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Tax Crime in Asia

Over the past several years, Asia Pacific financial institutions have come under increasing pressure to obtain and retain more information about their customers to meet regulatory requirements, driven by unprecedented global coordination on issues such as AML (anti-money laundering), CTF (countering terrorist financing) – and tax evasion.

In the latter regard, 2018 is a key year for the region, with more than 12 national authorities having signed up to AEOI (Automatic Exchange of Information)[1], which was developed by the OECD (Organisation for Economic Cooperation and Development) to combat cross-border tax evasion by facilitating data sharing between different jurisdictions.

One of the adoptees, Singapore, has adopted the widest approach to AEOI, and requires financial institutions to collect data on all account holders, not just those resident in countries with which it has an agreement. Among more than 60 bilateral relationships, within Asia Pacific the main markets Singapore has agreed to share information with are Australia, Japan, South Korea, Pakistan, Indonesia and India[2].

In the context of global efforts, it could be argued that the Asia Pacific region is at the vanguard of martialling support for anti-tax evasion initiatives, particularly as the US appears to be more generally rolling back from post-crisis regulation more widely.

We see the CRS initiative influencing on national regulations on tax crimes throughout Asian states, developing precedents set in Hong Kong and Singapore, where there is already a legal requirements for financial institutions to proactively screen customers and their assets for tax red flags – to establish tax legitimacy," says Douglas Wolfson, Director, Financial Crime Compliance for LexisNexis Risk Solutions.

On the institutional front, Chinese banks have invested heavily to deal with the risk of breaching laws on tax, money laundering and terrorist financings, particularly as they start to seek more business relationships, and even acquisitions, overseas.

Under pressure

At the same time, governments and financial institutions are also under pressure from the public to come clean on tax. Over the past few years, whistle blowers have become emboldened, and the democratisation of technology has facilitated exposés such as the Panama[3] and Paradise Papers[4].

The latter is a 1.4 terabyte, 13.4 million file cache of documents which was leaked to German newspaper Süddeutsche Zeitung and shared with the International Consortium of Investigative Journalists in 2017.

Unlike the information revealed in the Panama Papers, which preceded the Paradise exposé, there is no evidence the money in the Paradise accounts was obtained illegally. However, the Tax Justice Network's estimates up to USD32 trillion of private wealth could be located in untaxed or lightly taxed jurisdictions[5] – it would be surprising if none of this vast amount of cash weren't the product of illicit activity – and legal tax avoidance using offshore accounts is often a predicate of illegal money laundering. Indeed, in some cases it is assumed by authorities to be direct evidence of such.

So, whether it's from governments or citizens, banks are under growing pressure to act more effectively on financial crime of all forms – whether tax evasion, or processing the proceeds of crimes such as modern slavery.

"Added to this is social pressure – we are seeing banks invest more in ensuring their behaviour meets the expectations of society more generally," explains Wolfson. "Reputation among consumers is paramount, nobody wants to be associated with financial institutions that enable unethical or illegal activities, such as illegal logging, disregard of environmental protections, or exploitative labour practices. Similarly, there is little tolerance of banks that appear to be aiding their clients to evade taxes."

"It's an area in which banks' reputation risk management controls is very real, because it ultimately underpins their perceived trustworthiness," he adds.

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The increasing concern about offshore assets is driven by the fact illicit activity tends to seek the path of least resistance. Typically, established offshore centres have been considered the main locations for tax avoidance, but increasingly the largest financial centres and global cities are becoming the targets of tax evasion campaigns.

"If there is a jurisdiction where it is easier to park assets or avoid tax illegally that is where tax evaders are going to go," Wolfson says. "What this has meant is there is a growing awareness for international collaboration. These intergovernmental initiatives make sure the same standards are applied – and enforcement agencies can share more information."

High stakes

The stakes for financial institutions not conforming to national and global tax initiatives are high too.

HSBC has said it could face fines of more than USD1.5 billion for helping clients evade tax by stashing their money with its Swiss private banking unit, citing investigations in multiple jurisdictions including India[6].

In China, the fact the legal framework for its adoption was introduced jointly by its banking, insurance and securities regulators, tax authority, finance ministry and central bank shows how all-encompassing the issue is. The Chinese regime captures commercial banks, securities and futures companies and fund managers, among other financial institutions. Failure to comply can be punished by disciplinary measures including license revocations and industry bans[7].

"We are seeing financial institutions coming under increasing scrutiny," notes Wolfson. "There is more supervision across Asia Pacific and specifically in certain sectors of the financial system, such as private banking and wealth management."

At the most basic level, the key questions are to whether money has come from a legitimate source of wealth, and then whether the requisite tax was paid[8]. Institutions need to ask whether they have the resources and solutions to identify and report properly in this new era of tax transparency. Do they have the right information in their legacy databases, and if not, can they capture it? Do they have an efficient conduit through which to deliver huge amounts of information which tax authorities now require?

Arguably, the fact that the computing power available today has made it possible for inquisitive individuals to analyse and make sense of millions of documents should be some comfort as well as a concern for financial institutions – if citizen journalists can do it, then so can banks.

The economic imperative

But AEOI, CRS (the Common Reporting Standard)[9], and campaigns against tax avoidance are not just about increasing global tax transparency. For many countries in Asia Pacific, it is an economic and social imperative.

The revenue squeeze many governments around the world have faced since the 2008/09 global financial crisis is compounded in Southeast Asia, South Asia and other developing Asia Pacific economies by the fact tax collection is notoriously ineffective, inefficient, and often unenforced.

According to an OECD report compiled before the 2016 introduction of Indonesia's tax amnesty and other measures to improve revenue collection, Indonesia's tax-to-GDP ratio is a mere 11.8 percent – versus the OECD average of 34.3% – with the figure little better in Malaysia and the Philippines at 15.3% in and 17% , respectively[10].

Meanwhile, the IMF (International Monetary Fund) has said competition in Southeast Asia to attract foreign investment using tax incentives has hurt national revenues, with an official recently describing this as a "race to the bottom"[11]. On the other hand, boosting the tax helps bring people out of poverty and meet growing infrastructure needs to support economic development.

"In terms of the bigger picture, when you look at the costs of tax crime and evasion it has a tremendous impact in terms of government budgets and the delivery of services," Wolfson explains. "Whether it is it is corporate tax evasion or BEPS (Base Erosion and Profit Shifting[12]), or individuals hiding their taxable income or assets from authorities, both have a similar impact. It means wealth is not distributed in the way the laws of individual countries determine – and the most vulnerable and poorest countries are impacted the most."

This confluence of factors mean Asia Pacific governments are increasingly motivated to improve tax transparency through domestic initiatives.

In early March 2018, in the aftermath revelations that more than 3,000 Indonesians had assets stashed in tax havens, Indonesia introduced new transparency standards requiring companies to declare beneficial owners[13].

"The issue of corporate tax evasion is being addressed through these demands for increased transparency – especially on beneficial ownership," says Wolfson. "Fewer types of corporate structure are acceptable from the perspective of compliance risk, and companies in offshore jurisdictions overall are coming under more scrutiny. Today, bank risk assessments often 'red flag' a company's presence in an offshore jurisdiction, which means due diligence is going to be more onerous.

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There have been even more dramatic measures to bring more citizens into the banking and tax systems – and draw out ill-gotten gains kept in cash –including Indian President Narendra Modi's 2016 cancellation of his country's INR1,000 and INR500 notes as legal tender[14].

Virtual reality

The overall challenge is further complicated by Asia Pacific economies' moving ever faster into the virtual realm, according to Wolfson: "There is significant interest in virtual currency, although it is still a young medium for money laundering, terrorist financing and tax evasion, some Asian jurisdictions have gone in quite hard to tackle the problem, as a proactive measure prevent financial crime."

Most recently, Japan introduced a law requiring investors to include cryptocurrency trading profits in their tax returns as "miscellaneous income", subject to a tax rate of 5% to 15%[15].

Among more widely used technologies, authorities across Southeast Asia (Thailand, Vietnam, Indonesia, Malaysia and Singapore, among others) have made or are considering legislative changes to bring online transactions into the corporate, personal and value-added tax net.

Vietnam wants all cross border payments to be made via its National Payment Corporation, although capturing domestic taxable spending is a challenge due to the prevalence of cash invoicing and payment even for online transactions[16] with those using electronic means often not electronically connected to the tax collector's systems[17].

When such measures to bring in more tax work, they can work well. In Vietnam, for example, the tax take increased by 18% year-on-year in the first half of 2017[18].

In India, the government has made the use of Aadhar identity cards, which contain biometric information, compulsory for opening bank account and for obtaining a PAN (Permanent Account Number) for tax[19], although the initiative has met with delays and concerns about data security[20].

The Philippines is planning to create national identity cards including biometrics which will be compulsory for all of its citizens within the next two years[21]. In Indonesia, tax authorities are now able to directly able to access information on bank accounts held by citizens and foreigners, part of efforts to meet its CRS/AEOI obligations and effectively ending banking secrecy[22].

Sharing

"The utility concept is one that will be increasingly promoted because of the benefits of information sharing to prevent a crime are clear," explains Wolfson. "This is not just true of national governments, but also for individual institutions – one might only hold one facet of a customer's activity, but pooling all the facets together makes each individual piece of information more valuable."

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Supranational organisations such as FATF (the Financial Action Task Force) are also extending technical support to emerging Asian jurisdictions to ensure they have the right regulatory and reporting instruments in place. Financial institutions, meanwhile, are realising that it is not just a case of throwing bodies at the issue – which has been the typical reaction to overall more burdensome regulatory and compliance requirements since the last financial crisis.

"The combination of more regulatory pressure and more social pressure is leading to more process-based responses. The temptation in Asia Pacific to throw people at the issue is strong because the cost of labour is relatively low – but there is a growing understanding that this is not sustainable – that more technology and process improvements are needed."

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