

FRAUD

Anti-money laundering measures and tax fraud enquiries

BY CLAIRE SPENCER



It is often the case that cases of money laundering and tax fraud seem to rise during a downturn. This economic downturn is no exception, and has led to a surge in white collar crime. However, pinning the rise to a single factor is difficult to justify, and unlikely to be correct – ultimately, there are myriad drivers. For example, because companies and regulators are tightening up on their systems and controls, either because of other instances of fraud or as a reaction to the general market conditions, it is likely that more cases of money laundering and/or tax fraud will be discovered. But regardless of the cause, companies that do not have an adequate mitigation strategy in place for such risks would be well-advised to do so, considering the continuing ascent in the number of cases.

A spotlight on financial crime

But instances tend to fluctuate by country and sector, and not all types of fraud are created equal. “The current environment tends to open opportunities for criminal activity within both business organisations and government programs, but tax fraud, on the other hand, tends to remain fairly consistent. In thriving economic times individuals and businesses are making more money and don’t want to pay their required share and in

economic downturns, individuals and businesses look to reduce their tax burden so they can have more money to spend or keep their business afloat,” explains David Gannaway, a director at Marks Paneth & Shron LLP. He adds that tax fraud is primarily driven by greed, although simply having the opportunity to commit fraud cannot be ignored – the individual business person or company owner has the greatest opportunity to not report all of their income or claim/create fictitious business deductions.

But regardless of the drivers behind the law-breaking, the fact that an increasing number of cases are coming to light has had an effect. In the US, Mr Gannaway notes that the recent case involving UBS, the Swiss government and the IRS has had a strong impact on the reporting of foreign bank accounts, and the income earned from or through those accounts. “For many years, Switzerland has been characterised as a tax haven country where proceeds from a crime or unreported income could remain untraceable, and not be disclosed to the IRS. Since UBS has cooperated with the IRS and disclosed a limited number of client names, many of whom reside in the New York area, and the Swiss government has entered into a new Tax Treaty with the US, the landscape has completely changed. Some of the Swiss-based banks have closed

accounts of Americans as a result of the deferred prosecution agreement with UBS.” He explains that by closing the accounts, such individuals have been forced to repatriate the funds into the US, thereby causing income taxes to be paid on the earnings starting in 2009. Indeed, the Bill compels foreign financial institutions, trusts and corporations to provide information about their US account holders, and aims to give the IRS new tools to detect and discourage offshore tax evasion. Further, the US Joint Committee on Taxation estimated that the provisions of the new Bill would prevent taxpayers from evading \$8.5bn in US tax over the next decade.

It should also be noted that this case is also an example of cross-border enforcement, which has become increasingly common in the last few years. Another such example occurred in 2008, when Siemens was successfully prosecuted for bribery in the US, Germany and a number of other jurisdictions – which cumulated in the firm paying record fines of \$1.36bn. These cases may be unusually large, but as detection of white collar crime and enforcement of penalties seems to be intensifying, companies need to be thinking about how they can mitigate fraud risk, if they are yet to do so. To start at the beginning, a fraud risk assessment is very useful – it should cover a company’s business policies and internal controls, and should seek to identify the weaknesses that are most likely to provide opportunities to commit fraud. Furthermore, adequate staff training should play a central role to mitigating the risks associated with money laundering and tax fraud, adds Sam Eastwood, a partner at Norton Rose LLP. “In the regulated sector firms will have a Money Laundering Reporting Officer (MLRO), who is obviously important in ensuring the firm’s compliance with anti-money laundering regulations. However, the MLRO can only perform his duties correctly if he is receiving appropriate reports from the staff dealing with customers and the financial dealings of the firm. Workers need to understand their responsibilities in relation to anti-money laundering, and also what sort

of transactions or circumstances should arouse their suspicions," he says.

All change?

The financial crisis may have had other, less predictable effects on how cases of money laundering and tax fraud are detected and enforced. In the UK, the two crimes are handled by two separate agencies: the Serious Organised Crime Agency (SOCA) for money laundering; HM Revenue & Customs (HMRC) for tax fraud. The role of SOCA is to process all 'Suspicious Activity Reports' (SARs), and will give consent to the transaction or investigate further as required. In addition, HMRC also has some responsibility for anti-money laundering regulations with regards to certain types of institution – such as bureaux de changes. Both of these authorities pass cases to be prosecuted to the specialist Revenue and Customs Prosecutions Office (RCPO) – but not for much longer, says Mr Eastwood. "The Attorney General has announced that RCPO is to merge with the CPS, which deals with all crimes except those covered by the SFO and the FSA. The aim of the merger is to improve efficiency and reduce cost, but it remains to be seen what effect this will have on prosecutions in tax fraud and money laundering cases. As a transitional measure, there will be a ring-fenced team dealing with money laundering and tax fraud work, but we cannot be sure how long this will survive in the new enlarged organisation." However, he explains that as long as the specialist prosecutors within RCPO are retained by the CPS post-merger, it is unlikely that there will be a decline in prosecutions, going forward.

Indeed, HMRC has shown that it is willing to experiment with different methods of detection and enforcement in order to reduce instances of tax fraud. For example, earlier this year, it introduced an amnesty for taxpayers with offshore accounts who wish to voluntarily disclose and pay reduced penalties. "A taxpayer who takes advantage of the amnesty – which ends on 12 March 2010 – will be required to pay the tax owing, plus a penalty of 10 percent, or 20 percent for taxpayers written to by the UK government in 2007 who did not respond at that time," explains Mr Eastwood. "However, taxpayers who do not take advantage of the amnesty will be subject to a penalty of between 30 percent and 100 percent of the tax owing and may be subject to criminal prosecution." He adds that, much like the IRS in the US, HMRC has recently obtained authorisation to order over 300 financial institutions with a UK presence to disclose details of UK persons holding offshore accounts. Furthermore, it has also entered into a number of information-sharing agreements (with the Cayman Islands and Liechtenstein, to name but a couple) to try and obtain more information about UK taxpayers who have money offshore. So-called carousel fraud is also under the spotlight – this is where a trader charges VAT to a customer, but then disappears without paying the VAT to HMRC. This has been particularly notable in the area of carbon trading.

For now, it looks as though a more targeted method of tackling tax fraud and money laundering may be here to stay on both sides of the Atlantic. "With the Obama Administration's focus on combating offshore tax evasion, it is

likely that enforcement will be on the rise and the IRS will be taking a hard line on individuals who knowingly and wilfully evade taxes," predicts Mr Gannaway. "A significant pending item to this agenda is the new Tax Treaty between Switzerland and the US. However, there will be minimal impact going forward if the Tax Treaty starting point is 1 January 2010, as many individuals who evaded taxes in the past are aware of the UBS case and many Swiss-based banks have closed the accounts of US individuals. In either scenario, it is likely that the new Tax Treaty, once revealed, will significantly deter US tax evaders from sending unreported income to Switzerland in the future," he asserts. Nonetheless, the time period that Switzerland will provide records to the IRS is critical. If the Swiss Government will now provide bank records to the IRS going back several years, this will have a significant impact on individuals who have evaded taxes through their bank account(s) in Switzerland.

The US and the UK are not alone in having made the detection and enforcement of white collar crimes such as money laundering and tax fraud a priority. Furthermore, cases such as UBS and Siemens demonstrate that countries are increasingly happy to work together to crack down on such crimes. As such, companies will need to be aware of this and, more importantly, must act accordingly to uncover and mitigate potential exposures to fraud and money laundering risks. If they fail to achieve this, the penalties could be severe, and in the current climate, the effect of such penalties may ultimately be magnified to an unmanageable degree. ■



David Gannaway

Director

T: +1 (212) 710 6206

E: dgannaway@markspaneth.com

www.markspaneth.com



David Gannaway, MBA, CFE, CAMS, EA, is a Director in the Litigation and Corporate Financial Advisory Services Group at Marks Paneth & Shron LLP. In this role, he provides comprehensive litigation consulting services with a focus on complex white-collar fraud investigations, forensic accounting, civil and

criminal income tax investigations and anti-money laundering policies and procedures.

Prior to joining Marks Paneth & Shron, Mr. Gannaway was a director in the forensic services practice of a Big Four accounting firm for nearly 2 years, where he worked with external counsel

and led a forensic team. He also served as a special agent with the Criminal Investigation Division of the Internal Revenue Service (IRS) for 17 years. From 1987 to 1991, Mr. Gannaway was a revenue agent with the IRS and conducted audits of sole proprietorship, corporate and partnership tax returns.