Facta + Trade based Money laundering

Only slightly related but both require a bit of homework

Summary

- Facta; what is it
- The impact of facta
- Trade base money laundering (TBML)
- examples of TBML
- The “techniques”
- Red Flags

Foreign Account Tax Compliance Act - **Facta**

- Facta itself is a US law which states that all FFI's have to report to the IRS all accounts/assets held by US Persons/entity and to withold 30 % on payments that meet the definition of a withodable*** payment when made to con-compliant payees* *
- Effective july 2014
- *FFI's , deposit taking FI's (a/o banks), certain insurance companies and others (!)
- ** US Person, someone born in the US (territories) , or someone born outside US but holding a greencard , a US entitity is a company incorporated under US law whereever located
- *** witholdable payment generally refers to most types of US source income such as interest, dividends on US securities, as well as gross proceeds from the sale or redemption of US securities. Please note this does not apply to certain payments made in the course of normal trade or business however reporting will still be required.

Facta

- US law dictates that all US persons/entities, regardless where they are located globally, to report their Tax returns to the IRS

- In order to enforce this the US has made another dictate stating that FFI’S globally will have to report all income/assets on accounts held in he name of US persons/entities and if and when acting as a payor to withold 30 % to non Facta complying payees

- For non resident US persons (additional) tax is due to the US if the local tax is lower than the US equivalent tax (tax up)

Facta

- a payment made by a U.S. payor to a non-compliant foreign financial institution, is required to "deduct and withhold from such payment a tax equal to 30 percent (!) of the amount of such payment

- Bank operating in participating countries will report through their local tax authority towards the IRS
- All this required FI’s to set up policies and check whether their account holders would be seen as a US person/entity and report annually

TBML

- As per PWC report January 2015 ; **80 % of illicit financial financing flows from developing countries are accomplished through trade-based money laundering**

- Banks have a role to play in minimizing the impact of trade-based money laundering by reviewing the trades that are financed and conducting due diligence checks on customers to determine the legitimacy of those trades. Regulators are increasingly focused on ensuring that banks identify where the goods are being shipped; what transportation is used; and whether the goods are potentially used for dual use purposes.
- **Exporters/Importers** need to ensure that they are not dragged into these schemes, sometimes willingly or unwillingly

What is common in your line of business?

when dealing with new clients, new markets it is important to know what is “normal”, remember if it sound to good to be true it usually it

- - a sport company now involved in sugar trade?
- - an exporter shipping shoes at USD 500 a piece ? (and no we are not talking Jimmy Choo’s)
- - “non logical” paperwork under an L/C ?

TBML

- That doesn’t mean each and every transaction which deviates from the norm is TBML however it certainly requires extra due dilligence when noticing a red flag

- As a client you could be dragged into a transaction which from your side would look quite normal but in the bigger scheme of things could be part of an elaborate taxevasion scheme

Common TBML techniques

- Under invoicing
- Over invoicing
- Multi invoicing
- Over and under shipment
- Fraudulent description of trade goods
- Phantom shipment

Under invoicing

- Exporter ships potatoes for EUR 50 per MT whereas the current market for potato is at EUR 125
- Although from a book keeping perspective this would create a loss, the end result is money which now has a supposedly “clean” origin

- Second senario, the potatoes invoiced under market value yet freight charges are overstated, this usually to avoid paying taxes, duties
- Please note this can be already done with differences in the range of 5 to 10 % making it quite difficult to discover

Over invoicing

Exporter inflates amount invoice when exporting under l/c or overstates quantity

- To apply for Tax incentives when exporting certain goods
- Evading capital controls buy placing “overpaid” funds into an offshore account
- Moneylaundering by creating artificial profits

- As an exporter or importer you might be abused in such a scheme without knowing it!

Multi invoicing

- Transaction is “sold” multiple times on paper under various instruments
- 1 l/c receives the actual title documents, another one receives copies (and this can be replicated multiple times)
- Please note that this does not automatically mean that every lc requesting for copy docs is trying to over-invoice there could be valid reasons (shipment only takes 2 days and it does not make sense to present original shipping docs under an L/C)

Over / Under shipment

- Similar to over or under invoicing however instead of doctoring the amounts the quantities are manipulated
- to avoid import duties
- to avoid lc charges

- Please note that overshipment can be used for legitimate purpose to compensate for for instance breakage during shipment

Fraudulent description of goods

- - for instance shipping goods appearing on the Cites list (such a endangered wood)
- - dual use i.e. misrepresenting goods to avoid discovery
- - tax incentive i.e. on paper ship goods which are eligible for a tax incentive or subsidies
- - foreign currency control, ship goods on paper which are allowed to import which otherwise would not allow for access to foreign currency

Phantom Shipment

- No actual shipment by either only presenting non-title documents or even by falsifying shipping documents

- - pescanova
- - Simetal

Red Flags

- Transaction flows to illogical countries (selling refrigerators to eskimos on the north pole)
- Over extending letters of credit by amending time and time again
- Mismatch on import and export leg when dealing with Trading companies
- Prepayments on high value goods to high risk counterparts or countries
- (Cash) payments from third parties not directly involved in the transaction

Red Flags

- Documents request do not evidence actual and correct shipment
- client is vague about it's line of business, ownership etc
- Background of client is not inline with the current business (a succesfull grocery shop going into the export of crude oil)
- Public domain email addresses (hotmail, gmail, yahoo)
- Size of the business is out of line with the size of the company
- Logic of the shipment when shipping through various jurisdiction or entities
- Quantity/amount of the transaction in relation to the instrument (example high value goods under doc collection) or quantities which when looked upon closer do not make sense due to their sheer size (sugar equal to brazils annual production in 1 single shipment)
- "End user" is a freight company
- Discrepant documents under letters of credit evidencing over shipment

Red Flags

- Shipment not in line with lc (different ports)
- Complex trade structures which look overly complicated
- Incorrect packaging; 40 foot container for parcel of spareparts weighing 10 kilos
- High value goods ; precious metals/stones, electronics, cars

conclusion

- Use common sense
- Don’t be afraid to ask questions
- You should be able to explain !