyse the extent of IFFs from Africa and to determine the cause of such IFFs, the report takes the opportunity to articulate the consequences of IFFs observed from case studies and literature reviews. The report stipulates that IFFs result in weakened governance, impediments on domestic and international development, discouraged

56 A Lane Rule of law reform and development (2010) 7.
57 The term ‘law’ includes legislation, common law and regulations. Societal norms include norms of behaviour and self-imposed codes of conduct.
58 Blankenburg & Khan (n 3 above) 23.
62 While the report stipulates that the consequences of IFFs are determined from case studies and literature review, it does not provide a comprehensive summation of the nature of the case studies.
structural transformation and transparency and strained government resources.

It would be imprudent to restrict an analysis of the impact of IFFs to the negative effects of such flows. In the interests of establishing a well-informed policy, consideration must be given to all the impacts of IFFs, including those that are positive in nature. The positive result of IFFs must not be confused with ICFs with a positive or negligible effect. As discussed above, IFFs are those flows with a negative impact on economic development. However, despite the negative impact in which they result, it is also possible to observe the indirect positive impact. For example, while money derived from criminal activities exacerbates crime, the increase in criminal activity may cause an increase in the demand for legal services. On the other hand, an example of an ICF with a positive result may be a flow that violates an ill-considered statute which has undesirable economic results, such as the protection of monopolies, and which, but for the violation of the statute, does not have a negative effect. The morality of observing the positive impact of IFFs is neither here nor there. Such observation merely seeks to provide a holistic view of the impact of IFFs.

3.2 Positive spill-overs

Some scholars allege that IFFs may have some positive effects. These effects include the contention that the circulation of IFFs may lead to the increased demand for financial and legal services. This increased demand is said to be pro tem. Furthermore, a study by Perez et al identifies a nexus between IFFs and FDI. These authors estimate the role of money laundering and illegal capital flight in FDI decisions. The authors employ secondary data depicting FDI outflows from a selection of East European countries. The authors premise that the use of data illustrating FDI outflows serves as an indicator for investment decisions. In order to illustrate the effects of illicit capital flight and money laundering on FDI, the authors adopt a parsimonious model which takes into consideration the standard factors that influence FDI. The authors' parsimonious model is a variation of the knowledge-capital model (KC model) used to analyse the rationale behind FDI location decisions. The KC model looks at the movement of FDI between two countries and factors in the impact of skilled and unskilled labour across two sectors. In their model, the authors assume that FDI will be located in a country where the investment is profitable because the business undertakings are profitable or because the conditions in the country enable illegal capital flight or money laundering. The authors apply the model to six transitional East European

63 Unger (n 15 above) 7.
64 MF Perez et al 'Illicit money flows as motives for FDI' (2012) 40 Journal of Comparative Economics 109.
countries (FDI destinations), which are Bulgaria; the Czech Republic; Estonia; Hungary; Macedonia; and Slovenia, over a four-year period (2000-2003). This resulted in a total of 449 observations and 83 FDI host countries. The authors conclude that 29 per cent of FDI is attracted by countries that may be considered money-laundering centres. In addition to this, of the 29 per cent that is directed to money-laundering hubs, 20 per cent is believed to be motivated by the desire to facilitate money laundering. The authors conclude that 29 per cent of FDI is attracted by countries that may be considered money-laundering centres. Furthermore, of the 29 per cent that is directed to money-laundering hubs, 20 per cent is believed to be motivated by the desire to facilitate money laundering.66

4 Conclusion

The first observation worth noting is the lack of quantitative research that has sought to determine the effects of IFFs in all its forms (that is, the effects of specific forms of tax evasion such as trade mispricing). Furthermore, a significant number of the studies discussed above employ secondary data which is subject to the authors’ interpretation and validity of which is often left unchallenged. Thus, a need for further research in this area is evident. It is also evident that illicit flows present a wide range of adverse effects. Furthermore, in some instances the effects are interconnected and often precipitate themselves as a result of this synergy. While most of the consequences observed are undesirable, there are some alleged positive effects of IFFs. However, the negative spill-overs resulting from IFFs have the potential to impede on developmental goals and human rights.67 This is because the forfeited revenue impedes on government’s ability to attain the 2030 Sustainable Developmental Goals and, while income distribution may not amount to a human right, the inequality exasperated by the poor distribution imposes a limitation on society’s right to market participation. Furthermore, a failure to indiscriminately enforce existing laws on private individuals and government officials brings government’s authority into disrepute and threatens the rule of law, a principle upon which democracy is premised. While it is not the intention of this chapter to incite the inception of policy directed at correcting the negative externalities resulting from IFFs, it is imperative that cognisance of these externalities be considered in devising the appropriate panacea aimed at the root cause of IFFs.

66 Perez et al (n 66 above) 125.
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Abstract

The current international development agenda presents inter-agency cooperation as one of the relevant tools that may be necessary to achieve sustainable development. This chapter places inter-agency cooperation in the context of the concept of good governance and, in particular, tax good governance. It suggests that inter-agency cooperation is an inherent element of this. Based on this assumption, the case of the good tax governance agenda of the European Union is discussed. It is recommended that inter-agency cooperation should be included as one of the tools on the EU development agenda addressing third countries. Many developing countries could benefit from the experience of EU member states in this area.

1 Introduction

In connection with the 2030 Agenda, the European Union (EU) has committed itself to supporting developing countries in strengthening domestic resource mobilisation in these countries. In light of this commitment, a new strategy (‘Communication’) was issued. This strategy addresses the way in which to fight aggressive tax avoidance. It also looks at the potential to support developing countries. According to the European Commission, Communication is a key measure for fighting aggressive tax avoidance and supporting developing countries. The

* The author would especially like to thank Jeffrey Owens for his constructive comments.
standards of tax good governance as defined by the European Commission are prominently featured in this Communication. These are the basis of the strategy applied by the EU with respect to third countries. They have been suggested as a primary tool for assessing the tax regimes of third countries. In addition, the European Commission has proposed to introduce them in bilateral trade agreements that are concluded by the EU and the member states. Finally, their implementation in third countries is expected to be supported with assistance from the EU. In an attempt to promote and enhance tax good governance among third countries, the European Commission has not recognised the role of inter-agency cooperation. This may be due to the fact that thus far the role of inter-agency cooperation in enhancing tax good governance also has not been discussed by academia or international bodies. Inter-agency cooperation has appeared on the agendas of many international bodies, including on those of the Organisation for Economic Co-operation and Development (OECD) and the Financial Action Task Force on Money Laundering (FATF), to name but a few. However, none of institutions mentioned drew a direct link between tax, good governance, inter-agency cooperation and illicit financial flows (IFFs). This chapter intends to bridge this gap.

The chapter begins with a brief introduction to the theory of good governance. It is followed by a brief account of how it occurred that taxation was recognised as a catalyst of good governance and that, as a result, tax good governance developed. Against the picture of tax good governance, the role of inter-agency cooperation is discussed. The attention then shifts to the role of the EU as promoter of good governance and tax good governance. The special focus is on Communication as the latest tax good governance agenda addressing third countries. Based on this analysis, the recommendations addressing the EU tax good governance agenda are formulated.

5 See sec 3 of this article.
6 Eg, in 2011, the OECD launched the ‘Oslo Dialogue’ which is designed to increase cooperation between authorities in numerous countries when approaching financial crimes, tax evasion and illicit flows. With this initiative, the whole government approach was developed. See also the report OECD Effective inter-agency co-operation in fighting tax crimes and other financial crimes (2013).
2 Theory of tax good governance

2.1 Good governance

The concept of tax good governance was built on the theory of good governance. Thus, in search for the basis of the concept of tax good governance, it is necessary to first understand the concept of good governance.

Regarding the concept of good governance, it is difficult to agree on one operational definition, namely, its roots, or way of measurement. A review of the literature suggests that the sole term of governance is employed in a variety of meanings. For instance, in a number of studies by the OECD, 17 definitions of ‘governance’ were identified. A baseline consensus is that governance refers to the development of governing styles in which boundaries between and within public and private sectors have become blurred. The essence of governance is its focus on governing mechanisms which do not rest on recourse to the authority and sanctions of government.

As some scholars have indicated, ‘[t]he governance concept points to the creation of a structure or an order which cannot be externally imposed but is the result of the interaction of a multiplicity of governing and each other influencing actors’.

It is not surprising that the term ‘good governance’ is also ambiguous, and it is difficult to determine one precise definition. It appears that, according to different organisations and different actors, it may have various meanings. Some scholars, when searching for the roots of good governance, analyse the works of Aristotle and his theory of good governance as defined by the city’s state of happiness achieved through the entire action of all the institutions that comprised the state mechanism.

11 Stoker (n 9 above) 17.
Others refer to Plato for whom good governance is simply a right order.\textsuperscript{15}

The theoretical basis for this chapter is a definition of good governance as refined in the development agenda. Taking into account that the aim is to examine Communication as the latest EU tax agenda with respect to third countries, for the purpose of this chapter, the meaning of the concept on the development agenda is relevant. In this context, it was decided to employ the definition as developed by the United Nations (UN) as this definition played the most important role in defining good governance. It also seems to capture the core elements common to most of the various approaches to the concept of good governance.\textsuperscript{16} In a publication by the UN,\textsuperscript{17} it was defined as being determined by eight characteristics, namely, being consensus oriented; participatory; following the rule of law; effective and efficient; accountable; transparent; responsive; and equitable and inclusive.

The first of the UN characteristics of good governance relies on being consensus-oriented, indicating that it should call for mediation of different interests in society. Good governance should aim at reaching a broad consensus in society regarding what is in the best interests of all community members.\textsuperscript{18} It should also be focused on providing sustainable development. Second, governance should be participatory. Participation in the context of good governance should be translated as providing the opportunity for participation of men and women either directly or through legitimate intermediate institutions or representatives. Third, the rule of law in this context refers to fair legal frameworks that are impartially enforced. It requires the full protection of human rights, particularly those of minorities. Fourth, good governance also requires effectiveness and efficiency. These features require the best use of the resources at their disposal. Fifth, good governance does not exist if governmental institutions as well as the private sector and civil society organisations are not accountable to the public and to their institutional stakeholders. Sixth, good governance requires transparency which means that the decisions taken and their enforcement are completed in a manner that is in


\textsuperscript{16} There are different definitions of the term ‘good governance’ in the literature. Eg, Potter pointed that it encompasses a sphere of public sector management; accountability and legal framework for reforms; information and technology; legitimacy of government; and competence of governments to formulate appropriate policies, make timely decisions; execute them effectively and deliver social services to the people. D Potter ‘Democratisation, good governance and development’ in T Allen & A Thomas (eds) Poverty and development into the 21st century (2000) 379.

\textsuperscript{17} UNESCAP ‘What is good governance?’ http://www.unescap.org/sites/default/files/ good-governance.pdf (accessed 14 September 2016).

\textsuperscript{18} This may be achieved through the introduction of mediation among different stakeholders. See eg K Qudrat-I Elahi ‘UNDP on good governance’ (2009) 36 International Journal of Social Economics 1167-1180, https://doi.org/10.1108/030 68290910996981 (accessed 14 September 2016).
accordance with rules and regulations. It also means that information is freely available and directly accessible to those who will be affected by such decisions and their enforcement. It requires that enough information is provided and that it is provided in easy-to-understand forms and media. Seventh, good governance should meet the standard of responsiveness which refers to institutions and processes that attempt to serve all stakeholders within a reasonable time frame. Finally, it should be based on the principle of equity and inclusiveness, which indicates that all members of society should feel included in the mainstream of society.19

All features collectively address actions primarily undertaken by government institutions. The important part of public institutions' agendas is the administration of the tax system. As was explained in the literature, ‘[t]he state’s capacity to raise taxes is closely linked to its ability to deliver sound policies and there is much to suggest that tax raising is a good proxy indicator of overall governance capability’.20 Conversely, a sound tax system is a pillar and condition of good governance. How the connection between taxation and good governance was developed will be explained.

2.2 Tax good governance

It took a long time before the association between taxation and governance was discovered and became the subject of thorough research. The main reason for this may lie in the evolution of state revenues. The importance of taxes as the primary source of revenues has in recent centuries steadily gained significance. Earlier in the seventeenth century, taxation was linked to war expenditures.21 However, in certain earlier works of philosophers some recognition of the role of tax systems in developing a strong and stable country is evident. For instance, both Aristotle and Confucius identified a fair and effective tax system funding a political leadership and administration as a requirement for a prosperous and politically stable society.22 Adam Smith also observed that ‘[l]ittle else is requisite to carry a state to the highest degree of opulence from the lowest barbarism but peace, easy taxes, and a tolerable administration of justice; all the rest being brought about by the natural course of things’.23


22 Everest-Phillips (n 20 above) 76.

23 Stewart reported this as the view of his friend Smith in D Stewart ‘Account of the life and writing of Adam Smith, LL’D in Adam Smith’s posthumous Essays on Philosophical Subjects, 1795, lxxx, lxxxi. https://www.adamsmith.org/adam-smith-quotes/ (accessed 12 December 2017).
The literature review suggests that since the early twentieth century, taxation has been perceived as central to state building. At that time, it began to be associated with revenue creation; the redistribution of income and assets; the curbing of socially undesirable behaviour, for example, by means of tobacco and alcohol taxes (repricing); and the realm of democratic state building (representation). The last dimension – representation – was presented as the emanation of the need for revenues. A corollary of this was the creation of representative governments. This vision of the role of taxation evolved over the course of time, and it became obvious that there is a close association between taxation and government services in general. The level of taxation is not contested as long as commensurate government services are provided to citizens. Stated differently, there is a direct link between taxation and democratisation as such.

In general, there now is substantial research material on the correlation between tax and governance. It is worth noting what Trevor Manuel, then Finance Minister of South Africa, recognised: 'Effective revenue administration contributes to a country more than simply filling its national coffers; it is an essential component of good governance.'

To paraphrase these words: There is no good governance without a tax system that would satisfy all the characteristics of good governance. It is the condition that addresses the operations of tax administrations and its organisation as well as the law and all legislative and administrative processes. All aspects of administering and creating a tax system must meet the criteria of good governance. What does this mean?

First, tax good governance should be consensus-oriented that could be translated as a requirement of a tax system that is the result of consensus reached not only in works of a parliament representing society, but also in cooperation with a wider society represented by civil society, trade unions, and so forth. In the context of the administration of a tax system, it may require openness to taxpayers and providing an opportunity to communicate. In this respect, it will also meet the requirement of being participatory and involving all stakeholders in building a tax system. Second, good governance requires that all stakeholders that can contribute to building a tax system be invited to do so. Third, a tax system should also meet the requirements as imposed by the rule of law, both its formal and substantive elements. This means that it should meet all institutional

26 Opening speech at the International Conference on Taxation, State-Building and Capacity Development in Africa, hosted by the South Africa Revenue Service as referred to in Everest-Phillips (n 20 above) 75.
requirements (laws made by duly-empowered institutions, access to independent courts), procedural requirements (fair representation, due process, rights of appeal), and requirements addressing the content of the law (generality, certainty, proportionality, equal treatment).  

Fourth, the feature of effectiveness and efficiency requires that a tax system be administered by making the best use of the resources at its disposal. It may be reflected in development of risk management strategies and implementation of compliance risk management.  

Fifth, a tax system should be based on accountable institutions. Sixth, a tax system should be transparent. Transparency currently is often used with respect to increased pressure on transparency among taxpayers’ data. In the context of tax good governance, the request for transparency requires not only transparent taxpayers but, first of all, transparency around tax administrations and their operations. Seventh, a tax system should be responsive, which indicates that tax administrations should be able to modify their operations and decisions for a specific taxpayer’s situation. Finally, it should be based on the principle of equity and inclusiveness which, building on substantive elements of the rule of law, is again supported by an invitation to all stakeholders for building a tax system.

2.3 Inter-agency cooperation as an effective and efficient measure in the promotion of a tax good governance agenda

As has been discussed, one of the pillars of good governance and tax good governance is effectiveness and efficiency. Whereas effectiveness addresses the results of tax administrations’ operations, efficiency refers to the issue of costs that tax administrations must bear. Achieving these goals may require different measures depending on the types of operations. Among many functions allocated to a tax administration, one of its core roles is to enforce tax law. Currently, many tax administrations develop various risk management strategies that allow for adjusting their operations to targeted tax behaviour. Thus, they build their operations based on the enforcement pyramid that differentiates between compliant;

30 This is also a requirement under the Tax Administration Diagnostic Assessment Tool. For more, see http://www.tadat.org (accessed 16 October 2017).
31 For a discussion on responsiveness in the context of tax administration, see L Osofsky ‘Some realism about responsive tax administration’ (2012) 66 Tax Law Review 121.
willingness to be compliant; compliant only if they are controlled; and non-compliant taxpayers.\(^{33}\) Whereas most operations can be undertaken by tax administrations on their own solely with capacities they already are equipped with, in some cases they may require support from and expertise of other agencies. In particular, this is the case when they identify non-compliant taxpayers who commit tax crimes.\(^{34}\)

Tax crimes commonly are committed along with other crimes such as money laundering, corruption, drug trafficking, and many others. They sometimes are referred to as ‘illicit financial flows’ (IFFs).\(^{35}\) It is important to emphasise that there are substantial similarities between the techniques exploited to commit these different types of crimes. Money launderers, tax evaders and bribe takers intend to conceal the illicit origins of funds and integrate them into apparently legitimate sources. Therefore, they manipulate prices (over- and under-invoicing), manipulate turnover/sales, fabricate loans, fabricate a rise in net worth of purchased and sold items, and use trusts and shell companies. Their ultimate goal is to create apparent legal origins of illicitly-obtained proceeds to enable them to use these and benefit from them as if they were legal. All activities undertaken here thrive on secrecy, inadequate legal frameworks, tax regulation, poor enforcement, and weak inter-agency cooperation.\(^{36}\) Moreover, conduct involving money laundering, corruption or other economic crimes usually is also a tax crime. In this context, it should be recalled that international standards\(^{37}\) recognise a tax crime as a predicate offence to money laundering.\(^{38}\)

Bearing this in mind, it is not surprising that a large number of agencies may be involved in countering IFFs. They detect, investigate and prosecute crimes resulting in IFFs. They also carry out preventive activities. Finally, they are in charge of the recovery of proceeds.\(^{39}\)

Considering the criminal character of most IFFs, police forces and prosecution authorities play an important role here. Tax and customs administrations as well as financial regulators also are relevant. In the course of their normal activities, tax and customs administrations and financial regulators collect and retain information which might be

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33 OECD (n 29 above) 41.
35 OECD (n 6 above).
37 FATF (n 7 above).
39 OECD (n 6 above).
necessary in the detection and investigation of IFFs. With respect to tax administrations, it should be emphasised that a tax crime is perceived as one of the major sources of IFFs. Some studies even indicate that the majority of all IFFs are related to cross-border tax-related transactions which would require cross-border cooperation. That is why, in order to be effective and efficient, as is required by good governance criteria, a tax administration should establish cooperation with law enforcement agencies, a so-called inter-agency cooperation which builds on a ‘whole-of-government’ approach.

Entering into inter-agency cooperation may substantially enhance efforts of a tax administration and also other agencies in stemming illicit financial flows. Among many benefits of the concept of inter-agency cooperation are increased effectiveness of agencies participating in this cooperation; improved chances of stemming IFFs; operational efficiency; and an improvement in agencies’ skills due to collaboration. It is also a way in which a tax system may become better integrated with other agencies. From a good governance perspective, it may contribute to promoting inclusiveness by replacing separate actions of different agencies with a collaborative effort. Inclusiveness is being repeated by many fora as a key element in building capacities, ensuring sustainable sources of government revenue and, finally, supporting good governance.

Inter-agency cooperation may be framed in different ways. This may range from tools as simple as joint training that supports an exchange of expertise and discussing obstacles faced, to more enhanced forms such as joint investigations or even special task forces.

The value of inter-agency cooperation has been recognised by the international community. Many developed countries have initiated special programmes based on inter-agency cooperation as an effective and efficient way of preventing, detecting, tracking and prosecuting illicit financial flows. Joint investigation teams, inter-agency centres of intelligence and secondments, and co-location of personnel are but some

41 It is worth referring to the Agenda 2030 that states: ‘We envisage a world in which every country enjoys sustained, inclusive and sustainable economic growth and decent work for all. A world in which consumption and production patterns and use of all natural resources – from air to land, from rivers, lakes and aquifers to oceans and seas – are sustainable. One in which democracy, good governance and the rule of law, as well as an enabling environment at the national and international levels, are essential for sustainable development, including sustained and inclusive economic growth, social development, environmental protection and the eradication of poverty and hunger. One in which development and the application of technology are climate-sensitive, respect biodiversity and are resilient. One in which humanity lives in harmony with nature and in which wildlife and other living species are protected.’
42 OECD (n 6 above) 14-18.
examples of existing strategies of inter-agency enhanced cooperation. A number of interesting initiatives were developed in The Netherlands,43 the USA,44 Australia and Finland.45

International organisations have also recognised the value of inter-agency cooperation. It began with the Communiqué by the G20 Leaders who, at the 2011 Cannes Summit, called for the adoption of and compliance with the international standards in the tax, prudential, and AML/CFT areas, and requested international organisations to 'work closely together to enhance transparency and facilitate cooperation between tax and law enforcement agencies in the implementation of these standards'. The initiative was adopted by the OECD, the World Bank, the International Monetary Fund (IMF), the FATF and the UN. However, thus far there has been no involvement of the EU. This may be surprising considering the fact that the EU promotes the concept of good governance and tax good governance.

3 European Union tax agenda as a case study

3.1 Rationale for the new tax good governance agenda within the European Union framework

The EU introduces itself as a leader in promoting good governance in tax matters and the principles of transparency, the exchange of information, and fair tax competition that are now worldwide gaining traction. It is noteworthy to recall the OECD discussion paper on 'A Contribution to the Third Financing for Development Conference in Addis Ababa’. Here the EU stated:46

… put the EU at the forefront in improving tax governance within its own borders and given the EU a leading role in pushing for an ambitious global agenda. Major improvements have been made in tax governance in the EU internal market while taking into account implications for third countries.

43 In 2013 the criminal investigations leg of the Netherlands Tax and Customs Administration established a Centre for Intelligence and Operational Excellence. The Centre consists of authorities that are involved in any actions against money laundering.
44 The United States established the Organized Crime Drug Enforcement Task Force Fusion Center (OCDETF-FC) in 2006 under the auspices of the Department of Justice, Homeland Security and the Department of Treasury.
45 Eg, in Finland the Grey Economy Information Unit (GEIU) was established. It aims at promoting the fight against the shadow economy. The GEIU collects information from different authorities, regardless of existing confidentiality provisions.
Tax good governance was developed by the EU primarily with respect to a policy that addresses third countries. The first proposal of minimum standards of tax good governance was issued in the Commission Recommendation regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters in 2012, although the concept of pure good governance had even earlier been present on the EU agenda. The recommendation included the set of rules addressing third countries. The rules were aimed at incentivising third countries to meet the standards of tax good governance. Three of these standards, namely, transparency, exchange of information and fair tax competition, were regarded as the core of the recommendation. Thus, they were seen as criteria in the assessment of third countries' tax regimes. In case of non-compliance with these core rules, common counter-measures could be applied. The criteria were approved by the Economic and Financial Affairs Council (ECOFIN). Next, they were used in the course of work of the Platform for Tax and Good Governance. Very soon it was recognised that the rules needed to be updated.

First of all, over the course of time it was recognised that the criteria were used in an inconsistent manner, and sometimes not at all in regard to both their application by the Platform for Tax and Good Governance as well as by member states. This lack of a coherent approach resulted in the need for more clarity.

In addition, the EU Tax Good Governance criteria had become obsolete. Since 2012, when the recommendation was issued, there have been many advancements on the tax agenda. The automatic exchange of information has become widespread across many countries around the world and gathered the support of the largest economies. However, it was the BEPS project, led by the OECD under the auspices of the G20 Leaders, who significantly reshaped the international tax agenda and

49 The Platform for Tax and Good Governance brings together representatives from business, civil society, trade unions and national tax administrations. It was established in 2013 in the context of an Action Plan to strengthen the fight against tax fraud and tax evasion presented by the Commission in 2012. In 2015 it was decided to prolong its mandate. For more, see: https://ec.europa.eu/taxation_customs/business/company-tax/tax-good-governance/platform-tax-good-governance_en (accessed 16 October 2017).
50 The Communication, point 2.
52 Base Erosion and Profit Shifting (BEPS) Project. For more details, see http://www.oecd.org/ctp/beps-about.htm (accessed 16 October 2017).
influenced the understanding of good governance criteria. Following the creation of new standards created by the OECD under the BEPS project, the EU faced the necessity to update its agenda and apply a common approach across all member states in order to answer the current tax challenges in a consistent matter. As a result, the Action Plan for Fair and Efficient Corporate Taxation in the EU (Action Plan) was developed. The Action Plan proposed five key areas for action: re-launching the Common Consolidated Corporate Tax Base (CCCTB); ensuring fair taxation where profits are generated; creating a better business environment; increasing transparency; and improving EU co-ordination. From the perspective of the EU Single Market, it aims at ensuring that all member states adopt a coordinated approach against the phenomenon of profit shifting and base erosion.

As a follow-up to the Action Plan, on 28 January 2016 the European Commission released the Anti-Tax Avoidance Package (ATA Package). The new set of measures was suggested with the intention of ensuring that a minimum standard against the phenomenon of base erosion be established across all member states. As was explained by the European Commission, the ATA Package offered immediate solutions to tackle tax avoidance, boost tax transparency, and ensure a fairer and more stable business environment. As a next step, the Commission proposed the relaunch of the Common Consolidated Corporate Tax Base (CCCTB) project. The relaunch was announced in October 2016. It was suggested that the project would be implemented through a two-step process and that it would be compulsory for the largest groups of taxpayers in the European Union.

The integral part of the ATA Package is Communication. The Communication does not have a binding form, constituting only soft law. Thus, as a soft law instrument, it only requires endorsement by the Council

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54 On 20 June 2016 tax commissioner Pierre Moscovici stated that the EU Commission would relaunch proposals for a common consolidated corporate tax base (CCCTB) in the EU in the autumn of that year. He confirmed that ‘[b]usinesses and investors need simplicity, certainty, and a level playing field. They also need a swift and efficient system to solve double tax disputes and the Commission will make proposals to improve the current situation by the end of this year. This will come together with the real prize for businesses: the CCCTB, which the Commission will re-launch in the autumn.’
and Parliament. Communication on an External Strategy already has been endorsed by the ECOFIN.57

3.2 New approach to promoting tax good governance

Within Communication, the EU Commission suggested several tools that should internationally promote tax good governance. These are implementing tax good governance clauses and state aid provisions in agreements with third countries; assisting developing countries in improving their tax systems and increasing their domestic resources; developing a common approach to listing third countries; and strengthening the relationship between EU funds and tax good governance. To understand how these tools fit the definition of good governance and tax good governance, it is essential to comment on each of the suggested tools.

The first items proposed in Communication suggests inserting a good governance clause to treaties concluded with third countries. The idea as such is not novel. Since 1995 it has been the official policy of the EU to include references to democratic principles and human rights in agreements between the EU and third countries. The most prominent of this practice is the clause agreed to in the Cotonou Agreement.58 In 2008, the uniformed wording of such a clause was agreed upon. It was seen as a basis for future tax good governance clauses in international agreements. The Commission was given a mandate to negotiate this type of clause. In the meantime, the international tax environment dramatically changed, whereas the suggested good governance clause quite often was the subject of discussion during the negotiations around the treaties, and caused delays in reaching final consensus. In a direct response to these issues, the EU Commission set out core elements in the Communication of good governance which should be included in a negotiated treaty. The Communication included transparency and exchange of information upon request; Automatic Exchange of Information (AEoI) of financial account information; fair tax competition; G20/OECD BEPS Standards; and FATF Recommendations.59

The EU Commission acknowledged that in some cases, countries may not be prepared to meet all the criteria. It was suggested that in these cases member states should adopt a different approach. The EU Commission

58 Art 9 of the Cotonou Agreement signed in Cotonou on 23 June 2000 includes reference to good governance standards that should underpin the domestic and international policies of parties to the agreement and constitute a fundamental element of the agreement.
59 FATF (n 7 above).
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referred to two potential solutions. Member states can try to offer a so-called ‘simplified approach’. Another option would be to support these countries in the implementation of the clause. It remains to be seen whether member states will abuse this gateway to create a myriad of differentiating good governance clauses. Considering that there are 28 member states, it is easy to conceive that each of these may compose dissimilar good governance clauses. Whereas diversity should be welcomed, it should not be equal to diminishing standards.

A new interesting measure that was suggested in Communication is the monitoring of whether a third country is compliant with the good governance clause inserted in the agreement. In the event of its violation, the agreement’s consultation mechanism should be initiated. The implementation of this proposal would be a long-anticipated change on the EU good governance agenda. One of most important weaknesses of previous good governance clauses was the lack of a proper operational mechanism for the implementation, the monitoring of compliance with the clause, and an evaluation of the effectiveness of sanctions. As was sometimes pointed out, the EU policy in respect of enforcing good governance was ‘aspirational’ and aimed at fostering dialogue. The EU Communication provides no additional details of how this mechanism will function.

Along with the good governance clause, state aid provisions would have a dissuasive influence on any type of harmful subsidies when included in agreements with third countries, and would ensure that government interventions do not distort competition. Therefore, it was also suggested that they be included. Taking into account the active position over previous years of the European Commission in enforcing state aid provisions, it could be accepted that the new clause may play an important role in shaping the relationship with companies from third countries that are active in the EU.

Communication also discusses a suggestion to assist third countries in mobilising domestic resources. In particular, this can be done by strengthening their tax systems. It is an important position on the EU tax good governance agenda since it is an indication of preference for an active approach towards promoting good governance in third countries. Good governance should not only be a clause in a treaty, but should also demand implementing a certain policy agenda, and the EU should provide the required support in its implementation. In this respect, the EU intends to follow its strategy regarding developing countries that was presented in the ‘Collect More – Spend Better’. Within this initiative, the EU intends to


61 European Commission (n 48 above).
address tax policy and tax compliance gaps. This can be achieved by adopting various measures addressing both the substantive laws of taxation as well as law of tax administration and procedure. The aim of the EU is to address aggressive tax avoidance and tax evasion. In this respect, the EU Commission also alludes to the issue of illicit financial flows. However, it does not articulate what should be initiated to address the issue. Only in a number of earlier documents was there a proposal of strengthening monitoring capacities in the fight against illicit financial flows. This suggests a rather limited scope of operations that target these flows, whereas nothing has been suggested with respect to inter-agency cooperation. It appears that the EU agenda is focusing only on pure tax or public finance issues. The EU Commission is silent on a ‘whole-of-government’ approach.

The next suggested measures resurrect the antiquated concept of blacklisting. In Communication, the Commission suggests a system consisting of three steps. These are assessing; screening; and listing third countries. The first ‘go’ of the EU blacklist was in 2015, but it was heavily criticised internationally. The wider society commented that it lacked objectivity and logic concerning which jurisdictions were on the list. The new EU blacklist is based on a screening and listing process. The process addresses countries that do not ‘play fairly’.

In order to identify these countries, a common EU list of third countries will be developed within a three-step process (a scoreboard phase, a screening phase and a listing phase). The first step is the identification of the jurisdictions to be prioritised for screening at the EU level. The basis for prioritisation would be a scoreboard of indicators described in Communication. The second step consists of a selection of jurisdictions for the assessment and the actual assessment. The selection would be done based on the outcome from the first step. This would be followed by the assessment, done by the EU Commission. In the assessment, the EU Commission would take into consideration the Code

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63 In a report issued in 2000, the OECD identified a number of jurisdictions as tax havens according to criteria it had established. However, in 2009, the last three countries were removed from the list and, since then, the initiative has not been relaunched. For more, see http://www.oecd.org/countries/monaco/listofunco-operativetaxhavens.htm (accessed 17 July 2016).

64 For more comments, see V Houlder ‘Tax blacklist provokes offshore fury’ Financial Times 22 June 2015.


of Conduct for Business Taxation. Finally, the third step is an agreement on a list. Based on a recommendation by the Commission, member states will agree on the countries that need to be on the list. Communication did not address the counteraction against listed countries.

The developed procedure promotes good governance and enhances its implementation. It attempts to avoid the previous massive criticism of being arbitrary. According to the EU Commission, the procedure should be more transparent. The format of the information should also be easier to access. This proves that high standards of good governance mirrored in a transparent policy are relevant to the EU.

Nonetheless, it may be doubtful how effective the mechanism of the listing will be. The entire process of listing third countries seems to be quite complex and long. It is not surprising that the Commission stated that it will be applied only in exceptional cases. According to the Commission, ‘[l]isting a jurisdiction should always be considered as a last resort option. It should be reserved for those jurisdictions that refuse to engage on tax good governance matters or fail to constructively acknowledge EU concerns with their tax systems.’ This may undermine the idea of listing and make it an even weaker mechanism. The process already has been criticised by some non-governmental organisations (NGOs) as being ‘doomed to fail’ because it will not include some countries where international financial secrecy thrives.

Finally, Communication also recognised the role of international financial institutions in promoting good governance. The EU Commission referred to the EU Financial Regulation (article 140(4)). In particular, it discussed the ban on investing and channelling EU funds through entities in third countries if these do not comply with international tax transparency standards.

67 The options that have so far been considered are a possibility to review and even suspend free trade agreements and prohibiting access to EU funds.
68 A detailed description of the process of deciding on the EU list of non-cooperative jurisdictions is described in the Communication.
69 Although the new list will be the result of certain proceedings and will be based on clear criteria, it was welcomed with some criticism, particularly by NGOs. They claim that it is ‘a highly political exercise, where rich and powerful countries such as the US and Switzerland are protected from blacklisting’. See https://financialtransparency.org/false-eu-promise-listing-tax-havens/ (accessed 17 July 2016).
70 Communication, 5.3.
4 Call for promotion of inter-agency cooperation as a way of enhancing tax good governance in third countries

The new EU agenda promoting good governance in relationship to third countries is an important increment in promoting and enhancing good tax governance. Many developing countries experience weak governance and, as a result, widespread corruption, tax evasion and money laundering. With the suggested set of policy instruments, the EU, given its unquestionable political impact and important role on the international agenda, may have a unique opportunity to improve the situation whereby none of the competing parties has an advantage at the initiation of a competitive activity in many third countries. However, a thorough analysis reveals certain weaknesses of the updated EU agenda.

In the context of the conducted analysis, it appears that the EU thus far has not recognised the value of inter-agency cooperation as a tool that not only tackles illicit financial flows, but also increases the effectiveness and efficiency of tax administrations and promotes inclusiveness within a frame of a ‘whole-of-government’ approach. This is quite surprising considering the wide array of actions suggested in Communication.

It may even be more surprising considering current initiatives undertaken over the last few years by many member states of the EU. On such an initiative, the Croatian State Prosecutor’s Office for the Suppression of Organized Crime and Corruption (USKOK) is a Croatian agency supervised by the state attorney’s office but which also cooperates with the tax administration or Tax Cobra, a cooperation of police, custom and finance administration in the Czech Republic. The concept of inter-agency cooperation seems to be widespread in Europe, and many countries have well-grounded experience in this field.

Considering the experience of developed countries experienced in this area, they could assist those that are still developing to increase their knowledge on how the effective and efficient inter-agency cooperation should be constructed. Existing studies suggest that there still are many legal and practical challenges that will need to be overcome. The role of developed countries is to share their experiences of how the issues of confidentiality, sharing information and responsibilities could be addressed. It seems that thus far not much has been done. Various

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75 A Majdanska et al ‘Inter-agency co-operation and illicit financial flows in Africa’ Working Draft.
international stakeholders are focusing on tax cooperation whereas, to face the challenges of many modern threats (eg IFFs) and to ensure sustainable sources for development, cooperations should include more agencies than tax administrations.

At the same time, when examining the experience of some developing countries, it appears that many of these countries continue to struggle with constructing efficient channels for inter-agency cooperation. A good case study may be sub-Saharan African countries. Capacity in sub-Saharan African countries is limited and further complicated by the need to significantly improve cooperation between existing institutions. Even where appropriate architectures of government agencies are in place, the effectiveness of their work is diminished by the lack of cooperation. Responsibilities are duplicated, and information is very limited.

Nigeria is an example of an African country where many regulatory agencies already exist, for instance, the Special Control Unit Against Money Laundering or the Nigerian Financial Intelligence Unit. Nevertheless, the country ranks in the top five African countries by cumulative IFFs in the period 1970 to 2008. The situation may be the result not only of inadequate capacities of existing institutions, but also the lack of coherence between them. Again, some responsibilities between agencies are duplicated.

On the other hand, a slow move in the direction of inter-agency cooperation can be observed. Kenya is an example of a less-developed country that implemented inter-agency strategy. In 2015 Kenya established the Multi-Agency Team (MAT) on Corruption and other Economic Crimes that ensures the cooperation of a number of agencies on a regular basis. There is evidence that the MAT has been used successfully to share information between the various agencies, and a number of cases are currently before court as a result of information sharing.

78 UNECA Report (n 77 above) 36.
It cannot be ignored that inter-agency cooperation not only is a tool that affords an opportunity to effectively address certain types of crimes. It may also address issues of scarce capacities which, when coupled with complex law systems and opaque administration, become unable to effectively utilise law enforcement and ultimately enables IFFs to flourish. Efficient inter-agency cooperation could mitigate some of these problems. The benefits of implementing this strategy that may be most important from the perspective of the least developed countries could be providing a sustainable source of revenues; promoting good governance; capacity building; and, finally, improving effectivity and efficiency of law enforcement.

The effective fight against illicit financial flows demands the participation of different sets of actors. Among them, tax authorities, customs administrations, the police, financial intelligence units and anti-corruption agencies play the most significant role. Therefore, the slow move to inter-agency cooperation in some developing countries must be welcomed and support from international fora must be demanded.

5 Conclusions

In terms of enhancing good governance, the inclusiveness and participation of main stakeholders are of great value. An important dimension is cooperation. Cooperation should stand as an invitation to all stakeholders. It also refers to good governance in taxation. This statement implies a twofold collaboration. It not only is about collaboration between tax administration and taxpayers. Cooperation between tax administration and other types of law enforcement agencies, both at the international and domestic levels, plays an equally significant role in countering different types of illicit financial flows. The shift to a cooperative approach among different governmental bodies could be a long-term project that may result in preventions that are more effective and efficient in detecting, investigating and prosecuting different types of illicit financial flows. From the perspective of developing countries, creating this type of cooperation is of the greatest importance. It also equals access to data, experience and knowledge of other agencies required by the tax administration. Their limited capacity could gain in cooperation with financial intelligence units and different law enforcement agencies.

Taking into account the rich experience of member states, the EU has a unique opportunity to promote the concept of inter-agency among developing countries. It may help design appropriate modes of information exchange and subsequent communication channels. By improving cooperation between tax administrations and other law enforcement agencies, the efficiency and effectiveness of tax administrations could be improved. In this manner, it may fulfil its commitment to strengthen domestic resource mobilisation in developing countries. Tax
administrations as well as other law enforcement agencies would be better informed and equipped to conduct investigations. Finally, by supporting cooperation at the inter-institutional level, the EU could contribute to building enforcement agendas of third countries that are more coherent. In the same way, the EU would also fulfil its obligation of supporting the achievement of Sustainable Development Goals.

In examining the operations of other international bodies, inter-agency cooperation already is present on the agendas of the OECD, the World Bank Group and the IMF. Perhaps it is the right time for the EU to join these institutions and support developing countries in building their good governance agenda by implementing inter-agency cooperation.
How to effectively promote tax good governance in third countries

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Abstract

The level of cooperation between tax administrations and other domestic law enforcement agencies is critical in addressing illicit financial flows (IFFs). Recent international strategies addressing financial crimes and illicit flows have primarily focused on achieving greater synergies in information exchange. However, traditional concerns about taxpayer confidentiality and society’s best interests have impeded cooperation in many jurisdictions, whereas others have found innovative solutions to resolve this conflict. Although there are several limitations on the scope of domestic inter-agency cooperation, opportunities do exist for countries to improve existing cooperation models by means of task forces, fusion centres and by applying international best practice. For African countries to meet the recommendations for inter-agency cooperation, as set out in the Report of the High-Level Panel on Illicit Financial Flows from Africa, this requires that appropriate legal gateways are in place, that strategies and objectives to combat IFFs are aligned and that appropriate co-ordination mechanisms are identified and implemented.

1 Introduction

A key challenge posed to African countries by the recommendations of the Report of the High-Level Panel on Illicit Financial Flows from Africa is that African states should ‘strengthen the independent institutions and agencies of government responsible for preventing IFFs’ and ‘create methods and mechanisms for information sharing and co-ordination among the various institutions and agencies of government responsible for preventing IFFs’.

The relationship between different spheres of government is characterised by layers of inter-dependencies as it is not possible to have a complete separation of policy responsibilities and outcomes amongst different levels of government. Producing deliverables and achieving government objectives requires co-ordination between government agencies. Charbit and Michalun define this as a complex relationship because at the same time it is vertical (across different levels of government), horizontal (among the same level of government) and networked, as the lines of communication and co-ordination for an agreed policy objective may traverse as it involves a multitude of actors and stakeholders in the public and private sectors.

In addressing the above problem, Charbit and Michalun identify five dominant challenges to multi-level governance. These are described as information gaps; capacity gaps; fiscal gaps; as well as administrative and policy gaps. The information gap refers to ‘information asymmetries between levels of government when designing, implementing and delivering public policy’. The capacity gap refers to a lack of human resources, knowledge and skills and supporting infrastructural resources. The fiscal gap represents ‘the difference between sub-national revenues and the required expenditures for sub-national authorities to meet their responsibilities’. An administrative gap refers to a disjoint when administrative boundaries do not correspond to functional economic areas at sub-national levels, whilst a policy gap arises when strictly vertical approaches to cross-sectoral policy are taken by ministries. It can be argued that an administrative and policy gap arises when there is no nexus between the heads of administrations and policy setters (that is, a horizontal approach is taken without considering the vertical relationships).

The level of cooperation between tax administrations and other domestic law enforcement agencies is critical in countering financial crimes. Recent international strategies to address financial crimes and illicit flows primarily have focused on achieving greater synergies in information exchange. However, traditional concerns on taxpayer confidentiality and society’s best interests have impeded cooperation in many jurisdictions, whereas others have found innovative solutions to resolve this conflict. The current state of affairs in domestic cooperation reveals that, whilst there are several limitations on the scope of cooperation, opportunities do exist in the form of existing cooperation.

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3 As above.
4 As above.
5 As above.
6 As above.
models, the use of task forces and fusion centres and in applying international best practice.

Tax administrations have a key role to play in addressing serious crime, and this role often is expressed in specific terms in country legislation. This obligation of sharing taxpayer information with other departments, however, should be measured against the potential impact on the integrity of the tax system. The Financial Action Task Force (FATF) points out that in most countries there are regulatory restrictions in place that govern the collection and use of information (whether from the public or from other government agencies). Such restrictions can limit an agency’s ability to share information with other government agencies and countries. It is, therefore, necessary to find a balance between data protection rights and in government departments to share information and may lead to a situation where no sharing whatsoever will take place.

Moore points out that revenue administrations are highly networked and dependent on active cooperation from a variety of stakeholders that may include ministries of finance; commerce and trade; justice; as well as functionaries responsible for registering property; new businesses; motor vehicles; public utilities; and public procurement agencies. In addition to these stakeholders, there are the police; the judiciary; public prosecutors; security agencies; tax administrations of other countries’ financial services industries; business associations; and professional associations of accountants and auditors.

The ability of government institutions to share relevant information is often a key indicator of the effectiveness of a department to pro-actively identify risks pertinent to its mandate. The failure to relate its core functions and mandate to that of similar departments will not allow for a common line of sight desperately needed in countering financial crime.

In 2011 the first International Forum on Tax and Crimes was held in Oslo, Norway, with the aim of finding more effective ways of using a ‘whole-of-government’ approach in countering financial crimes. In response, the Organisation for Economic Co-operation and Development (OECD) produced an in-depth analysis of inter-agency cooperation in fighting financial crimes in 32 countries wherein four different models of cooperation are mapped. These are discussed in the next section.

7 Eg, in South Africa through sec 3 of the Financial Intelligence Centre Act (FICA) that singles out the tax authority next to law enforcement agencies.
9 M Moore ‘Obstacles to increasing tax revenues in low income countries’ (2013) 8.
10 As above.
2 Models for cooperation

Strategies for combating financial crimes are dependent on the ability to share information and that becomes a necessary pre-condition for inter-agency cooperation. Such cooperation is required over various stages, including prevention; detection; investigation; prosecution; and recovery of the proceeds of crime. From the perspective of combating financial crimes, a number of government agencies need to be involved in part or throughout an investigation, depending on the circumstances.

The OECD identifies the key agencies involved in the different stages of combating financial crimes, and identifies frameworks that support arrangements for inter-agency cooperation. It further identifies information flows of importance that enable different agencies to effectively combat financial crime, whilst describing the ‘legal gateways’ in countries that make or need to make information flows possible.

In assessing the ways in which countries have allocated responsibilities for countering tax crimes, four models were identified:

- In the first model, the tax administration has the responsibility of directing and conduction investigations (Model 1).
- In the second scenario, tax administrations conduct investigations under the auspices of the public prosecutor (Model 2).
- A third way identified is where a specialist tax agency is constituted outside the tax administration but under the auspices of the finance ministry to conduct investigations (Model 3).
- The fourth model is one where the police or the public prosecutor has the responsibility for conducting investigations (Model 4).

All countries assessed by the OECD have ‘legal gateways’ in place to allow tax administrations to share information collected for the purpose of a civil tax audit or law enforcement agencies that conduct tax crime

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13 These agencies can include the tax and customs administration(s); anti-money-laundering authorities; the police; specialised law enforcement units; the public prosecutor’s office; and financial regulators.
14 OECD (n 13 above) 8.
15 Applied in a number of Commonwealth countries (including the United Kingdom; Australia; Malaysia; South Africa; New Zealand; Uganda; and India); Japan; South Korea; Switzerland; and the United States.
16 Eg applied in Austria, Spain, Portugal and the US. The US is included in both models 1 and 2 as two types of criminal investigations are conducted: (i) administrative – conducted by the tax administration and handed over to the prosecutor’s office; (ii) grand jury investigation initiated and conducted under the direction of a prosecutor.
17 Ghana, Greece, Iceland and Turkey.
18 Eg Belgium, Brazil, Burkina Faso, Denmark, Finland, France, Iceland, Norway, Slovenia and Spain. Spain is included under models 2 and 4 as it can conduct investigations under the direction of an examining judge or, because a case was initiated outside the tax administration, it may fall under the direction of the police.
investigations. However, there are shortcomings regarding the sharing of non-tax information by tax administrations with the police or public prosecutor. Some countries explicitly prohibit tax administrations from sharing information relevant to non-tax crimes. Four countries assessed have prohibitions on the financial intelligence units (FIUs) from obtaining tax information from the tax authority. Wider information sharing is possible as far as customs information is concerned for tax and non-tax crimes. In the case of the latter, the customs mandate includes facilitation of trade and the collection of duties and security that puts it in a position where it will always collect both tax and non-tax information.

Cooperation between customs and tax can create financial and efficiency gains in the collection of duties and taxes, the exchange of information and a coordinated approach in pursuing common objectives such as improving compliance, fostering cross-border trade and supporting economic development. Effective cooperation can bring about better deterrence of tax and customs fraud through the holistic application of risk management methodologies. In this regard, import and export data and purchase and sales data can be matched to improve risk identification of under-declaration practices. When verifying the customs value for related party transactions involving multinational enterprises, customs administrations can benefit from information derived from the transfer-pricing studies that have been developed for profit tax purposes, and which are generally based on the application of the OECD transfer-pricing guidelines.

The World Customs Organization (WCO) identifies the following underpinning enablers for effective and sustained cooperation and information exchange between tax and customs administrations:

(a) Political will and executive commitment is required because once a policy decision is taken, it is the commitment and involvement of heads of both authorities that provides credibility and the necessary drive to ensure that officers in both administrations understand the importance of co-operation and information exchange and that they can actively pursue that agenda through a sustained process.

(b) A legal framework is required for the effective exchange of information and the protection of data.

19 OECD (n 13 above) 14.
20 As above.
21 OECD (n 13 above) 14-15.
23 As above. Both the OECD transfer pricing guidelines and the WTO customs valuation methodology are designed to ensure that related party prices are comparable to those between unrelated parties. The WCO notes that there are opposing risks, namely, the risk to customs generally is the undervaluation of imported goods to reduce customs duties, whereas the tax risk is the overvaluation of goods and services to reduce the taxable profit.
24 WCO (n 23 above) 7-8.
(c) Governance processes and resources: An adequately-resourced governance process laying down detailed co-operation mechanisms and designated contact points should be put in place.

(d) Cross-sectoral understanding: Both administrations should develop and enhance their capability to identify information of use that may be held by the other administration.

(e) Data confidentiality and protection: Proper legal safeguards governing data privacy and protection are required and both administrations need to promote an organisational culture of data confidentiality.

(f) The standardisation of communication protocols (inclusive of information technology systems) is required.

(g) Data analytics: Large data requires robust data analytics capability and analytical techniques including predictive analytics which will assist in identifying patterns/trends, compliance and/or non-compliance history, gaps, risks and modi operandi.

(h) Information and system security management.

Legal gateways are available in most countries (although a request-based limit may be imposed in some countries) whereby the police or prosecuting authority can provide relevant information to agencies that are investigating tax crimes.

In as far as information sharing between tax administrations and FIUs is concerned, several variations were identified. In some countries, tax authorities may have direct access to FIU information while, in others, the FIU may not share information with the tax authority for purposes of doing tax assessments. In the six countries assessed, FIUs are prohibited from sharing information with the customs authorities. In most countries, legal gateways are in place for FIUs to provide information on possible tax offences to the responsible authority, although in many instances, the FIU is able to exercise a discretion as to what information is made available.

From an African perspective (of the countries assessed by the OECD), only Uganda allows tax crime investigators to have direct access to information obtained by the tax administration for purposes of administering and assessing taxes. Ghana operates on a request based only premise, and South Africa is able to share information spontaneously (it is under no obligation to do so and may exercise its discretion in opting whether to do so).

The four models for cooperation reveal that various options are available to countries for structuring inter-agency cooperation. Whichever agency is chosen to lead inter-agency efforts preferably should have both

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25 OECD (n 13 above) 16.
26 OECD (n 13 above) 49 51.
strong governance procedures and institutional capacity in place to lead. It is also imperative that the underpinning enablers to cooperation, as identified by the WCO, are in place.

3 Strategies for cooperation

The United States Joint Chiefs of Staff hold the view that ‘commitment to interorganisational cooperation can facilitate cooperation in areas of common interest, promote a common operational picture, and enable the sharing of critical information and resources’. Where such commitment is present and actioned, inter-agency cooperation will enable:

(a) unity of effort whereby national objectives are translated into unified action;

(b) the pursuit of commonly-shared objectives by integrating joint and multinational operations at the strategic level and through co-ordination at the operational and tactical level;

(c) achieving a common understanding that will allow for the identification of opportunities for co-operation and that can assist in mitigating unnecessary conflict or unintended consequences; and

(d) a ‘whole-of-government approach’.

In 2009 the OECD described the rationale for ‘whole-of-government’ work as the recognition of the interdependence among levels of government. The term ‘whole-of-government approach’ is described as a resurgent form of co-ordination between government agencies, and the spectrum can range from improvements in horizontal co-ordination between different policy areas in the central administrative apparatus to improved inter-governmental vertical co-ordination between ministries and agencies. The intent behind this greater recognition of the existence of interdependencies generally is aimed at achieving better regulation and enhancing performance, effectiveness and efficiency.

The whole of government approach requires a particular way of working, which involves various managerial inputs. First, joining up policy making at the centre is required to achieve ‘a shared vision in support of implementation’. This means that all stakeholders should have

27 WCO (n 23 above) 5-6.
29 Four attributes are associated with a framework that can improve unity of effort, namely, common vision or goals; common understanding of the operational environment; co-ordination of efforts to ensure continued coherency; and compatible measures of progress and ability to change course, if necessary (US Army JP 3-08: 2016: 1-5/6).
30 US Army Joint Publication 3-08 (n 29 above) I-12.
31 US Army Joint Publication 3-08.
the same understanding of the problem and the ‘same vision and buy-in to
the same strategic priorities’ where they are part of the consultation process
from the agenda-setting stage right through to policy development.\textsuperscript{33}
Colgan, Kennedy and Doherty make the point that whenever complex
policy and policy implementation decisions are taken, there needs to be
recognition of inter-dependencies between government agencies which is
followed up by effective management between different government
departments and the different levels of government to make the
implementation work.\textsuperscript{34} Fundamental to successful cooperation is the
ability of heads of agencies to personally work together. In this regard,
interpersonal communication skills that emphasize consultation,
persuasion, compromise and consensus building are necessary
contributors to achieving unified objectives and to build personal
relationships that inspire trust and confidence.\textsuperscript{35}

Agencies have found various ways of working together in addressing
financial crimes, such as joint investigation teams; joint training
interventions (for example, Iceland and Latvia);\textsuperscript{36} inter-agency centres of
intelligence/fusion centres; secondments of personnel (for example, Italy,
Ghana, Korea and Japan);\textsuperscript{37} the use of shared data bases; joint committees
to coordinate policies in areas of shared responsibility; and inter-agency
meetings and training interventions.

3.1 Aligning objectives and developing a common
understanding

By comparing the goals and objectives of two different agencies that are
responsible for addressing IFFs, an indication of the feasibility of inter-
agency cooperation can be obtained. To illustrate this point, the objectives
of the South African Revenue Service (SARS) and the South African
Financial Intelligence Centres (FICs) are compared to determine levels of
alignment. The FICs’ mission and objectives are clear and are summarised
in legislation: Section 3 of the Financial Intelligence Centre Act states that
the principal objective of the Centre is to assist in the identification of the
proceeds of unlawful activities, the combating of money-laundering
activities and the financing of terrorist and related activities. The other
objectives of the Centre are (a) to make information collected by it
available to investigating authorities, the intelligence services and the
South African Revenue Service to facilitate the administration and
enforcement of the laws of the Republic; and (b) to exchange information

\textsuperscript{33} A Colgan et al \textit{A Primer on implementing whole of government approaches} (2014) 4.
\textsuperscript{34} As above.
\textsuperscript{35} US Army Joint Publication 3-08 (n 29 above) I-12.
\textsuperscript{36} OECD (n 13 above) 232 265.
\textsuperscript{37} OECD (n 13 above) 251 218 258 254.
with similar bodies in other countries regarding money-laundering activities and similar offences.  

One of the five-year priority initiatives of SARS is to ‘achieve increased customs compliance.’^\textsuperscript{39} To achieve this outcome, it proposes, amongst others, to ‘continue to adopt a whole of government view in managing the customs border environment; continue to strengthen risk management capabilities and to continue to strengthen international agreements and links with other jurisdictions.’^\textsuperscript{40} Its strategic plan further states that SARS will adopt a whole-of-government view in managing the customs border environment through collaboration with other government agencies. Collaboration with other government agencies is done in such a way as ‘to improve government’s overall value chain.’^\textsuperscript{41} These sentiments capture the essential need for co-ordination and how the administration tends to go about in achieving this.

SARS also indicates that it will continue to strengthen international agreements and links with other jurisdictions and, given the level of interconnectivity in global trade, it acknowledges the importance of building and maintaining good relations with other tax and customs jurisdictions. SARS states that it

will collaborate with the Financial Action Task Force (FATF) to support its mandate in implementing global safeguards to protect the integrity of the financial system, in order to meet the objectives of tackling money laundering. This is particularly relevant to SARS as tax crime is considered as a base to money laundering and smuggling. Customs and excise duties offences are also included in this exercise. ^\textsuperscript{42} Furthermore, SARS indicates that it will seek to strengthen and leverage South Africa’s international treaty networks to cooperate and exchange information with other tax and customs jurisdictions. ^\textsuperscript{43} Thus, the collaborating agencies and objectives are clearly defined.

In its latest strategic plan,^\textsuperscript{44} the inclusive language has dissipated to the extent that reference to FATF is limited to the participation of SARS in both domestic and global anti-terrorism bodies to assist SARS in the identification, mitigation and sharing of information regarding potential terrorist threats through the trade supply chain networks. Also, in dealing with the threat of the illicit economy and illicit financial flows,
it is proposed that (i) engagement with other state enforcement agencies such as state security agency and police takes place to agree on memoranda of understanding (MOUs) for establishment of dedicated resources for fighting illicit trade; and (ii) enhancing the inter-agency co-operation in fighting tax and other financial crimes.\(^{45}\)

Notably absent from the language is specific reference to the term ‘money laundering’ and the FIC. It can be inferred from the language that an obstacle to co-ordination may have arisen as a result of changes in constituents. Another inference is possible in that the co-ordination levels are so well developed that they do not need mentioning. Be that as it may, it would have been preferable that specific reference to money-laundering activities be maintained because of the overlaps that exist between tax evasion and laundering.\(^{46}\)

The excerpts from the SARS strategic plans demonstrate sufficiently that its objectives overlap with other agencies and that it sees the need to coordinate actions at different levels to achieve its goals. As pointed out earlier, the FIC mandate and objectives are clear, and the Act leaves little room for different interpretations. Turning to the tax legislation analysed below, it is shown that high levels of discretion in determining what may or may not be shared may become problematic in advancing cooperation and co-ordination mechanisms.

Under section 70(3)(c) of the Tax Administration Act of 2011, provision is made for the disclosure of information to the Financial Intelligence Centre where such information is required for the purpose of carrying out the Centre’s duties and functions under the Financial Intelligence Centre Act 38 of 2001.\(^{47}\) According to section 70(7), SARS may not disclose information if it is satisfied that the disclosure would seriously impair a civil or criminal tax investigation. Section 71 allows SARS to make an \textit{ex parte} application to a judge in chambers for an order authorising SARS to disclose the information under certain circumstances.\(^{48}\)

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\(^{45}\) SARS (n 45 above) 27 28.

\(^{46}\) Eg, both crimes entail some form of concealment or hiding of assets through shell companies or by means of deliberate steps to break the audit trail. Risk indicators also overlap, such as transactions that lack reasonable explanation; the use of offshore accounts, trusts or companies not supported by economic rationale for doing so; schemes involving suspect territories; over-complicated tax schemes; unrealistic wealth compared to client profile; short-life businesses involved in imports/exports; and the use of cash transactions.

\(^{47}\) Under sec 70(5). The information disclosed may only be disclosed to the extent that it is (a) necessary for the purpose of exercising a power or performing a regulatory function or duty under the legislation; and (b) relevant and proportionate to what the disclosure is intended to achieve as determined under the legislation.

\(^{48}\) Where it may reveal evidence that (a) an offence (other than a tax offence) was or may be committed in respect of which a court may impose a sentence of imprisonment exceeding five years; (b) that may be relevant to the investigation or prosecution of the offence; or (c) of an imminent and serious public safety or environmental risk.
A serious impediment to information sharing may be caused if section 70(7) is applied with a wide discretion or without some fixed criteria for determining what would cause or be a serious impairment of a civil or criminal tax investigation. Conversely, some criteria could be set for instances where information sharing should be compulsory because there are indicators within the scope of tax administrations which are relevant to anti-money-laundering initiatives.

The South African example shows that clear language should be used to describe the objectives of an agency and, also, in which areas it has interdependencies with another agency and how those inter-dependencies will be addressed. It is also evident that clarity in legislation and/or regulations is necessary where ‘discretion’ is left too wide for interpretation.

3.2. Joint investigation teams

A working example of an integrated task team is Project Wickenby which is run under the auspices of the Australian Tax Office (ATO).49 The ATO is included in the Commonwealth’s Organised Crime Strategic Framework as ‘an agency with shared responsibility for addressing the impact on Australia of serious and organised crime’.50 The ATO has direct access to information collected by the Australian FIU (AUSTRAC) which accords with the relevant provisions of the Financial Transactions Reports Act (FTR) and a memorandum of understanding between AUSTRAC and the ATO. There are no specific restrictions on the use of information by the tax authorities as the principle object of the FTR is to facilitate the administration and enforcement of tax laws. Under AML/CFT legislation, the tax authorities are entitled to access AUSTRAC information for any purpose that relates to facilitating the administration or enforcement of a tax law.51

The ATO’s role is explained by ‘the profit driven nature of organised crime’ and the fact that the necessary skills are available to the ATO to help with the identification of unexplained wealth that is generated through the proceeds of crime.52 The basis of this framework is the understanding that law enforcement agencies have differing powers and responsibilities, and that cooperation will result in these responsibilities and powers being used to maximum effect. The purpose of the framework is to initiate and sustain

49 ATO (no longer available).
50 As above. The introduction, in 1985, of sec 3D of the Taxation Administration Act 1953 (allowing disclosure of ATO information to the National Crimes Authority (NCA), a precursor to the Australian Crime Commission (ACC) and the introduction, in 1989, of sec 3E of the TAA 1953 (which allowed the ATO to share information on serious offences with law enforcement bodies) formally inducted the ATO into the armoury of state and Commonwealth law enforcement.
52 ATO (no longer available).
a collaborative and integrated Commonwealth approach to address organised criminal activity in order to reduce the social and economic impacts of organised crime on the Australian community by targeting the most significant threats. Whilst taxation secrecy and disclosure provisions are designed to keep protected tax information confidential, limited circumstances allow the disclosure of protected information by the tax authorities to other agencies. Such circumstances include investigating a serious offence or when disclosure is in connection with a prescribed task force and one of the main purposes of the task force is protecting the fiscus.

3.3 Task force and the fusion centre concept

Information sharing by ATO officers for purposes of law enforcement is enabled under legislation. Information sharing through a task force allows the ATO to chase after assets of criminals by means of tax remedies. The task force’s law enforcement impact is the result of having an integrated approach to confiscation of assets and by combining inter-agency resources. In July 2010, the National Criminal Intelligence Fusion Centre was launched, which is described as an important component of the Commonwealth Organised Crime Strategic Framework. The Fusion Centre concept is designed to bring together information, skills and knowledge, data and technology across government departments. The Fusion Centre integrates information and intelligence at a central or national level in order that ‘real time’ intelligence is generated on risk areas such as organised crime. It also draws together a variety of skills in a single environment that allows for better collaboration and for an improved view of factors associated with organised crime, such as risks, threats and vulnerabilities. From these factors, targets common to all participants can be identified.

The United States (US) in 2006 established the Organised Crime Drug Enforcement Task Force Fusion Centre (OCDEFT-FC) under the auspices of the Department of Justice, Homeland Security and the Department of Treasury. The task force/fusion centre serves a central point for developing and utilising technologies that provide an analysis of law enforcement and intelligence data to support inter-agency cooperation. Through the Fusion Centre, law enforcement data is shared and different agencies derive different benefits from the Centre. For example, the involvement of the Internal Revenue Service Criminal Investigation’s (IRS-CI) at the OCDEFT-FC is focused on money laundering activities, and it does not make tax information available. The design of the OCDEFT-FC is aimed at generating cross-agency

53 As above.
54 ACIC ‘National criminal intelligence fusion capability’ (2016).
55 OECD (n 13 above) 117.
56 As above.
integration and the analysis of drug and drug-related financial data to derive comprehensive intelligence pictures of targeted entities. The IRS-CI contributes resources and information for the purpose of generating analytical products, investigative leads, target profiles, strategic reports and field query reports. This contribution is important as it is an acknowledgment that the pursuit of national objectives relies on collaboration. As such, it provides a basis for addressing risks such IFFs through a whole-of-government approach in the form of fusion centres or task teams.

3.4 International developments in domestic cooperation

In 2013 criminal investigations leg of The Netherlands Tax and Customs Administration established a Centre for Intelligence and Operational Excellence which includes all national agencies involved in countering money laundering. The main goals of the Centre are to

- enhance ongoing work on anti-money-laundering activities;
- improve seizure and confiscation procedures;
- centralise the management and preparation of money-laundering cases;
- optimise resources; and
- continuously identify ways of strengthening the process of combating money laundering though improved inter-agency and international co-operation.

In achieving these goals, the Centre acts as nodal point for case management and the evaluation of completed cases; for developing a network of cooperation; and establishing and maintaining partnerships and the sharing of information. The Centre is also responsible for the exploration of new strategies and techniques for addressing money laundering, including the use of digital technology and social media.

In 2011 the Grey Economy Information Unit (GEIU) was established in Finland as a means of addressing the grey economy. The Unit’s mandate to collect information is described as ‘the right to receive, on request, necessary information held by other authorities, even where that information would not normally be available to the tax administration due to secrecy provisions.’ A key role of the Unit is to produce compliance reports requested for purposes of levying taxes, the enforcement of tax

57 As above.
58 OECD (n 13 above) 20.
59 OECD (n 13 above) 115-116.
60 The grey economy is defined as ‘any activities that result in the failure to meet legal obligations for payment of taxes, customs fees or to obtain unjust repayment’.
61 OECD (n 13 above) 203.
controls and the prevention or investigation of money laundering or terrorism.\(^{62}\)

France regards cooperation between the tax authority and customs as a critical aspect in the fight against tax evasion. This is recognised through a national agreement between the agencies. Cooperation is based on a legislative framework which allows for the receipt of information on request by the tax authority and also for spontaneous reporting by customs to the tax authority of information collected in the course of conducting customs activities.\(^{63}\) Under Ghana’s anti-money-laundering legislation, the Ghana Revenue Authority must spontaneously provide all information concerning suspicious transactions to the FIU. The framework for enhanced cooperation is contained through the governing body of the FIU which includes representatives of the various agencies combating financial and tax crimes.\(^{64}\)

India in 2011 constituted a High-Level Committee under the Chairmanship of the Secretary (Revenue) with representatives of the reserve bank, intelligence agency, enforcement directorate and other relevant agencies, following the recognition that a multi-disciplinary approach was required for the co-ordination of investigations into incidences where funds are generated illicitly in the country or where these are illicitly moved to foreign jurisdictions.\(^{65}\)

In October 2012 Mexico published the law (which came into effect in 2013) on the Federal Prevention and Identification of Operations from Illicit Resources that contains provisions to improve cooperation in information sharing and in the prevention, detection and combating money laundering between government agencies.\(^{66}\) New Zealand’s information exchange is largely case-specific and the means of transferring information is dependent on the type of data.\(^{67}\) In 2011 Switzerland placed a duty on every federal civil servant (including tax officials) to report to the police or public prosecutor ‘suspicions of all misdemeanours or felonies which they come across in the course of their professional activity’.\(^{68}\)

From the random country selection above, it is evident that many jurisdictions have recognised the need that an effective response to financial crime is best achieved through a ‘whole-of-government’ approach which is premised on the better gathering and sharing of information to allow for quicker responses through the pooling of resources.

\(^{62}\) As above.

\(^{63}\) OECD (n 13 above) 209.

\(^{64}\) OECD (n 13 above) 218.

\(^{65}\) OECD (n 13 above) 249.

\(^{66}\) OECD (n 13 above) 288.

\(^{67}\) OECD (n 13 above) 299.

\(^{68}\) OECD (n 13 above) 22.
3.5 FATF best practice – Principles for sharing information and joint operations

The FATF best practice on addressing proliferation finance provides useful guidance as far as principles for the sharing of information and joint operations are concerned. These best practices can be applied to a variety of target areas, including financial crimes, as it allows for joint analysis, coordinated and complementary operations, and more developed policy positions. The FATF points out that some of the benefits of joint initiatives are relationship and confidence-building measures that bring together representatives of various government agencies.69 Some common issues that can be addressed through joint initiatives include

- the monitoring and analysis of risks, threats, new trends and vulnerabilities;
- policy development on combating financial crime and illicit financial flows;
- recommendations of appropriate responses for competent agencies to take action;
- identification of key intelligence gaps related to financial crimes and illicit flows and the development of possible solutions to close those gaps;
- consideration of potential interdiction opportunities to impede financial crimes and co-ordination of such actions;
- co-ordination and ‘de-conflicting’ the activities of competent agencies (including financial, intelligence and law enforcement agencies) in terms of combating the problem;
- co-ordination and de-conflicting of financial, intelligence and law enforcement agencies in terms of potential plans to identify individuals and entities who may be involved in or supporting financial crimes; and
- a review of mechanisms to ensure effective scrutiny of suspicious activity reporting.70

Underlying these principles is the question whether the necessary information management systems are in place and whether risk management practices are followed. Similarly, the WCO71 points out that joint tax and customs activities may potentially include activities such as

- joint risk profiling/analysis for the identification of potential risk areas;
- joint investigations or audits; joint identification of measures and their application in the fight against customs duty, tax offences and transnational crime (for instance, money laundering);
- co-ordination of control and compliance activities within free trade zones;

69 FATF (n 8 above) 9-10.
70 As above.
71 WCO (n 23 above) 5.
• co-ordination on transfer pricing and customs valuation matters;
• integrated programmes on approved economic operators (AEO) and co-
  operative compliance;
• joint research and analysis on tax and customs topics; joint training
  initiatives to enhance the understanding of each other’s roles and
  responsibilities and to educate officers on cross-sectoral risks and
  challenges;
• joint approach on legislative/policy matters and taxpayer education; and
• secondment programmes involving officers being interchanged between
  agencies to enhance cross-sectoral capacity.

Such initiatives should be backed by a proper risk management framework
that provides for clear terms of reference for the setting up of risk
committees and periodic meetings that will have the responsibility of
assessing the performance of such programmes and to make operational
decisions to address high-risk operators or tax entities identified.

4 Limitations to the scope of cooperation

The obligation of sharing taxpayer information with other departments in
addressing serious crimes should be measured against the potential impact
on the integrity of the tax system. A 2012 New Zealand study found that a
tax administration’s partaking in information sharing to address serious
crime is acceptable as long as it is ‘fit for purpose’.72 Aspects considered in
the sharing of information include

• balancing the individual’s right to privacy and the benefits to society;
• the nature of the serious crime in question and the scope of the
  information required;
• the authority of the information and the ability of the tax administration to
  provide it,
• the intended and potential use of the information,
• the risk and error of misuse.73

When the above is considered in context of Recommendation 2, a twofold
question may be posed, namely, to what extent information is available
and to what extent it is shared. For example, the FATF shows that, while
South Africa has ‘most of the necessary legal tools and funding to combat
money laundering, there is a very low number of ML investigations and
prosecutions, despite an acknowledged level of organised crime and
predicate offences’.74 A key constraint identified is the insufficient
recording of statistics to allow for a pro-active pursuit of money-laundering

72 OECD (n 13 above) 20.
73 As above.
Chapter 4

offences. Recommendation 2 requires countries to have national AML/CFT policies in place that are informed by (a) the risks identified (requiring accurate information to be available) and (b) mechanisms in place to enable policy makers, FIUs and law enforcement authorities to cooperate. In addition, mechanisms should be in place on a domestic level for coordination in developing and implementing AML/CFT policies and activities, both on policy-making and operational levels. Recommendation 2 also should be viewed in the context the prevalence of corruption and a country’s structural deficiencies. The FATF methodology provides as follows:

An effective AML/CFT system normally requires certain structural elements to be in place, for example political stability; a high-level commitment to address AML/CFT issues; stable institutions with accountability, integrity, and transparency; the rule of law; and a capable, independent and efficient judicial system. The lack of such structural elements, or significant weaknesses and shortcomings in the general framework, may significantly hinder the implementation of an effective AML/CFT framework; and … other contextual factors that might significantly influence the effectiveness of a country’s AML/CFT measures include the maturity and sophistication of the regulatory and supervisory regime in the country; the level of corruption and the impact of measures to combat corruption …

In taking a ‘whole-of-government approach’ to addressing financial crimes, Recommendation 29 clearly sets the requirements for effectiveness in respect of information sharing:

The FIU should (a) in addition to the information that entities report to the FIU, be able to obtain and use additional information from reporting entities, as needed to perform its analysis properly; and (b) have access to the widest possible range of financial, administrative and law enforcement information that it requires to properly undertake its functions.

The OECD advances that if the ongoing objective of a whole-of-government approach is to identify ways in which agencies can work together in combating crime in order for better results to be attained over shorter time frames and with less costs, it may be opportune to consider extending the application of FATF Recommendations to include the public-sector institutions, especially in relation to the following:

75 FATF (n 75 above) 67-69.
76 FATF ‘Methodology for assessing technical compliance with the FATF Recommendations and the effectiveness of AML/CFT systems’ (2013) 6.
77 The importance of structural reforms and good governance may be ignored at a country’s own peril. Eg, by implementing OECD governance principles, Mauritius overtook South Africa in 2013 to become the most competitive economy in sub-Saharan Africa.
78 FATF (n 77 above) 6.
79 n 77 above.
• Secrecy laws should not inhibit the implementation of FATF Recommendations.80
• Suspicion or reasonable grounds to suspect that funds are the proceeds of a criminal activity should be a mandatory reporting requirement.

The underlying rationale is that institutions of government daily come across information that may be relevant in addressing financial crimes. Without such information being channelled to a central repository for analysis and interpretation, a vast knowledge base is foregone. For example, suspicious activity that may come to the attention of any agency or department official which requires further scrutiny could be any of the following:

• transactions requested outside the normal service;
• transactions outside the company’s relationship with the client;
• a person entered into a business relationship for a single transaction;
• extensive and unnecessary foreign travel; and
• loans to government employees.

Indicators within the scope of tax administrations:

• transactions that have no reasonable explanation;
• a person’s use of offshore accounts, trusts or companies that does not support such economic requirements;
• tax schemes involving suspect territories;
• over-complicated tax schemes;
• unrealistic wealth compared to client profile;
• short-life businesses involved in imports/exports;
• cash transactions instead of appropriate financial instruments.81

The inclusion of tax crimes as predicate offences to money laundering has put the exchange of information high on the agenda of many countries. It is therefore important that agencies develop cross functional indicators in order to improve data quality that allow for meaningful exchange.

Most countries make provision for the protection of taxpayer information. For example, in South Africa, section 71 of the Tax Administration Act82 provides for the disclosure in criminal, public safety or environmental matters if so ordered by a judge, while section 70 makes provision for disclosure to other (specified) entities. Section 69 contains the

80 FATF Recommendation 9.
82 Act 28 of 2011.
prohibitions on information sharing. Similarly, in terms of the Customs Control Act no SARS official, customs officer or person referred to in section 12(3)(a), and no person who was such an official, officer or person, may disclose any information acquired by him or her in the exercise of powers or duties in terms of this Act or the Customs Duty Act concerning the private or confidential matters of any person, except to the extent that such disclosure is made in the exercise of those powers or duties, including for the purpose of any proceedings referred to in Chapter 36.

Section 22(1) provides that any disclosure in terms of section 21(e) ‘to … (i) an organ of state referred to in section 20(j) must be confined to information necessary for enforcing the legislation administered by that organ of state regulating the movement of goods or persons into or out of the Republic’; and section 22(2) provides that ‘an authorised recipient may use the information disclosed in terms of subsection (1) only for the purpose for which the information was disclosed’. ‘Authorised recipient’ under section 20 includes ‘the police, public prosecutor, FIU and any organ of state administering legislation applicable to the crossing of goods or persons into or out of the Republic’.

The importance of cooperation between customs and other law enforcement agencies is acknowledged in section 12(2) that provides for a customs officer to perform an enforcement function at any time and without a warrant or previous notice. Importantly, section 12(3) allows for a customs officer to ‘be accompanied and assisted by any interpreters, technicians, workers, police officers or any other persons whose assistance

83 Sec 69 provides: ‘(1) A person who is a current or former SARS official must preserve the secrecy of taxpayer information and may not disclose taxpayer information to a person who is not a SARS official. (2) Subsection (1) does not prohibit the disclosure of taxpayer information by a person who is a current or former SARS official (a) in the course of performance of duties under a tax Act, including (i) to the South African Police Service or the National Prosecuting Authority, if the information relates to, and constitutes material information for the proving of a tax offence; (ii) as a witness in civil or criminal proceedings under a tax Act; or (iii) the taxpayer information is necessary to enable a person to provide such information as may be required by SARS from that person; (b) under any other Act which expressly provides for the disclosure of the information despite the provisions in this chapter; (c) by order of a High Court; or (d) if the information is public information.’

84 Act 31 of 2014.

85 ‘Such official, customs officer or person may be obliged to disclose such information in terms of other legislation, eg the Financial Intelligence Centre Act, 2001.’


87 ‘Enforcement function’, in relation to the customs authority or a customs officer, means a power or duty assigned to the customs authority in terms of this Act or assigned or delegated to a customs officer in terms of this Act to (a) implement and enforce this Act or a tax levying Act; or (b) to assist in the implementation or enforcement of other legislation referred to in ch 34 or 35.
may reasonably be required for the performance of that [enforcement] function’.88

It is worth noting that the OECD Report also acknowledges that customs administrations are key in addressing financial crimes because of the records customs holds regarding individuals, companies, transactions and indirect taxes.89 In addition, its control and security function should also entail a vast repository of information on crimes such as smuggling, money laundering and false declaration.

5 Conclusion

In meeting the challenge of strengthening their independent institutions and agencies of government responsible for preventing IFFs, countries are required to identify frameworks and mechanisms for information sharing and co-ordination. This chapter highlights some fundamental aspects that are necessary for inter-agency cooperation. It is shown that various models and gateways for cooperation are available in most countries and that strategies for cooperation should be founded on a shared commitment to inter-organisational cooperation. This commitment should be reflected in a common understanding of the goals and objectives as well as a unified effort through a whole-of-government approach. Countries, therefore, should recognise that the foundation for cooperation first and foremost lies in information sharing through appropriate legal gateways and, thereafter, in collaboration which is premised on a common line of sight.90

Because the relationship between different spheres of government is characterised by layers of inter-dependencies, an optimal effort toward reducing illicit financial flows should be premised on common areas of interest and knowledge. Collaboration between different agencies, therefore, requires

- a common understanding of the problem;
- the identification and inclusion of all relevant stakeholders;
- policy co-ordination that supports the nexus between administrations and policy setters;
- horizontal and vertical alignment between the goals and objectives of different agencies;

88 Sec 12(4) provides that ‘[a] person assisting a customs officer in terms of subsection (3)(a) must, whilst and for the purpose of assisting, be regarded to be a customs officer under the supervision of the customs officer that person is assisting’.
89 OECD (n 13 above) 8.
90 I use the term ‘common line sight’ as cooperation goes further than having shared objectives – there should also be a shared view on how those objectives are to be achieved, in other words, an inter-departmental alignment of both goals and objectives in furtherance of a commonly-understood strategic imperative, is required.
• defining and implementing the strategies for cooperation; and
• implementing or revising existing legal gateways to streamline cooperation.

Fundamental to successful cooperation is the ability of heads of agencies and ministries to personally work together in a manner that seeks consensus, where such consensus leads to the implementation of strategies and actions that allow agencies to work together to address IFFs.
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Tax Administration Act 28 of 2011 (South Africa)
Abstract

Corruption is a major impediment to sustainable development in African countries. Corrupt acts result in revenue losses to the fiscus at the expense of society, and the proceeds of corruption then are hidden through money laundering and tax evasion. The purpose of acts of corruption, money laundering and tax evasion generally are aimed at achieving a financial gain in a manner which aims to hide that gain – this often manifests in capital outflows. The obstacles to different government agencies in addressing this objective are the same, namely, a lack of transparency, excessive secrecy and a lack in institutional responsiveness through coordinated action. Because of the impact of acts of corruption, laundering and evasion on sustainable development, measures to address such acts necessarily are intertwined. It is shown that an institutional response which recognises this inter-relationship is more successful in harnessing a cross-selection of preventative measures available to government agencies in dealing with these diverse crimes – thus placing institutions in a better position to address illicit financial flows.

1 Introduction

Corruption is described as ‘a major impediment to sustainable development for mineral, oil and gas producing countries’ in Africa.¹ In the extractive sector, revenue losses at the expense of society most often are due to corrupt acts in all parts of the extractive value chain. The proceeds of corruption then are hidden through money laundering and tax evasion. The purpose of acts of corruption, money laundering and tax evasion generally are aimed at achieving a financial gain in a manner which aims to hide this gain. The obstacles to different government agencies in addressing this objective are the same, namely, a lack of transparency, excessive secrecy and a lack in institutional responsiveness through coordinated action. Due to the impact of corruption, money laundering and

evasion on sustainable development, measures to address such acts necessarily are intertwined. From the perspective of illicit financial flows (IFFs), many bribes result in capital outflows to tax havens, which are useful for hiding embezzled payments or to syphon off revenue intended for the fiscus.

It is shown that an institutional response which recognises this inter-relationship is more successful in harnessing a cross-selection of preventative measures available to government agencies in dealing with these diverse crimes – thus placing institutions in a better position to address IFFs. In this regard, it should be pointed out that anti-money laundering (AML), for example, is a major element in the standard list of interventions available to countries with the potential to reduce IFFs, both into and out of developing countries. AML interventions are also powerful tools to address other elements of IFFs, such as corruption and tax evasion. However, this potential is largely dependent on the implementation of the relevant Financial Action Task Force (FATF) Recommendations, the level of reporting in administrations and the level of inter-agency cooperation and international cooperation.

Corruption, estimated at USD40 billion dollar per year,\(^2\) is given as a primary reason for the weak economic performance of resource-rich countries, because it manifests in rent seeking and patronage.\(^3\) According to Kolstad and Søreide,

> resource rents induce rent seeking, as individuals compete for a share of the rents rather than use their time and skills more productively, whilst resource revenues induce patronage as governments pay off supporters to stay in power, resulting in reduced accountability and an inferior allocation of public funds.\(^4\)

The possibility for both tax avoidance and tax evasion is created with the negotiation of contracts with companies seeking a favourable investment climate, and where contractual arrangements are the consequence of corruption (such as payments by companies to public officials to secure better terms). Tax havens become useful for hiding embezzled payments or to syphon off revenue intended for the fiscus.

The FATF is of the view that

> [t]he fight against corruption is inextricably intertwined with that against money laundering in that the stolen assets of a corrupt public official are

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\(^4\) As above.
useless unless they are placed, layered and integrated into the global financial network in a manner which does not raise suspicion.5

The FATF also highlights the role of politically-exposed persons (PEPs) in money-laundering schemes. PEPs are deemed a high risk due to the positions they occupy in government, where they have access to public funds and contractual information.6 PEPs can also influence the way in which contracts are awarded and, therefore, can award contracts for personal financial reward.7

The level of governance, the strength of legal controls and cultural aspects can influence the degree to which corruption is present in a country.8 The FATF identifies the most prevalent forms of proceeds in the grand corruption context as those resulting from accepting bribes; various forms of extortion; self-dealing and conflict of interest; and embezzlement from the treasury through fraud.9 From a tax perspective, two important concerns arise: first, tax revenue due to the fiscus is diverted, which affects public spending; and, second, the proceeds of corruption in the hands of corrupt officials escape taxation should they remain undetected.

The focus of this chapter, therefore, is on the inter-relationship between corruption, tax crimes and money laundering. The first part examines the dynamics of corruption, money laundering and tax evasion and how these impact on society. The second part of the chapter examines regulatory issues, barriers thereto and different preventative measures available to address different aspects of these crimes.

2 Dynamics of corruption

The World Bank describes corruption as a ‘complex phenomenon’10 because its roots may lie deep in government institutions. How corruption affects development is influenced by country conditions and the interventions governments make on policy and contractual levels. For example, in pursuit of financial gain, government officials may intervene in areas where no intervention is required, or they may fail to enact or implement policies.11 The term ‘corruption’12 covers a broad range of

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5 FATF Laundering the proceeds of corruption (2011) 5.
6 As above.
7 FATF (n 5 above) 9.
8 As above.
9 FATF (n 5 above) 16.
10 UNODC ‘New UNODC campaign highlights transnational organised crime as a USD 870 billion a year business’ (not dated); World Bank ‘Helping countries combat corruption: The role of the World Bank (not dated).
12 According to the Online etymology dictionary ‘corrupt (adj)’ takes its meaning from old French corrupt which means ‘unhealthy; corrupt; uncouth’ and directly from Latin corruptus, meaning ‘to destroy; spoil’ or figuratively ‘corrupt, seduce, bribe’. 
human actions.\textsuperscript{13} The World Bank defines it as the ‘abuse of public office for private gain’\textsuperscript{14} and primarily included in this definition are bribery and theft.\textsuperscript{15} Bribes can be intended for the bribe taker himself or for a third party – the relationship of the public official to the beneficiary and the reasons why the official might want to benefit the third party is of no relevance.\textsuperscript{16} The link between the bribe and the action or omission on the part of an official is inherent in the definition of bribery. However, the requirement of a causal link between the bribe and the specific action or omission by the official could be extremely difficult to prove. Furthermore, an act or omission by an official does not have to be illegal \textit{per se} or in breach of the official’s duties – if the bribe is aimed at inducing a breach in an official’s duty, it implies that there is a duty on public officials to exercise their judgment or discretion impartially.\textsuperscript{17} For a corrupt act to constitute active bribery of a foreign public official, the goal of the bribe ‘must have been to obtain or retain business or other undue advantage in relation to the conduct of international business’.\textsuperscript{18} Undue advantage (meaning that the company or person has no legitimate right to it) in the context of business includes the relaxation of regulatory standards or granting undue tax breaks.\textsuperscript{19}

It is interesting to note that acts of bribery of foreign public officials for non-business purposes are not covered by the definition of transnational bribery and, therefore, are not criminalised in international law. An example of non-business purposes includes the bribery of an official so that an unqualified person is hired and appointed in a position where that person could advance the agenda of the briber. This can be in the form of allowing the briber to evade taxes in return for some personal or political favour, often with the tacit approval of the tax administration or finance ministry.\textsuperscript{20} According to article 4 of the African Union (AU) Convention,\textsuperscript{21} the scope of application explicitly covers such instances where there is

\begin{itemize}
  \item There is no internationally agreed definition on corruption; furthermore, a different meaning is attached to the term depending on the discipline (e.g., political science, economics, legal or sociological) with which it is approached. Corruption also occurs in business and corporate relationships which exist between private businesses and suppliers. It may also involve illegal behaviour by corporate officials for private monetary gain.
  \item The World Bank (n 11 above) states that ‘bribery occurs in the private sector, but bribery in the public sector, offered or extracted, is the Bank’s main concern, since the Bank lends primarily to governments and supports government policies, programmes, and projects’.
  \item JB Terracino \textit{The international legal framework against corruption. States' obligations to prevent and repress corruption} (2012) 103.
  \item Terracino (n 16 above) 104 107.
  \item Terracino (n 16 above) 108.
  \item Terracino (n 16 above) 108 109.
  \item African Union (AU) Convention on Preventing and Combating Corruption 7.
\end{itemize}
the offering or granting, directly or indirectly, to a public official or any other person, of any goods of monetary value, or other benefit, such as a gift, favour, promise or advantage for himself or herself, or for another person or entity, in exchange for any act or omission in the performance of his or her public functions.

Illicit enrichment\(^{22}\) is a criminal act that is only indirectly related to an illegal act by a public official, but which manifests through a variety of criminal acts such as accepting a bribe or embezzlement. In the case of illicit enrichment, it is not the act as such, but the use of the proceeds from the illegal acts. The reason for the existence of the criminal act of illicit enrichment lies in the difficulty of proving corruption in a court of law and, by focusing on the unexplained wealth accrued through the illicit enrichment, the burden of proof can be discharged with lesser difficulty.\(^{23}\)

The government benefits purchased with bribes can vary from large contractual awards to petty corruption such as that found in the issuing of licences or fast-tracking services.\(^{24}\) Grand corruption typically is associated with international business transactions which involve government officials, and these are usually concluded outside the official’s home country.\(^{25}\) While instances of grand corruption capture the world’s attention, the World Bank cautions that ‘the aggregate costs of petty corruption, in terms of both money and economic distortions, may be as great if not greater’.\(^{26}\)

Corruption flourishes in environments that are characterised by abuse of office.\(^{27}\) Some 2,000 years ago, Caesar Augustus recognised that the efficient and honest collection of taxes is of no lesser importance than the tax structure for the fairness of a financial system. Consequently, Augustus attempted a rationalisation of tax collection techniques by making the provincial governors salaried imperial employees, thereby lessening their exposure to the temptation of diverting tax income of their provinces for their personal benefit.\(^{28}\)

\(^{22}\) According to art 20 of the United Nations Convention against Corruption (UNCAC), it is provided that ‘[s]ubject to its constitution and the fundamental principles of its legal system, each State Party shall consider adopting such legislative and other measures as may be necessary to establish as a criminal offence, when committed intentionally, illicit enrichment, that is, a significant increase in the assets of a public official that he or she cannot reasonably explain in relation to his or her lawful income’.

\(^{23}\) Most acts of corruption are consensual and there are no ‘direct’ victims – it is society that is affected, but because society is not aware of the corruption, it can be said that it is a victimless crime. The absence of direct victims defies traditional procedures of starting with a complaint by a victim, and in many instances there are no witnesses, documents or other means of evidence available.

\(^{24}\) World Bank (n 10 above).

\(^{25}\) As above.

\(^{26}\) As above.

\(^{27}\) FATF Corruption: A reference guide and information note on the use of the FATF Recommendations to support the fight against corruption (2012) 3.

\(^{28}\) K Loewenstein The governance of Rome (1973) 304.
From a governance perspective, the absence of knowledge of economic causation saw to it that the ancient Roman Empire overextended its state activities to a degree that was never matched by public income. In many instances, public income was recklessly used for the maintenance of a sumptuous establishment of the imperial court; more and better equipped and paid armed forces; and an immensely wasteful bureaucracy which depleted general resources. The conspicuous consumption of the upper classes contrasted with the desperate plight of the masses. The never-mastered economic imbalance grew into a chronic crisis of society at large, while a relentless tightening of the tax screw exacerbated the plight of the common people.29

Whilst the latter contributed to the fall of the Roman Empire, Roman state practice provided the intangibles for good governance: patriotism; civic virtues of dedication to the community; honesty; probity; and disinterested service for the nation.30 Today it is accepted that ‘tax systems in developing countries perform poorly due to weak capacity, corruption and the lack of any reciprocal link between tax and public and social expenditures’.31 Moore32 proposes that

political regimes are the outcome of tension and conflict between (a) elites who control the state, and wish to remain in power and to exercise that power as freely as possible; and (b) societal actors who want to place restraints on the power of a potentially overweening state.

In this ‘conflict’, revenue is central for two reasons: First, it represents a ‘key strategic resource for state elites’ and ‘if non-state actors can limit and control elites’ access to revenue, they enjoy countervailing power in relation to the state’.33 Secondly,

if state elites need to depend on general taxation because they lack alternative, easier revenue sources, they generally have to put considerable organisational and political effort into obtaining the revenue, and face strong incentives to bargain and negotiate, directly or indirectly, with at least some taxpayers, rather than simply to extract revenue forcibly.34

Moore concludes that ‘dependence on general taxation provides incentives for state elites and taxpayers to resolve their differences through bargaining’.35

29 Loewenstein (n 28 above) 473.
30 Loewenstein 488.
33 As above.
34 Moore (n 32 above) 15.
35 As above.
Encouraging constructive state-society engagement around taxes is one of four channels by which tax reform contributes to state building.\textsuperscript{36} This implies the prominence of taxation issues on the public political agenda, and the levying of taxes as ‘consensually and as transparently as possible’.\textsuperscript{37} This means that assessments should be raised objectively and there should be equal and fair treatment of taxpayers in the recovery of debt.

According to the World Bank, the causes of corruption are ‘always contextual, rooted in a country’s policies, bureaucratic traditions, political development and social history’.\textsuperscript{38} Corruption tends to flourish in the presence of weak institutions and where policies are designed to generate economic rents. According to the World Bank, the dynamics of corruption in the public sector may be depicted in a simple model where ‘the opportunity for corruption is a function of the size of the rents under a public official’s\textsuperscript{39} control, the discretion that official has in allocating those rents, and the accountability that official faces for his or her decisions’.\textsuperscript{40} The level of discretion of public officials may be too wide (due to a lack of explicit regulations), which in turn can be ‘exacerbated by poorly-defined, ever-changing, and inadequately disseminated rules and regulations’.\textsuperscript{41} The World Bank identifies several characteristics associated with a lack of institutional integrity:

- weak accountability with ethical values eroded or never having been established;
- rules regulating the conduct of officials and management of conflict of interest are not enforced and financial monitoring systems (for instance, mechanisms for recording revenues collected and budgeted expenditures) are dysfunctional;
- formal mechanisms for holding public officials to account for achieving specific results, are not in place or not applied;
- oversight institutions (for instance, press, external auditors or ombudsmen) responsible for scrutinising government performance are ineffective;

\textsuperscript{37} Fjeldstad & Moore (n 36 above) 255.
\textsuperscript{38} World Bank (n 11 above).
\textsuperscript{39} According to sec 2(a) of UNCAC, ‘[p]ublic official’ shall mean ‘(i) any person holding a legislative, executive, administrative or judicial office of a State Party, whether appointed or elected, whether permanent or temporary, whether paid or unpaid, irrespective of that person’s seniority; (ii) any other person who performs a public function, including for a public agency or public enterprise, or provides a public service, as defined in the domestic law of the State Party, and as applied in the pertinent area of law of that State Party; (iii) any other person defined as a ‘public official’ in the domestic law of a State Party. However, for the purpose of some specific measures contained in Chapter II of this Convention, “public official” may mean any person who performs a public function or provides a public service as defined in the domestic law of the State Party and as applied in the pertinent area of law of that State Party.’
\textsuperscript{40} World Bank (n 11 above).
\textsuperscript{41} As above.
• divergence between the ‘formal’ and ‘informal’ rules in the public sector;\(^{42}\)
and
• special anti-corruption bodies are used as partisan instruments whereby those in government are protected, opposition members are harassed and fraud detection is not prioritised.\(^{43}\)

In South Africa, such actions are described as ‘state capture’, and these actions are evidenced in the appointment of public officials for the sole purpose of promoting the interests of those who appointed them.\(^{44}\)

The presence of these characteristics requires the recognition by governments that a strong legal framework to control corruption is required, and that institutional strength is returned to departments by placing renewed emphasis on the ‘formal’ rules.\(^{45}\)

Reuter states that ‘it is fanciful to imagine that Marcos, Mobutu or Suharto would have allowed the operation of an effective domestic AML, whatever laws they might have permitted to be placed on the books’. This predicament repeats itself continuously, as is reflected by recent reports from South Africa relating to delays by the President’s office in passing the Financial Intelligence Centre Amendment Bill, which is aimed at bringing greater transparency to the financial system, and complementing government’s objective to fight corruption. It gives banks powers to perform due diligence on politically-exposed persons or, as termed in the Bill, ‘prominent influential persons’. The Bill was unanimously adopted by parliament in May 2016.\(^{46}\) In November of the same year, the Bill was referred back to parliament due to the wide formulation of searches without a warrant.\(^{47}\) Although the amendments are in line with legislation

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42 The World Bank (n 11 above) describes situations where corruption is systemic as one where the ‘formal rules remain in place, but they are superseded by informal rules: Thus it may be a crime to bribe a public official, but in practice the law is not enforced or is applied in a partisan way, and informal rules prevail.’

43 World Bank (n 11 above).

44 Daily Maverick ‘gupta-leaks.com: Everything you ever need to know about #GuptaLeaks in one place’ (2017).

45 World Bank (n 11 above).

46 S Mkhwanazi ‘FICA Bill in line with Global Standards’ (2016).

47 Amendment of sec 45B of Act 38 of 2001, as inserted by sec 16 of Act 11 of 2008 proposes under (1C) that ‘an inspector otherwise required to obtain a warrant under subsection (1B) may enter any premises without a warrant (a) with the consent of the owner or person apparently in physical control of the premises after that owner or person was informed that he or she is under no obligation to admit the inspector in the absence of a warrant; or (b) if the inspector on reasonable grounds believes that (i) a warrant will be issued under subsection (1B) if the inspector applied for it; and (ii) the delay in obtaining the warrant is likely to defeat the purpose for which the inspector seeks to enter the premises. (1D) Where an inspector enters the premises without a warrant, he or she must do so (a) at a reasonable time; (b) on reasonable notice, where appropriate; and (c) with strict regard to decency and good order, including to a person’s right to (i) respect for and the protection of dignity; (ii) freedom and security; and (iii) personal privacy.’
in other jurisdictions it was restricted by the courts.\textsuperscript{48} In the context of political events\textsuperscript{49} in South Africa, the referral would have been of serious concern, had the President found the provision relating to, for example, ‘politically-exposed’ persons (or ‘persons in prominent positions’, as referred to in South African legislation) to be unconstitutional.\textsuperscript{50}

### 3 Dynamics of money laundering

IFFs are said to ‘often leave developing countries via the commercial financial system’ through which ‘funds are laundered to disguise their origin’.\textsuperscript{51} Anti-money-laundering (AML) and counter-terrorist-financing (CFT) regimes are potentially effective tools to identify and prevent illicit funds from being ‘held, received, transferred and managed by major banks and financial centres’.\textsuperscript{52} The latter actions, whereby IFFs are facilitated, can be damaging not only to the financial sector, as far the reputational risk of financial institutions is concerned, but also to entire economies which are dependent on a well-functioning financial sector.\textsuperscript{53}

In many countries, money laundering is rarely successfully prosecuted, due to the difficulties in proving the offence, capacity constraints and the like.\textsuperscript{54} Money laundering refers to any act that that aims to disguise the illicit nature or the existence, location or use of the

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\textsuperscript{48} Federation of Law Societies of Canada \textit{v} Canada (Attorney-General) [2013] BCJ No 632. The issue revolved around whether Canada's anti-money-laundering and anti-terrorist-financing legislation, as it applies to the legal profession, infringes on the right to be free of unreasonable searches and seizures; and whether legislation infringes on the right not to be deprived of liberty otherwise than in accordance with principles of fundamental justice and, if so, whether the infringements are justifiable. The court argued that these provisions had a predominantly criminal law character, rather than an administrative law character. They facilitate detecting and deterring criminal offences, and investigating and prosecuting criminal offences. There are penal sanctions for non-compliance. These provisions authorise sweeping searches of law offices which inherently risk breaching solicitor-client privilege. The provisions in question were unconstitutional insofar as they applied to lawyers and law firms only.

\textsuperscript{49} At the time, various allegations of bribery and accepting kickbacks were made against the president resulting from the so-called Gupta leaks. The leaks consist of a few hundred gigabytes of information containing between 100 000 and 200 000 unique e-mails and a host of other documents. The e-mails portray members of government, a substantial number of ministers and senior state employees illegally sharing confidential state information with members and associates of the Gupta family. \textit{Daily Maverick} (n 44 above).

\textsuperscript{50} The Bill has since been passed and it is now known as the Financial Intelligence Centre Amendment Act 1 of 2017.

\textsuperscript{51} OECD (n 31 above) 15.

\textsuperscript{52} As above.

\textsuperscript{53} As above.

\textsuperscript{54} B Schlenther ‘The taxing business of money laundering: South Africa’ (2013) 16 \textit{Journal of Money Laundering Control} 23 reveals that 927 confiscation orders under ch 5 and 6 of the Prevention of Organised Crime Act were made in South Africa amounting to ZAR 577 million from 1 April 2003 to 1 April 2008. The confiscation data reportedly does not show whether the confiscations were related to money laundering per se. It is, therefore, not known whether these figures are representative of the pervasiveness of money laundering in South Africa. Based on reports for later years, it can be assumed that a small number of confiscations related to money laundering took
proceeds of crime. Money-laundering legislation typically provides for three substantive offences in respect of the crime of money laundering. These offences are the concealment of criminal property; arrangements made with regard to criminal property; and the acquisition, use and possession of criminal property. For money-laundering schemes to achieve their objective, De Koker identifies criteria which they must meet, namely, that ‘they must appear to make commercial sense, be structured in a tax efficient way, have the appearance of legitimacy and be transnational in nature’. The aid of professional advisors (also referred to as gatekeepers) in accounting, banking, law and financial services is integral to the success of sophisticated laundering schemes. The socio-economic and political environment also plays a role, and a greater incidence of money laundering will be present in countries with high levels of corruption and with a high prevalence of organised crime, specifically through the production or distribution of prohibited goods.

Experience across the globe shows six general money-laundering techniques used: (i) the investment of proceeds of crime in a legal business

place in the years 2009-2010 and 2010-2011. The National Prosecuting Authority (NPA) reported success in 192 trial cases for the latter year, which included five racketeering convictions and 25 counts of money laundering. The year 2009 only delivered six finalised money-laundering cases. In addition, the FIC Annual Report for 2014-2015 makes no mention of successful money-laundering prosecution in South Africa for the year under review. However, the NPA’s report for the same period indicates that 11 cases involving racketeering and/or money-laundering charges were finalised with verdicts (eight of these cases were finalised with guilty verdicts, and the remaining three were acquittals). Five cases involving money laundering were finalised with verdicts (all were finalised with guilty verdicts). In its 2015/16 Annual Report, the FIC makes mention of the number of investigations they assisted in with no reference to successful prosecutions. For the same period, the NPA reported only three money-laundering convictions, namely, S v Hinzelman; S v Norman and Hendricks and S v Letsie & Others.

56 According to De Koker (n55 above) 4, ‘three stages are generally distinguished in the money laundering process, namely placement, layering and integration. During the placement stage, money enters the financial system. The aim of the layering process is aimed at separating the illicit proceeds from their criminal source, which may entail a complex series of transactions which are solely aimed at blurring the money trail. The last stage involves the integration of all the funds – the original amount minus the costs of the laundering process, is amassed and controlled as apparent legitimate business funds.’
57 De Koker (n 55 above) 7.
58 Schlenther (n 54 above) argues that ‘tax efficiency may not necessarily be a requirement, as paying taxes timeously creates the perception of a compliant taxpayer and with that, brings legitimacy to the criminal enterprise’. 
59 The Transparency International Corruption Perception Index ranking provides a breakdown of the country perception of that country which is likely to be most/least corrupt.
60 The CIA world factbook (not dated) classifies countries’ attractiveness to criminal activity. Eg. Ghana is identified as a ‘major transit hub for Southwest and Southeast Asian heroin and, to a lesser extent, South American cocaine, destined for Europe and the US; widespread crime and money-laundering problems, but the lack of a well-developed financial infrastructure limits the country’s utility as a money-laundering centre’. South Africa is described as ‘an attractive venue for money launderers, given the increasing level of organised criminal and narcotics activity in the region and the size of the South African economy’. 
venture, either through shell or fictitious companies or in genuine companies under a false identity; (ii) the acquisition of assets accompanied by payment of the requisite taxes; (iii) the deposit of money in tax havens or in banks in non-cooperative countries, and remittances back to the host country through normal banking channels; (iv) the use of underground banking channels for the transfer of funds; (v) the over-invoicing of goods in import or export transactions; and (vi) the routing of funds through safe tax haven countries. These forms of financial systems and corporate vehicle abuse can cause extensive reputational damage to institutions, damage the investment climate and ultimately can weaken the financial system.62

Money laundering has numerous underlying predicate offences, which need to be established before a charge of money laundering can be pursued – thus the removal of the predicate offence (for example, tax evasion or corruption) may provide a better long-term solution. The FATF recognises the ‘link between corruption and money laundering’ and takes into account compliance by countries with the FATF Recommendations.63 Some compliance measures include:

- the degree to which the FATF Recommendations are implemented;
- implementation measured against the number of money-laundering investigations, prosecutions and convictions, as well as the value of assets confiscated as a result of money laundering or a predicate offence;
- measures to prevent and combat corruption.64

Several indicators are used to measure the strength of the anti-corruption framework. These are the level of transparency; the presence of good governance principles and ethical codes of conduct for officials; as well as the efficiency of the courts and the degree to which court decisions are enforced.65 These indicators are regarded as significant because, where they are absent or weak, the effective implementation of the FATF Recommendations may be jeopardised.66

4 Dynamics of tax evasion

Considerable evidence is available that tax evasion depends on opportunities for successful evasion and these differ widely, depending on
the circumstances of the taxpayer.\textsuperscript{67} Tax compliance, therefore, is not solely reliant on the taxpayer’s analysis of the benefits and costs of evasion, but also on the presence of a belief that the state lacks legitimacy.\textsuperscript{68}

International initiatives to limit tax evasion and address the proceeds of crime are ongoing and are led by the Organisation for Economic Co-operation and Development (OECD) Global Forum on Taxation, the FATF and the United Nations Office on Drugs and Crime (UNODC). However, these efforts in curbing IFFs are still being evaluated, but it is clear that any approach will require greater co-ordination and cooperation around key issues and stakeholders, such as the private sector, government, international organisations and civil society.\textsuperscript{69}

The predicament posed by tax evasion is well phrased by Everest-Phillips, who states that

\begin{quote}
 effective states require effective, efficient, and equitable tax systems. Creating the commitment of citizens not to evade taxation is a political process central to state building; cajoling elites to pay taxes has always been an essential step to any state becoming effective. Bad governance manifests itself through an unjust tax system and rampant tax evasion.\textsuperscript{70}
\end{quote}

The latter then becomes or remains a trigger for or indicator of political instability. Tax evasion, corruption and criminality as the main drivers of illicit capital flows at the same time are ‘both causes and effects of the fragility of state institutions, and in this sense, are challenges to state legitimacy’.\textsuperscript{71} Everest-Phillips draws an important correlation between tax evasion and corruption. He states that tax evasion undermines the funding of the state and, therefore, the legitimacy associated with the state through the delivery of public services. Corruption, in turn, affects the moral legitimacy of the government, and criminality becomes a challenger to the legitimacy of the government.\textsuperscript{72} It is evident that good governance is an essential element to addressing IFFs and, therefore, remedies should be more than ‘technocratic solutions’.\textsuperscript{73} This requires that the correlations or inter-relationships between tax evasion and corruption are recognised, but also those that include money laundering, and other financial crimes over and above evasion and corruption must be recognised.

\textsuperscript{68} Everest-Phillips (n 20 above) 73.
\textsuperscript{69} World Bank (n 11 above).
\textsuperscript{70} Everest-Phillips (n 20 above) 70.
\textsuperscript{71} Everest-Phillips (n 20 above) 71.
\textsuperscript{72} As above.
\textsuperscript{73} Everest-Phillips (n 20 above) 72.
5  Inter-relationship between corruption, money laundering and tax evasion

Examples of the inter-relationship between corruption, money laundering and tax evasion may be drawn from the extractive industries. To illustrate, the risk of corruption in the extractive sector already appears in the tender process, where bidding companies in which public officials or their affiliates have a stake may receive preferential treatment, or where the potential for bribes for bid exclusion exists. In some instances, the awarding of a bid may require a joint venture between a foreign entity and a local company or a state-owned enterprise. This obligation, however, can be diverted from the initial objective of empowering the local entity to one where companies owned by or connected to public officials are favoured.74

The OECD identifies forms of corruption risks in contract negotiation as trading in influence, political capture and interference. Trading in influence is described as ‘the process or act by which a person who has real or apparent influence on the decision making of a public official, exchanges this influence for an undue advantage’.75 Political/state capture or interference refers to situations where private interests significantly influence decision-making processes of public officials for private gain.76

In contract negotiations, the typology of corruption risks includes exercising undue influence to obtain favourable contractual terms, to get access to otherwise restricted or commercially-sensitive information, or to obtain permit approvals. Often ‘influencing’ can be in breach of legislation in that a royalty rate is agreed to, which it is not provided for in law, or a permit is granted in a protected area.77 In exercising undue influence, companies may

offer or be solicited to provide improper advantages in the form of anything of value, such as illegal commissions, gifts and entertainment (ie, first class flights, expensive hotels, dining, school fees), job or business opportunities to public officials and politicians or their family members, with a view to unduly influencing the negotiation process.78

During contract negotiations, funds intended for public use can be diverted to benefit private individuals. Such misappropriation of public funds or embezzlement often is exacerbated by a lack of transparency in the contract negotiation phase. This then creates an environment conducive to corrupt activities, which are intended to circumvent or violate existing legal provisions for the payment of taxes and royalties.79

74 OECD Corruption in the extractive value chain (2016) 43.
75 OECD (n 74 above) 37.
76 As above.
77 As above.
78 As above.
79 OECD (n 74 above) 39.
With regard to the latter, provisions negotiated in a non-transparent way may set inappropriately low corporate tax rates in comparison to the standard national rates.\(^80\)

Kick-backs and bribes received during the negotiation phases can easily be routed to foreign jurisdictions through corporate vehicles. The use of corporate vehicles and trusts are established means of money laundering and are addressed in FATF Recommendations 33 and 34. Because shell corporations provide advantages in concealing the identity of the beneficial owner, they often are used by politically-exposed persons (PEPs) to hide wealth, since their careers and reputations may be at stake if they are found to be in possession of unexplained wealth.\(^81\) In this sense, ‘shell companies ensure that specific criminal assets cannot be identified with or traced back to them’.\(^82\) The Panama Papers again confirmed the trend.\(^83\) Corporate vehicles, therefore, are a preferred and effective means of separating the origin of the illegal funds from the PEP who controls it.\(^84\)

Those wishing to hide proceeds from corruption or other crimes make use of gatekeepers or skilled professionals to establish corporate structures in offshore jurisdictions, with the sole purpose of disguising the source and ownership of the funds. With the focus on foreign PEPs and the requirements of enhanced due diligence regarding the source of funds deposited into financial institutions, corporate vehicles are in high demand.\(^85\)

6 Overview: Regulatory measures to address corruption, tax evasion and money laundering

Corruption today is classified as a category of transnational crime (other crimes in this category include drug trafficking, human trafficking and the

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\(^{80}\) As above. Examples of such practice are cited in the UNECA Report, where one company negotiated a corporate rate of 1.43\% and another whereby the royalty rate on mining was set at only 20\% of the rate prescribed in legislation.

\(^{81}\) Due to the high visibility of their office, both in and outside their country, PEPs frequently make use of nominees (middlemen or other intermediaries such as close associates, friends and family) to conduct financial business on their behalf. According to the FATF (n 5 above) 19, the use of middlemen is aimed at sheltering or insulating the PEP from unwanted attention. The use of intermediaries can also serve as an obstacle to customer due diligence where the individual acting on behalf of the PEP has special status such as diplomatic immunity.

\(^{82}\) FATF (n 5 above) 19.

\(^{83}\) International Consortium for International Journalists (ICIJ). The ICIJ describes the Panama Papers as ‘a global investigation into the sprawling, secretive industry of offshore jurisdictions that the world’s rich and powerful use to hide assets and skirt rules, by setting up front companies in far-flung jurisdictions. Based on a trove of more than 11 million leaked files, the investigation exposes the use of offshore companies to facilitate bribery, arms deals, tax evasion, financial fraud and drug trafficking.’

\(^{84}\) FATF (n 5 above) 19.

\(^{85}\) FATF Recommendation 6.
financing of terrorism).\textsuperscript{86} The emergence of the international framework against corruption is the result of the convergence of a combination of values (moral and religious) and interests (economic and development). Terracino describes the highly-political processes of the negotiation of international anti-corruption instruments as a response of traditional normative values and the interests of global players to corruption. On the African continent, this is reflected by two anti-corruption treaties adopted in 2003: the Southern African Development Community (SADC) Protocol against Corruption; and the Economic Community of West-African States (ECOWAS) Protocol on the Fight against Corruption. Later, in 2003, the AU Convention on Preventing and Combating Corruption was adopted, while in the same year the UN adopted the United Nations Convention against Corruption, which is the most recent and significant international law instrument against corruption.\textsuperscript{87} The latter includes provisions on the recovery of stolen assets, and establishes various measures for international cooperation for the purpose of detecting the transfer of proceeds of crime, determining the ownership of assets, as well as their confiscation, return and disposal.\textsuperscript{88}

While current international instruments against corruption require state parties\textsuperscript{89} to establish a number of offences as crimes of corruption in their domestic laws, the same instruments have taken different approaches to the criminalisation of corrupt acts. Some call for the criminalisation of the act of bribery, and some are broader in scope, requiring the criminalisation of embezzlement; the trading in influence; the abuse of functions, and illicit enrichment. Under the United Nations Convention Against Corruption (UNCAC), it is mandatory to criminalise bribery and embezzlement in domestic law, while the criminalisation of the second group of acts is not mandatory, but preferred.\textsuperscript{90} The SADC Protocol deals with both the primary and secondary acts, while the ECOWAS Protocol covers the same, but without the inclusion of ‘abuse of function’. The immediate concern flowing from the above is that where acts other than the prescribed ones are not accepted by countries party to the UNCAC, their acceptance as corrupt acts at the international level is not clear and can complicate judicial processes. An additional feature to the AU Convention is a monitoring role constituted as the African Peer Review Mechanism (APRM), which is a mutually-agreed upon instrument to which member states can voluntarily accede as a means of self-monitoring to ascertain whether they are in conformity with the agreed political, economic and corporate governance values.\textsuperscript{91}

\textsuperscript{86} Terracino (n 16 above) 3.
\textsuperscript{87} Terracino (n 16 above) 19 51.
\textsuperscript{88} Terracino (n 16 above) 52.
\textsuperscript{89} A ‘state party’ to a treaty is a country that has ratified or acceded to that particular treaty, and therefore is legally bound by the provisions of the instrument.
\textsuperscript{90} Terracino (n 16 above) 82.
\textsuperscript{91} As above.
Other international instruments, such as the OECD Anti-Bribery Convention, establish legally-binding standards to criminalise the bribery of foreign public officials in international business transactions, and are focused on the supply side of bribery transactions. The US Foreign Account Tax Compliance Act (FATCA) targets the non-compliance by US taxpayers using foreign accounts. The FATCA requires foreign financial institutions (FFIs) to report to the Inland Revenue Service (IRS) information about financial accounts held by US taxpayers, or by foreign entities in which US taxpayers hold a substantial ownership interest.92

The criminalisation of corrupt offences in domestic legislation is the first step towards ensuring the ability of states to prosecute and sanction offenders. Part of this obligation is the obligation to criminalise money laundering that has its origins in corrupt acts.93 Countries accordingly have to apply the money-laundering offences to the proceeds of corrupt acts. Therefore, there are two distinct crimes, namely, (a) the corrupt act, which is the predicate offence by which the proceeds are generated; and (b) the laundering of such proceeds. As most money-laundering cases involve an international element, countries are required to establish the extraterritoriality of predicate offences.

In keeping with the inter-relationships between corruption and money laundering, both the regulatory measures aimed at the proceeds of corruption and the AML measures applicable to the diamond value chain are highlighted below.

The following FATF Recommendations are applicable to diamond dealers: Recommendation 22 mandates that customer due diligence and record-keeping requirements set out in Recommendations 10, 11, 12, 15 and 17 apply to dealers in precious stones when they engage in any cash transaction with a customer equal to or above the applicable designated threshold (US dollars/EUR 15,000). Recommendation 28 requires that dealers in precious stones be subject to effective systems for monitoring and ensuring compliance with AML/CFT requirements, which should be

92 IRS 'Summary of FACTA reporting' (not dated).
93 This obligation is covered in specific terms in the UNCAC. Art 23(1)(a) provides for '(i) the conversion or transfer of property, knowing that such property is the proceeds of crime, for the purpose of concealing or disguising the illicit origin of the property or of helping any person who is involved in the commission of the predicate offence to evade the legal consequences of his or her action; (ii) the concealment or disguise of the true nature, source, location, disposition, movement or ownership of, or rights with respect to property, knowing that such property is the proceeds of crime; (b) subject to the basic concepts of its legal system (i) the acquisition, possession or use of property, knowing, at the time of receipt, that such property is the proceeds of crime; (ii) participation in, association with or conspiracy to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the offences established in accordance with this article'.
performed on a risk-sensitive basis by a supervisor or by an appropriate self-regulatory body.\textsuperscript{94}

In some instances, countries without national AML/CFT regulations regarding diamond dealers may have national legislation in place for sector regulation. South Africa, for example, does not have industry-specific AML/CFT regulations directed at diamond traders, and diamonds are only covered under the Diamond Act, which deals with the regulation of the diamond industry in its entirety.\textsuperscript{95}

The inherent involvement of public officials in corrupt activities in many instances entails jurisdictional privileges and immunities, which can impede efforts to combat corruption. Where immunities are abused by those in public office, immunity becomes impunity and the international legal framework does not adequately address the issue of immunities.\textsuperscript{96} According to article 30 of the UNCAC, jurisdictions

shall consider establishing procedures through which a public official accused of an offence established in accordance with this convention may, where appropriate, be removed, suspended or reassigned by the appropriate authority, bearing in mind respect for the principle of the presumption of innocence.

In short, countries are only required to apply an appropriate balance between immunities and adjudication.\textsuperscript{97}

Bank secrecy typically is aimed at protecting the financial privacy of citizens from unauthorised access, and its foundation lies in the right to privacy. A different meaning is attached to the protection afforded by bank secrecy laws. On the one hand, it is regarded as a private law issue (breach of contract or delict\textsuperscript{98} where false reporting of corruption is made) and, on the other, it is seen as a public interest matter, and a breach of secrecy constitutes a criminal offence. From a transnational investigative perspective, jurisdictions cannot deny mutual legal assistance to another jurisdiction on the grounds of bank secrecy.

After the financial crisis of 2008/2009, the G20 countries compelled tax havens to sign bilateral treaties providing for the exchange of bank information. Policy makers reportedly celebrated this as the momentum required to end bank secrecy. Johannesen and Zucman assessed the impact of tax treaties on bank deposits in tax havens, and found that rather than

\textsuperscript{94} FATF ‘Money laundering and terrorist financing through the trade in diamonds’ (2013) 36-37.
\textsuperscript{95} FATF (n 94 above) 38.
\textsuperscript{96} Terracino (n 6 above) 195.
\textsuperscript{97} Terracino (n 16 above) 212.
\textsuperscript{98} According to art 5(7) of the AU Convention, provision is made for the adoption of national legislative measures in order to punish those who make false and malicious reports against innocent persons in corruption and related offences.
repatriating funds, tax evaders merely moved deposits to tax havens which are not covered under a treaty with their home countries. What is celebrated as a crackdown, thus, is merely a relocation of deposits to the benefit of the least compliant havens.  

The liability of legal persons is highly relevant to corruption cases, since these are frequently committed through or under cover of legal entities. With corporate structures becoming increasingly complicated, holding individuals to account for a particular decision has become progressively more difficult. Legal persons have elaborate financial structures (especially in the case of corporates) and accounting practices, making it easier to conceal corrupt acts and the identity of decision makers. The attribution of responsibility to legal persons is possible through three major approaches. The first is the identification theory, which assigns liability to the individual who is in a leading position; the second approach is based on the agency principle which attaches vicarious liability (that is, an employee acting within the scope of his or her duties and for the benefit of the company). The third approach relates to corporate culture, where ‘the legal person fails to create or maintain a corporate culture that requires compliance with the relevant laws’.

A legal person is only held responsible for corrupt acts committed by its employees when there is a connection between the act and the legal person – the act must have been committed ‘for the benefit of the legal person and not in the interest of the employee’. When assessing the liability of the legal person, a key test is whether the legal person has exercised due diligence in supervising and controlling its employees.

From a tax perspective, the greatest weapon in the arsenal of the tax authority no doubt is its ability to tax all income – including that generated through illegal means, for example, section 1 read with section 23 of the South African Income Tax Act 58 of 1962, which respectively deal with gross income and non-allowable deductions. ‘Trade’ is widely defined to include ‘every profession, trade, business, employment, calling, occupation or venture’, while section 23(o) does not allow for deductions ‘where the payment of that expenditure or the agreement or offer to make that payment constitutes an activity contemplated in Chapter 2 of the

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100 Terracino (n 16 above) 255.
101 Terracino (n 16 above) 258.
102 As above.
103 Due diligence requires steps such as the implementation and application of a code of conduct, an efficient internal audit control system, compliance programmes as well as effective training and enforcement. In some jurisdictions, effective due diligence constitutes a defence (eg in Italy and Korea), while in others it is only a mitigating factor in sentencing (eg the US).
Prevention and Combating of Corrupt Activities Act 12 of 2004. Similar provisions are contained in the new Ghana Income Tax Act, which defines income in section 2(1) as ‘the assessable income from employment, business or investment’. Excluded deductions specifically include bribes and expenses incurred in corrupt practices, as well as interest, penalties and fines paid or payable to a government or a political division of a government of any country for breach of any legislation.

Preventive measures have the potential to make corruption riskier where these are targeted at systemic weaknesses that facilitate corrupt practices. Their successful implementation could significantly reinforce institutions necessary to prevent corruption. Such measures can include, for example, (a) increased transparency (through initiatives such as the Extractive Industry Transparency Initiative (EITI); (b) approaching treaties as mechanisms that can police interactions between countries; (c) establishing effective anti-corruption and anti-money laundering bodies; (d) implementing sound risk management policies; (e) implementing beneficial ownership requirements; and (f) implementing a legislative and regulatory environment that is conducive to revenue collection.

7 Conclusion

The underlying conditions that create incentives for corrupt activities are diverse and can manifest in rent seeking through payoffs and kickbacks. In order for bribery to be worthwhile to public officials, they must be in a position to create or distribute rents. The economics approach predicts that the higher the rent, the higher the incentive for corruption, and the more managers will be prone to corrupt behaviour. Good governance requires the implementation of measures that improve the external environment in which enterprises operate, and that improve the effectiveness of institutions which regulate, facilitate and enforce regulations. As acts of corruption, money laundering and tax evasion generally are aimed at achieving a financial gain in a manner which aims to hide that gain, they are necessarily intertwined. An institutional

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104 Act 896 of 2015.
105 Business income includes income from a trade, profession, vocation or isolated arrangement with a business character; gains from the realisation of capital assets and gifts received in respect of the business.
108 The gain could be legal or illegal. Where the gain is legal but the entity attempts to hide the gain from the tax authorities, it becomes tax evasion and, therefore, is illegal.
response should recognise this aspect, in order to successfully deal with these diverse crimes.

Taxation is a key shaper of accountability relationships between citizens and government, and the anti-money-laundering framework can further delineate this relationship by highlighting agreements which are opaque and where beneficial ownership is not transparent. For a tax administration, this may mean better revenue collection, and for tax policy greater transparency in the design of, *inter alia*, incentive and/or exemption regimes.

In addressing money laundering and tax evasion, cognisance should be taken of the fact that anti-money-laundering and counter-terrorist-financing regimes support economic development though three primary roles:

(a) by serving as an additional tool in combating and preventing crime and tax evasion;

(b) by protecting the financial system from criminal influences and by preventing tainted money from being injected into the economies of countries; and

(c) by contributing to good governance and by promoting the rule of law to the benefit of society as a whole.

The different regulatory frameworks aimed at fighting corruption, evasion and money laundering are complementary and provide diverse options to enforcement agencies. For instance, instead of pursuing embezzlement under anti-corruption laws, it may be better for tax authorities to pursue tax evasion charges, as unexplained wealth forms the basis of the embezzlement crime and life style audits are the bread and butter of revenue agencies. Strong sanctions of the AML Framework, coupled with a wealth of financial information, puts it in a formidable position to assist tax administrations with up-to-date information, where the tax authority is hampered by a lack of updated, comprehensive and comparable data.

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International cooperation in tax matters: A gap analysis of the legal instruments framework of Ghana, Nigeria and South Africa

Sathi Meyer-Nandi

Abstract
Illicit financial flows (IFFs) strip essential resources from developing countries, which could be used to foster development. International tax evasion constitutes one major source of IFFs out of developing countries. This problem, being global by nature, resulted in an unprecedented peak in global tax cooperation with a creation of global infrastructure to jointly fight IFFs resulting from tax aversion. Although this global cooperation covers various aspects, one main element is the consensus that transparency is an important antidote. Vast amounts of resources are allocated to global exchange of information for tax purposes between countries. There are additional efforts to broaden the scope for which the information exchanged can be used so that not only tax authorities can benefit from the information received (so-called inter-agency cooperation). Additionally, one can see an increase in the cross-border assistance in the collection of taxes. However, for various reasons many developing countries are benefiting from the increased global tax cooperation in a limited way. Accordingly, this chapter focuses on the global tax cooperation mechanisms implemented by Ghana, Nigeria and South Africa with regards to (i) global transparency; (ii) inter-agency cooperation; and (iii) the cross-border assistance in the collection of taxes. It provides a gap analysis with regard to the embeddedness of the respective countries into bi- or multilateral frameworks. Based on the results of the gap analysis, recommendations are given on how to improve the benefits of the increased global tax cooperation in respect of Ghana, Nigeria and South Africa.

1 Introduction

Governments around the globe are joining forces to combat illicit financial flows (IFFs) with special attention being given to the position of developing countries. While IFFs occur and are damaging in all countries, their impact are more severe in developing countries due to their limited resource base and smaller, less stable markets. Estimates on the exact volume of IFFs are heavily debated and vary greatly. However, in these debates there is general consensus that each year large amounts of money
are transferred illegally out of developing countries, likely exceeding inbound aid and investment flows in volume.

There is further consensus that the IFFs strip essential resources from developing countries, which could otherwise be utilised to finance public infrastructure and services in education, health, security and justice, with a decelerating effect on development. Various definitions are used for IFFs, which in essence can be summarised as ‘methods, practices and crimes aiming to transfer financial capital out of a country in contravention of national or international laws’.\(^1\) International tax evasion constitutes a major source of illicit financial flows from developing countries. As capital – be it from individuals or companies – has become more mobile, all countries on equal footing are dealing with new international challenges, such as the tracing of offshore assets; how to tax multinational enterprises adequately; building effective transfer pricing regimes; establishing and using information sharing arrangements to obtain tax information about taxpayers from other countries; and how to use this information most effectively. These challenges, being global by nature, resulted in an unprecedented peak in global tax cooperation with a creation of global infrastructure to jointly fight IFFs resulting from tax aversion. Although this global cooperation covers various aspects, one major element is the agreement that transparency is the antidote. Since the primary goal of IFFs is to hide funds from governments, vast amounts of resources are allocated to the global exchange of information for tax purposes between countries. There are additional efforts to broaden the scope for which the information exchanged can be used so that not only tax authorities can benefit from the information received (so-called inter-agency cooperation). Additionally, one can see an increase in the cross-border assistance in the collection of taxes.

Developing countries are included in the discussions and can benefit from this global momentum in cooperation. Strikingly, however, many developing countries are only utilising and benefiting from the increased global tax cooperation in a limited way. They rarely use the global infrastructure that now exists to request information on companies and wealthy individuals, to share the information exchanged with other government agencies or request assistance in the cross-border collection of taxes.\(^2\) The reasons are diverse, for instance, the lack of a legal basis; the lack of awareness of tax administrations of the potential benefits of global cooperation; or simply a lack of knowledge about the implementation of


required means to enable tax cooperation. However, the argument commonly brought forward about the lack of capacity and bargaining power to include instruments in relevant treaty negotiations no longer is a valid excuse, since multilateral instruments for the exchange of information are now readily available, which developing countries can adhere to without the need to negotiate individually with other states. However, it still is not being utilised sufficiently.

1.1 Aim of the research

All these limitations seem abstract without placing them into an actual country’s framework. Hence, this chapter focuses on the global tax cooperation mechanisms implemented by Ghana, Nigeria and South Africa with regard to (i) global transparency; (ii) inter-agency cooperation; and (iii) the cross-border assistance in the collection of taxes. It provides a gap analysis with regard to the embeddedness of the respective countries into bi- or multi-lateral frameworks. However, this chapter does not cover national law mechanisms. Based on the results of the gap analysis, the aim is to develop recommendations on how to improve the benefits of the increased global tax cooperation for Ghana, Nigeria and South Africa. The first part provides a general overview of the range of the bi- and multi-lateral frameworks of each country. Thereafter, the second part conducts the gap analysis on the three aspects, namely, global transparency, interagency cooperation and the cross-border assistance in the collection of taxes. Based on the conclusions of the gap analysis, the last part provides some recommendations.

2 Network of global tax cooperation partners

In order to utilise the new global infrastructure in international cooperation in tax matters, developing countries need to have in place an adequate framework. First, a legal basis is required for doing so, which can be included in a bilateral or a multilateral framework. Second, it is important that the framework covers all relevant countries that constitute trading partners and wealth management centres.

2.1 Bilateral framework

A bilateral framework would require tax treaty partners to incorporate administrative assistance provisions, such as an exchange of information article in their relevant double tax treaty (DTT). The disadvantage of solely relying on such a provision in a bilateral tax treaty is that they might not

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represent international standards due to pressure in the process of negotiations. Additionally, as international standards on global cooperation are over time steadily refined and changed, a bilateral provision needs to be renegotiated in order to reflect the ‘state of the art’.

Since developing countries may not have the capacity, negotiation skills or bargaining power, the clauses might be outdated and restrictive, not exhausting the whole potential of the global cooperation. Another bilateral instrument is the conclusion of tax information exchange agreements (TIEA), which have a material scope of only covering the provision of information exchange. However, since these instruments are bilateral, again they require resources and the willingness of third countries to conclude such agreements with developing countries. Hence, multilateral instruments in this regard are far more beneficial, since harmonised wording applies to a wide network of treaty partners with no need for individual negotiations by the developing country.

2.2 Multilateral framework

The Multilateral Convention on Mutual Administrative Assistance in Tax Matters constitutes such multilateral framework. It’s ‘birth’ resulted from the work carried out jointly by the Council of Europe and by the Organisation for Economic Co-operation and Development (OECD). It constitutes one of the most ambitious and comprehensive endeavours for cross-border tax cooperation and originally was opened for signature only to members of the Council of Europe and the OECD as of 25 January 1988.4

The Convention was amended according to the call of the G20 at its 2009 London Summit to harmonise it to the international standard on exchange of information on request included in article 26 of the 2008 OECD Model Tax Convention. It is understood that the EoI provisions of the Convention, as amended by the 2010 Protocol (amended Convention), are generally given the same interpretation as that expressed in the OECD Commentary thereon.5 Furthermore and, more importantly, the amending protocol opened the Convention to all interested countries, with the rationale to ensure in particular that developing countries could benefit from the new more transparent and cooperative environment. On 1 June 2011 the amended Convention was ready for signature.6 A non-OECD or

non-Council of Europe member wishing to join the amended Convention must address the Secretary-General of the OECD or of the Council of Europe. The decision to invite a requesting country to become a party to the Convention will be taken by consensus by the parties through the coordinating body. The decision will be based on several factors, taking into account, inter alia, the confidentiality rules and practices of the country concerned and whether the country is a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes. As of 26 September 2016, 104 jurisdictions participate in the amended Convention. This covers a wide range of different countries, including all G20 countries, all BRIICS, all OECD countries, major financial centres and an increasing number of developing countries.

2.3 Outreach to trading partners and wealth management centres

A treaty network – be it bi- or multi-lateral – that facilitates cross-border cooperation in tax matters with all relevant trading partners of a country is very valuable, since it can help in circumstances of tax audits on cross-border activities; transfer pricing issues; the transfer of knowledge with regard to special industry practices; or to share strategic information on VAT evasion schemes. Additionally, since high net worth private individuals often use offshore global wealth management centres for the management of their funds, a treaty network covering the classical wealth management hubs is also important. The biggest global wealth management centres currently comprise of Switzerland, the United Kingdom (UK), the United States (US), Panama and the Caribbean, Hong Kong and Singapore. Although Switzerland still constitutes the biggest wealth management hub, Hong Kong has achieved a growth of 146 per cent (±US $0.4 trillion) in cross-border client assets during the period between 2008 to 2014 and, hence, has the biggest amount of inflows of new assets – more inflows than any other centre. Below, one can find an overview of the outreach of the global tax cooperation partners of Ghana, Nigeria and South Africa.

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10 Deloitte Wealth Management Centre Ranking (n 9 above) 2
2.3.1 Ghana

Ghana has a market-based economy with relatively few policy obstacles to trade and investment in comparison with other countries in the region. Ghana is a commodity-exporting country as it is equipped with natural resources and has a strong agricultural sector. Agriculture accounts for nearly one-quarter of gross domestic product (GDP), and the services sector accounts for about half of the GDP. Gold and cocoa exports, as well as individual remittances, are major sources of foreign exchange. The expansion of Ghana’s nascent oil industry has boosted economic growth, but the recent crash in the oil price reduced by half Ghana’s 2015 oil revenue.\textsuperscript{11} Ghana’s main export and import commodities and partners are summarised in Table 6.1 below.

Table 6.1: Ghana’s Import and Export Commodities and Partners

<table>
<thead>
<tr>
<th>Imported commodities</th>
<th>Capital equipment; refined petroleum; foodstuffs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import partners</td>
<td>China 32.6%; Nigeria 14%; Netherlands 5.5%; US 5.4% (2015)</td>
</tr>
<tr>
<td>Exported commodities</td>
<td>Oil; gold; cocoa; timber; tuna; bauxite; aluminium; manganese ore; diamonds; horticultural products</td>
</tr>
<tr>
<td>Export partners</td>
<td>India 25.2%; Switzerland 12.2%; China 10.6%; France 5.7% (2015)</td>
</tr>
</tbody>
</table>


With regard to its global tax cooperation partners, Ghana only has a limited treaty network in place. Currently, with only nine DTTs in force, the treaty network covers Belgium, Denmark, France, Germany, Italy, Netherlands, Switzerland, the United Kingdom and South Africa. Ghana further has concluded one tax information exchange agreement (TIEA) with Liberia.\textsuperscript{12} As a major step forward, on 10 July 2011 Ghana signed the amended Convention on Mutual Administrative Assistance in Tax Matters with entry into force on 1 September 2013. Participation in the Convention significantly broadened Ghana’s framework of global tax cooperation partners, since the Convention currently covers the participating countries listed in Box 6.1.\textsuperscript{13}

\textsuperscript{11} For more information on Ghana’s economy, see https://www.cia.gov/library/publications/resources/the-world-factbook/geos/gh.html (accessed 7 November 2016).
Accordingly, Ghana’s bi- and multi-lateral framework of global tax cooperation partners generally covers its main import and export partners. With regard to global wealth management centres, Ghana’s global tax cooperation network covers Switzerland, the United Kingdom, some of the Caribbean islands and Singapore. However, since the United States and Panama have not ratified the amended Convention yet and Hong Kong is not participating so far, Ghana’s treaty network does not cover these countries/regions.

2.3.2 Nigeria

Nigeria constitutes Africa's largest economy, with 2015 GDP estimated at USD1.1 trillion. Nigeria is a commodity-exporting country with a strong

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**Box 6.1: Participating countries in the Convention on Mutual Administrative Assistance in Tax Matters**

Albania; Andorra**; Anguilla; Argentina; Aruba; Australia; Austria; Azerbaijan; Barbados; Belgium; Belize; Bermuda; Brazil; British Virgin Islands; Bulgaria; Burkina Faso*; Cameroon; Canada; Cayman Islands5; Chile; China (People’s Republic Of); Colombia; Costa Rica; Croatia; Curacao; Cyprus; Czech Republic; Denmark; Dominican Republic*; El Salvador*; Estonia; Faroe Islands; Finland; France; Gabon*; Georgia; Germany; Ghana; Gibraltar; Greece; Greenland; Guatemala*; Guernsey; Hungary; Iceland; India; Indonesia; Ireland; Isle Of Man; Israel*; Italy; Jamaica*; Japan; Jersey; Kazakhstan; Kenya*; Korea; Latvia; Liechtenstein**; Lithuania; Luxembourg; Malaysia*; Malta; Mauritius; Mexico; Moldova; Monaco*; Montserrat; Morocco*; Nauru; Netherlands; New Zealand; Nigeria; Niue; Norway; Pakistan*; Panama*; Philippines*; Poland; Portugal; Romania; Russia; Saint Kitts And Nevis**; Saint Vincent And The Grenadines**; Samoa**; San Marino; Saudi Arabia; Senegal**; Seychelles; Singapore; Sint Maarten; Slovak Republic; Slovenia; South Africa; Spain; Sweden; Switzerland**; Tunisia; Turkey*; Turks & Caicos Islands; Uganda; Ukraine; United Kingdom; United States*, Uruguay**

Notes:
*) signed but not in force;
**) signed and entry into force latest by 1 January 2017.


14 With the exception of the United States, since it signed the Convention but ratification is still open.
agricultural sector. Oil has been a dominant source of income and has constituted approximately 70 per cent of government revenues since the 1970s. Over the last five years, Nigeria’s economic growth has been driven in the sectors of agriculture, telecommunications and services. Due to regulatory constraints and security risks, only limited new investment in oil and natural gas has taken place and Nigeria’s oil production has contracted every year since 2012. Because of lower oil prices, GDP growth in 2015 fell to around 3 per cent, and government revenues declined, while the non-oil sector also contracted due to economic policy uncertainty. In Table 6.2 Nigeria’s main export and import commodities and partners are summarised.

**Table 6.2: Nigeria’s Import and Export Commodities and Partners**

<table>
<thead>
<tr>
<th>Imported commodities</th>
<th>Machinery; chemicals; transport equipment; manufactured goods; food and live animals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import partners</td>
<td>China 25.7%; US 6.4%; Netherlands 6.1%; India 4.3% (2015)</td>
</tr>
<tr>
<td>Exported commodities</td>
<td>Petroleum and petroleum products 95%; cocoa; rubber (2012 est)</td>
</tr>
<tr>
<td>Export partners</td>
<td>India 18.2%; Netherlands 8.5%; Spain 8.2%; Brazil 8.2%; South Africa 7.8%; France 5.2%; Japan 4.5%; Côte d’Ivoire 4.2%; Ghana 4% (2015)</td>
</tr>
</tbody>
</table>


With regard to its global tax cooperation partners, Nigeria only has a limited treaty network in place. Currently, with only 14 DTTs in force, the treaty network covers Belgium, Canada, China, Czech Republic, France, Netherlands, Romania, Slovak Republic, South Africa, Spain, Sweden and the United Kingdom. As a major step forward, on 29 May 2013 Nigeria signed the amended Convention on Mutual Administrative Assistance in Tax matters with entry into force on 1 September 2015. Participation in the Convention significantly broadened Nigeria’s framework of global tax cooperation partners, since the Convention covers multiple countries. Nigeria’s bi- and multi-lateral framework of global tax cooperation partners generally covers its main import and export partners. With regard to global wealth management centres, Nigeria’s global tax cooperation network covers Switzerland, the United Kingdom, some of the Caribbean Island States and Singapore. However, since the United States and Panama have not yet ratified the amended Convention and

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Hong Kong is not participating so far, Nigeria’s treaty network does not cover these countries/regions.

2.3.3 South Africa

South Africa is a middle-income emerging market well equipped with natural resources, well-developed financial, legal, communications, energy and transport sectors, and a stock exchange that is Africa’s largest and among the top 20 in the world. However, unemployment, poverty and inequality – among the highest in the world – remain a challenge. The current government faces growing pressure from urban constituencies to improve the delivery of basic services to low-income areas and to increase job growth.\textsuperscript{16} South Africa’s main export and import commodities and partners may be summarised as follows:

Table 6.3: South Africa’s Import and Export Commodities and Partners

<table>
<thead>
<tr>
<th>Imported commodities</th>
<th>Machinery and equipment; chemicals, petroleum products; scientific instruments; foodstuffs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import partners</td>
<td>China 17.6%; Germany 11.2%; US 6.7%; Nigeria 5%; India 4.7%; Saudi Arabia 4.1% (2015)</td>
</tr>
<tr>
<td>Exported commodities</td>
<td>Gold; diamonds; platinum; other metals and minerals; machinery and equipment</td>
</tr>
<tr>
<td>Export partners</td>
<td>China 11.3%; US 7.3%; Germany 6%; Namibia 5.2%; Botswana 5.2%; Japan 4.7%; UK 4.3%; India 4.2% (2015)</td>
</tr>
</tbody>
</table>


With regard to its global tax cooperation partners, South Africa has in place an extensive treaty network. Currently, with 76 DTTs in force, the treaty network covers the countries listed in Box 6.2.

South Africa has further concluded three TIEAs with Cayman Islands, Guernsey and San Marino. Additionally, on 3 November 2011, South Africa signed the amended Convention on Mutual Administrative Assistance in Tax matters with entry into force on 1 March 2014. Participation in the Convention further broadened South Africa’s framework of global tax cooperation partners, since the Convention covers multiple countries. South Africa’s bi- and multi-lateral framework of global tax cooperation partners generally covers its main import and export partners. With regard to global wealth management centres, South Africa’s global tax cooperation network covers Switzerland, the United Kingdom, the United States, some of the Caribbean island states, Singapore and Hong Kong. Only Panama is not included, since Panama has not yet ratified the amended Convention.

3 The Gap Analysis on Global Tax cooperation Framework

3.1 Global transparency

The late US Justice Louis Brandeis famously stated that ‘sunlight is the best disinfectant’. Correspondingly, an important mechanism for the elimination of tax avoidance and aversion is transparency. Transparency through the exchange of information on a global scale helps to avoid information asymmetries though enhancing a more transparent global tax footprint. Particularly for developing countries, it constitutes an important tool to inhibit the loss of revenues from assets held offshore or misrepresented cross-border activities. The G20 and the OECD’s Global
Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) were the driving forces to improve transparency through setting global standards for information-sharing around the world. As a result, the number of agreements on exchange of information between tax authorities and the scope of the exchange have steadily increased, incorporating also the agreements between OECD countries and developing countries.\textsuperscript{18} The Global Forum became the venue for a peer review programme aimed at assessing the effective practical implementation of OECD transparency standards.\textsuperscript{19} Action was taken against jurisdictions that fail to comply with the international standards of fiscal transparency, and the era of bank secrecy was declared extinct because of the new information exchange obligations. The international standard for the exchange of information upon request over time was gradually refined and now envisages information exchange to the widest extent possible, namely, that the information can relate to persons who are not resident in either contracting state, and it can cover information regarding taxes that are not covered by the tax treaty, such as VAT.\textsuperscript{20} However, speculative requests for information with no apparent nexus to an open inquiry or investigation – so-called ‘fishing expeditions’ – are not permitted. This fine balance between broadness and the limit on ‘fishing expeditions’ was created by introducing the standard of ‘foreseeable relevance’ into article 26(1)\textsuperscript{21} of the OECD and UN Model Tax Convention.\textsuperscript{22}

3.2 Automatic exchange of information

Invited by the G20 countries, the OECD has recently developed what it refers to as the new single global standard for the automatic exchange of information (AEOI) between tax authorities globally. The OECD defines the AEOI as the systematic and periodic transmission of ‘bulk’ taxpayer information by the source country to the residence country in a common

\textsuperscript{18} OECD (n 1 above).
\textsuperscript{19} Statement of G8 Finance Ministers, Lecce, Italy, 13 June 2009: ‘We welcome progress in negotiations of agreements on the exchange of information for tax purposes. We urge further progress in the implementation of the OECD standards and the involvement of the widest possible number of jurisdictions, including developing countries. It is also essential to develop an effective peer-review mechanism to assess compliance with the same standards. This could be delivered by an expanded Global Forum. We also look forward to an update on progress on the G20 agreement to tackle tax havens at the next OECD Ministerial meeting.’ https://www.treasury.gov/press-center/press-releases/Pages/tg171.aspx (accessed 15 November 2016).
\textsuperscript{20} Para 7.2 UN Model: Commentary on Article 26 (2011) and para 5 OECD Model: Commentary on Article 26 (2014).
\textsuperscript{21} See Appendix A for the wording of art 26 of the UN Model (2011) and the OECD Model (2014).
\textsuperscript{22} The commentaries to art 26 OECD and UN Model Tax Convention additionally stipulate that the term ‘foreseeably relevant’ can be substituted with ‘necessary’, ‘relevant’ or ‘may be relevant’. These terms are equivalent to the international standard of the term ‘foreseeably relevant’, if those terms are understood to require an effective exchange of information and are understood to mean ‘appropriate and helpful’ but not ‘essential’; paras 7.1-7.2, UN Model: Commentary on Article 26 (2011).
reporting format or standard.\(^{23}\) Local banks and financial institutions of participating countries would be required to obtain information on financial accounts, which they would make available to the local tax authorities. In turn, they would provide that information on an automatic basis to other countries in a standardised format (without the need for sending a specific request). As at 10 April 2017, 52 jurisdictions have committed to undertaking their first exchange by 2017, with another 48 indicating that they would start their exchange by 2018.\(^{24}\)

Generally, the principal purpose of exchanging information is to provide countries with information to detect tax evasion, thereby allowing them to protect their tax base and limit their exposure to revenue loss. Especially for developing countries, the detection of tax evasion is considered critical, due to the estimation by the OECD that approximately US $8.5 trillion of household assets are held abroad in developing countries.\(^{25}\) For instance, in 2012 more than 25 per cent of all Latin American and almost 33 per cent of all Middle Eastern and African household wealth was held abroad compared to the worldwide average of 6 per cent.\(^{26}\) The successful implementation of the AEOI can alert tax administrations to tax evasion that was previously unknown and, hence, limit the tax revenue and illicit financial flows lost by developing countries.

However, the practical adoption of the AEOI standard presupposes an onerous administrative burden on countries, and this burden arguably is bigger on developing countries. Developing countries usually – albeit on different degrees – do not have the same level of administrative resources and intellectual capital as developed countries. Additionally, developing countries also are not at the same level regarding the system already in place for the exchange of information as developed countries are.\(^{27}\)

The special needs and position of developing countries in their AEOI implementation was acknowledged by the OECD and G20, in particular, at the St Petersburg Summit in 2013.\(^{28}\) G20 leaders called on the Development Working Group (DWG) in conjunction with the Finance

\(^{23}\) OECD (n 1 above) 76.
\(^{28}\) G-20 ‘Leaders’ declaration with regard to AEOI and BEPS’ www.g20.org/sites/default/les/g20_resources/library/Saint_Petersburg_Declaration_ENG_0.pdf (accessed 10 November 2016).
Chapter 6

Track, to work with the OECD, the Global Forum and other international organisations to develop a roadmap to assist developing countries.29

The mentioned roadmap for developing countries to participate in the AEOI was delivered by the Global Forum to the G20 DWG on 5 August 2015.30 It is described as a high-level implementation policy by the OECD to broadly address the concern of developing countries.31 However, next to the identification of high-level hurdles32 and the drafting of principles and steps, the roadmap does not provide concrete solutions or tangible assistance suggestions. Thus, it does recommend to all developing countries to volunteer to participate in a pilot project, which should assist with effective implementation.

The pilot projects are conducted by the Global Forum, together with the World Bank Group and other Global Forum members. These projects are undertaken as a collective effort by the pilot country (the developing country participant) and a developed country that has agreed to partner with the pilot country, the Global Forum Secretariat, the World Bank Group and other organisations depending on the particular case.33 According to the Global Forum, six pilot projects are already underway: Albania supported by Italy; Colombia by Spain; Ghana by the United Kingdom; Morocco by France; the Philippines by Australia; and Pakistan by the United Kingdom. The pilot projects are conducted through a step-by-step approach to implementation. Thereby it is assumed that gradually each developing country participant (‘pilot country’) would reach full implementation in accordance with the standard.

Next to the pilot projects, dedicated further technical assistance is being offered by the Global Forum on Transparency and Exchange of Information for Tax Purposes, including training seminars (with more than 400 government officials attending training in 2015 alone) and one-one-one advisory services, particularly focusing on legislation and other areas highlighted through an ongoing monitoring process.34

29 G-20 (n 29 above) para 52.
30 As above.
31 Sadiq & Sawyer (n 28 above) 114.
32 As above.
34 More information on the technical assistance provided can be found at http://www.oecd.org/tax/transparency/technical-assistance/aeoii/#d.en.352223 (accessed 10 November 2016).
Nevertheless, the participation of developing countries in the AEOI remains an exception due to their lack of capacity, and its wide-scale accessibility will still require some time.35

3.3 Interim period before AEOI

Until AEOI becomes viable for developing countries, the exchange of information upon request will be instrumental to attaining cross-border information. Likewise, its workability includes difficult hurdles to pass. The tax authorities need to link a tax evader to a specific different jurisdiction in order to pass the ‘foreseeably relevant’ hurdle. In order to do so, someone must have spilled evidence and this information needs to be adequate. Hence, the use of exchange of information upon request in practice might be of limited use, due to the difficulties to attain this evidence, when one only has limited resources available. However, what one should not forget is that the exchange of information is not restricted to taxpayer-specific information. More generic industry knowledge can also be subject to exchange. Industry knowledge is particularly helpful for tax administrations in developing countries that may lack valuable industry-specific knowledge necessary for adequate transfer pricing outcomes. An industry-wide exchange of information is the exchange of tax information, especially concerning a whole economic sector (for instance, the oil or pharmaceutical industry, the banking sector, and so forth) and not taxpayers in particular.36

Irrespective of the mode of exchange – be it upon request, spontaneous or automatic – as stated above, countries need to have an adequate legal basis for doing so. The following part will be devoted to a gap analysis of the frameworks available for Ghana, Nigeria and South Africa, with regard to the exchange of tax-specific information.

3.3.1 Gap analysis on Ghana, Nigeria and South Africa

Bilateral framework

As already discussed above, Ghana and Nigeria have in place only a limited bilateral treaty network while South Africa has an extensive bilateral treaty network. All three countries underwent the peer-review process of the Global Forum, implying an in-depth monitoring and peer review of the implementation of the international standards of

35 The OECD’s new landmark model agreement on automatic exchange of financial information currently is likely to exclude many less-developed countries from its benefits on the grounds that they lack the resources to set up the data collection arrangements required to qualify as a reciprocating partner. However, resources are allocated in order to help developing countries to build their capacity.

transparency and exchange of information for tax purposes. Accordingly, for purposes of this chapter, there is no need to go into details with regard to the quality of the jurisdictions’ legal and regulatory framework for the exchange of information. This issue is covered extensively in the respective peer-review reports.37

In summary, the exchange of information provisions in DTT of Ghana, Nigeria and South Africa vary strongly in their wording and scope. They are generally based on article 26 of the OECD or UN Model Treaty. However, depending on the point in time the DTT was concluded and the tax policy considerations of the two contracting parties, there are significant treaty variations. The majority of the EoI provisions of Ghana, slightly less than half of those of South Africa, and only two of those of Nigeria contained in bilateral treaties include a broad personal as well as material scope and, hence, could facilitate information exchange to the widest extent possible with regard to taxes and persons covered. Accordingly, these provisions potentially facilitate a broad exchange, which can relate to persons who are not resident in either contracting state and they can cover information regarding taxes that are not covered by the Convention, for instance, VAT. However, the rest of their EoI provisions are either restricted to information requests limited to ‘taxes covered by the Convention’, generally taxes on income and capital gains. A minority of EoI provisions even are very restrictive, since they are firstly restricted in their taxes covered and the persons covered. Additionally, they can include wording that can significantly limit the information to be exchanged. 38


38 Eg, the exchange of information provision in the treaty between Ghana and Switzerland limits the scope of exchange to the residents of the contracting states and does not cover taxes of every kind and description, but is limited to ‘the taxes which are the subject of the Convention’, ie taxes on income, capital and on capital gains. A further restricting factor is the treaty provides for the exchange of ‘such information (being information which is at their disposal under their respective taxation laws in the normal course of administration)’. If interpreted restrictively, this wording can significantly limit the information to be exchanged to information that is already available to the tax authorities. However, on 22 May in Accra, Switzerland and Ghana signed a protocol amending the agreement for the avoidance of double taxation (DTA) with respect to taxes on income, capital and capital gains. This protocol broadens the exchange of information provision and brings the administrative assistance clause into line with the applicable international standard for the exchange of information upon request. It still needs to be approved by parliament in both countries before it can enter into force. A further example of a very restrictive clause is South Africa’s DTT with Switzerland. It is drafted in a distinct way and constitutes a good example of a restrictive clause with various elements. First, the EoI provision provides for the exchange of information ‘as is necessary for carrying out the provisions of this
Chart 6.1 below provides an overview of the scope of the bilateral EoI provisions of the three countries. ‘Broad’ means neither restricted by article 1 (persons covered) nor by article 2 (taxes covered); ‘restrictive’ means either restricted by article 1 (persons covered) or by article 2 (taxes covered); and ‘very restrictive’ means restricted by article 1 (persons covered) and by article 2 (taxes covered) and, in some cases, with additional restrictive wording.


Source: Author’s own analysis of treaties.

Looking at the bilateral treaty landscape of the three countries, Ghana and Nigeria generally have a very limited network of DTTs in place. Although South Africa’s bilateral network is more extensive, the level of the EoI Convention and, upon request, of the provisions of domestic law concerning tax fraud in relation to the taxes which are subject of this Convention. This wording provides that other than for carrying out the provisions of the Convention, the exchange of information is only granted in case of tax fraud. The protocol further defines the term ‘tax fraud’ as fraudulent conduct which constitutes a tax offence which, in both contracting states, can be punished with imprisonment. Hence, in order for information to be exchanged, the act needs to constitute a crime under the laws of both contracting states. To put it in different words, this so-called principle of dual criminality requires the act under investigation to constitute a crime also under the laws of the requested state. This requirement limits the scope of the EoI provision extensively, because of an idiosyncratic feature in Swiss law. Under Swiss law, there is a distinction between tax fraud and mere tax evasion. Tax evasion is given when a taxpayer fails to submit a tax return or submits incomplete information. This tax evasion is seen as a regulatory offence, which is subject to a fine rather than constituting a criminal offence. Tax fraud, on the other hand, occurs when falsified or non-genuine records, such as accounts, balance sheets or income statements are used for the purpose to avoid taxes. The concept of tax fraud was further broadened by the Swiss Supreme Court, stipulating that tax fraud does not necessarily imply the use of false documents; there may also be tax fraud in situations of tax evasion, which have been provoked by a particularly cunning act (astuce) on the part of the taxpayer. The mere omission to declare something, however, constitutes only tax evasion. Accordingly, the threshold under Swiss law to constitute tax fraud is much higher than in other jurisdictions and even further limits the EoI.
mechanisms leaves sufficient room for improvement for all three countries. Since renegotiation or – in the case of Ghana and Nigeria – the conclusion of new DTTs with more countries, is time and resource-consuming, it is positive to note that bilateral EoI provisions do not limit, nor are they limited by, those contained in existing international agreements or other arrangements between the contracting states which relate to cooperation in tax matters.39 Hence, it is worthwhile exploring the scope of EoI under the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

3.3.2 Multilateral framework

The amended Convention is the most comprehensive multilateral instrument available for all forms of tax cooperation to tackle tax evasion and avoidance and provides for a single legal basis for bilateral and multi-country cooperation. As stated above (sec II.1-3), Ghana, South Africa and Nigeria have already signed the Convention, and it has gone through the required ratification processes and entered into force.40 Accordingly, by being members of the Convention, all three countries have expanded their network of mutual administrative assistance partners extensively through one single legal basis.

Generally speaking, the amended Convention provides for wide-ranging cooperation between tax authorities. First, the personal scope is broad, since it is stipulated that the parties shall provide administrative assistance to each other in tax matters, irrespective of whether the person affected is a resident or national of a party or of any other state (article 1). Second, the material scope is even broader. Different forms of administrative assistance are contemplated, including the exchange of information that is foreseeably relevant for the administration or enforcement of domestic laws concerning taxes covered by the Convention – explicitly mentioning exchange of information upon request; automatic exchange of information as may be agreed between two or more parties; and spontaneous exchange of information in specified circumstances.41 The Convention also provides for assistance in the recovery of taxes;42 simultaneous tax administrations;43 and tax examinations abroad.44 Regarding taxes covered, the Convention potentially covers all forms of

39 See para 5.5 OECD Model: Commentary on Article 26 (2014).
41 Ch III, sec I, arts 4-6.
42 Ch III, sec II, arts 11-16.
43 Ch III, sec I, art 8.
44 Ch III, sec I, art 9.
compulsory payments to the general government with the sole exception of customs duties and all other import-export duties.\textsuperscript{45} However, \textit{de facto} the taxes covered are not homogenous between the different contracting parties. At signature or upon ratification of the amended Convention, states are free to declare reservations within stated limits as to the taxes covered, or as to certain types of administrative assistance that they will not provide.\textsuperscript{46}

\begin{itemize}
\item In the case of Ghana, the amended Convention applies to income tax; petroleum income tax; mineral royalties; withholding tax on interest; withholding tax on dividend; withholding tax on goods and services; capital gains tax; gift tax; value added tax; and excise tax.
\item In the case of Nigeria, the amended Convention applies to personal income tax; company income tax; petroleum profit tax; capital gains tax; value added tax; excise duty; tertiary education tax; and a national information technology development levy. However, taxes imposed on behalf of political subdivisions or local authorities, compulsory social security contributions payable to general government or social security institutions established under public law and taxes on the use or ownership of motor vehicles are explicitly excluded in Nigeria.
\item In the case of South Africa, the amended Convention applies to income tax; withholding tax on royalties; tax on foreign entertainers and sportspersons; turnover tax on micro-businesses; dividend tax; withholding tax on interest, effective date 1 March 2015; capital gains tax; estate duty; donations tax; transfer duty; value added tax; excise tax; and securities transfer taxes. However, taxes imposed on behalf of political subdivisions or local authorities, compulsory social security contributions payable to general government or social security institutions established under public law and taxes on the use or ownership of motor vehicles are explicitly excluded in South Africa.
\end{itemize}

The resulting asymmetrical application of the amended Convention is not formally addressed by the Convention itself. However, paragraph 11 of the explanatory report stipulates:

\begin{quote}
The legal principle of reciprocity is another element of balance in the implementation of the Convention, since a state cannot ask for a form of assistance that it is not ready to grant to other states. The same principle of reciprocity is also a factor in the development of mutual assistance, because a state which wishes to draw more benefits from the Convention will be encouraged to offer more extensive assistance to other states.
\end{quote}

Accordingly, the more a state decides to limit the taxes covered, the less information it will receive from other states. Hence, one must also assess the reservations made of the requested party to see the exact scope of the

\textsuperscript{45} Ch I, art 2.
\textsuperscript{46} Ch VI, art 30; the list of the reservations at the time of writing can be found at http://www.coe.int/en/web/conventions/search-on-treaties/-/conventions/treaty/127/declarations (accessed 11 October 2016).
taxes covered. However, irrespective of the reservations made, the taxes covered by Ghana, Nigeria and South Africa are wide-ranging and the number of countries participating in the amended Convention are extensive. Hence, the participation of the three countries in the amended Convention significantly upgraded their constrained bilateral framework.

Due to the participation in the amended Convention, the network of global cooperation partners with broad EoI provisions in compliance with the international standard covers all relevant trading partners. Since the US and Panama have not yet ratified the amended Convention and Hong Kong is not party to the Convention, these wealth management centres are not part of the network (with the exception of Hong Kong and the United States with regard to South Africa, since a bilateral framework is in place). Due to the growing importance of Hong Kong, it is advisable to try to establish a framework for EoI that includes Hong Kong.

Additionally, since the AEOI will require some time until developing countries are able to participate, the EoI upon request is the standard for attaining information. Due to the hurdles of overcoming the ‘foreseeably relevant’ threshold, receiving taxpayer specific information upon request is in practice of limited use. To enhance the benefits of the EoI instrument in the interim period before AEOI is in place, the competent authorities of Ghana, Nigeria and South Africa could establish specific procedures\(^47\), for instance routine exchange of industry know-how, with timeframes and types of information to be exchanged. This can be especially helpful if such a procedure is established with targeted sophisticated tax administrations, with extensive exposure to industry practices and know-how, such as the UK, The Netherlands and Switzerland. Since Ghana, Nigeria and South Africa are all commodity exporting countries, receiving pricing information or other industry know-how from these countries might be of value.

\(3.3.3\) Interagency cooperation

Since the tax information exchanged – in whichever mode – is likely not only to be valuable to the recipient tax administrations, but may be useful to other government agencies, for instance, to prosecute additional crimes such as money-laundering, bribery, corruption and terrorism financing, there is a further international understanding to improve the holistic use of the information received. This transparency should spread over other

\(^47\) In order to encourage the development of methods and techniques for efficient and effective information exchange, the UN Model includes an additional paragraph 6 in its art 26 for the establishment of procedures. Although the OECD Model does not contain such a provision, the OECD Commentary also offers drafting options (para 10, OECD Model: Commentary on Article 26 (2014)). Looking at the DTTs of Ghana, Nigeria and South Africa, neither Ghana nor Nigeria has such an additional provision in place. Six out of its 76 DTTs in force in South Africa have a similar provision.
government authorities. In a world of limited resources and increasing complexity, different government authorities should not work in a vacuum but rather should work together in a ‘whole of government’ approach to pursue shared objectives. Accordingly, the role of national tax administrations has been elevated, constituting a vital cog in the fight against illicit financial flows. Tax authorities have moved closer to other authorities, including customs administration, the Financial Intelligence Unit (FIU) and law enforcement agencies. The enabling legal instruments increasingly are present in bilateral or multilateral frameworks to facilitate the better use of the intelligence received by tax authorities and facilitate the exploitation of information synergies between different authorities. The bundling of knowledge with closer cooperation between different authorities is important to inhibit tax and other serious crimes.49 However, restrictive confidentiality provisions in EoI instruments are an inhibiting factor for inter-agency exchange.

Generally, the confidentiality provisions stipulate that information received through the information exchange mechanism shall be treated as secret in the receiving state in the same manner as information obtained under the domestic laws of that state. Since an absolute prohibition on disclosure would render the information exchange useless, they mostly enumerate the persons and authorities to whom the information can be disclosed and for what purpose, which means mainly that the information received can only be used for tax purposes.50 However, under such strict confidentiality rules, if the information obtained through the EoI framework appears to be valuable to the receiving state for purposes other than tax and outside the scope of purposes mentioned in the EoI provision, that state may not use the information for such other purposes. Other means for those non-fiscal purposes need to be utilised, such as a treaty concerning judicial assistance. This fragmentation can be impractical and time-consuming due to the additional procedural layers. Hence, in case the same set of information on the taxpayer is useful to a third country or for purposes other than tax, for example to prosecute additional crimes such as money-laundering, bribery, corruption and terrorism financing, a certain provision needs to be present in the EoI provision. In order to


49 This is why, in October 2010, the OECD Council’s Recommendation ‘to facilitate co-operation between tax and other law enforcement authorities to combat serious crimes’ included a recommendation to establish ‘an effective legal and administrative framework and provide guidance to facilitate reporting by tax administrations of suspicions of serious crimes, including money laundering and terrorism financing, arising out of the performance of their duties, to the appropriate domestic law enforcement authorities’. For more information, see OECD (n 49 above).

facilitate a broader use of the information, the contracting states need to include the following sentence:51

Notwithstanding the foregoing, information received by a contracting state may be used for other purposes when such information may be used for such other purposes under the laws of both states and the competent authority of the supplying state authorises such use.

The incorporation of this sentence into the EoI provision enables the pooling of knowledge and skills between different government authorities to make the fight against financial crimes more effective. Subject to prior authorisation, it could also enable the transmittal of received information to a foreign authority, to which the information could be of value.

3.3.4 Gap analysis of Ghana, Nigeria and South Africa

Bilateral framework

All EoI articles in the DTTs of Ghana, Nigeria and South Africa contain confidentiality provisions. Although there are slight variations in the wording, these provisions generally contain all the essential aspects of the international standard on confidentiality, enshrined in article 26(2) of the OECD/UN Model Tax Convention. The Global Forum on transparency and exchange of information for tax purposes came to the same conclusion with regard to the three countries. The respective peer review results further stated that also the complimentary domestic legislation contains appropriate confidentiality provisions and enforcement measures.52 In addition, the de facto practice was assessed, coming to the conclusion that all three countries in practice also have a comprehensive system of measures in place to assure confidentiality when processing EoI requests; there are clear handling and storage security measures; and all personnel are bound by strict confidentiality rules against any disclosure of information concerning EoI requests. Further information on the domestic procedures available can be found in the respective peer review reports. Whether these confidentiality provisions enable interagency cooperation was not subject to the peer review reports.

If one examines the DTTs of Ghana, Nigeria and South Africa, they include the amendment to their confidentiality provision only in very limited cases (see Chart 6.2). Nigeria has none, whereas Ghana has only one such provision in the treaty with Denmark. South Africa has three DTTs in force that include such a provision.53

Chart 6.2: Analysis of treaties regarding the presence of interagency cooperation provision

Source: Author’s own analysis of relevant treaties.

Multilateral framework

As already stated, Ghana, South Africa and Nigeria have already signed the Convention, and it has gone through the required ratification processes and entered into force.54 Accordingly, by being members of the Convention, all three countries have extensively expanded their network of mutual administrative assistance partners through one single legal basis. Also, the Convention includes confidentiality provisions, which restrict the purpose for which the information may be used. According to article 22, paragraph 1, any information obtained by a party under the Convention shall be treated as secret and protected in the same manner as information obtained under the domestic law of that party. This corresponds to the secrecy obligation included in article 26 of the OECD/UN Model. The amended Convention, however, goes further by stipulating that

53 The DTTs with Norway, India and Austria.
to the extent needed to ensure the necessary level of protection of personal
data, [any information obtained by a party under the Convention shall be
treated as secret and protected] in accordance with the safeguards which may
be specified by the supplying party as required under its domestic law.

Furthermore, the exchanged information should ‘be disclosed only to
persons or authorities (including courts and administrative or supervisory
bodies) concerned with the assessment, collection or recovery of, the
enforcement or prosecution in respect of, or the determination of appeals
in relation to taxes of that party, or the oversight of the above’ (article 22,
para 2).

Notwithstanding these limitations, the amended Convention includes
the exception to facilitate inter-agency cooperation and the exchange of
such information to a third state. The amended Convention stipulates that
‘information received by a party may be used for other purposes when such
information may be used for such other purposes under the laws of the
supplying party and the competent authority of that party authorises such
use’. In addition, information received by one party could be transmitted
to a foreign authority, subject to prior authorisation of the initial
information sending party (article 22, para 4). Hence, though the
participation of the three countries in the amended Convention, their
constrained bilateral framework with regard to inter-agency cooperation
was upgraded. However, the effective inter-agency cooperation ultimately
will be dependent on the national law of the countries involved.

Since most of the DTTs of Ghana, Nigeria and South Africa do not
include the amendment to the EoI provision which enlarges the scope for
which information can be used, the fact the amended Convention includes
such a provision by default is a huge advantage. Hence, information
received through the EoI mechanism in the amended Convention can be
shared with other agencies, subject to certain conditions. The final
conditions, however, are determined by domestic law. The effective inter-
agency cooperation ultimately is still dependant on the national law of the
countries involved; an analysis which is outside the scope of this chapter.

4 Cross-border assistance in the collection of taxes

The enhanced global cooperation with regard to transparency helps tax
authorities track and trace foreign assets and determine the correct amount
of tax due at a lower cost. However, since the taxpayers may have their
assets spread throughout the world, the collection of the tax can be
difficult. Because of state sovereignty, tax authorities usually cannot work
beyond their borders to collect taxes. However, based on a bilateral or
multilateral legal framework, foreign tax authorities can assist in the
collection of taxes of the other state. Previously, cross-border tax collection
on the basis of bilateral tax treaties was rarely seen and, when present, only
in a restricted form of assisting some neighbouring countries with strong economic and political ties (such as the 1952 Benelux Mutual Assistance Treaty or the 1972 Nordic Convention on Mutual Assistance in Tax Matters). In 2003, the new optional article (article 27) on assistance in tax collection was approved by the OECD Council for its inclusion in the update of the OECD Model Convention. Where contracting parties agree to help in the collection of taxes levied by the other state, they can include the article in their treaties. The decision will be based on a number of factors, including the importance of their cross-border investment; reciprocity; the ability of their respective administrations to provide such assistance; and the similarity of the level of their legal standards, particularly the protection of the legal rights of taxpayers. In addition to the potential recovery of taxes, one should not underestimate the deterrent effect created through such a provision. In some countries, this deterrent effect might be even more beneficial than the benefit of the actual tax debts recovered. So far, of the 222 treaties signed between OECD countries and developing countries between 2007 and 2012, only 20 treaties included a provision for assistance in tax collection (between 11 developing countries and 13 OECD countries). Accordingly, these OECD countries have the legal basis for collecting taxes on behalf of their developing country treaty partners if requested to do so. They need to take the necessary steps to recover taxes that are enforceable under the laws of the requesting state and owned by a person who, at the time, cannot, under the laws of the requesting state, prevent their collection. Such revenue claims need to be collected by the requested state in accordance with its tax enforcement and collection laws as if it were its own revenue claim.

Accordingly, this possibility potentially can provide developing countries with a valuable tool to combat international tax evasion and facilitate the actual payment of taxes legally due by their citizens or companies. One could also say that it constitutes a very practical way for OECD countries to provide meaningful assistance to developing countries in mobilising domestic resources. However, since its use is dependent on the knowledge of developing countries on the location of offshore funds to be able to request such assistance, the real benefits of such instrument will truly unfold once the AEOI is in place.

55 OECD (n 1 above) 66.
56 As above.
58 As above.
Chapter 6

4.1 Gap analysis of Ghana, Nigeria and South Africa

Bilateral framework

In the treaty networks of Ghana, Nigeria and South Africa, a legal basis for the assistance in the collection of taxes is only scarcely present (see Chart 6.3.) Ghana’s treaties with Belgium, Denmark, the Netherlands and South Africa include such a clause; Nigeria has one DTT with France that entails a legal basis for the cross-border assistance in the collection of taxes. South Africa’s DTTs with the following countries include a relevant legal basis: Algeria, Algeria, Botswana, Democratic Republic of the Congo, Denmark, Ghana, India, Japan, Kenya, Lesotho, Mauritius, Mexico, Mozambique, Namibia, The Netherlands, Norway, Swaziland, Tanzania, Uganda, Ukraine, the United Kingdom and the United States.

Chart 6.3: Cross-border assistance in the collection of taxes

![Chart showing cross-border assistance in the collection of taxes]

Source: Author’s own analysis of relevant treaties.

Multilateral framework

Ghana, South Africa and Nigeria have already signed the Convention, and it has gone through the required ratification processes and entered into force. Since the amended Convention includes a legal basis for cross-border assistance in the collection of taxes, all three countries generally expanded their network for global tax cooperation partners in this regard. Article 11, para 1 stipulates that at the request of the applicant state, the requested state – subject to certain conditions – shall take the necessary

59 Eg, the assistance applies only to tax claims that form the subject of an instrument permitting their enforcement in the applicant state and, unless otherwise agreed
steps to recover tax claims of the first-mentioned state as if they were its own tax claims.60

However, as indicated above, the amended Convention does not have a homogenous application between the different contracting parties. At signature or upon ratification of the amended Convention, states are free to declare reservations within stated limits to certain types of administrative assistance which they will not provide, which includes assistance in the recovery of tax claims.61 Several contracting parties have made use of such reservations. Hence, only the states listed in Box 6.3 will provide this form of assistance either broadly or to certain types of taxes.

Box 6.3: Reservations regarding assistance in the recovery of tax claims

Albania; Aruba; Australia; Azerbaijan; Belgium; Bulgaria; Burkina Faso*; Curaçao; Czech Republic; Denmark; Dominican Republic*; El Salvador*; Estonia; Faroe Islands; Finland; France; Gabon*; Georgia; Ghana; Greece; Greenland; Guatemala*; Hungary; Iceland; India; Italy; Jamaica*; Japan; Kenya*; Korea; Latvia; Lithuania; Luxembourg; Malaysia*; Malta; Mauritius; Mexico; Moldova; Monaco*; Morocco*; Nauru; Netherlands; New Zealand; Niue; Norway; Pakistan*; Philippines*; Poland; Portugal; Romania; San Marino; Saint Maarten; Slovenia; South Africa; Spain; Sweden; Tunisia; Turkey*; Turks & Caicos Islands; Uganda; Ukraine; and the United Kingdom.

Notes:
*) signed but not in force;
**) signed and entry into force latest by 1 January 2017.


The other states either excluded the application of this provision (as Nigeria did) or reserved their right to decide not to do so, which results in an asymmetrical application of the amended Convention. Due to the legal principle of reciprocity as discussed above, this means that those who

between the parties concerned, which are not contested. However, where the claim is against a person who is not a resident of the applicant state, the assistance in recovery shall only apply, unless otherwise agreed between the parties concerned, where the claim may no longer be contested (art. 11, para 2).

60 Except in relation to time-limits which are governed solely by the laws of the applicant state (art 14) and in relation to priority (art 15).
61 Ch VI, art 30; the list of the reservations at the time of writing can be found at http://www.coe.int/en/web/conventions/search-on-treaties/-/conventions/treaty/127/declarations (accessed 11 October 2016).
reserved their right not to provide these form of administrative assistance, will not receive such assistance by other contracting states either. Irrespective of the outreach of the global cooperation partner in this regard, the actual benefits of such assistance are still rather limited, since they presuppose a knowledge of the funds located in a different country. Once the AEOI is in place, the existence of such knowledge will no longer constitute an impediment.

Before the AEOI is in place, though, a more effective method of cross-border assistance in the collection of taxes, based on an alternative path, could be established. Ghana, Nigeria and South Africa could try to conclude bilateral agreements with major wealth management centres, under which a withholding tax is levied at source by the bank, acting as paying agent.62 The withholding taxes applied should correspond to the rate of tax in the country of residence of the taxpayer and transferred back to the state of residence, while preserving the confidentiality of the taxpayer. This method has already been applied by Switzerland, known as ‘Rubik Agreements’ and offered to Austria and the UK.63 It could be a valuable tool for developing countries to receive taxes on the wealth held by their residents in offshore jurisdictions. It preserves confidentiality while also securing tax compliance. Since it does not presuppose the burdensome administrative request for information and the existence of knowledge on offshore funds, such a system would be a workable and practicable alternative as an interim solution, before the AEOI is in place.

Ghana’s network of global cooperation partner for cross-border assistance in the collection of taxes covers only three of its major trade partners, namely, India, France and The Netherlands. With the exception of the UK and some Caribbean islands, the major wealth management centres are not included. With regard to Nigeria, due to its reservation, it will not receive administrative assistance in the cross-border collection of taxes. It only has one bilateral connection with France, which includes a legal basis for doing so. South Africa has a more extensive network available. Some of its major trading partners (the US, Botswana, Japan, the UK and India) are either bilaterally or multilaterally covered. However, with the exception of the UK, some Caribbean Islands and the US, no wealth management centre is included.

Since the benefit of such administrative assistance is dependent on a knowledge of offshore funds and administrative burdens, the three countries should try to conclude bilateral agreements with major wealth management centres on withholding taxes levied at source by paying agents. This would facilitate tax revenues from the funds located and

63 For more information on the Rubik Agreements, see X Oberson International exchange of information in tax matters: Towards global transparency (2015) 143ff.
managed in these wealth management centres without the passing of the foreseeable relevant threshold to receive information. Since some of these centres already offered such a model to some OECD countries (for instance Switzerland), which implies that the relevant infrastructure is already in place and due to the current momentum of sincerely trying to help developing countries in their revenue generation, there could be sufficient political willingness of states to offer such interim solution before the AEOI is a viable instrument for developing counties.

5 Conclusion and Recommendations

Based on the gap analysis above, the following recommendations are suggested to assist Ghana, Nigeria and South Africa in improving their benefits from the unprecedented peak in global tax cooperation:

- Participate in pilot programmes for AEOI implementation. Since transparency is the foundation of all other global tax co-operation instruments, having the AEOI in place as soon as possible is key to increase tax compliance.

- Focus on the multilateral framework. The bilateral framework of Ghana, Nigeria and South Africa either does not cover all relevant trading partners and wealth management centres, the wording is outdated, or the legal basis for inter-agency co-operation and the cross-border assistance of taxes is missing. The necessary renegotiation or conclusion of new bilateral treaties would be very resource and time-consuming. In light of the fact that the amended Convention already includes the relevant provisions, devoting resources into the bilateral framework is not necessary.

- Reconsider reservation. In the amended Convention, due to the principle of reciprocity, Nigeria should reconsider its reservation on the cross-border assistance in the collection of taxes in order to benefit from it.

- Include Hong Kong in the network as a global tax corporation partner. There should be increased effort to have Hong Kong sign the amended Convention due to its rising importance in the wealth management centre landscape.

- Establish a specific procedure for routine exchange of industry know-how with targeted tax administrations. Since in the interim period before the AEOI is in place, the EoI upon request is the only instrument to receive cross-border information and its practical benefits for receiving taxpayer specific information are limited due to the hurdle of passing the ‘foreseeably relevance’ test, the exchange of information mechanism should be used to receive more generic industry know-how. Such specific procedures should be implemented with tax administrations, having extensive industry exposure and know-how, such as the UK, The Netherlands and Switzerland.

- Conclude bilateral paying agent withholding tax agreements with wealth management centres under which a withholding tax is levied on passive income at source by the bank located in the wealth management centre.
Examples already exist between OECD countries. Such agreements can be used as an interim solution before the AEOI.

Appendix: Wording of art 26 of the UN Model (2011) and the OECD Model (2014)

The wording of Article 26 is as follows (the underlined text can only be found in the Article 26 of the UN Model (2011) and the bold text in the OECD Model (2014)):

1. The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws of the Contracting States concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. In particular, information shall be exchanged that would be helpful to a Contracting State in preventing avoidance or evasion of such taxes. The exchange of information is not restricted by Articles 1 and 2.

2. Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and it shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions. Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes under the laws of both States and the competent authority of the supplying State authorises such use.

3. In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:

   (a) To carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

   (b) To supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

   (c) To supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or
information, the disclosure of which would be contrary to public policy (ordre public).

4. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.

5. In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

6. The competent authorities shall, through consultation, develop appropriate methods and techniques concerning the matters in respect of which exchanges of information under paragraph 1 shall be made.
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The misuse of legal vehicles by individuals is a common technique used for abusive or criminal tax non-compliance and money laundering. For a long time information on the natural persons, who are ultimate beneficiaries of corporate vehicles or legal arrangements, was not readily accessible to tax administrations. This was due to the fact that the Commentary on the Model OECD Convention until 2005 was not explicit as to whether the exchange of information clause may be relied upon by the tax authorities to obtain ownership information in the cross-border context. Furthermore, until 2014 there was no internationally agreed standard concerning the requirement for financial institutions to engage in customer due diligence procedures for tax purposes. After a series of political priorities arising in the aftermath of the global financial crisis, access for tax authorities to information on the ultimate owners or controlling persons of legal vehicles in the framework of cross-border administrative assistance in tax matters has become an internationally agreed standard. This contribution provides a short chronology of policy developments leading to the acceptance of the concept of anti-money-laundering beneficial ownership in the field of taxation, and presents the extent of the scope to which this concept has been included in the instruments for cross-border administrative assistance in tax matters.

1 Misuse of corporate vehicles as a prerequisite for successful money laundering and tax non-compliance

The use of legal vehicles is a technique commonly used for both tax non-compliance and money-laundering practices. Legal vehicles allow for the achievement of a high degree of anonymity, particularly in cases where more than one layer in different jurisdictions is interposed between the beneficial owner and a country where illicit financial flows originate. The authorities seeking to establish the trail of illicit financial flows generally would face legal and administrative obstacles in obtaining adequate
information from the other jurisdictions. Legal vehicles often are used not only for illegal, but also for abusive tax practices, such as treaty shopping or the diversion of taxable revenues to low-tax jurisdictions. Not knowing who the ultimate beneficial owners of legal vehicles are makes the efficient diagnosis of criminal or abusive tax practices literally impossible.

2 Beneficial ownership concept under the anti-money-laundering framework

The identification and verification of beneficial ownership is an inherent feature of the customer due diligence process under the anti-money-laundering framework. The obligation to identify beneficial owners under this framework is deferred to the obliged entities. National frameworks prescribing know-your-customer and customer due diligence procedures closely follow the international standard developed by the Financial Action Task Force (FATF), which is set out in the document called *International standards on combating money laundering (FATF Recommendations).* Although the FATF Recommendations are a soft law instrument, their acceptance was ensured by means of a mutual evaluation process.

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1 The notion ‘obliged entity’ includes credit and financial institutions, as well as designated non-financial businesses and professions as defined in the 40 Recommendations (2012) (see 113-114).

2 The FATF was constituted on a decision of G7 due to the growing concerns over the threats posed by international money-laundering practices. Initially, the FATF had 11 members and was set up for one year. The original members of the FATF were Australia, Austria, Canada, China, Denmark, Finland, France, Germany, Italy, Japan, Sweden, Switzerland, the United Kingdom, the United States and the European Commission. The FATF mandate gradually was extended and the number of its members grew consistently to the current 36 members. Additionally, the FATF counts 22 observers and eight FATF-style regional bodies which allow for extensive geographical representation. All in all, the FATF AML regime is estimated to have been adopted by more than 180 jurisdictions. E Tsingou ‘Money laundering’ in D Mügge (ed) *Europe and the governance of global finance* (2014) 143.

3 The first version of the FATF Recommendations is available online at http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%201990.pdf (accessed 14 June 2016). For a comprehensive overview of the development of FATF activities, refer to the FATF Report ‘25 years and beyond’ 2014, http://www.fatf-gafi.org/media/fatf/documents/brochuresannualreports/FATF%2025%20years.pdf (accessed 14 June 2016). The FATF Recommendations are from time to time reviewed to ensure that they provide adequate measures to catch up with changing facets of money laundering and include new global threats, eg terrorism, which can be countered through the anti-money-laundering framework.

4 The first mutual evaluation round was started in 1992 and ended in 1995. In 2016 the FATF launched the 4th round of mutual evaluations. The mutual evaluations are carried out by FATF expert groups or by the FATF-style regional bodies on the basis of methodology developed by the FATF. Countries of which the legal systems exhibit substantial non-compliance with the FATF Recommendations are put on the periodic supervision process, which generally has proved to be an efficient measure in achieving the change of national laws and bringing national anti-money-laundering systems to substantial compliance with the international standard. For a detailed consideration of the effects of mutual evaluations, see eg KL Gardner ‘Fighting terrorism the FATF
The FATF Recommendations provide the following definition of a beneficial owner:5

Beneficial owner refers to the natural person(s) who ultimately own or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement.

The scope of beneficial owner identification and verification procedures varies depending on whether the business relationship has been entered into with a legal person or a legal arrangement, for instance a trust, foundation or such like.

Where a business relationship is entered into with a legal person6 the beneficial owner should include at least

- natural persons who ultimately have a controlling ownership interest in a legal person; and

- to the extent that there is doubt after identifying natural persons with a controlling ownership interest as to whether they are the beneficial owner(s) or where no natural person exerts control through ownership interests, the identity of the natural persons (if any) exercising control of the legal person or arrangement through other means;

- where no natural person is identified, then person holding the position of senior managing official.

As far as access to the beneficial ownership information of legal persons is concerned, the FATF Recommendations do not prescribe any mandatory mechanisms, but recommend several alternatives such as the availability of information at the level of legal entities, beneficial ownership register or a combination of different databases already available in a jurisdiction.7

For legal arrangements,8 'beneficial owner' must include at least the following persons: (i) the settlor; (ii) the trustee(s); (iii) the protector; (iv) the beneficiaries or classes of beneficiaries; and (v) any other natural person exercising ultimate control over the legal arrangement by reason of direct or indirect ownership or by any other means. The recommended mechanisms for the availability of beneficial ownership information for legal arrangements include registries; the keeping of information by any of the competent authorities; or subjecting service providers to keep such information.9

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6 Interpretative note to Recommendation 10.
7 Interpretative note to Recommendation 24.
8 Interpretative note to Recommendation 10.
9 Interpretative note to Recommendation 25.
Increasing use of the beneficial ownership concept

3 Triggers for the adoption of the money-laundering beneficial ownership concept in the tax transparency framework

The financial crisis of 1998 had already prompted the debate on the misuse of corporate vehicles for money-laundering and tax non-compliance purposes. Another financial crisis in 2008 was necessary to relaunch the debate which has successfully materialised into the nearly global consensus on a set of tax transparency measures also accepted by off-shore financial centres.

The origins of international efforts on beneficial ownership transparency in the tax field could be traced back to 2000, when the Organisation for Economic Co-operation and Development (OECD) was tasked by the Financial Stability Forum to make a detailed enquiry into the ways in which legal vehicles commonly are misused for illicit purposes. The OECD released its report in 2001 under the title ‘Behind corporate veil. Using corporate entities for illicit purposes’. This study had a two-fold purpose: on the one hand, to contribute to the efforts of the OECD in its work on harmful tax practices and, on the other, to provide the FATF with insights for the planned review of its Forty Recommendations.

In 2003 the FATF was the first international body to develop the international beneficial owner standard and to achieve its nearly global implementation by means of periodic mutual evaluations. Nearly a decade later, the beneficial ownership concept, developed under the anti-money-laundering framework, was imported into several initiatives and legal instruments concerning international tax transparency and administrative assistance between competent tax authorities. In 2005 the Committee of Fiscal Affairs agreed to include an explicit clarification in the Commentary to article 26 of the OECD Model Convention (OECD MC) that the competent tax authorities may not refuse to exchange information where a request concerns ownership information. The Common Reporting Standard released by the OECD in 2014 adopted a ‘look-through’ approach for financial accounts held by passive non-financial entities, which requires the identification of natural persons standing at the end of the ownership chain and having control over such entities. In the first round of peer reviews, the Global Forum assessed whether jurisdictions under their laws required ownership information to be available and accessible to the competent tax authorities. In the second round of peer reviews planned for 2016-2020, particular attention, in fact, will be placed on the availability of beneficial ownership information. As a result, today the ownership transparency is profoundly enrooted in the international tax transparency agenda.
4 Exchange of ownership information under article 26 of the OECD MC

Article 26 of the OECD MC is recognised as constituting an international standard on administrative cooperation in the form of the exchange of information between the tax authorities of the treaty partners. The main provision determining the scope of information exchange, to be found in article 26(1), provides:

The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind …

This provision delimits the scope of obligation to exchange information by clarifying that the information requested must satisfy the standard of foreseeable relevance either for the purposes of domestic tax laws or for the purposes of the correct application of the Convention.

In the past it was not clear whether a request for ownership information submitted on the basis of article 26 of the treaty would be the standard of ‘foreseeable relevance’. In 2005 the OECD included paragraph 5 to article 26 in its MC in order to clarify that the exchange of information may not be refused solely because of the fact that it concerns information on ownership interest in a person and that such information would constitute a variation to the laws and administrative practices of the requested state, or would not be obtainable under the laws or in the normal course of the administration in the requested state. However, it was not clarified whether the term ‘ownership’ was intended to include only the immediate shareholder of a legal person or whether it should be interpreted broadly to comprise also the ultimate beneficial owner.

In the view of the OECD’s work on misuse of corporate vehicles, it is plausible to expect that a broad interpretation of this term was intended. A broad interpretation seems to also be supported by the example (g) provided in paragraph 8 in the Commentary to article 26(1) of the OECD MC (see Figure 7.1). This example describes a situation where the competent authority of state A wishes to determine whether the directors of company A also have a direct or indirect ownership interest in company B, which is a shareholder of company A. Should this be the case, state A intends to apply its CFC legislation and would tax dividends paid to company B by company A as income of the individuals X, Y and Z, all three of them being residents of state A.

10 Art 26(1) OECD MC 2014 (my emphasis).
11 Art 26(3)(a) OECD MC 2014.
12 Art 26(3)(b) OECD MC 2014.
The Commentary clarifies that information on direct or indirect ownership may be requested and, accordingly, the exchange of information may not be refused. Where information on ultimate owners is not available, at least information on shareholders should be provided so that the requesting state may continue its investigation. Additionally, it is also clarified that before refusing the exchange of information due to a lack of ‘foreseeable relevance’, the requested authority should consult the requesting authority and seek more information.

Figure 7.1: Example (g) of the OECD MC 2014 Commentary to article 26

The OECD has consistently aligned its Tax Information Exchange Agreement\(^\text{13}\) and the Multilateral Convention on Mutual Administrative

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\(^{13}\) The Model Tax Information Exchange Agreement (2005) is much more explicit and detailed if compared to art 26(5) as far as the exchange of ownership information is concerned. Art 5(4) provides that ‘[e]ach Contracting Party shall ensure that its competent authorities for the purposes specified in Article 1 of the Agreement, have the authority to obtain and provide upon request: (a) information held by banks, other financial institutions, and any person acting in an agency or fiduciary capacity including nominees and trustees; (b) information regarding the ownership of companies, partnerships, trusts, foundations, Anstalten and other persons, including, within the constraints of Article 2, ownership information on all such persons in an ownership chain; in the case of trusts, information on settlors, trustees and beneficiaries; and in the case of foundations, information on founders, members of the foundation council and beneficiaries. Further, this Agreement does not create an obligation on the Contracting Parties to obtain or provide ownership information with respect to publicly traded companies or public collective investment funds or schemes unless such information can be obtained without giving rise to disproportionate difficulties.’
Assistance in Tax Matters (Multilateral Convention)\(^\text{14}\) with article 26 of the OECD MC. Accordingly, any of these instruments may be used by the tax authorities that have an interest in discovering the beneficial owners of the foreign entities. Similarly, as in the case of article 26 of the OECD MC, the standard of ‘foreseeable relevance’ must be satisfied also when an information exchange request is made on the basis of these two instruments.

5 Common reporting standard

In 2014 at the G20 Leaders’ Summit in Brisbane, the OECD presented its Global Standard for Automatic Exchange of Financial Account Information (Global Standard). The Global Standard consists of two essential elements: the Common Reporting Standard (CRS) and the Competent Authority Agreement (CAA). The CRS sets the scope of, amongst others, customer due diligence and reportable accounts, and the CAA is an agreement between tax authorities which sets out the terms under which the automatic exchange of financial account information should take place.\(^\text{15}\)

The due diligence procedures provided by the CRS are designed to identify natural persons having effective control over financial accounts opened at the financial institutions in jurisdictions where the controlling persons are not resident for tax purposes. Therefore, not only accounts held directly by natural persons but also accounts held indirectly through passive entities generally will be subject to reporting under the CRS. The CRS defines the term ‘entity’ in a broad sense to encompass not only companies but also partnerships, limited liability partnerships and legal arrangements such as trusts or foundations.\(^\text{16}\)

In the process of identifying reportable accounts, financial institutions must differentiate between accounts held by active non-financial entities (active NFEs)\(^\text{17}\) and accounts held by passive non-financial entities (passive NFEs).\(^\text{18}\) For a series of NFEs that are unlikely to be misused for tax non-compliance purposes by individuals, exclusion rules have been

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15 There must be a legal basis between the two jurisdictions for the automatic exchange of information in tax matters.
16 For a definition of the term ‘entity’, see CRS, sec VIII, E(3).
17 For a definition of the term ‘active NFE’, see CRS, sec VIII, D(9).
18 For a definition of the term ‘passive NFE’, see CRS, sec VIII, D(8).
Increasing use of the beneficial ownership concept

provided. This particularly concerns entities that derive more than 50 per cent of their gross income from active income sources, entities listed on recognised stock exchanges; financing or holding entities of the groups transacting only with group members; and entities established for charitable and non-profit purposes without clauses in their charters allowing for distributions to natural persons.

Where a financial account is held by a passive NFE, a ‘look-through’ approach must be applied to identify whether there are any controlling persons who are also reportable persons for the purposes of the CRS. Where controlling persons are resident in jurisdictions that have committed to adhere to the Global Standard, the financial account must be classified as reportable and financial information on reportable accounts will be exchanged with the tax authorities where the controlling persons are resident for tax purposes.

The CRS defines the term ‘controlling persons’ as ‘the natural persons who exercise control over an entity’, and clarifies that the term ‘controlling persons’ should be interpreted in a way consistent with interpretation of the ‘beneficial owner’, as provided for in the FATF Recommendations. The interpretative guidance to the term is provided in the Commentary to the CRS, whereas the term ‘controlling person’ always should be interpreted in a way consistent with Recommendation 10 ‘Customer Due Diligence’ and its Interpretative Note.

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19 The OECD CRS Commentary on sec VIII at para 126 provides that the term ‘passive income’ should be interpreted in accordance with the rules of the reporting jurisdiction and provides the following non-exhaustive list of possible types of passive income: dividends; interest; income equivalent to interest; rents and royalties other than rents and royalties derived in the active conduct of a business conducted, at least in part, by employees of the NFE; annuities; the excess of gains over losses from the sale or exchange of financial assets giving rise to the passive income described previously; the excess of gains over losses from transactions (including futures, forwards, options, and similar transactions) in any financial assets; the excess of foreign currency gains over foreign currency losses; net income from swaps; or amounts received under cash value insurance contracts. However, the term ‘passive income’ should not include, in the case of a NFE that regularly acts as a dealer in financial assets, any income from any transaction entered into in the ordinary course of such dealer’s business as such a dealer. However, the OECD CRS does not clarify what types of income should be considered active for entity classification purposes.

20 For a complete list, see CRS, sec VIII, D(9).

21 Each of the interposed passive NFEs have to be ‘looked through’ until it is possible to determine who is a natural person controlling the passive NFE or that there are no controlling persons at the end of the control chain.

22 CRS, sec VI, A(2).

23 The reporting financial institutions have to transmit information to their domestic tax authorities which will then exchange information with tax authorities of jurisdictions participating in the CRS.

24 CRS, sec VIII, D(6).

25 CRS, sec VIII, D(6), last sentence.

26 CRS Commentary on sec VIII, para 132.

27 CRS, sec VIII, D(6).
In the case where a financial account is held by a legal person, the notion of ‘control’ should correspond to controlling ownership with an ownership interest equal to or exceeding 25 per cent. When no natural persons hold the controlling ownership interest in an entity due to diluted shareholding, it subsequently becomes necessary to determine whether there are any natural persons who exercise control through any other means.28 Where no such natural person is identified, then, for the purposes of the CRS, a controlling person should be a natural person who holds the position of senior management official.29

If a passive NFE concerned is a trust or an entity functionally similar to a trust (for instance, a foundation), the reporting financial institution is explicitly required to treat the settlor(s); the trustee(s); the protector(s) (if any); the beneficiary(ies); and class(es) of beneficiaries as ‘controlling persons’.30 As this is a specific requirement, the determination of effective control over a trust or any other functionally similar arrangement is not necessary. In addition, any other natural person exercising ultimate control over the trust (or any other functionally similar arrangement) should be considered as a ‘controlling person’.

In the process of due diligence for CRS purposes, the reporting financial institutions may be permitted to rely on information collected and maintained pursuant to anti-money-laundering know-your-customer procedures provided that such procedures are consistent with Recommendations 10, 24 and 25 of the FATF Recommendations (2012).31 Such requirement provides for a motivation for jurisdictions to closely follow the FATF customer due diligence standard.

By transposing FATF’s beneficial owner concept in the Global Standard, the OECD has expanded the scope of its application. Whereas the anti-money-laundering framework covers only the criminal dimension of tax non-compliance, the OECD’s CRS has the aim also of improving tax compliance in general and counter the abuse of the tax system.

6 Peer reviews and availability of ownership information

The origins of the OECD’s initiative to enhance international tax transparency may be traced back to its initiative against harmful tax competition launched at the end of the 1990s. A Forum on Harmful Tax Practices was established to identify tax havens and jurisdictions with preferential tax regimes on the basis of criteria identified in the 1998 Report

28 No clarification is provided for the term ‘any other means’.
29 CRS Commentary on sec VIII, para 133.
30 CRS Commentary on sec VIII, para 134.
31 CRS Commentary on sec VIII, para 137.
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'Harmful Tax Competition: An Emerging Global Issue'.\(^{32}\) Next to the criteria concerning specific substantive tax system elements, the lack of the effective exchange of information and lack of transparency were named among the four main criteria that would warrant a jurisdiction to be placed on a 'black list'. As a result of this campaign against harmful tax competition, the black-listed jurisdictions largely had adhered to the demands of the OECD and had adapted their legal systems by (partly or fully) eliminating the elements of harmful tax competition.

The financial crisis of 2008 acted as a necessary trigger to expand the tax transparency initiatives beyond financial centres and cause this standard to be a must for any jurisdiction. For this purpose, the OECD's Global Forum on Taxation was restructured in 2009 into the Global Forum for Tax Transparency and Exchange of Information for Tax Purposes (Global Forum) and opened to all jurisdictions.\(^{33}\) The Global Forum had enhanced the tax transparency standard and launched the two-phase peer review process to ensure the adherence to and effective implementation of this standard by relevant jurisdictions.\(^{34}\) Phase 1 sought to determine whether information that may be necessary for tax assessment or enforcement purposes were collected, could be made available to competent authorities, and whether there was a sufficiently broad network of information exchange instruments entered into by a jurisdiction under review (see Figure 7.2). The jurisdictions were also reviewed in respect of their ability to exchange ownership information in a cross-border context.\(^{35}\)

\(^{32}\) In the 1998 Report 'Harmful tax competition: An emerging global issue' OECD identified that the main features of tax havens are (i) no or only nominal taxes; (ii) a lack of an effective exchange of information; (iii) a lack of transparency; and (iv) no substantial activities (see 23). Additionally, factors identifying harmful preferential tax regimes were provided. These are low or zero effective tax rates on the relevant income; the availability of 'ring-fencing' provisions banning from the preferential tax treatment income derived domestically; the operation of the regime in a non-transparent manner; and no effective exchange of information with other states by the jurisdiction operating regime (see 27).

\(^{33}\) Although the OECD peer review process was launched in 2009, the Global Forum, albeit under a different name and with different functions, has existed from the beginning of 2000. Initially having its membership limited to OECD member states, the Global Forum has become an open platform for the states sustaining the values prophesied by it. The mandate of the Global Forum has developed from the strict focus on the policing tax havens and harmful preferential tax regimes to spreading the culture of jurisdictional transparency through voluntary compliance with a global standard of tax transparency and exchange of information.

\(^{34}\) For the methodology of peer reviews, see Global Forum 'Revisited methodology for peer-reviews and non-member reviews' (2013) http://www.eoi-tax.org/keydocs/3a4dca676433deb37b910032fa0848ba#default (accessed 14 June 2016).
Ownership information in the context of peer reviews was to be understood broadly and, therefore, not limited to information on shareholders or legal owners, but also including effective owners of legal entities. The peer review methodology explicitly provided that for all companies and bodies corporate ‘[o]wners include legal owners and, in any case, where a legal owner acts on behalf of any other person as a nominee or under a similar arrangement, that other person, as well as persons in an ownership chain’. This requirement is similar to what is required from financial institutions (and other persons) in the customer due diligence process under FATF standards.

The Global Forum provided that the availability of ownership information in jurisdictions should be ensured for a broad range of legal arrangements and should not be limited to companies and, therefore, should also extend to

- foundations, Anstalts and any similar structures;
- partnerships or other bodies of persons;
- trusts or similar arrangements;
- collective investment funds or schemes;
- any persons holding assets in a fiduciary capacity; and

The Peer Review Methodology provides that ‘[e]ffective exchange of information requires the availability of reliable information. In particular, it requires information on the identity of owners and other stakeholders as well as information on the transactions carried out by entities and other organisational structures. Such information may be kept for tax, regulatory, commercial or other reasons. If such information is not kept or the information is not maintained for a reasonable period of time, a jurisdiction’s competent authority may not be able to obtain and provide it when requested.’ OECD Implementing the tax transparency standards: A handbook for assessors and jurisdictions (2011) 23-24-26, http://dx.doi.org/10.1787/9789264110496-en (accessed 14 June 2016).
• any other entities or arrangements deemed relevant in the case of the specific jurisdiction.\textsuperscript{38}

Additional clarifications concerning the scope of ownership information were made in respect of partnerships, trusts and foundations.\textsuperscript{39} Jurisdictions that under their laws allow partnerships were also assessed in respect of their ability to access information on the identities of the partners in any partnership that (i) has income, deductions or credits for tax purposes in the jurisdiction; (ii) carries on business in the jurisdiction; or (iii) is a limited partnership formed under the laws of that jurisdiction.

Jurisdictions that provide for possibilities to set up trusts were checked against their ability to ensure that information is available to their competent authorities that identifies the settlor, trustee and beneficiaries of express trusts (i) created under the laws of that jurisdiction; (ii) administered in that jurisdiction; or (iii) in respect of which a trustee is resident in that jurisdiction. Finally, jurisdictions that allow for the establishment of foundations were checked against their ability to ensure that information is available to their competent authorities for foundations formed under those laws to identify the founders, members of the foundation council and beneficiaries (where applicable), as well as any other persons with the authority to represent the foundation.

The peer review methodology did not require jurisdictions to have any specific mechanisms, such as beneficial ownership registers, to ensure the availability of ownership information. The methodology required that beneficial ownership information is available at least at the level of financial institutions or other intermediaries. Should beneficial ownership information be relevant to respond to a request for information received under exchange of information instrument, the competent tax authorities should have access to such information.\textsuperscript{40} The standard required that any national legal secrecy provisions are relinquished when ownership information is requested in the context of an exchange of cross-border tax information.\textsuperscript{41} It is important to highlight that jurisdictions would also be expected to exchange information on any entities in the ownership chain, as long as information on such entities is in the possession or control of persons within the jurisdiction’s territorial jurisdiction.\textsuperscript{42}

The move to phase 2 was conditional on the successful completion of phase 1. Where the assessors determined that some of the essential elements were absent, the jurisdictions under review were asked to adapt their legal and regulatory frameworks to eliminate the highlighted deficiencies. In phase 2, jurisdictions that had practical experience in

\textsuperscript{38} OECD 24.

\textsuperscript{39} As above.

\textsuperscript{40} OECD (n 35 above) 27.

\textsuperscript{41} As above.

\textsuperscript{42} As above.
exchanging information with the jurisdiction under review were asked to provide information and statistics on the efficiency of such cross-border administrative cooperation. As a result of phase 2, reviewed jurisdictions were rated as compliant, largely compliant, partially compliant or non-compliant.\footnote{Ratings of the jurisdictions reviewed by Global Forum are available at http://www.oecd.org/tax/transparency/exchange-of-information-on-request/ratings/#d.en.342263 (accessed 14 June 2016).}

Jurisdictions reviewed in the first round of peer reviews most frequently were found not to be able to completely satisfy the standard on availability of ownership information. This element was a reason to provide jurisdictions not commonly referred to as offshore financial centres with a ‘largely-compliant’ rating. This, for example, occurred in the cases of Austria, the Czech Republic, Germany, Greece, Hungary, Israel, the Netherlands, Poland, Portugal, the Russian Federation, the Slovak Republic, the UK and the US, which received the same rating as jurisdictions widely known as financial centres, such as Aruba, the Bahamas, Belize, Bermuda, Cayman Islands, Cook Islands, Liechtenstein, Niue, St Kitts and Nevis, the Seychelles, and others.

In the second round of peer reviews, which are to be undertaken during 2016 to 2020, new and already-reviewed jurisdictions will be assessed as to the progress made in implementing the standard for exchange of information on request. In this round of reviews, the Global Forum will be focusing, among other matters, on the availability of ownership information. The new methodology explicitly provides that in order to ensure a level playing field and to respond to the G20’s call to draw on the work of the FATF on beneficial ownership, the Global Forum strengthened its EOIR\footnote{Exchange of information on request.} standard for its second round of review by introducing the FATF concept of beneficial ownership in its assessments …\footnote{Global Forum Exchange of information on request. Handbook for peer reviews 2016-2020 (2016) 9-10.}

In line with this statement, the Global Forum also changed the language in the methodology and no longer refers to ‘ownership information’, but rather to the term ‘legal and beneficial owners’ with direct reference to the definition of ‘beneficial owner’ as provided in the FATF Recommendations (2012).\footnote{Global Forum (n 45 above) 19.} It furthermore is extensively emphasised that the jurisdictions will be assessed also with respect to the availability of beneficial owner information concerning companies and other bodies corporate incorporated elsewhere, but having a substantial economic nexus with the jurisdiction under review. Such nexus would be constituted by, for example, tax residence or headquarters.\footnote{As above.}
The Global Forum also acknowledged that its standard-setting and evaluation closely relates to areas covered by other international bodies, and in particular the FATF, the principles developed by the FATF may be taken into consideration to interpret and apply the standard where appropriate.\textsuperscript{48}

Accordingly, it may be expected that in the future the synergies between the tax transparency and financial transparency frameworks will be strengthened.

7 Concluding remarks

The lack of beneficial ownership transparency has been recognised as constituting one of the major factors contributing to the misuse of corporate vehicles for both tax non-compliance and money-laundering practices. The foregoing discussion clearly has demonstrated that the agendas of the OECD and the Global Forum in countering the misuse of the legal vehicles increasingly intertwine with the principles of the anti-money-laundering framework shaped by the FATF. This trend acquired momentum after the last financial crisis when the peer review process launched by the Global Forum included in the methodology requirement that beneficial ownership information is available and accessible for tax purposes in the reviewed jurisdictions. The availability of beneficial ownership information remains a priority focus of the second round of peer reviews which commenced in 2016 and will continue until 2020.

Whereas the peer review process assessed the availability of beneficial ownership information on an on-request basis, the OECD’s CRS was designed to provide on automatic basis information on the controlling persons of the financial accounts to the jurisdictions where such persons are resident for tax purposes. Today more than 100 jurisdictions have committed to adhere to the Global Standard which may be said to be a manifestation of the first exchange of beneficial ownership information instigated for tax reasons.

\textsuperscript{48} Global Forum (n 45 above) 29.
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FATF Recommendations is available online at: http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%201990.pdf (accessed 14 June 2016)


OECD, Model Tax Information Exchange Agreement, 2005


OECD, Multilateral Convention, 2014


Abstract

Technological advances can transform the environment in which governments enforce compliance with tax legislation and collect tax revenues. This includes the emergence and rise of mobile money payments, which have been changing the financial landscape in Africa since the launch of the mobile money transfer platform, M-Pesa, in Kenya in 2007. The emergence of this payment platform may present unique opportunities for driving tax compliance and tax investigations. This article is aimed at stimulating debate on how this emerging platform can be used for providing additional information to be used by the tax administration. It uses Kenya as a case study and highlights how these platforms can provide additional information that can be used for tracking and monitoring tax payers' activities, to enable tax administrations to determine whether tax payers' declarations in their tax returns reflect their economic activities. The article also highlights how it can provide information on individuals and businesses that, by the nature of their activities, ought to be included in the tax base, and also to provide information for identifying individuals and businesses that do not file tax returns despite being economically active. The article also highlights that the real-time data that could be made available to tax administrations could be useful for compliance monitoring, and provide a more reliable audit trail and, finally, the potential challenges.

1 Introduction

According to the Organisation for Economic Co-operation and Development (OECD), the overriding objective of tax administration is to minimise revenue losses due to non-compliance with tax laws. Compliance with tax laws is not limited to filing tax returns. This covers a broader range of processes which often takes place outside the view and

* The author would especially like to thank Jonathan Leigh-Pemberton for the constructive and thoughtful comments.
control of a tax administration.\textsuperscript{1} It also notes that the advancement of technology increasingly has led tax administrations to utilise technological developments to enhance tax compliance.\textsuperscript{2} Using Kenya as a case study, the article examines the emergence of the mobile payments platform and how revenue bodies can tap into it to enhance tax compliance.

It is structured as follows: I first examine the emergence of mobile money payment platforms, and then highlight the challenges posed by tax administrations, particularly in the informal sector and small and medium enterprises (SMEs). I then turn my attention to tax compliance strategies adopted by tax administrations, as proposed by the OECD, and how these have over time evolved, particularly dealing with the increasing adoption of technology by businesses. I then look at how the emergence of mobile money payment platforms presents a unique opportunity to tax administration for tax investigations and enhancing compliance with a case study of Kenya. Finally I highlight the potential challenges.

2 Background

Mobile money payment platforms have been changing the financial landscape in Africa since the launch of the M-Pesa in Kenya in March 2007.\textsuperscript{3} However, following the launch of M-Pesa, other mobile money platforms, such as Airtel money, Orange Money, Equitel, Mobikash and Tangaza have also emerged to provide robust payment platforms. Adapted from \textit{pesa}, the Swahili word for money, and an abbreviation of 'M' for mobile, it translates to mobile money. M-Pesa allows for easy transfer of money between registered users, whether individuals or businesses, without using the traditional banking channels. It allows any person registered on the platform to do almost everything, from paying for routine grocery shopping to settling utility bills to paying their doctors' bills.\textsuperscript{4}

The main effect of M-Pesa, and similar mobile money transfer platforms in Kenya, is financial sector deepening: Groups that hitherto had limited access to formal financial services have benefited from the financial products offered through M-Pesa. Of special interest, M-Pesa has empowered business creation as many individuals and small companies

\begin{itemize}
\item \textsuperscript{1} OECD \textit{Right from the start: Influencing the compliance environment for small and medium enterprises} (2012) 3.
\item \textsuperscript{2} As above.
\item \textsuperscript{3} J Bright 'A brief overview of Africa's tech industry and 7 predictions for its future. World Economic Forum' https://www.weforum.org/agenda/2016/05/a-brief-history-of-africa-s-tech-industry-and-7-predictions-for-its-future (accessed 14 December 2017).
\end{itemize}
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now rely on M-Pesa for nearly all transactions, or provide services underpinned on the M-Pesa platform.5

Over time, M-PESA has evolved from a money transfer service to a robust payment platform and driver of financial inclusion for Kenyans. According to Safaricom, it has grown to incorporate over 19 million customers, of which 13 million are active and supported by a nationwide agent network of 81 025 outlets. The key M-Pesa services include Lipa na M-Pesa (pay using M-Pesa); Lipa Kodi (paying property rent using M-Pesa); salary disbursements; utility payments (for example water and electricity); airtime purchase; M-Shwari (a bank account pinned on an M-Pesa account); linkages to a bank account to facilitate deposits into and transfers from the bank account without visiting the bank or using an automated teller machine; and cashless distribution for companies such as Coca Cola; Unilever; East African Breweries Ltd; British American Tobacco; Nairobi Bottlers; Nation Media; and the Standard Group.6

Lipa na M-Pesa promotes the use of M-Pesa as a primary tool for payment collection and is part of the broader M-Pesa initiative to convert Kenya to a cashless or cash-lite economy (utilising electronic payments rather than cash). It enables individuals as well as companies to effortlessly collect and manage cashless payments from M-Pesa’s significant customer base.7 It also facilitates trade between businesses and their customers while improving business efficiency. As at December 2014, there were 122 000 merchants on Lipa na M-Pesa of which 24 137 were active. Further, as at December 2014, M-Shwari7 had 3.6 million active customers with Kshs 4.0 billion in deposit and Kshs 1.2 billion worth of loans issued per month with non-performing loans (NPLs) at 2.7 per cent.8 Over and above providing SMEs with a formal electronic payment collection service, the other key benefits of Lipa na M-Pesa include enhancing record keeping as every transaction made is readily accessible via till statements. M-Pesa is also already integrated with 37 financial institutions.9

However, can the data underlying the M-Pesa transactions be useful to tax administrations to facilitate tax compliance and tax investigations? Before that question is answered, it is necessary to first consider the tax compliance challenges of SMEs and the informal economy that are prevalent in developing countries such as Kenya.

5 D Runde ‘M-Pesa and the rise of the global mobile money market 12 August 2015
http://www.forbes.com/sites/danielrunde/2015/08/12/m-pesa-and-the-rise-of-the-
global-mobile-money-market/#4e82e32423f5 (accessed 13 June 2016).
9 Safaricom Limited Annual Report 2014 19 43.
Chapter 8

In many countries, SMEs have been identified as the least compliant component of the taxpayer population. As a result, they have become a target for many tax administrations.\(^{(10)}\) Recent studies have concluded that there is a considerable risk that SMEs may not report some of their income in their tax returns with the aim of reducing their tax liability. This may be prevalent where the income of SMEs may not be subject to third party reporting to the tax administration and/or where it is difficult for the tax administration to directly verify the income with third parties, hence making it easy for SMEs to conceal income. Another risk is that expenses claimed against business income may be overstated with the aim of reducing the tax liability. These challenges may be compounded during audits due to poor-quality, or non-existent, books and records. For these reasons, it is acknowledged that auditors need a set of tools to indirectly measure taxpayers’ taxable income.\(^{(11)}\)

Many developing countries also have a significant informal (shadow) economy that largely operates outside the formal tax system. Many countries have not been able to tax these sectors, thereby effectively limiting or shrinking the tax base.\(^{(12)}\) For example, the Kenya Revenue Authority (KRA) has projected that the informal sector has been growing faster than the formal sector. In its Sixth Corporate Plan,\(^{(13)}\) the KRA projected that the latter grew at 82 per cent against the former at 18 per cent, implying that the proportion of the hard-to-tax informal sector will continue to grow.\(^{(14)}\)

In a cash economy, it is difficult for the tax administration to identify players in the informal sector and bring them into the tax bracket. The records of financial transactions to enable the tax administration to detect economic activities or to be used for verifying turnover or as confirmation of transactions are limited. However, if SMEs and the informal sector are not brought within the tax bracket or if they are not properly taxed, the burden of taxation will continue to be borne by a small percentage of businesses.

It therefore is likely that the mobile money payment platforms could present an opportunity for developing investigative tools and for


\(^{(13)}\) The Kenya Revenue Authority, Sixth Corporate Plan was launched on 18 September 2015 and covers three years, ie the period 2015/16-2017/18. It was developed by KRA to provide a road map for attaining revenue collections of up to Kshs 5.2 trillion in the next three years and also provides a framework for further transforming KRA in its quest to facilitate Kenya’s ease of doing business ranking scores. For more, see the press release at http://www.kra.go.ke/notices/pdf2015/PRESS-RELEASE-6TH-CORPORATE-PLAN.pdf. It is available at http://www.kra.go.ke/index.php/6th-corporate-plan (accessed 13 June 2016).

enhancing tax compliance. However, how does this harmonise with the current thinking on tax compliance? The following part traces the evolution of tax compliance strategies at the OECD to the current acknowledgment of the growing role of technology in enhancing tax compliance with a particular focus on mobile money payment platforms and SMEs, which will provide a basis of how utilising data from mobile money platforms could be useful for the KRA.

3 Evolution of tax compliance strategies: Perspectives from the OECD

Tax compliance strategies have over time evolved. Since tax administrations have traditionally been viewed as the enforcers of tax law, as a result most confined themselves to reviewing filed tax returns, verifying their correctness and targeting non-compliance by subjecting taxpayers to audits, which targeted high-risk tax returns.\textsuperscript{15} The success of this approach was measured by audit yield and relied largely on the careful selection of audit cases through a proper identification of risks.\textsuperscript{16} This method often targeted past events with the audit deployed as the main compliance tool. This was a costly and time-consuming process which required the collection of information from and exchanges of positions with the taxpayer before the case was concluded. When positions were disputed, there could be lengthy appeal process before tax dispute resolution bodies.\textsuperscript{17}

The focus on better selection of audit cases led to an increased interest in risk management. In 2004 the work of the OECD’s Forum on Tax Administration (FTA) on compliance risk management\textsuperscript{18} concluded that improved compliance rather than audit yield was the desired outcome of any compliance process and, therefore, it was important to understand the underlying causes of non-compliance and look at the taxpayer holistically rather than focusing on audit yield. This led to a shift towards managing risks, which in turn led to an increased interest in understanding the compliance behaviour of taxpayers. Consequently, the FTA through its 2010 Information Note entitled ‘Understanding and influencing taxpayer compliance behaviour’\textsuperscript{19} concluded that a strategy based solely on deterrence can have major drawbacks and does not necessarily result in improved compliance. The key point was that compliance was not about finding as many errors as possible, but rather about influencing the

\textsuperscript{15} OECD \textit{Tax compliance by design: Achieving improved SME tax compliance by adopting a system perspective} (2014) 21.

\textsuperscript{16} As above.

\textsuperscript{17} OECD (n 10 above) 3.

\textsuperscript{18} OECD \textit{Compliance risk management: Managing and improving tax compliance} (2004).

\textsuperscript{19} OECD \textit{Understanding and influencing taxpayer compliance behaviour} (2010).
environment of the taxpayer to make it easier for them to comply and difficult not to comply.\textsuperscript{20}

The compliance risk management approach gave way to the ‘right from the start’ approach, as elucidated in the FTA 2012 Information Note ‘Right from the start: Influencing the compliance environment for small and medium enterprises’.\textsuperscript{21} This approach marked a shift in compliance strategies and placed the emphasis on influencing the taxpayer’s environment.\textsuperscript{22} The conclusions from the work that evolved out of the 2012 FTA Information Note were that, first, there was a tendency to overestimate the importance of external factors when assessing people’s behaviour; second, that small changes in a taxpayer’s environment can have a big impact on their compliance levels.\textsuperscript{23}

The ‘right from the start’ approach is a way of working and thinking that encompasses four different dimensions, namely, (a) the tax administration acts in real time and addresses problems as they occur; (b) that the tax administration focuses on the taxpayers’ end-to-end processes and adapts its processes to fit into those of the taxpayers instead of attempting to make the taxpayers’ processes fit into those of the tax administration; (c) making it easy to comply and difficult not to comply; and (d) involving the taxpayers and their intermediaries in the compliance process.\textsuperscript{24}

The ‘right from the start’ approach recognises that participants, such as tax intermediaries, third parties, software developers, banks and industry associations can play a significant role in driving compliance up by providing additional certainty and/or more cost-effective solutions.\textsuperscript{25} For example, the information note suggests that tax intermediaries can transform information on taxable transactions into information on taxable profit and deliver it to the tax administration; third parties can have information on taxpayers’ transactions that can substantiate, or verify, the information from the taxpayer; software developers can provide an infrastructure for transferring, transforming and storing information in a secure way; banks can supply information, handle tax payments and provide support services to the taxpayer; and, finally, industry associations can have specialised competences regarding the taxpayers’ context that can support both the taxpayer and the tax administration.\textsuperscript{26}

\textsuperscript{20} OECD (n 19 above) 19.
\textsuperscript{21} OECD (n 1 above).
\textsuperscript{22} OECD (n 1 above) 21.
\textsuperscript{23} OECD (n 1 above) 22.
\textsuperscript{24} OECD (n 1 above) 3 10 23.
\textsuperscript{25} As above.
\textsuperscript{26} OECD (n 15 above) 25.
The ‘right from the start’ approach recognises that compliance is a main function of tax administrations. Compliance with tax laws is not limited to filing tax returns. It covers a broader range of processes which often take place outside the view and control of the tax administration. This approach seeks to redirect the tax administration’s attention from the tax return to the taxpayer’s environment. The approach focuses on the processes that culminate into the tax return. Therefore, it emphasises the need to create an environment that underpins compliant behaviour and reduces opportunities for non-compliant behaviour at an early stage in a taxpayer’s processes, preferably before the tax return is filed. The approach emphasises on getting it ‘right from the start’ by involving and engaging taxpayers and participants and putting in place more up-front measures to support compliance and prevent non-compliance as opposed to reactive measures. The main argument for this approach is that up-front investment in the taxpayer’s environment can foster a culture of voluntary compliance by influencing all the taxpayer’s processes at the input stage. This may lead to correct declarations and returns being filed. It therefore can improve the efficiency and effectiveness of the tax administrations themselves, while at the same time benefiting the taxpayers: getting tax issues right from the start means less trouble (extensive audits, re-assessments and fines) and uncertainty in the end.

As a result, most tax administrations have over the years adopted strategies to address tax compliance risks before a taxpayer files a tax return with the primary aim of creating an environment which promotes compliance because it is the inevitable result of actions and transactions performed by taxpayers. Although aimed at eliminating errors and reducing the possibility for non-compliant behaviour, the approach has the broader objective of reducing intentional tax evasion and strengthening the overall willingness to comply. The approach requires the tax administration to shift its focus from the past to the present; from reports of previous fiscal years to ongoing tax-related processes in the taxpayers’ businesses. It recognises that intervening at the front end of a taxpayer’s process could be more effective than checking individual returns afterwards. The fact that a taxpayer knows that tax compliance is built into his or her processes could significantly model their behaviour.

27 OECD (n 1 above) 1.
28 OECD (n 1 above) 7.
29 OECD (n 1 above) 1.
30 OECD (n 15 above) 220.
31 OECD (n 1 above) 8.
32 OECD (n 1 above) 1.
33 OECD (n 1 above) 3.
34 As above.
35 OECD (n 1 above) 8.
36 OECD (n 1 above) 35.
party data; education and support initiatives; field inspections; initiatives designed to influence social norms; and other tailor-made interventions to ensure that effective results will arise from a combination of these tools.  

The 2014 FTA study stretches the ‘right from the start’ approach further to be effective in money payment systems. The FTA notes that the digital landscape has evolved significantly and that taxpayers, more so SMEs, are adapting to these technological changes to increasingly manage their information and payments digitally. It recognises that a complete digital chain of information and payments, where everything fits together from recording business transactions to bookkeeping and accounting for tax, can improve processes as well as tax compliance. Hence, business transactions can be captured digitally and co-ordinated with electronic payments and electronic bookkeeping and further on with electronic reporting and payments to the government.

The 2014 FTA study recognises that, in an effort to shape the compliance environment, tax administrations increasingly are utilising technological developments and are promoting further developments in order to be more effective. Examples of the initiatives that build on these developments are certified cash registers; on-line bookkeeping and filing; and e-invoicing arrangements. These measures encapsulate the ‘tax compliance by design’ concept as recommended by the OECD, which seeks to make tax compliance a natural part of the day-to-day transactions of taxpayers as they take place by leveraging technological developments.

The ‘tax compliance by design’ concept relies on two principal strategies, namely, the secured chain approach and the centralised data approach. First, there is the secured chain approach, where the primary focus is on the taxpayer’s internal processes and how these processes are supported by trusted intermediaries. Using this approach, the collection of data and processing it into information takes place within the taxpayer’s business and the intermediaries that support the taxpayer’s business. Second, there is the centralised approach where data is collected by third parties and the information is supplied directly to the revenue body which then transforms it into information about tax liabilities and payments that is fed back into the business. The latter approach is premised on the idea that tax administrations can capture as many business transactions from the source as possible in order to determine the right amount of tax to be

37 OECD (n 1 above) 10.
38 OECD (n 15 above) 25.
40 OECD (n 15 above) 30.
41 As above.
42 As above.
43 As above.
44 OECD (n 15 above) 31.
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paid with minimum information from the taxpayer. Tax compliance requirements are built into the information technology systems and processes used by taxpayer and data is delivered by third parties who may not have an incentive to manipulate it. Theoretically, therefore, this makes it easier to gain a desired level of certainty as data is not delivered by the taxpayer. The OECD 2014 study notes that although the secured chain approach and centralised data approaches are different designs under the ‘tax compliance by design’ concept, they are all premised on the need for real-time collection of data about a business transaction and its use in automated processes that translate that data into information about taxes due and, where possible, payment of those liabilities.

4 Utilising mobile money payment systems data to facilitate tax investigations

The evolution of tax compliance strategies indicates that tax administrations are called upon to leverage technological advancements and innovations to facilitate tax compliance. More so, recent work by the FTA indicates that growth in e-commerce, which has been enabled by the availability of and faster internet connectivity, on the one hand, and the emergence and continued growth of electronic payment systems, internet payment services and mobile payment services, on the other, may offer greater opportunities for concealing income especially from underground economic activities in both domestic and offshore locations. The flip side is that these payment systems can also create electronic records that could prove to be a significant source of intelligence for tax administrations on unreported business proceeds.

The FTA, drawing on the work of the Financial Action Task Force (FATF), concluded that the significant rise in transactions and the volume of funds using these models require that they be kept under review as they could be used to facilitate tax evasion practices. As a result, the FTA therefore recommends that tax administrations should be vigilant for evidence of tax non-compliance facilitated by the use of electronic payment systems and, where appropriate, to take advantage of electronic records created by the electronic point of sale (EPS) to identify unreported business income that may have been earned by those participating in the underground economy.

45 OECD (n 15 above) 35.
46 OECD (n 15 above) 30. See 39 for the differences about the secured chain and centralised data approaches for tax compliance by design concept table 3.1.
47 OECD (n 10 above) 2.
48 OECD (n 10 above) 3.
49 As above.
In Kenya, mobile payment is used by approximately 90 per cent of the population, not only to make peer-to-peer payments but also as a broader ‘branchless banking’ platform. This creates an opportunity for tax compliance mainly in terms of tax payment and data on mobile transactions that informs the recruitment of more taxpayers.50

Historically, the primary tax compliance tool in Kenya has been audit and compliance checks. However, the KRA has noted that audit has a narrow focus as it mainly targets corporations. The KRA recognises that the process is mostly manual and takes a long time to complete, leading to a long list of pending cases.51 Because the traditional methods of improving tax compliance based on examination and sanctions have been counter-productive and ineffective, the KRA has had to rethink how to revamp its recruitment strategy to ensure that more taxpayers are brought into the tax net.52

Hence, the combination of a shrinking tax base and the advancement of technology, more specifically the emergence of mobile payment platforms, has led the KRA to include a plan to broaden the tax base through enhanced taxpayer recruitment in its Sixth Corporate Plan. To this end, the target of the KRA is to recruit an additional two million taxpayers by targeting, among others, SMEs that transact through mobile payment platforms or use agency banking, to register for electricity or water connections or pay for services of which the payments are automated.53 The KRA has estimated that there are over 2.7 million SMEs in Kenya that are mainly unregistered for tax purposes.54

One of the key thrusts of the Sixth Corporate Plan is leveraging technology to enhance service delivery and promote compliance.55 According to this Plan, the KRA intends leveraging technology to achieve a fully electronic service, in the hope that this will enhance its operational efficiency and thus result in greater customer satisfaction.56 The KRA plans to achieve this by identifying opportunities for digital integration with partners and stakeholders in the tax system and explore a real-time automated review of taxpayer submissions.57

Keeping abreast with recent approaches to tax compliance, particularly the ‘right from the start’ approach and the ‘tax compliance by design’ concept, the KRA has the opportunity to tap into mobile payments data and influence the taxpayer environment at the transaction level. This

51 Kenya Revenue Authority (n 50 above) 33.
52 Kenya Revenue Authority 21.
53 Kenya Revenue Authority 30.
54 Kenya Revenue Authority 46.
55 Kenya Revenue Authority xiv xv 3.
56 Kenya Revenue Authority x.
57 Kenya Revenue Authority 23.
data could facilitate tax investigations under the new approaches to tax compliance in the following ways:

4.1 Tracking and monitoring taxpayers

An important task of tax administration is to bring together information from different sources, both within the administration and from other relevant government and private sources, in order to verify the information supplied by taxpayers themselves.\(^{58}\) It usually is difficult to monitor transactions that are cash-based. However, the use of banking channels for payment makes transactions easier to observe and monitor. The growth of the financial sector and its greater role in the market economy broaden the potential scope of taxation and makes administration of certain taxes simpler.\(^{59}\)

The KRA can leverage technology to use mobile payments data as a tool for observing and monitoring transactions and taxpayers, thus detecting economic activity in the informal sector and bringing them into the formal sector.\(^{60}\) Additionally, mobile payments data can be used to track receipts and expenditures not only of businesses into focus, but also of their suppliers and businesses down the economic activity chain. In this way it provides information about the financial capacity of both the seller and purchaser, and this can be matched to tax returns to authenticate the tax position.\(^{61}\) It is reported that in September 2015 alone, *Lipa na M-Pesa* transacted Sh15 billion. This, therefore, will enable the KRA to monitor individual transactions and profile businesses and individual M-Pesa users to measure the spending habits of an individual or a business, and its turnover and income levels.\(^{62}\) It therefore presents a huge data mining opportunity for the KRA.

4.2 Identifying individuals and businesses that fail to file returns

When access to mobile payment data has been granted, the KRA will receive information on a taxpayer’s transactions with other businesses and information from intermediaries on the mobile payment platforms that transact with the taxpayer. Access to M-Pesa information can provide an

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\(^{58}\) Zolt & Bird (n 12 above) 16.

\(^{59}\) Zolt & Bird 9.

\(^{60}\) Zolt & Bird 8.

\(^{61}\) Zolt & Bird 9.

individual’s expenditure, including bill payments, which can be analysed and the resulting data matched with tax returns to reveal discrepancies. The information from mobile money transfer platforms then can be matched with the taxpayer’s tax records and their filing patterns analysed using their personal identification numbers (PINs). This could help in identifying both individuals and businesses that are active but that are not meeting their tax obligations.\(^{63}\) If properly analysed, it can point out those that are not registered for tax purposes, while their activity levels indicate that they should be registered. It can also help to identify those that are active but do not file returns. Further, it can help to give indicators of those that are not filing appropriate returns and not paying the correct amount of taxes. These persons then can be profiled for targeted compliance monitoring or audits.

### 4.3 Expanding the tax base

Data from mobile money payments could be used to bring the hitherto untaxed population into the tax base. This is in line with the Sixth Corporate Plan, which outlined the KRA’s intention to use electronic data to suggest incomes of those using mobile money to pay bills and make purchases as part of the effort to expand the tax net and rope in individuals and businesses using retail level data.\(^{64}\) The move will enhance the KRA’s financial data-gathering scheme to unearth income sources which have not been declared in tax returns and demand full compliance.

### 4.4 A more reliable audit trail

Tax audits play a critical role in the administration of tax laws through their detection of non-compliance and by serving as a deterrent to the wider population of taxpayers who might otherwise engage in non-compliant behaviour.\(^{65}\) Audits are necessary because it may be the only way to reveal intentional noncompliance where other means have failed to reveal underpayment of tax. It involves examining returns filed by taxpayers as well as supporting documents to determine the correctness of self-assessed taxes.\(^{66}\) According to Bird and Zolt audits may also be used for studying the characteristics within a group of taxpayers which serve as indicators within that group. However, the strategy deployed in auditing and the success thereof ‘... depend on the quality of the information available to the auditor, which in turn depends on three factors: the information gathered from the taxpayer and third parties; the information-processing capacity of auditors; and the strategy pursued.’\(^{67}\)

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63 [Kenya Revenue Authority (n 50 above) 30-31.](#)
64 [Kenya Revenue Authority (n 50 above) 57.](#)
65 [OECD (n 11 above) 7.](#)
66 [Zolt and Bird (n 12) 21.](#)
67 [As above.](#)
Revenue bodies have been encouraged strongly to be vigilant for evidence of tax non-compliance facilitated by the use of electronic payment systems and, where appropriate, to take advantage of electronic records created by the electronic payment systems to identify unreported business income that may have been earned by those participating in the underground economy. The third party records created by for example, the *Lipa na M-Pesa* transaction till, can therefore create meaningful electronic evidence that can be used during audits.

### 4.5 Pre-filling tax returns

Information from mobile money payment platforms could also be used as a pre-case investigation tool. For example, the information could be analysed and, where found to be relevant, used to pre-fill tax returns. Using the current system of self-assessment, a taxpayer will be required to verify this information. This declaration then could be compared to information obtained from the mobile money payment platform and which is already hosted in the system to determine whether a true account of the taxpayer’s activities had been rendered. Where there are mismatches and where there is no full declaration, further investigations can be launched into the taxpayer’s affairs.

### 5 Potential challenges

Access to mobile payment data needs to be anchored in law. To this end, the KRA has planned to propose legislation that will grant it full and regular access to data collected by other organisations for the purpose of tax administration, specifically targeting mobile companies. In the 2016 Budget Statement, the Cabinet Secretary for the National Treasury announced:

> In order to make it easier for taxpayers to submit their tax returns in the i-Tax system, I propose to amend the Tax Procedure Act to grant Kenya Revenue Authority powers to collect information in advance from identified persons for purposes of pre-populating the information in the i-Tax system.

However, any proposed amendment to the law may face challenges, and there is a need to widely sensitise and lobby both the National Assembly

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68 OECD (n 10 above) 3.
69 OECD (n 15 above) 35.
70 Kenya Revenue Authority (n 50 above) 31.
and the Senate and the mobile money payment platform operators on the advantages that may be brought about by granting such access.\textsuperscript{72}

Another potential challenge to access to mobile payments data is invasion of privacy.\textsuperscript{73} Following this announcement, concerns have already been raised about the plan going against the right to privacy as enshrined in article 31 of the Constitution of Kenya. Banking and microfinance laws also provide for confidentiality of data and may require to be amended for access to be granted.

It has also been noted that the mobile payment data may be abused by government officials and others.\textsuperscript{74} Therefore, there is a need for proper safeguards to ensure that data from mobile payments is used only for intended purposes.

Lastly, because of the significant data that is available on mobile payments, there is a need for proper infrastructure, both software and hardware, and analysis so as to derive any meaningful value from this data. There will be a need to train and equip KRA officers with appropriate skills to enable them to handle the data gained from such access and properly analyse it so that it gives out information that is useful for tax compliance monitoring.

6 Conclusion

The advances in technology have the potential to alter the economic environment in which governments seek to collect tax revenue. In developing countries, the upsurge in mobile payments may make it easier to move some individuals and businesses from the informal to the formal economy. Data from this payment platform can be used as an investigative tool to enhance compliance. However, there are obstacles such as the enactment of enabling legislation; overcoming privacy concerns; and assembling an enabling infrastructure before the revenue bodies can use the available data as an aid to compliance.

\textsuperscript{72} C Munda ‘Tax experts laud KRA on its bid to access M-Pesa, bank accounts to nab tax cheats’\textsuperscript{ }\textit{The Star} 20 May 2016 http://www.the-star.co.ke/news/2016/05/20/video-tax-experts-laud-kra-on-its-bid-to-access-m-pesa-bank-accounts_c1354133 (accessed 13 June 2016).

\textsuperscript{73} Zolt & Bird (n 12 above) 36.

\textsuperscript{74} As above.
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OECD Tax compliance by design: Achieving improved SME tax compliance by adopting a system perspective (OECD Publishing: OECD 2014)


Safaricom Limited Annual Report 2014

Abstract

In the aftermath of a succession of data leaks, insufficient accuracy and accessibility of basic and beneficial identification and ownership information have been identified as an enabler of illicit financial flows. As a result, many have called for greater transparency around corporate data. The purpose of this chapter is to present the current transparency initiatives that are aimed at improving access to this data. Different registers have been proposed, not only internationally but also in many domestic fora. These should help counter the use of corporate vehicles for illicit purposes. They are expected to address especially money laundering, bribery and corruption. In this chapter, three new initiatives are discussed: the European Union (EU) register as implemented under the 4th AML Directive; the UK register of beneficial owners; and the Global Legal Entity Identifier (LEI) system. The primary issue is how ready these instruments are to be put into effective operation. This chapter analyses their pros and cons, as well as a number of challenges that regulators will have to face.

1 Why are these transparency initiatives important?

Illicit financial flows thrive on secrecy.\(^1\) Shell companies, complex ownership and control structures, trusts and other legal arrangements are commonly used to obscure the true beneficial ownership of assets.\(^2\) These


\(^2\) The classical example of the role corporate vehicles might play in transactions involving illicit financial flows is the Abacha case. Sani Abacha was Nigeria’s former President and is estimated to have stolen up to USD5 billion during his rule from 1993 to 1998. Part of the money was held in trusts in Guernsey which had bank accounts in London, secret bank accounts in Europe, and shell companies in British Crown Dependencies. Source: OECD Report on the Misuse of Corporate Vehicles for Illicit Purposes 2001 92.
are not only channels for money laundering, tax avoidance and tax evasion, but are also used to hide the proceeds of corruption. Not many jurisdictions collect information about beneficial ownership at the time a company is set up. This makes international cooperation more difficult.\(^3\) Not surprisingly, substandard beneficial ownership requirements are perceived as a dangerous legal deficiency which must be addressed.

Considering this, many international bodies have urged governments to take specific actions to enhance the transparency of corporate vehicles. The G8 Leaders were the first to demand action against corporate secrecy. In Lough Erne in 2013, the G8 Leaders recognised data as a key instrument to assist government effectiveness, efficiency and responsiveness to citizens, whereas the lack of transparency was perceived as an important obstacle to sustainable development.\(^4\) The Leaders formulated eight ‘Action Plan Principles’ to prevent the misuse of companies and legal arrangements. In their Communiqué, first, they indicated that companies, as well as trustees of express trusts, should retain adequate, accurate and current information on who owns and controls them and their beneficial ownership. Second, law enforcement, tax administrations and other relevant authorities, including, as appropriate, financial intelligence units, should be provided with access to beneficial ownership information on companies and trusts. Additionally, they requested that domestic agencies work together effectively. The cooperation should take place not only at the domestic but also the international level. These operations should address illicit activities stemming from the abuse of companies and legal arrangements.

In response to existing loopholes in legal frameworks, the Financial Action Task Force (FATF) also initiated significant steps to improve the transparency of corporate data. Considering the abuse of legal persons and arrangements for the purpose of illicit activities, the FATF added standards on transparency of beneficial ownership information concerning corporates and legal arrangements to its Forty Recommendations and Interpretative Notes (FATF Recommendations).\(^5\) Currently, the body requires countries to ensure that tax administrations can access adequate, accurate and timely information regarding the beneficial ownership of corporate vehicles and legal arrangements. The recommendations by FATF which incorporate these principles were endorsed by the G20.\(^6\)

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3 OECD Illicit Financial Flows from Developing Countries: Measuring OECD response 2014 41.
4 G8 Leaders’ Communiqué, Lough Erne, 18 June 2013.
5 FATF Recommendations 24 and 25.
The request to improve transparency of corporate data elicited direct responses from national governments as well. A number of countries committed to establish public registries of corporate ownership information (for example, Denmark, the United Kingdom and Norway). The EU also took significant steps by proposing domestic public registers under the new 4th Anti-Money Laundering Directive.\(^7\)

At the same time, the transparency of corporate vehicles was also recognised as beneficial for financial stability in the wake of the financial crisis. This was why the legal entity identifier (LEI) was introduced. This should improve the measurement and monitoring of systemic risk. The LEI is a unique and exclusive identification code based on basic data regarding an entity that is held in a register. The vision is that the LEI will obtain global reach and enable the worldwide recognition of transaction parties.

The existence of several parallel initiatives to improve transparency does raise some questions. Will these initiatives satisfy the relatively high standards of adequate, accurate and current information that are necessary to support the efforts to curb illicit financial flows? The purpose of this chapter is to examine three of these initiatives (the UK register; the 4th AML Directive registers; and the LEI) to identify challenges that regulators could face when implementing them. All these instruments have the potential to curb illicit financial flows by improving transparency.

2 The misuse of legal persons and arrangements and the FATF recommendations

The FATF\(^8\) recognised the need to tackle the misuse of legal persons and arrangements to facilitate illicit activities and added to its Forty Recommendations and Interpretative Notes (FATF Recommendations).\(^9\) Although the FATF standards for transparency of beneficial ownership

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8 The FATF is an inter-governmental body. It was established in 1989 by the Ministers of its member jurisdictions. The FATF is currently seen as the main standard-setting organisation in the field of legal, regulatory, and operational measures for combating money laundering, terrorist financing, and other related threats to the integrity of the international financial system.

9 FATF International Standards of Combating Money Laundering, and the Financing of Terrorism and Proliferation, the FATF Recommendation, February 2012. The FATF Recommendations do not constitute a legally-binding instrument under international law. However, they have been globally recognised and, therefore, can be considered to be soft international law. In order to comply with the FATF Recommendations, countries are expected to implement them in their national legal
information were designed to prevent misuses of corporate vehicles for money laundering or terrorist financing, they also support the efforts to prevent and detect other illicit activities, such as tax crimes and corruption.

FATF Recommendation 24 establishes standards on transparency in respect of legal persons. The standard states the following:

Countries should take measures to prevent the misuse of legal persons for money laundering or terrorist financing. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. In particular, countries that have legal persons that are able to issue bearer shares or bearer share warrants, or which allow nominee shareholders or nominee directors, should take effective measures to ensure that they are not misused for money laundering or terrorist financing. Countries should consider measures to facilitate access to beneficial ownership and control information by financial institutions and DNFBPs undertaking the requirements set out in Recommendations 10 and 22.

The interpretative note to Recommendation 24\(^\text{11}\) explains that the subjective scope of the standard refers not only to legal persons but also to foundations, Anstalt, and limited liability partnerships. Recommendation 24 also clarifies the minimum basic information that should be obtained.
and recorded, which includes (a) company name; proof of incorporation; legal form and status; the address of the registered office; basic regulating powers (for example, memorandum and articles of association); a list of directors; and (b) a register of its shareholders or members containing the names of the shareholders and members as well as the number of shares held by each shareholder and categories of shares (including the nature of the associated voting rights).

FATF Recommendation 25 refers to the transparency of legal arrangements and reads as follows:

Countries should take measures to prevent the misuse of legal arrangements for money laundering or terrorist financing. In particular, countries should ensure that there is adequate, accurate and timely information on express trusts, including information on the settlor, trustee and beneficiaries that can be obtained or accessed in a timely fashion by competent authorities. Countries should consider measures to facilitate access to beneficial ownership and control information by financial institutions and DNFBPs undertaking the requirements set out in Recommendations 10 and 22.

The interpretative note to Recommendation 25\textsuperscript{12} indicates that the standard refers to both trusts and other types of legal arrangements that may have a similar structure or function. The minimum scope of information which should be recorded encompasses the identity of the settlor; the trustee(s); the protector (if any); the beneficiaries or class of beneficiaries; and any other natural person exercising ultimate effective control over the trust and information on other regulated agents of and service providers to the trust, including investment advisors or managers, accountants and tax advisors.

Both Recommendations recognise the necessity of international cooperation on exchange of beneficial ownership information between competent authorities. Therefore, the standards recommend easing and smoothing the access to basic information that is held by registries for foreign competent authorities. They also call for exchanging information between foreign competent authorities. Finally, they encourage the making use of powers to obtain beneficial ownership information prescribed in domestic law. This may be the way to help a foreign counterpart in accessing beneficial ownership information.

Thus far, the implementation of the FATF standards on transparency of beneficial ownership information has not been that simple, as evidenced by the FATF Guidance on Transparency and Beneficial Ownership (Recommendations 24 & 25) issued in 2014, aimed at assisting countries in the implementation of Recommendations 24 and 25. Moreover, the last OECD report measuring responses of the OECD countries to illicit

\textsuperscript{12} FATF Recommendations 2012 89.
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financial flows\(^\text{13}\) revealed that compliance with Recommendations 24 and 25 was substandard. Regarding all FATF Recommendations, average OECD country compliance is the lowest for transparency of legal persons and arrangements.\(^\text{14}\) The report indicates that several OECD countries do not require beneficial ownership information on all types of legal structures and particularly not in respect of trusts.\(^\text{15}\)

Nonetheless, the G20 has endorsed the FATF standards on transparency of beneficial ownership and encouraged countries to address the risks raised by the opacity of corporate vehicles. In their 2013 public declaration they stated:\(^\text{16}\)

> We commit to take measures to ensure that we meet the FATF standards regarding the identification of the beneficial owners of companies and other legal arrangements such as trusts that are also relevant for tax purposes. We will ensure that this information is available in a timely fashion to law enforcement, tax collection agencies, and other relevant authorities in accordance with the confidentiality legal requirements, for example, through central registries or other appropriate mechanisms. We ask our Finance Ministers to update us by our next meeting on the steps taken to meet FATF standards regarding the beneficial ownership of companies and other legal arrangements such as trusts by G20 countries leading by example.

### 3 New European Union legislation on corporate ownership information

The move to beneficial ownership registers has been quickened by the European Union. The 4th AML Directive imposed an obligation on member states to store beneficial ownership information a central register, aligning its policy with FATF Recommendations. The new directive must be transposed into national laws by the member states within two years from 26 June 2015.

The basic concept for the analysed obligation is that of the ‘beneficial owner’ which, according to the 4th AML Directive, is ‘any natural person who ultimately owns or controls the customer and/or the natural person(s) on whose behalf a transaction or activity is being conducted’.\(^\text{17}\) The directive also specifies how to identify beneficial ownership in the cases of corporate entities, trusts and other legal entities such as foundations.\(^\text{18}\)

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\(^{13}\) OECD (n 3 above).

\(^{14}\) OECD 27.

\(^{15}\) OECD 35.

\(^{16}\) G 20 Leader’s Declaration, St Petersburg Summit, 6 September 2013.

\(^{17}\) Art 3 para 6 of the 4th AML Directive.

\(^{18}\) Art 3 paras 6(a), (b) and (c) of the 4th AML Directive.
The 4th AML Directive obliged member states to establish two types of beneficial ownership registers, including one for corporate and legal entities and another for trusts. For this purpose, member states can use a central database that already is in place, provided that it collects beneficial ownership information, business registers, or any other central registers. It is worth noting that neither form of these registers is relevant to foundations that are not legal persons.

As for registers of corporate and legal entities, the information they contain shall be accessible to competent authorities and FIUs in all cases without any restriction; to obliged entities within the framework of customer due diligence in accordance with the 4th AML Directive; and to any person or organisation that can demonstrate a legitimate interest for acquiring the information. Certain limitations to access is permitted on a ‘case-by-case basis in exceptional circumstances where such access would expose the beneficial owner to the risk of fraud, kidnapping, blackmail, violence, or intimidation or where the beneficial owner is a minor or otherwise incapable’. Member states are also allowed to ensure the protection of personal data that is included in the registers.

A separate register is provided for trusts. The 4th AML Directive differentiates obligations imposed between trusts governed by the law of a member state, trustees in general, and trusts that generate tax consequences. The first type of entity is required only to store data but not to report it anywhere. The second type must disclose its status and provide basic information in the event that they form a business relationship or perform an occasional transaction above the thresholds stipulated in the 4th AML Directive. Only the last type, trusts that generate tax consequences, is required to provide certain data to a central register. This apparent loophole in the new European Union legislation is discussed below.

Access to the data held in the trusts register is restricted by comparison to the register for corporate and legal entities. Only competent authorities and financial intelligence units are granted timely and unrestricted access. Timely access may be also granted to obliged entities within the framework of customer due diligence in accordance with the 4th AML Directive.

The 4th AML Directive will increase the transparency of company ownership. It should also enhance control to both regulatory and criminal enforcement agencies in the European Union. Registers that member states have been required to introduce should reduce illicit financial flows, particularly money laundering. They are expected to help identify potential misconduct and those businesses that are either intentionally, or

19 Art 30 para 9 of the 4th AML Directive.
20 Art 31 para 4 of the 4th AML Directive.
21 Art 31 para 4 of the 4th AML Directive.
unintentionally involved in illicit activity. This will be possible because the central registers will enable different enforcement agencies to access a broad scope of information to conduct due diligence. Masking money laundering transactions and other illicit financial flows will be much more difficult, as the registers listing information about the ultimate beneficial ownership of the parties to financial transactions will enable greater transparency in these transactions.

Nevertheless, some important issues still need to be addressed.

First and foremost, the new directive proposes registers but only at the national level. As most illicit financial flows involve cross-border transactions, it will be necessary to access data held in the registers of other countries to piece together a complete picture of a transaction. Consequently, the exchange of information between competent authorities and FIUs from different member states will be essential. To address this issue, the 4th AML Directive suggests that member states use the system of interconnection of central registers established via the European central platform established by article 4(a)(1) of Directive 2009/101/EC. At this time it is difficult to assess whether it will be sufficient to address the needs of competent authorities. The 4th AML Directive obliged the Commission to provide a report on the conditions and the technical specifications and procedures for ensuring safe and efficient interconnection of the central registers by 26 June 2019. This allows two years for testing how beneficial owner register will function in practice.

In addition, so far the 4th AML Directive is very limited in terms of who gains access to data stored in registers and the purposes for which the information may be used. It does not grant unrestricted access to tax authorities, asset recovery offices, other law enforcement services and anti-corruption authorities. Information cannot be accessed for the purposes of law enforcement investigations, including asset recovery and tax offences. The Commission is, however, considering whether to change that in the future.22

There are also doubts concerning the protection of personal data under the 4th AML Directive. The Directive attempts to strike a balance between addressing the risks of money laundering and the protection of each individual’s personal data and right to privacy. The Directive explicitly stipulates that the processing of personal data ‘should be limited to what is necessary for the purposes of complying with the requirements of’ the 4th Directive. It is worth noting that the 4th AML Directive does not explicitly require the member states to make these registers public. The member states have the option to choose between a central or public register. In

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either case, they are obliged to ensure that the information is available to individuals with a ‘legitimate interest’ in the information. Moreover, member states are allowed to at least partially restrict access, for instance by requiring some form of registration in order to obtain information, or by imposing a fee. To the extent that access is conditional on being able to demonstrate a ‘legitimate interest’ in acquiring the relevant data, the practical impact of this requirement will depend on how the concept of a ‘legitimate interest’ is construed.

The serious privacy implications of a public register of beneficial owners have sparked an intensive debate about the scope of the register. The ‘obliged entities’ that must be included do not cover only legal entities but also trusts. In common law countries trusts are regularly used to protect vulnerable beneficiaries, some of whom could be at significant risk should their identities be published. There were some concerns that if a new register applied to all trusts, it would be at the expense of the right of individuals to privacy. In addition, it would impose significant administrative burdens and costs on families. The current text of the 4th AML Directive applies only to taxable trusts and will not be made public. It means that only trusts that generate tax consequences will be captured by new regulations. It will only contain information that in any case is made available to tax authorities as part of international initiatives for automatic exchange of tax information. In this way, the interests of trusts used for protection of family wealth should be kept protected.

Some questions may arise with respect to the recognition of foundations by the 4th AML Directive. According to the Preamble:23

In order to ensure a level playing field among the different types of legal forms, trustees should also be required to obtain, hold and provide beneficial ownership information to obliged entities taking customer due diligence measures and to communicate that information to a central register or a central database and they should disclose their status to obliged entities. Legal entities such as foundations and legal arrangements similar to trusts should be subject to equivalent requirements.

Foundations are also mentioned in the definition of beneficial owner. In the case of foundations, the 4th AML Directive defines a beneficial owner as ‘the natural person(s) holding equivalent or similar positions to those referred’ in the case of trusts. Although this seems to indicate that foundations should be listed in a central register, it is not very clear in the text of the 4th AML Directive. This may be an issue of interpretation that may only be resolved if a dispute is referred to the courts.

23 Para 17 of the 4th AML Directive.
4 UK law on new register of corporate ownership information

Among the member states, it has been the United Kingdom that has led the way with its central register. Its proposal of a central open registry of information on companies’ ultimate controllers and owners came as a result of the commitment of the UK government at the G8 Summit in June 2013. In the Communiqué issued after the summit in Lough Erne, G8 Leaders agreed as follows: ‘We agree to publish national Action Plans to make information on who really owns and profits from companies and trusts available to tax collection and law enforcement agencies, for example, through central registries of company beneficial ownership.’ As a follow-up, the UK launched a process to establish a register of beneficial ownership information. The legislation received royal assent in March 2015 and entered into force on 6 April 2016.

The new law as implemented in the Small Business Enterprise and Employment Act 2015 requires companies to maintain a register of individuals who have significant control over a company. The proposed register is known as the PSC register and is directed only to unlisted companies from the UK, since listed companies are already encompassed within the disclosure requirements provided for under the DTR.

The key definition under the new law is ‘a person who has significant control over the company’. A person is perceived as holding significant control if he or she has met one of the following conditions:

- the individual directly or indirectly holds more than 25 per cent of the nominal share capital;
- the individual directly or indirectly controls more than 25 per cent of the votes at general meetings;
- the individual is directly or indirectly able to control the appointment or removal of a majority of the board;

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the individual actually exercises or has the right to exercise significant influence or control over the company; or

• the individual actually exercises or has the right to exercise significant influence or control over any trust or firm (which is not a legal entity) that has significant control (under one of the four conditions above) over the company.

The unlisted company is required to identify and maintain an up-to-date register of persons with significant control. However, the scope of information is quite broad. The register includes a name; a residential address; date of birth (this information is protected from disclosure to the public, thereby making identity theft more difficult); a service address; and information about the way in which they have significant control. The information must be updated on an annual basis.

Companies are obliged to keep a register of people with significant control from January 2016 onwards and, as from 30 June 2016, companies’ annual returns (in the future to be known as ‘confirmation statements’) to Companies House have to include beneficial ownership information. This information will constitute a central register. The register will be made public. This means that it will be publicly accessible. A special protection regime is also in place. The UK legislation includes many provisions designed to ensure the non-disclosure of personal data. For example, the residential addresses of all individuals with significant control will be kept by the company. These addresses will not be available to the public and will not appear in the central public register.

The British initiative is ground-breaking. It is claimed to be the first law to introduce the public register into domestic legislation. It is expected to improve transparency over company ownership and control to both regulatory and criminal enforcement agencies in the UK and abroad. It is estimated that the UK register will affect approximately 2.5 million companies and partnerships. Following the adoption of the 4th AML Directive, the UK law will need to be revised, but this may not happen if the UK leaves the EU. First and foremost, the scope of a register of individuals with significant control will need to be extended to encapsulate


31 V Houlder ‘Tax havens told to drop opposition to UK call for central register’ Financial Times 27 March 2015.

32 In a referendum held on 23 June 2016 the majority of UK citizens voted for the ‘leave’ option. The UK is currently in the process of discussing with the EU the terms and conditions of its exit from the EU.
other entities in addition to companies. Also, updates of information stored in a register of people with significant control will need to occur more often to ensure that the information is current.33

Although the UK initiative is striking, its impact necessarily is limited because, in common with all purely national registers, it can only tell part of the story. As long as registers are limited to one jurisdiction, or even to the EU, it is difficult for stakeholders and regulators to get a full picture of the global activities of all of the entities under the control of a specific individual or individuals. This is why the UK also initiated international cooperation on sharing information about the ultimate owners of companies. In its letter to the G20 countries, the UK, joined by France, Germany, Italy and Spain, indicated:34

We need to take firm collective action on increasing beneficial ownership information transparency, building on our actions to date … We commit to establishing as soon as possible registers or other mechanisms requiring that beneficial owners of companies, trusts, foundations, shell companies and other relevant entities and arrangements are identified and available for tax administration and law enforcement authorities … As a next step, we should also call for the development of a system of interlinked registries containing full benefit ownership information and mandate the OECD, in co-operation with FATF, to develop common international standards for these registries and their interlinking.

Currently, 55 countries have committed to participate in the pilot on exchange of information about beneficial ownership.35 A global exchange

34 As at 14 December 2016, 55 countries (including Crown dependencies) were committed to the initiative for the systemic sharing of beneficial ownership information: France, Germany, Italy, Spain, United Kingdom, Afghanistan, Anguilla, Argentina, Austria, Belgium, Bermuda, Brazil, British Virgin Islands, Bulgaria, Cayman Islands, Chile, Colombia, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, Gibraltar, Greece, Guernsey, Hungary, Iceland, India, Ireland, Isle of Man, Jersey, Latvia, Liberia, Lithuania, Luxembourg, Malta, Mauritius, Mexico, Moldova, Montserrat, Netherlands, Nigeria, Norway, Poland, Portugal, Romania, Saudi Arabia, Seychelles, Slovakia, Slovenia, Sweden, Turks and Caicos Islands and United Arab Emirates. See updates on https://www.gov.uk/government/publications/beneficial-ownership-countries-that-have-pledged-to-exchange-information/countries-committed-to-sharing-beneficial-ownership-information (accessed 10 March 2016).
35 As at 8 June 2016, the following countries committed to sharing beneficial ownership information: Afghanistan, Anguilla, Austria, Belgium, Bermuda, Bulgaria, Cayman Islands, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Gibraltar, Germany, Greece, Hungary, Iceland, India, Ireland, Isle of Man, Italy, Jersey, Latvia, Lithuania, Luxembourg, Malta, Mexico, Montserrat, Netherlands, Nigeria, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Arab
of beneficial ownership information will complement the Common Reporting Standard.\textsuperscript{36} Nevertheless, even this initiative is highly dependent on the consistency of implementation and may need to be supported by a process of peer review, along the same lines as already existing for EOI for tax (through the Global Forum).

5 Global LEI system

5.1 Rationale of the initiative

The idea of the Global LEI system was developed in the aftermath of the global financial crisis. The fragmented system of firm identifiers and the lack of a standard identification system for financial counterparties were blamed for the inability of market participants to form a consistent and integrated view of their exposures. In 2009, the G20 called for the strengthening of financial markets and the harmonisation of existing standards.\textsuperscript{37} Later, in 2012, it supported the creation of the Global LEI system and mandated the Financial Stability Board (FSB) to deliver concrete recommendations. The LEI was designed to become a global standard governed within the Global LEI system to support authorities and market participants in identifying and managing financial risks. Thus far, the initiative has been endorsed by many countries as well as the EU. At the moment, the standard is being developed at domestic levels.

5.2 Scope and purpose

As stated by the FSB,\textsuperscript{38} financial stability demands improved risk management; better assessment of micro and macro-prudential risks; facilitation of orderly resolution; containing market abuse and curbing financial fraud; and enabling higher quality and accuracy of financial data overall. The Global LEI system attempts to achieve these objectives by offering harmonised standards of entity recognition. The system is based

\textsuperscript{36} The Common Reporting Standard (CRS) is the single global standard for the collection, reporting and exchange of financial account information on foreign tax residents developed in the context of the OECD. It addresses banks and other financial institutions. These two types of institution are obliged to collect and report financial account information of non-residents to the tax administration. This information will be exchanged by the tax administration with the participating foreign tax authorities of those non-residents. Simultaneously, financial account information on residents from the tax authorities of other countries will be received. The results of CRS should be twofold. This should work as a deterrent to tax evasion. In addition, residents with financial accounts in other countries should be encouraged to comply with tax law.

\textsuperscript{37} G20 Leaders Statement: The Pittsburgh Summit, 24-25 September 2009, Pittsburgh.

\textsuperscript{38} Financial Stability Board A global legal entity identifier for financial markets 8 June 2012.
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on ascribed unique codes, namely, the LEIs. It facilitates the creation of a robust data framework offering information on positions, exposures and risks between financial groups.

Technically speaking, the LEI, which is the core of the Global LEI system, is an alphanumeric code that enables identification of entities participating in global financial markets. Currently, it relies on a standard published by the International Organisation for Standardisation (ISO) on 30 May 2012 (ISO 17442:2012, Financial Services – Legal Entity Identifier (LEI)). It consists of 20 characters (numbers or letters), and their allocation within the code is not random. The first four characters reflect a prefix allocated uniquely to each Local Operating Unit (LOU) issuing LEIs. This prefix identifies (except for LEIs issued before 30 November 2012) the LOU that first issued the LEI, which helps to avoid the assignation of the same LEI to different LOUs. The entity may transfer its LEI to a different LOU. The next two characters (numbers 5 and 6) are always specified at zero. The following 12 characters (numbers 7 to 18) are the identification code of an entity. This part of the code is then entity-specific and is assigned by the particular LOU. The last two characters (numbers 19 and 20) are two check digits that are designed to prevent typing errors. They are assigned according to the standard ISO/IEC 7064 (MOD 97-10). Figure 9.1 presents the architecture of the code.

Figure 9.1: Architecture of the Legal Entity Identifier

Example: ERSTE Securities Polska SA.

There are two fundamental features of the LEI which reflects its character. First, it is unique, which indicates that a particular code is assigned to a specific entity and, even if this entity ceases to exist, the code cannot be reassigned to another entity. Second, the LEI is exclusive. The same entity can obtain only one LEI. The entity may decide to change its LOU, but even then the LEI will remain the same.

Not all entities may obtain the LEI. According to the ISO standard, the LEI identifies only legal entities involved in financial transactions. The term ‘legal entities’ refers to unique parties that are legally or financially responsible for the performance of financial transactions or have the legal
right in their jurisdiction to enter independently into legal contracts regardless of whether they are incorporated or constituted in some other way (for instance, by means of a trust, partnership, or other contractual mechanism). It also includes governmental organisations and supranationals, but natural persons are excluded from its scope.

The Global LEI system is being built in a few stages. In the first phase, legal entities applying for a LEI need to provide only the reference data (the ‘who is who’). The reference data consists of the basic information about the entity (see details in Table 1). Currently, the Global LEI system is moving to the second stage. Entities applying for the LEI (or who already have one) will be obliged to provide a much wider scope of information, namely, relationship data (‘who owns whom’). Relationship data will cover first data on direct and ultimate parents of legal entities as well as data about branches (see Box 9.1). There are already plans to develop a new policy with respect to individuals acting in a business capacity. In the future we may expect that the third step will cover financial data (‘who owns what’).

Box 9.1: The LEI reference data

The code is linked to data that refer to the basic information about the entity. The reference data include:

- the official name of the legal entity;
- the address of the headquarters of the legal entity;
- the address of legal formation;
- the date of the first LEI assignment;
- the date of last update of the LEI;
- the date of expiration, if applicable;
- for entities with a date of expiration, the reason for the expiration should be recorded and, if applicable, the LEI of the entity that acquired it;
- the official business registry where the foundation of the legal entity is mandated to be recorded on formation of the entity, where applicable;
- the reference in the official business registry to the registered entity, where applicable.

39 Currently, the technical specifications for recording the relationship data are finalised in consultation with LEI Issuers. It was expected that by 1 May 2017 all LEI Issuers will have developed the capacity to record relationships with direct and ultimate parents. See LEI ROC, Update by the LEI ROC, 12 January 2017.

40 This will refer to independent business activity as evidenced by registration in a business registry, eg, a sole trader.
Data on direct and ultimate parent legal entities will be provided based on the accounting definitions. This means that a direct parent legal entity will be identified as a ‘direct accounting consolidating parent’ and the ultimate parent legal entity as the ‘ultimate accounting consolidating parent’. The ‘relationship’ is explained in Figure 9.2.

Figure 9.2: Relationship Data

5.3 Infrastructure for operating LEI

The ultimate responsibility for the system was entrusted to the Regulatory Oversight Committee (ROC). This body was established by the Charter of the Regulatory Oversight Committee for the Global Legal Entity Identifier (LEI) System on 5 November 2012. It is comprised of representatives of public authorities from around the globe. The ROC is responsible for upholding governance principles and for overseeing the entire system. It releases guidance, standards, high-level plans, policies and protocols.

The operational arm of the whole system is served by the Global LEI Foundation (GLEIF) which provides a centralised database of LEIs and corresponding reference data that can be downloaded free of charge. Since October 2015, the GLEIF has been evaluating organisations that issue LEIs to legal entities engaging in financial transactions, and is responsible for the accreditation of LEI organisations. The GLEIF annually verifies whether organisations that are accredited to issue and maintain LEIs continue to meet the requirements regarding service orientation and quality as established in the Master Agreement. It aims at optimising the quality, reliability and usability of LEI data.

To obtain the LEI, an entity must register with one of the LOUs. Each LOU may differ with respect to the available languages, facilities to register many entities in bulk, and price, among others. Nevertheless, certain requirements are common. In particular, each LOU needs to collect a minimum set of reference data (as presented above) about the entity that must be confirmed or certified by the entity seeking an LEI. Entities are requested to periodically verify whether the reference data are accurate. A LOU is in charge of ensuring the quality of data. It is obliged to examine each entry against reliable sources (public official sources such as a business registry or private legal documents) before the LEI and associated reference data is published. It should ensure that an entity reviews the accuracy of this information at least once annually and promptly submit any changes. LOUs may charge a fee for issuing the LEI as well as for validating the reference data upon issuance and after each yearly certification. Figure 9.3 sets out the LEI hierarchy.

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41 The ROC is composed of the Plenary, the Executive Committee, the Committee on Evaluation and Standards and other committees, working groups or panels. Moreover, it has a Secretariat located in Basel, Switzerland.
43 Art 2(b)(1) of the Charter.
44 The list of pre-LOU is available on the website http://www.leiroc.org (accessed 10 January 2017).
45 The ultimate responsibility for data accuracy falls upon the registrant.
5.4 Regulatory application

Consistent with the goal to implement the LEI as the global standard and create the Global LEI system, the tool has already been employed in many regional legal frameworks. Approximately 40 regulatory actions require use of the LEI. So far, the standard is being used in the securities, banking and insurance sectors. Two examples of its implementation are presented below.

The first regulator to mandate the use of an identifier in regulatory reporting was the US Commodity Futures Trading Commission (CFTC). The first regulation, which entered into force on 12 October 2012, effected OTC interest rates and credit derivatives. It was later extended to OTC foreign exchange, commodity and equity derivatives. The rule requires the identification with standard identifiers of the parties, their counterparties, and any underlying reference entities of the contracts. The CFTC requires the use of a CFTC Interim Compliant Identifier (CICI) until the global LEI programme is implemented. To facilitate compliance with this requirement, a special utility was introduced by the CFTC. Market participants who are required to obtain a CICI can use the CICI website http://www.ciciutility.org. The website can be used at no charge and is available to the public. It is owned, managed and operated by DTCC-SWIFT.

Apart from the US, the use of the LEI has been mandated by the European Securities and Markets Authority (ESMA) for reporting derivative transactions to Trade Repositories under the European Market

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The LEI as a standard in financial transactions has also been implemented in many other legal fora. It appears that the tool is gaining increasing worldwide recognition. According to the Global Financial Market Association (GFMA), as of January 2017, approximately 490,000 LEIs have been issued.\(^{47}\) Of these, more than 90 per cent have been issued in Europe and North America.

5.5 Considerations and challenges in implementing the LEI as a global standard

The LEI is a public-private initiative. Certain benefits are expected for both regulators and business. The former demands an effective tool that can assist them in data aggregation and analysis between financial market participants. It should also provide the ability to identify trading patterns. Moreover, it should also offer an accurate risk assessment to the financial system. The key functionality should be the ability to analyse risk at an aggregate firm level. From the perspective of business, the Global LEI system should make it easier to more effectively measure and manage counterparty exposure. This could be achieved through a common perspective of legal entities across the organisation. It should improve the speed and accuracy of data aggregation for risk analysis and for managing corporate actions.

Some challenges still need to be addressed to ensure that the Global LEI system will be a successful experience for all market participants. Size matters: The Global LEI system was developed with an ambition to become the global standard. As a result, the success of the Global LEI system requires a significant commitment from all stakeholders. Because the benefits of the system are collective, they may only be fully realised once there is broader public participation. The fundamental question is how to ensure that the system is widely adopted. One way is to promote the benefits that the global standard could generate. However, it is not certain whether a voluntary solution could create wider buy-in and become an internationally recognised standard. It would certainly require intense political pressure. It seems that establishing LEI as a global system would be much more likely if it were established as a compulsory condition to enter certain markets. Consequently, regulators around the globe need to

\(^{47}\) Webinar slides The Legal Entity Identifier System 1 February 2017 (accessed 10 March 2017).
be encouraged to make use of the LEI as one of their compulsory requirements whenever a legal entity is to be identified and established as a market participant.

As far as risks are concerned, there are some concerns that suppliers of LEIs will exploit their position by overcharging registrants or by restricting access to data. Therefore, regulators must ensure that public interest will be protected in a manner that will make the system fully efficient and effective. To do so will demand introducing clear principles and standards governing this framework. This should be assured and monitored within the accreditation process governed by the GLEIF. To have a competence to issue a LEI, an authority must obtain a certificate of accreditation from the GLEIF.

The system will facilitate integration of different jurisdictions with varied regulatory, legal systems, and local languages from around the world. The Global LEI system should be responsive to these differences, while enabling the cooperation of all jurisdictions within a common framework. As a corollary, it should have enough capacity to be able to expand across the globe, including to the least developed countries. This dimension seems to be very dependent on political discretion. At the end of the day, it is up to domestic regulators to decide whether or not the LEI is required.

The need for integration of different regulatory and legal systems has very practical implications for the development of the Global LEI system. It has been evident in discussions on relationship data. Adding data on parent entities first required identification of what is meant by the terms ‘direct parent’ and ‘ultimate parent’. For this purpose, the ROC reviewed existing international standards, principles and best practices.48 To minimise the potential for overwhelming complexity, it was decided to base definitions on the accounting definition of consolidation applying to this parent.

The Global LEI system, first and foremost, will be a significant source of data about market participants from around the world. The first concern is how this data will be updated. This was already an issue when the concept of LEI was first presented. The burden was divided between a LOU and an entity. The LOU validates and publishes data and next annually revalidates data. The entity registers and provides the reference data and then provides an annual update. In light of the new standard of relationship data, the process may become more complex. In particular, the validation of data may require more efforts from LOUs. As some

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48 The review covered different standards ranging from those used for the purpose of banking supervision to anti-money laundering and countering the financing of terrorism. See LEI ROC ‘Collecting data on direct and ultimate parents of legal entities in the Global LEI Systems – Phase 1’ 10 March 2016 4.
indicate, this may be not sufficient. An independent source of entity
corporate actions may be required to govern and manage the reporting
process.49

There are also concerns about the costs involved. The more complex
the structure of a group of companies, the more significant the costs
involved. This may be a particular issue for least developed countries.
Scarce capacities pose a real issue there. For these countries, ensuring a
reliable process of validation of data may be an obstacle to joining the
Global LEI System. To achieve accreditation from the GLEIF, the LOU
needs to be able to comply with the operational and technical standards
and protocols.

Moreover, simply collecting data is not a solution. Analysts needs a
tool that would allow them to track the links existing between companies
located in different national jurisdictions. This would require additional
capacities for connecting and analysing databases.

Of even greater concern is the issue of data protection. Confidentiality
and privacy restrictions could pose an enormous challenge when
structuring such a system to function on a global scale. In order to avoid
the abuse of information, a proper system of protection must be ensured.
However, finding an effective solution could be a challenge to regulators.
The question is whether lessons can be learnt from the EU experience with
the 4th AML Directive. As discussed, in order to avoid any abuse of the
information collected under this Directive, member states are not required
to make their registers public. Moreover, in addition to specified
authorities, only those with a ‘legitimate interest’ in the information
contained in the registers will be allowed to access to the registers.
Numerous other exceptions designed to protect the confidentiality of
information are provided for. In the UK legislation, there are special
provisions addressing the issues of data protection.

5.6 Blockchain as a potential solution

Perhaps the answer to these challenges can be found in the digital sphere.
In particular, Blockchain technology may be an appropriate platform for
the Global LEI system.

Blockchain is a decentralised ledger that tracks transactions of digital
assets. It can be applied for tracing currency, stocks and bonds, or identity
details. The network is made up of a chain of computers, each of which has
a copy of the ledger and is able to see whether any changes have occurred.

49 AP Dolaney (ed) ‘The global LEI System: A solution for entity data?’ December 2013,
ReferenceDataReview.com.
Blockchain technology is seen as secure as all the computers in the network must verify and approve each transaction as it takes place.

Blockchain technology has already proved relevant to identity databases. Blockchain technology relies on data stored by individuals in a type of locker or escrow account, allowing people to access it on a need-to-know basis. In this way, it reverses the traditional method for establishing identity. Typically, identity is conferred by a national government, which certifies who an individual is and records this in a database. Using Blockchain technology, individuals create and store their own identity on networks of computers that no one person or entity controls, establishing a ‘self-sovereign identity’.

This could be a way of establishing a truly global LEI system. Entities could create and store their own identity on networks of computers. The requirement for registration would be embedded in the structure of the network, eliminating the need for actively supervising the registration process. It would establish a ‘self-sovereign identity’. This could eliminate the need for validation of data which is the greatest source of concern in the context of LEI. It may ensure a relatively smooth process of ensuring that data is up-to-date. As a result, Blockchain technology has the potential of significantly minimising any costs that the Global LEI system may imply. Blockchain technology could drive simplicity and efficiency across the entire process of setting, managing and updating the Global LEI system.

Moving to digital identity underpinned by Blockchain technology would also mitigate the current risk of information loss or theft. It streamlines and de-risks completion of public and private transactions. Currently business often suffers fraud resulting from stolen or incorrect data or poor identification.\(^\text{50}\)

However, regardless of how beneficial it may be for building the Global LEI system, it requires a concerted and co-ordinated effort. The implementation of digital identity is still perceived as a sensitive issue and addresses situational, operational and cultural factors, all of which are important for the development of digital systems. These are some of the non-technical barriers that implementation of the new technology would need to answer. Political consensus as well as agreement among market participants would be essential.

The GLEIF recently launched a research project called GLEIS 2.0.\(^{51}\) The project is considering the potential of using Blockchain technology.

6 Global LEI system and curbing illicit financial flows

The LEI and the Global LEI systems collect data that may contribute to the prevention of money laundering and other types of illicit financial flows.\(^{52}\) These systems could play a significant role in increasing the effectiveness of know-your-customer due diligence, particularly in correspondent banking. Since the know-your-customer due diligence process is complex, costly, time-consuming and labour-intensive, special utilities were designed with the intent of storing relevant due diligence information in a single repository. The Global LEI system could become an efficient global standard for the purpose of these utilities and information sharing mechanisms by offering a centralised database.\(^{53}\) Moreover, the widespread use of LEI could assist financial institutions to identify specific entities with a high level of certainty and increase the effectiveness of automatic screening packages, particularly for identifying sanctioned entities.\(^{54}\) The LEI may also facilitate the consolidation of information received in financial intelligence units by more easily identifying transactions undertaken by the same entity but reported by different financial institutions.\(^{55}\)

7 Global LEI system and a Global Beneficial Ownership Register

The Global LEI system is a model that was developed by a regulatory will with a global reach. Currently, many discuss the need for developing another global register. A number of scandals, from the Swiss UBS bank scandal and the Lichtenstein tax data leak, to the Offshore Secrets leaks and the Panama Papers, have revealed the need for more transparency with respect to beneficial ownership information. The question is what the lesson is to be drawn from the experience with the Global LEI system to design of a Global Beneficial Ownership Register.

53 As above.
54 As above.
55 As above.
Undoubtedly, the Global LEI system proved that the current technology allows to build a global system. It is possible to gather global interests and incentivize different entities from around the globe to sign up for a global register. Nonetheless, the current framework has some significant limitations. These limitations may have significant implications for the idea of a Global Beneficial Ownership Register.

First, the Global LEI system excludes natural persons. The LEI does not identify who a natural person in control of an entity is. It refers only to entities that belong to the same corporate group. Also, the latest update on scope of information available within the Global LEI system, which is the implementation of relationship data, does not cover who a beneficial owner is. The collection of data about parent entities under the LEI is distinct from the identification of the beneficial owner as defined under the FATF Recommendations or under the Common Reporting Standard.

Second, the LEI captures a well-defined group of entities. Only the population of regulated market participants are obliged to apply for a LEI. In the case of the Global Beneficial Ownership Register, it is practically impossible to define who the group of beneficial owners are. It certainly goes beyond the scope of entities obliged to apply for an LEI.

Third, market participants who are obliged to get a LEI have a clear motivation for registration. They have an interest in acquiring information about their counterparty. This explains why the Global LEI system gained the support of many regulators across the world. It would not be the case for beneficial owners registered in the Global Beneficial Ownership Register. In the current legal, institutional and regulatory framework, beneficial owners have no motivation to disclose their data and be a part of any registry. This raises the question of what benefits should be offered to beneficial owners to support this initiative.

This comparison illustrates that establishing the Global Beneficial Ownership Register, although a feasible task from a technological point of view, may need to overcome more practical hurdles. What may these be?

The first issue refers to trusts. As was seen, the Global LEI system relies on a common interest of capital market participants in assuring financial stability. Trusts that do not participate in the regulated capital market, especially those set up by wealthy individuals in offshore jurisdictions, do not share this interest. What incentives could then be provided to them?

56 LEI ROC (n 46 above) 18.
57 In the process of identifying the owner of the financial account, the Common Reporting Standard relies on the FATF definition of beneficial owner. See OECD Standard for Automatic Exchange of Financial Account Information on Tax Matters 204 57.
The second question addresses the conditions for regulation of retail investments. The current framework does not require retail investors to register. In fact, the scope of LEI is limited only to investment firms. It means that as long as someone invests in his own capacity, and not as an intermediary, there is no obligation to report using a LEI. It is a significant limitation to a scope of entities potentially covered by the register. How can that be changed? It seems that it is up to regulators to decide whether retail investors should also use a LEI.

Finally, the third doubt is whether we can unknowingly agree on the designatory data to be supplied. Perhaps the Common Reporting Standard can provide an interesting example. The Common Reporting Standard is built upon the FATF definition of beneficial owner. This means that reporting persons obliged by the standard to provide information to financial institutions are any natural persons that meet the definition of a beneficial owner as set by the FATF. It means that the standard captures all beneficial owners that own a specified financial account. There is still a need for a register that supplements the available information by providing some data on other beneficial owners that will not be captured by the standard.

8 Opportunities for developing countries

The promotion of a global register could be especially beneficial for developing countries that suffer from market abuse, tax evasion, aggressive tax planning and other types of illicit financial flows. Many of the least developed countries have substandard institutions and inadequate regulatory structures. The existence of legal loopholes and financial secrecy exacerbate the situation, making them even more susceptible to abuse. All of these factors contribute to entrenched impunity of those benefiting from illicit flows, which substantially weaken their economies. The ineffective response to this challenge is too often the responsibility of a fragmented network of different law enforcement agencies, tax administrations and financial intelligence units that neither cooperate nor undertake coherent operations. This is why setting up a domestic register – as is the case in the EU – might be not feasible at the moment in many of the least developed countries.

The Global LEI system could offer developing countries several effective solutions to existing problems. The system has the capability to improve the efficiency of their resource-constrained agencies. At the same

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58 As above.
time, the increased uniformity on available information would also simplify procedures and make them much less expensive. The cost of participation in the Global LEI would be limited to the issuance of the new law imposing obligations on market participants to employ the LEI when concluding contracts. From the perspective of developing countries, the crucial advantage of the Global LEI system is that it is financed by fees paid by legal entities. Countries deciding to rely on the LEI within its regulatory framework do not have to bear any additional costs. In this way, participation in the Global LEI system would directly impact developing countries’ ability to access information.

Since the Global LEI will aggregate information from most jurisdictions, the limited treaty network that currently appears to be a critical issue and prevents an intensive exchange of information would disappear as a barrier for tracing or detecting illicit activities. Although it is now changing and many less-developed countries joined the Multilateral Convention on Mutual Administrative Assistance, the capacity to safely store and use data is still a common issue. These countries are not able to track financial flows. The Global LEI system could solve this problem by offering access to the collection of data.

9 Conclusions

Accomplishing genuine change and improving the transparency demands global answers. It appears to be a prerequisite of building the effectiveness of legal, regulatory and institutional frameworks with respect to beneficial ownership transparency. Only those solutions having worldwide scope will effectively prevent tax avoidance, tax evasion and other types of illicit financial flows.

Most regulators have insufficient data and this is a particularly crucial issue for developing countries. Although many countries are now moving for domestic registers, the question remains of how to access data cross-border. Developing one common register would overcome these issues. It would minimise the need for the exchange of information and substantially contribute to a better allocation of scarce resources. Additionally, it would contribute to aligning standards in different regulatory areas, for example, taxation or finances. From this perspective, the 4th AML Directive may be a good example, but its regional scope may prove to be its most significant weakness.

The Global LEI system could be the answer. Although it was designed to address only specific types of abuse, it could be of benefit to all regulators and contribute to minimising all types of illicit activities.

Drawing a distinct line between market abuse and other types of abusive practices is sometimes difficult. For example, money laundering activities usually also involve market abuse, whereas aggressive tax planning schemes constitute financial abuses. Considering this, the Global LEI system could serve as a powerful source of data which could be utilised by financial regulators, financial intelligence units, tax administrations, and different law enforcement agencies to detect, track, and investigate not only market abuse but all types of illicit activities. Already it has the ambition of becoming relevant for statistics on the balance of payment or in the tax area, in competition laws, combating financial crime or in public procurement.61

The Global LEI system is the best evidence that it is a feasible task to establish a global register. The digitalisation of the LEI could facilitate many processes and mitigate some risks the standard is currently facing. The Global LEI system, when underpinned by the Blockchain technology, particularly could address some security risks and ensure up-to-date information.

However, there are many doubts as to how to create a Beneficial Ownership Register out of it. The Global Beneficial Ownership Register would require to capture a much wider scope of entities than is currently covered by the Global LEI system. As long as wholesale investors only are obliged to use a LEI, the relevance of the Global LEI system is limited. Regulatory willingness is essential to change the rules of the game and oblige other entities to participate in this register. These and other issues will have to be addressed if the global Beneficial Ownership Register were to be established.

Currently, there is no alternative international tool of a global reach. Certain interesting features may be found in the Common Reporting Standard. It gathers data on beneficial owners of financial accounts from all countries around the world that committed to the standard. However, the standard will neither collect data in a global register nor cover all beneficial owners.

Increasing transparency about corporate entities is highly relevant. The global initiative, such as the Global LEI system, provides a unique opportunity to connect corporate dots from all around the globe. Although the Global LEI system is still moving rather slowly, undoubtedly the initiative contributes to making the scenario of global corporate activity slightly less opaque. Therefore, at least it deserves support.

61 LEI ROC ‘Collecting data on direct and ultimate parents of legal entities in the Global LEI Systems – Phase 1’ 10 March 2016
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