HKMA Seminar

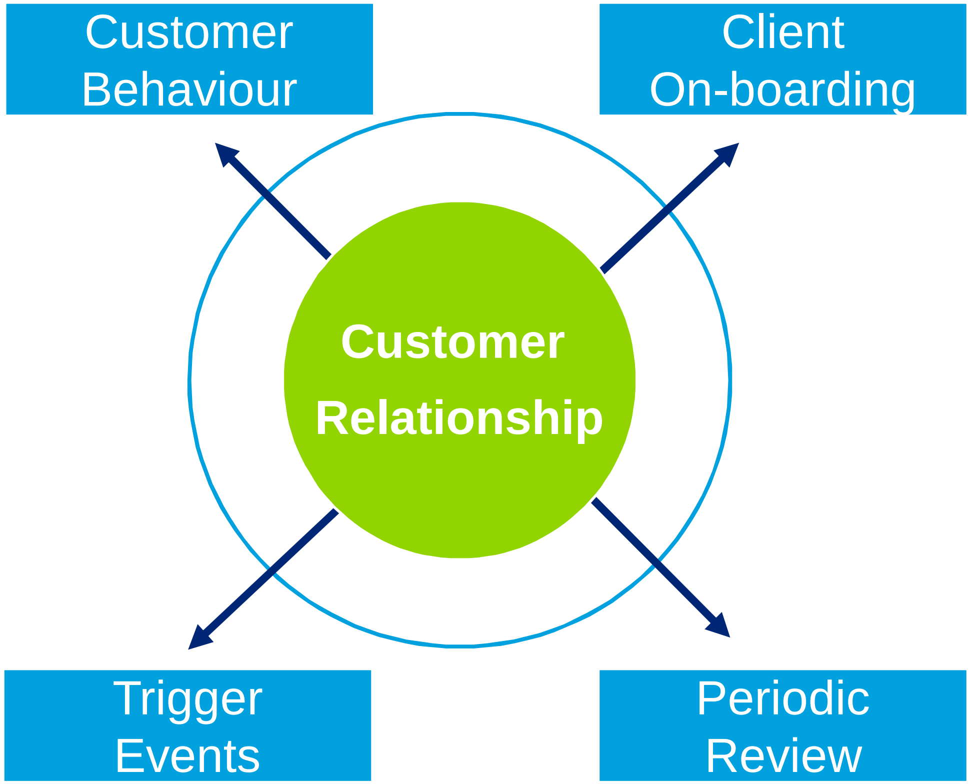
Tax Evasion in Hong Kong

30 October 2013

Contents - Control environment and risk mitigation

Know Your Customer

Understanding the customer tax risk profile



- Customer tax risk is initially assessed during the on-boarding process
- Periodic customer review process includes tax risk
- Trigger events requires reassessment of the customer's tax risk profile
- Ongoing monitoring of the customer's behavior leads to a reassessment of the customer's tax risk profile

Know Your Customer

Difference of regional standards

- Tax evasion is considered to be part of AML/CFT
  - Similar to AML/CFT, based on the jurisdiction, laws and regulations can differ
  - FIs policies can be identical or take local differences into account

Considerations regarding exiting customer relationships

- Risk assessments lead to escalation strategies, in which the exit of customer relationship is a potential outcome
  - Over a period of time the client's tax risk assessment can change
  - The client risk is considered too high to continue a banking relationship
- Compliance costs of certain client clusters have led to exiting moves in Europe
  - A result of FATCA, instead of charging American customers higher fees to offset the new costs, banks simply decided to shut down the accounts (money.cnn.com)
- Reputational risks might be considered differently in different markets, and the compliance costs can be different in different booking centers
  - Can a FI accept clients in one market and refuse the client in another market?

Voluntary Tax Compliance Programmes

Voluntary Disclosure

Customer actions

- Letter stating the intention of a customer to participate in a Voluntary Disclosure Programme
- Demand for copies of several years of account statements, portfolio statements or others
- Demand for copies of ‘all documents’ entitled to receive under local jurisdiction

Impact

- Reassessment of the Customer Risk Rating
- Working information flow between Relationship Managers, Compliance, Legal and Middle Office
- Production of standard set of documents for voluntary disclosures requests is supported by IT systems
- Document retention period is sufficiently long to handle requests to produce client documentation

Tax evasion

Examples of Red Flags

Customer Structure

- Structures used to avoid declaring certain information to banks
- Trust structure in order to avoid presenting detailed BO information

Corporate Governance

- Client uses a structure but does not follow the set of laws
- Rubber stamping in Trust structures
- Personal expenses paid with trust funds
- BO of a trust in a direct relationship with the bank

Suspicious Transactions

- Transactions with amounts below reporting thresholds
- Transfers or cash withdrawals split into amounts of less than USD10,000
- Withdrawals by legal representative without apparent business reason
- Tax representative regularly withdraws cash in large amounts

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Examples of Red Flags

Customer Nationality

- Customer fails to disclose dual citizenships or tax domicile
- Indicators of undisclosed nexus of customers through phone numbers in different jurisdictions, place of issue of passport, etc

Hold Mail

- Hold mail agreements over extended period of time / permanently
- Requests to have hardcopy documents retained for a short time only or personal collection with long time spans in between

Customer Interaction

- Passive role of the customer, little interaction
- Customers demands not to be contacted directly by the bank
- Personal contacts only when customer is visiting the country

Tax evasion

Examples of Red Flags

Soft Indicators

- Customer shows greater than normal interest in tax related topics
- Customer concerns about regulatory reporting by the bank
- Any communication and questions from customer that might indicate the customer has undeclared funds or evades taxes

Investment Types

- Few transactions on the customer's funds
- Investments in stocks without withholding tax

Cash and Cash-equivalent transactions

- Funds are withdrawn in such ways that the expenditure cannot be traced
- Credit card invoices of cards that are not part of the bank accounts
- Use of traveller's cheques

Suggested Approaches

Re-assessment of AML framework in regard to Tax Evasion Risk

- Risk assessments lead to escalation strategies in which the exit of customer relationship is a potential outcome
- Conduct a gap analysis between laws & regulations and local policies
- Document relevant processes relating to tax evasion within the organization
- Remediate gaps identified in policies and processes
- Test identified controls and processes
- Review client files
- Test transaction monitoring scenarios
- Test suspicious transaction reporting
- Regional perspective - regional policies

Suggested Approaches

Training

- Design role-specific training modules to address tax-specific red flags
- Ensure frontline staff have an understanding of additional KYC processes / tax evasion typologies
- Ensure Operations have an understanding of additional triggers involved in transaction monitoring and ongoing due diligence

Customer On-boarding

- Include documentation of customer communication regarding tax status
- Risk based questionnaires depending on customer type

On going Monitoring

- Review accounts and decide whether existing risk ratings are still valid
- Update ongoing KYC review methodology to incorporate tax risk-specific factors
- Periodic review of client files as part of AML processes
- Incorporate tax evasion-specific typologies into transaction monitoring systems / exception reporting

Case study – Bank Wegelin

Bank Wegelin ceased to exist in 2013 due to tax evasion of their customers

Bank Wegelin, founded in the year 1741, admitted on 3 December 2012 to having conspired with over 100 American taxpayers to hide USD 1.2 billion from the IRS from 2002 to 2011.

Bank Wegelin initially claimed to have operated in compliance with Swiss law. The bank had no branches outside Switzerland.

Case study – Bank Wegelin

The indictment states that the bank:

- Opened and serviced undeclared accounts, sometimes in the names of sham corporations under the laws of Panama, Hong Kong or Liechtenstein
- Beneficial Ownership was not identified correctly
- Used code names and numbered accounts to avoid having taxpayers' names appear on documents
- Ensured that banking documents were not mailed to the taxpayers' addresses
- Client advisors used their personal email addresses and phones to contact banking clients
- Issued checks in multiple batches or separated wire transfers to keep amounts to USD10,000 or less

Case study – Bank Wegelin

Lessons learnt

- It is not necessary for a FI to do business offshore to get involved in foreign tax evasion matters
- Information gained from FI A can lead to inquiries at FI B
- Tax authorities and regulators might want to receive client information data
- Whistleblowers have high monetary incentives to disclose information to regulators and tax authorities
- Voluntary disclosures allow tax authorities to gain insight into FI’s procedures and employees involved in client relationship management
- Bank employees can face personal inconveniences if tax authorities (e.g. IRS) suspect an employee or the FI of wrongdoing

Thank you

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