Factsheet:

Typologies & Red Flags: Indicators of Tax-Related ML

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Introduction

Tax evasion has become a global concern reducing the ability of governments to raise the revenue required to fill their reserves. Though long associated with money laundering (ML), the criminalisation of tax evasion led to the resulting proceeds being considered as proceeds of crime. Any further use or any efforts to legitimise these proceeds would therefore constitute money laundering.

From a local anti-money laundering and counter-funding of terrorism (AML/CFT) perspective, the definition of money laundering is based on an all-crimes regime, whereby all criminal offences can be predicate offences for money laundering. Given that tax evasion is a criminal offence, it could lead to the act of money laundering as defined in Article 2 of the Prevention of Money Laundering Act (PMLA)[1]. From a global AML/CFT perspective, the Financial Action Task Force (FATF) amended its recommendation in 2012 to include tax evasion as a designated offence for money laundering, and in 2015, the 4th Anti Money Laundering Directive required Member States to include tax crimes as predicate offences for money laundering.

The financial sector is a major contributor to the Maltese economy. Without excluding the local scenario, the sector is structured with the intention to attract mostly foreign operators targeting foreign markets. The flipside of such a system is that it can be abused by foreign individuals and entities to launder proceeds of crime, including the proceeds generated from tax evasion.

Amongst the measures being taken to curb laundering of illicit proceeds, the FIAU conducted a strategic analysis on Suspicious Transaction Reports (STRs) having a tax offence as the indicated predicate offence. Additionally, it is also focusing on providing more guidelines, including typologies and red flags, relating to tax evasion and associated money laundering. The guidance, based also on the strategic analysis referred to hereabove, is intended to increase subject persons' knowledge and enhance their ability to detect and ultimately report situations where they suspect that their services are or have been or are planned to be used to launder funds connected to serious tax evasion.

Whilst acknowledging that it is the subject persons' obligation to report any instance of ML independently of the value of the proceeds of crime involved, it is important to bear in mind that there will be cases of more relevance for the FIAU and the other authorities involved in combatting ML than others. These would include cases presenting one or more of the following elements – significant amounts, complex structures, multi-jurisdictional connections and other foreign elements, etc.

[1] Chapter 373 of the Laws of Malta (see Article 2, precisely the definition of 'criminal activity' and 'money laundering').

The typologies and red flags listed in the next pages have been grouped into categories for ease of reference. Each group of typologies and red flags in this document is accompanied by a symbol. These symbols will also be featured next to the case studies provided in this Factsheet to indicate the typologies and red flags present within the case study. Additionally, the icons will range in size to show the degree of presence in each case study. The group of typologies and red flags are the following:

- Customer's Identification Information
- Entity Structure & Governance
- Unusual or Suspicious Transactions
- Customer Interaction & Behaviour
- Source of Wealth & Source of Funds

Money Laundering Typologies and Red Flags related to Tax Evasion

Typologies are techniques known to be used to launder money, whereas red flags are possible indicators that money laundering and/or funding of terrorism (ML/FT) may be occurring. **If there is an indication of a typology or red flag, this does not automatically mean that ML/FT is taking place**. However, it should set off further questioning or the undertaking of more rigorous due diligence measures, such as obtaining documentation to back up a customer's claims.

Where the subject person is dissatisfied with the information collected after the detection of a typology or a red flag, the subject person should consider whether there are grounds to suspect ML/FT or criminal proceeds and hence file an STR in terms of Regulation 15 of the Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR). Being aware of the common typologies and red flags associated with tax evasion and related money laundering places subject persons in a better position to detect potential cases of ML and prevent the misuse of their services for criminal purposes.

When keeping an eye out for typologies and red flags, **subject persons should bear in mind the context and all relevant factors surrounding the parties and/or the transaction**. It should also be noted that subject persons may have different visibility over the various aspects that form part of the transaction, and therefore **not all the typologies and red flags are relevant to all subject persons**.

Customer's Identification Information

The red flags hereunder may be noted during the onboarding process and at any time throughout a business relationship, typically through information and documents relating to the customer's identity.

At times situations may indicate that a customer has failed to **disclose dual citizenship or tax residence**. In most cases this is not a requirement and would not be considered as wrong or suspicious. However, the act of non-disclosure could be intentional in an attempt to avoid fiscal responsibilities.

Subject persons providing certain services are nowadays required to collect information on the tax residency of their customers due to a number of tax-related reporting obligations. This would be especially relevant where there are differences between a customer's or a beneficial owner's place of birth, nationality, and place of residence or where one has dual or multiple citizenship. This could be noted at onboarding stage but also as the relationship progresses, where a customer provides the subject person with identification documents issued by a country other than that of his nationality or declared place of residence.

There may be situations where the **individual's business would not be in the same jurisdiction as their residential jurisdiction. This is not usually indicative of wrongdoing. However, subject persons should understand whether there is reasonable commercial justification for such**.

Unusual or Suspicious Transactions

During the onboarding process and also through the ongoing monitoring process, subject persons are to remain vigilant to identify any dubious activity that may be taking place.

The first typology which is a typical and common technique to launder tainted funds and which is itself a red flag is **structuring/smurfing**, i.e. when transactions, usually deposits and transfers, are broken up into small amounts to avoid detection and questioning by financial institutions. The Maltese AML/CFT system does not require subject persons to report transactions that exceed a set threshold. Nevertheless, subject persons may make use of thresholds to detect unusual activity on the part of their customers. Individuals and entities may structure their transactions into multiple smaller transactions processed over a period of time and/or through different locations and channels to avoid attracting unwanted attention. Within the context of tax evasion, regular deposits and transfers of smaller amounts may be indicative of the placement of undeclared earnings into the financial system.

While the above is a typology that has been noted particularly with respect to individuals and entities having cash generating activities in Malta, individuals or entities whose activities do not generate that much cash can still make use of a similar method involving **wire transferring**. This would involve the transferring of funds electronically across a network of banks or transfer agencies around the world. The red flag revolves around wire transferring without any legitimate business-related reason for such a transfer to occur. In other words, wire transferring would be the instrument facilitating, and at the same time concealing, the financial flow of money from one jurisdiction to another, which would usually offer tax advantages or may otherwise be listed as a non-cooperative jurisdiction. When the transactions occurring do not make economical, legitimate or a business sense then these transactions might be indicative of tax evasion.

Subject persons should also remain vigilant when a **transaction is not in line with the known customer profile**. It could be the buying of a highly-expensive car or repeatedly acquiring immovable properties when the individual is on minimum wage or declaring a very low income – this could be indicative of undeclared earnings. Within a corporate context, one should be attentive to any income generation or expenses incurred which may be indicative of an activity other than the one that the entity is known to carry out. Receiving income as consultancy fees when the company is not known to provide any such service nor as having any expertise or involvement in the particular subject may be one instance indicative of such a scenario.

The **establishment of a company in a jurisdiction where the company does not actually have any presence or conduct any activities** is also a further red flag to consider and is a known typology used to allow the movement of funds between different jurisdictions. The end purpose may be to disguise as much as possible fund movements and render their tracing as difficult as possible. While it is acknowledged that there are activities that do not require any particular level of activity or presence, the commercial purpose behind the incorporation of such legal entities should be questioned and understood, especially if it does not seem that the said entity have the ability to conduct any income generating activity. This to avoid situations where these entities are merely used as conduits to channel funds from one jurisdiction to another, possibly inflating costs in the process. This is especially relevant in the context of non-residents establishing entities in Malta.

The **use of shareholders' loans to finance corporate activities** may also be a further indicator of possible misuse of corporate vehicles for laundering the proceeds of tax evasion, especially where it results that the **amounts lent to the corporate entity are not in keeping with known customer profile and financial resources**.

Although there may be legitimate reasons for the granting of these loans, it is also true that their repeated occurrence, particularly when these loans are offered at very favourable conditions, and may even end up unpaid, should be considered as an important red flag that something amiss is taking place within the local entity. One should also consider how the total amount of any such loans compares with the overall value of the company's balance sheet.

The emphasis on the subject person's obligation to conduct proper due diligence and ongoing monitoring, as explained within the Implementing Procedures Part I (Chapter 4) is brought to the forefront when subject persons **encounter inconsistent withdrawals or deposits where the origins are not justified or are incompatible with the purpose of the account**, as documented in the customer records.

Other ML/FT typologies and red flags include the following:

- An entity that does not report any revenue but has executed transactions which have been reported by third parties. For example, Company A is not declaring any income. However, through evidence derived from Company B it would indicate that Company A is operating, transacting and making profits which shows that income is not being declared or is otherwise being underdeclared.
- Under or overvaluing goods and/or services where the declared value on the invoices for these goods and/or services does not reflect the market value. At times, the poor quality of an invoice can be an extremely important red flag. Invoices having a basic description of the goods or services supplied or that was issued at a point in time that defies temporal logic should all lead the subject person to question further the nature of the underlying transaction.
- Transactions involving services such as consultancy, marketing or research when the service provider is located in a non-cooperative jurisdiction or does not have the necessary resources to provide such services or it results that the company providing the said services only has inexplicably one or very few customers notwithstanding that it has a particularly high turnover. The commensurate capital outlay required to undertake any such activity easily explains why they can be easily used to inflate costs and justify the transfer of funds from one jurisdiction to another. In these instances, any questioning for supporting documentation would often result in the customer providing an invoice or, at most, very simple contractual terms. However, this should be supplemented through correspondence, presentations, etc. that demonstrate that a service has actually been contracted and delivered. Equally important here would be to determine what kind of nexus there is between the service provider in question, the customer and the jurisdictions involved to see whether any such arrangement makes economic sense or otherwise.

- Circular transactions or round-tripping transactions where funds are reinvested into the original jurisdiction after being transferred to a foreign entity (often, but not necessarily, in a tax haven).
- Funds are withdrawn in ways that the expenditure cannot be tracked. This occurs through the use of payment methods that cannot be tracked easily, such as cash or virtual financial assets, with the intention to divert and hide the trail of transactions.
- The above red flag could also be tied to the commingling of personal and business accounts, whereby business accounts are used to conduct personal transactions.
- Transactions for which there is no economic, commercial or logical explanation.
- Transactions where assets are transferred, including where assets are settled on trust or transferred to similar entities, in circumstances where there is no clear legal and rational choice to account for such transfers, and/or the assets are transferred to non-cooperative jurisdictions.
- Use of material levels of cash in a non-cash intensive business without a commercial or reasonable justification.
- Amount of tax paid in the past, prior to the establishment of an occasional transaction or business relationship with the subject person, is not justified or consistent with the circumstances, facts and documentation available.

Customer Interaction & Behaviour

Customers’ behaviour, including the way they communicate, make requests, or respond to requests from the subject person can at times be indicative of possible wrongdoing or ill intentions. This highlights the importance of the subject person’s customer-facing employees, as the first line of defence, who need to be able to detect any unusual or uncooperative behaviour and escalate it internally if needed.

Customers may show an uncommon interest as to whether income from a particular transaction or activity will be declared or reported. Otherwise, the customer could **ask about tax disclosure requirements other than for legal tax planning purposes**.

The subject person may encounter situations where the **customer provides information which might indicate that the service is being utilized in relation to undeclared funds**.

A **customer requests to use a tax adviser’s client account without a reasonable or commercial justification**. Subject persons are to note that client accounts are used for exceptional situations and they need to be vigilant and check whether a client’s request is genuine and there’s no intent for misuse. Limiting the use of the client account to specific services being provided and limiting the type of funds received in the client account (e.g. limiting incoming funds from non-reputable or high risk jurisdictions or funds coming from a foreign, non-EU/EEA credit or financial institution) should be considered. Additionally, the subject person should know who they are receiving funds from and should ensure that the value is commensurate with the intended purpose by cross-checking the information of the payments received against the services being provided. It is also recommended that the subject person accepts only electronic transfers of funds to limit the depositing of cash into the client account which would generate anonymity. Finally, a subject person should also scrutinise client instructions to ensure that the funds are only transferred out of the client account in the manner and to the beneficiaries that have been agreed to, and these instructions should make logical and economic sense.

Other ML/FT typologies and red flags include the following:

- A customer shows concerns about regulatory reporting by the subject person (e.g.: the customer asks, directly or indirectly, whether the subject person will declare their earnings to the respective authorities).
- The subject person realises that the customer did not file one or more tax returns or other prescribed documents and refuses to correct defaults.
- The subject person realises that the customer did not settle tax due on time and refuses to correct defaults and/or to settle unpaid tax.
- The subject person identifies one or more transactions as having been undertaken to try and evade taxes, or any other communication with the customer gives rise to suspicion that the customer has undeclared funds or evades taxes.
- The customer insists that they should not be contacted by the subject person directly. Similarly, the customer refuses any form of contact or communication with the subject person.
- The customer demands exceptionally high and atypical levels of confidentiality.
- The customer opens an account or requests a service when visiting the jurisdiction temporarily, without showing any apparent link with the jurisdiction or substantial reason in terms of assets, liabilities or activities to justify doing so.
- The customer requests to close the account upon the subject person's request for additional information on tax-related matters.
- A discrepancy between the customer's organisation structure and/or transactions and the documentation recorded on file.
- The customer opens an account and funds are transferred to/from non-cooperative jurisdictions or jurisdictions with recent material changes in their tax regime.
- The customer is non-compliant with tax obligations for a number of years.
- The customer refuses to provide information required to comply with international tax obligations, including documentation regarding declared income in their country of origin.
- The subject person has reason to suspect or believe that the customer is not complying with tax reporting obligations in other countries.
- The customer becomes uncooperative when due diligence is carried out (whether at onboarding stage or during the relationship).
- The customer requests or suggests not to disclose any pertinent information to the tax authorities where the disclosure of that information is required in terms of law.
- The incorporation of companies which are then abandoned shortly after their establishment.
- Adverse media, such as allegations of tax fraud or convictions on tax crimes, related to tax on the customer or any connected parties. In this regard, subject persons are to bear in mind the guidance provided in the Implementing Procedures – Part I with respect to the assessment of adverse media for risk assessment purposes which is equally applicable in these circumstances.
- False statements or documents relating to tax.
- The customer is unwilling to take advantage of tax mitigation opportunities available in certain specific circumstances with no reasonable explanation for such unwillingness.
- The customer shows apparent willingness to pay fees above market rates.
- The subject person discovers information or data showing that the customer has a history of tax advisor/other advisors shopping with no satisfactory explanation.

- The customer requests advice in connection with the repatriation of income or capital from a foreign jurisdiction without a reasonable or commercial justification related to the origins of the wealth.
- The customer asks for advice in regard to a proposed change of residence with no genuine intention of actually taking up residence.

Entity Structure & Governance

At times, the processes and practises adopted to direct and manage a corporate entity may indicate potential malpractice, including the possibility of tax evasion.

Subject persons may identify certain typologies and red flags related to the system of rules, practices and processes adopted to direct and manage an entity.

A common typology in tax evasion cases associated with companies is **rubber stamping,** i.e. when company officials carry out instructions given by a company's beneficial owner without questioning the same. Case in point would be a company director who would automatically approve company operations or transactions without proper consideration. In other words, these are instances where transactions are approved by a director without any indication of discussions and, through the interaction with the director, the subject person notes that the individual has no idea of the transaction's background/purpose.

Linked to the above ML/FT red flag, the subject person could suspect that the **administrative body of an entity, such as a company's board of directors, manifestly lacks the skill or time to properly undertake its function**. The subject person needs to achieve reasonable comfort that adequate arrangements are in place in the entity to ensure that the required functions are adequately executed.

Another ML/FT typology which is also included in the case studies is the **commingling of personal and business accounts**. Individuals are often advised by credit institutions that the indiscriminate use of personal accounts for business purposes is against bank policies. Nevertheless, during statutory audits, personal bank accounts are not typically looked at, and as such, income being passed through personal accounts could remain unaccounted for and undeclared. At times, individuals might carry out transactions using their business bank accounts that relate to personal non-business expenses to inflate their business expenses to reduce their tax burden. Personal accounts might also be used to receive payments that are business related, thus reducing the company's chargeable income.

A common ML/FT typology and red flag which also features in tax-related ML as well is the **use of inexplicably intricate structures**. This means that the complex structure has no clear and reasonable commercial purpose nor some rational explanation for being so. In other words there is no justification for this structure to be so complicated, when a simple structure would have been enough for the purpose. In addition, regard should be had as to whether the structure in itself makes it more difficult to determine who is the actual beneficial owner (BO). The concealment of the BO is of particular relevance for ML related to tax evasion.

Structures may be created with the intention of hiding information or to make it problematic to obtain specific information, such as beneficial ownership information. For example, there could be a trust or foundation which was established in a jurisdiction where there is no requirement to disclose beneficiaries. Structures with multiple entities within them, especially those across multiple jurisdictions, are usually set up based on professional tax advice. In situations where the **customer explains that the entities are structured in this manner for tax optimization purposes**, subject persons should request a copy of the tax advice to verify whether this was actually the case.

A **sudden, unexplained increase in revenue within an entity or a non-commensurate high revenue within a newly-formed company** is also considered a red flag requiring further scrutiny.

In the context of **cash-intensive businesses,** having a business that transacts heavily in cash should not, in and of itself, be considered as a red flag as such businesses are usually completely legitimate. However, a cash-intensive business is an entity that is exposed to a higher possibility of tax evasion. This can take place principally through the commingling of illicitly obtained funds with the proceeds of the legitimate business, and/or through undeclared cash sales. More caution should therefore be exercised when monitoring the activities and deposits of such entities. This is particularly relevant in the context of locally owned entities, where account activity may belie what is declared in the company's financial statements and may point at higher levels of activity and higher levels of profits than what is declared.

Of equal concern, especially in relation to domestically owned companies but not exclusively, are **companies which repeatedly fail to comply with their statutorily duty to file copies of their financial statements with the Malta Business Registry**. The absence of these documents limits anyone's ability to actually assess whether the nature and volume of activities conducted and declared by the company is in keeping with what has been disclosed in the financial statements, including when any such assessment is to be carried out by the tax authorities amongst others.

The **absence of a local footprint** is a further red flag to be taken into account. While it is recognised that foreign-owned local companies at times encounter difficulties in opening accounts with local institutions, the same cannot be said of companies that are locally owned and active. The question should be asked as to what might be the reason for a Maltese registered company, owned by locals and active in Malta not to have an account with a local credit or financial institution.

Other ML/FT typologies and red flags include the following:

- The setting up of two or more trading companies in different jurisdictions having the same company name without a commercial reason.
- The structure includes the use of bearer shares.
- The use of fiduciary shareholders within the entity structure with no clear and legitimate purpose or justification.
- The entity maintains materially incomplete records which would undermine the integrity and reliability of the records required for the proper determination of tax due.

Source of Funds & Source of Wealth

When referring to the source of wealth, this means the economic activity or activities that generate the customer's wealth (be it income through employment, business, or inheritance). The source of funds on the other hand is the activity, event, business, occupation or employment generating the funds used in a particular transaction, or to be used in future transactions. Understanding the customer's source of wealth and the source of funds behind a given transaction or set of transactions allows the subject person to establish that the funds have been derived legitimately. Moreover, it gives the subject person a picture of the type and nature of transactions and behaviour to be expected from the customer. The FIAU Implementing Procedures Part I provide additional guidance in Section 4.4.3. The following red flags relate to information and/or documents on source of wealth and source of funds.

- Where the **customer is unable or is unwilling to provide information and/or documentation on the source of funds and source of wealth** when so requested.
- When there are doubts about the information and/or documents provided on the **source of wealth or funds, as they seem odd or not sufficiently clear as to their source.** For instance, the information and documentation provided does not allow the subject person to reasonably conclude that the funds or wealth are derived from a history of investments, commercial gain, or family wealth.
- There are **indications that funds have not been properly declared to the tax authorities**. It is to be noted that subject persons do not have a specific obligation to establish that income has been properly declared to tax authorities. However, at times, the failure to declare becomes evident from the customer's behaviour or from the nature of the transaction. E.g.: the customer tells the subject person that funds have not been declared.
- Throughout the relationship, **the transactions being made or received would not be in line with the source of wealth and expected source of funds information held on file**. This may be an indicator of an additional income stream which the customer has not disclosed.
- The **source of funds information provided does not tally with the services being requested**. E.g.: a customer with an allegedly moderate income or revenue requesting services that are more appropriate for larger businesses.

Other ML/FT typologies and red flags include the following:

- Frequent amounts of deposits from unexplained sources.
- High volume of banking transactions within a short period of time.
- Sales and purchases are not backed by invoices or proper documentation, or there are doubts about the legitimacy of such documentation.

Case Studies

This section provides a number of local case studies analysed by the FIAU on the basis of reports submitted by subject persons and other intelligence in its possession.

Case Study 1

The FIAU received intelligence from a credit institution concerning a local individual who was **suspected of having under declared his income to the tax authorities**. During a periodic review of the business account, the credit institution noted a number of **credits being deposited into the individual's personal bank account from his business account which was held with the same bank**. The payments were **marked as being loan repayments to the shareholder** and as such, documentation to justify the payments was requested. The **individual was hesitant to provide the documents** which prompted the credit institution to request a face-to-face meeting with the customer. During the meeting, financial statements were presented as well as the respective tax returns. Following a detailed analysis of the documentation, the subject person noted that the **declared income for the year was approximately €1,000,000 whilst the total credits (excluding inter account transfers) in the bank account were much higher, at €1,200,000**. A suspicious report was submitted to the FIAU. The FIAU carried out further analysis on the individual's other bank accounts as well as a review of properties that were purchased by the individual. The report was sent to the Officer of the Commissioner for Revenue on the **suspicion of under declaring the company's income.**

Typologies and red flags to take into consideration:

- Commingling of funds between personal accounts and business accounts.
- Customer does not cooperate with the subject person.
- Numerous payments deposited in the personal bank account and indicated as being loan repayments to the shareholder.
- Under-declaring the company's income.

Case Study 2

The FIAU received intelligence from a local credit institution regarding a company registered in Jurisdiction ‘G’ which provided the services of affiliate marketing, having two beneficial owners, one resident in Jurisdiction ‘H’ and the other in Jurisdiction ‘I’. During a routine check, the credit institution was reviewing the documentation held belonging to several transactions and noted certain suspicious patterns relating to the invoices. **The shareholders of the company were issuing invoices addressed to the company requesting payment for services given to the company which did not make sense with the activity of the company.** Additionally, the subject person noted that whilst payments would be received throughout the month, the corresponding invoices would always be dated at the end of the month. Furthermore, the credit institution noted that **several transactions that were carried out from the personal accounts of the individuals, were most likely business-related transactions**. The FIAU carried out further analysis to establish whether the company or the individuals had any other ties to Malta, however no evidence of this was found. In total, **approximately €650,000 passed through the personal accounts of the BOs**. The intelligence was shared with two counterpart FIUs for further analysis.

Typologies and red flags to take into consideration:

- Transactions not in line with the customer’s profile.
- Discrepancy between the customer’s expected transactions as recorded on file, and the actual transactions being carried out.
- Alleged false invoices, statements and documents.
- Commingling of funds between personal accounts and business accounts.
- The only apparent link to Malta which was identified was the credit institution. No other ties were discovered.

Case Study 3

The FIAU received information from a credit institution that a Maltese registered company, “Company A” (whose trading activity is holding/trading of investments) requested to **transfer EUR 37,000 to** “Company B”, registered in Jurisdiction C. The FIAU was also informed that during a face-to-face meeting held with the ultimate beneficial owner (“Mr X”) of Company A, Mr X stated that the **payment represented the repayment of a loan between Company A and Company B**. It is pertinent to note that Mr X is the ultimate beneficial owner of Company A, Company B and Foundation C. Mr X is also one of the partners in Company V, registered in Jurisdiction H, which is an international tax consultancy firm.

The FIAU obtained information from credit institutions in relation to Mr X, the FIAU was informed that **Mr X has a special tax status by way of ‘The Residence Programme 2014’ and is not a subject to tax in Malta**.

Furthermore, from the transactional analysis conducted, it was identified that **funds were being sent from or received by Company A and then these funds were received or sent either to other companies, who’s ultimate beneficial owner is Mr X or towards personal accounts held by Mr X, held in other jurisdictions**.

Additionally, the **FIAU has also discovered that Company A, the holding/trading of investments company, purchased a yacht and Company V, the international tax consultancy firm, acquired a jet**.

The FIAU received information from the Jurisdiction H FIU noting down that the:

- Jurisdiction H national has made no declaration of foreign sourced income.
- There is suspicion that the Jurisdiction H national is using the Malta structure for tax fraud.
- Jurisdiction H national has minimal declarations in Jurisdiction H.

Typologies and red flags to take into consideration:

- The setting up of multi-jurisdictional structures.
- Purchases which are not in line with the trading activity of the company.
- Payments deposited in the personal bank accounts and business accounts and indicated as shareholder's loans.
- Use of means, other than dividends for profits, generated by these entities to flow to their local owners.
- Commingling of funds between personal and business accounts.
- Indications that funds have not been properly declared to the tax authorities.

Case Study 4

The FIAU received intelligence from a local subject person regarding a Maltese registered entity, B Operations Limited, a company providing consultancy services to oil and gas platforms. The company director and owner was a **Jurisdiction A national residing in Jurisdiction C**. The FIAU was provided with the individual's CV, which indicated that this person, **an engineer, was previously employed by a Jurisdiction D shipping company that was subject to adverse media**.

The onboarding documentation stated that B Operations Limited was to be managed from Malta, however both the analysis carried out by the FIAU and the subject person did not support this statement. The **FIAU were unable to justify the company's presence in Malta, or even the need for a local bank account**. During the same analysis it was also noted that **the larger majority of debits would take place immediately after funds were received**. In the account opening documentation, the **company's director indicated that the expected account turnover would be approximately EUR240,000 per year, however over EUR2,000,000 were observed in the previous year**.

Whilst the company could have been set up in Malta to minimize tax incidence, the FIAU was unable to confirm this because the **company had not submitted its' tax returns in previous years**. Given the above-mentioned observations, the **FIAU suspected that the company was being used to layer funds, whereby funds were primarily being received from two foreign companies, and then transferred to foreign natural persons**. **Adverse media was also found on one of the companies that was remitting funds to B Operations Limited. Several allegations were being made about the company in relation to tax fraud, corruption and illegal arms smuggling**.

Further analysis was carried out on the natural persons who involved in the case, and it was discovered that **one of the BO's father, was also subject to adverse media, involving bribery schemes related to embezzlement from a state-owned Jurisdiction A company**. Considering the adverse media found, a request for information was sent to the FIU of Jurisdiction A. The Jurisdiction A FIU confirmed the allegations that were found and stated that the individual was known to the FIU, however they stated that the allegations were regarding bribery schemes that took place between 2007 and 2010.

A request for information was also sent to the Jurisdiction C FIU given that several payments were being made to Jurisdiction C natural persons. The FIAU was informed that the natural persons were not adversely known, and all their tax related obligations were duly fulfilled with the Jurisdiction C Tax Authorities.

Being a Maltese-registered company, B Operations Limited was subject to Maltese Tax legislation. After further analysis, it was **determined that enough intelligence was available to the FIAU to indicate both tax evasion, as well as subsequent money laundering.** The intelligence was passed on to the Malta Police Force.

Typologies and red flags to take into consideration:

- Adverse media related to tax on the customer or any connected parties, such as allegations of tax fraud or convictions on tax crimes.
- Failure to submit tax returns.
- Discrepancy between the expected turnover documented in the customer file and the actual turnover.

Conclusion

The FIAU would like to underline the subject persons' requirements to have internal and external procedures providing for the reporting of suspected or known instances of ML/FT. This includes the laundering of proceeds of tax crimes. The typologies and red flags indicated in this Factsheet should be given due consideration, together with other general ML/FT typologies and red flags, when the requirement arises to report any knowledge, suspicion or reasonable grounds to suspect ML/FT. Where the subject person suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity, including tax evasion, they are obliged to promptly report their suspicions to the FIAU. Money laundering is a serious offence, and therefore subject persons should prioritize the reporting of suspicions or knowledge of potentially complex cases of money laundering. While there is no minimum value threshold to report a transaction, resources are better focused on cases that are likely to be of more significance to law enforcement authorities. Within the context of money laundering through tax evasion, subject persons should seek to increase their ability to detect and report serious cases of money laundering through tax evasion.

Annex I – Tax Evasion ML Typologies and Red Flags

1. Customer's Identification Information

- Customer failed to disclose dual citizenship or tax residence.
- Individual's business would not be located in the same jurisdiction as their residential jurisdiction and having no reasonable commercial justification for such.

2. Unusual or Suspicious Transactions

- Structuring/Smurfing.
- Wire transferring without any legitimate business-related reason for such a transfer to occur.
- A transaction which is not in line with the known customer profile.
- The establishment of a company in a jurisdiction where the company does not actually have any presence or conduct any activities.
- The use of shareholders' loans to finance corporate activities, especially where it results that the amounts lent to the corporate entity are not in keeping with known customer profile and financial resources.
- Inconsistent withdrawals or deposits in which the origins are not justified or incompatible with the purpose of the account, as documented in the customer records.
- An entity that does not report any revenue but has executed transactions which have been reported by third parties.
- Under or overvaluing goods and/or services where the declared value on the invoices for these goods and/or services does not reflect the market value.

- Transactions involving services such as consultancy, marketing or research when the service provider is located in a non-cooperative jurisdiction or does not have the necessary resources to provide such services or it results that the company providing the said services only has inexplicably one or very few customers notwithstanding that it has a particularly high turnover.
- Circular transactions or round-tripping transactions where funds are reinvested into the original jurisdiction after being transferred to a foreign entity (often, but not necessarily, in a tax haven).
- Funds are withdrawn in ways that the expenditure cannot be tracked. This occurs through the use of payment methods that cannot be tracked easily, such as cash or virtual financial assets, with the intention to divert and hide the trail of transactions.
- The above red flag could also be tied to the commingling of personal and business accounts, whereby business accounts are used to conduct personal transactions.
- Transactions for which there is no economic, commercial or logical explanation.
- Transactions where assets are transferred, including where assets are settled on trust or transferred to similar entities, in circumstances where there is no clear legal and rational choice to account for such transfers, and/or the assets are transferred to non-cooperative jurisdictions.
- Use of material levels of cash in a non-cash intensive business without a commercial or reasonable justification.
- Amount of tax paid in the past, prior to the establishment of an occasional transaction or business relationship with the subject person, is not justified or consistent with the circumstances, facts and documentation available.

3. Customer Interaction & Behaviour

- Customers may show an uncommon interest in tax-related issues as to whether income from a particular transaction or activity will be declared or reported.
- Customer would provide information which might indicate that the service is being utilized in relation to undeclared funds.
- A customer requests to use a tax adviser's client account without a reasonable or commercial justification.
- A customer shows concerns about regulatory reporting by the subject person.
- The subject person realises that the customer did not file one or more tax returns or other prescribed documents and refuses to correct defaults.
- The subject person realises that the customer did not settle tax due on time and refuses to correct defaults and/or to settle unpaid tax.
- The subject person identifies one or more transactions as having been undertaken to try and evade taxes, or any other communication with the customer gives rise to suspicion that the customer has undeclared funds or evades taxes.
- The customer insists that they should not be contacted by the subject person directly. Similarly, the customer refuses any form of contact or communication with the subject person.
- The customer demands exceptionally high and atypical levels of confidentiality.
- The customer opens an account or requests a service when visiting the jurisdiction temporarily, without showing any apparent link with the jurisdiction or substantial reason in terms of assets, liabilities or activities to justify doing so.
- The customer requests to close the account upon the subject person's request for additional information on tax-related matters.
- A discrepancy between the customer's organisation structure and/or transactions and the documentation recorded on file.
- The customer opens an account and funds are transferred to/from non-cooperative jurisdictions or jurisdictions with recent material changes in their tax regime.
- The customer is non-compliant with tax obligations for a number of years.

- The customer refuses to provide information required to comply with international tax obligations, including documentation regarding declared income in their country of origin.
- The subject person has reason to suspect or believe that the customer is not complying with tax reporting obligations in other countries.
- The customer becomes uncooperative when due diligence is carried out (whether at onboarding stage or during the relationship).
- The customer requests or suggests not to disclose any pertinent information to the tax authorities where the disclosure of that information is required in terms of law.
- The incorporation of companies which are then abandoned shortly after their establishment.
- Adverse media, such as allegations of tax fraud or convictions on tax crimes, related to tax on the customer or any connected parties.
- False statements or documents relating to tax.
- The customer is unwilling to take advantage of tax mitigation opportunities available in certain specific circumstances with no reasonable explanation for such unwillingness.
- The customer shows apparent willingness to pay fees above market rates.
- The subject person discovers information or data showing that the customer has a history of tax advisor/other advisors shopping with no satisfactory explanation.
- The customer requests advice in connection with the repatriation of income or capital from a foreign jurisdiction without a reasonable or commercial justification related to the origins of the wealth.
- The customer asks for advice in regard to a proposed change of residence with no genuine intention of actually taking up residence.

4. Entity Structure & Governance

- Rubber stamping.
- Administrative body of an entity, such as a company's board of directors, manifestly lacks the skill or time to properly undertake its function.
- Commingling of personal and business accounts.
- Inexplicably intricate structures.
- Structures may be created with the intention of hiding information or to make it problematic to obtain certain information.
- Customer explains that the entities are structures in such a manner for tax optimization purposes.
- Sudden, unexplained increase in revenue within an entity or a non-commensurate high revenue within a newly-formed company.
- Cash-intensive businesses.
- Companies which repeatedly fail to comply with their statutorily duty to file copies of their financial statements with the Malta Business Registry.
- The absence of a local footprint.
- The setting up of two or more trading companies in different jurisdictions having the same company name without a commercial reason.
- The structure includes the use of bearer shares.
- The use of fiduciary shareholders within the entity structure with no clear and legitimate purpose or justification.
- The entity maintains materially incomplete records which would undermine the integrity and reliability of the records required for the proper determination of tax due.

5. Source of Funds & Source of Wealth

- Customer is unable or is unwilling to provide information and/or documentation on the source of funds and source of wealth when so requested.
- Information and/or documents provided on the source of wealth or source of funds seem odd or not sufficiently clear as to their source.
- Indications that funds have not been properly declared to the tax authorities.
- Transactions being made or received would not be in line with the source of wealth and expected source of funds information held on file.
- The source of funds information provided does not tally with the services being requested.
- Frequent amounts of deposits from unexplained sources.
- High volume of banking transactions within a short period of time.
- Sales and purchases are not backed by invoices or proper documentation, or there are doubts about the legitimacy of such documentation.

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Questions on this document or on the application of AML/CFT measures may be sent to **queries@fiaumalta.org**

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