AML Tuesday's Session #35 on:

Tax Related ML Risk Assessment

17 October 2023

Purpose & Overview

National Risk Assessments

Important that risks are identified on the national level and are communicated to private sector so that every FI/DNFBP in Monaco can:

- Take the information into account when doing its own Business Risk Assessment, which is required by law and must be provided to AMSF /the Bar Association upon request. Remember the document needs to be in writing and its is not focused on individual customers but your business as a whole.
- Determine to what extent and in which ways the identified risks may or do in practice affect your risk profile as a business.
- Align your whole internal controls environment to focus on those areas of risks that are most pertinent and material to your business. Strengthen the risk mitigation measures in those areas.

National Risk Assessments

This year, Monaco already completed the following ML/TF focused Risk Assessments:

- Terrorism Financing National Risk Assessment
- Non-Profit Organizations National Terrorism Financing Risk Assessment
- Virtual Assets National Money Laundering Risk Assessment
- Tax National Money Laundering Risk Assessment
- Legal Entities National Money Laundering Risk Assessment (forthcoming)
- A number of Sectorial Risk Assessments Conducted by AMSF (forthcoming)

Of course also there is the National Risk Assessment Report of 2020 and the National Terrorism Financing Risk Assessment Report of 2021.

Tax Offenses and Money Laundering

- Tax related offenses were added to the FATF list of predicate offenses in 2012, which means since 2012 countries need to be able to apply the ML offense to proceeds generated from tax related offenses – whether committed abroad or domestically.
- Globally speaking the combined proceeds from tax related offenses are of course massive in terms of their volume.
- Yet it is a challenge as the types of tax offense vary greatly from one country to another = what constitutes tax evasion in country A may not even be criminalized in country B.
- These differences make it hard to agree on what constitutes “proceeds of crime” in a tax context, and to determine when the ML offense is to apply.

The Tax related ML Risk Assessment

Specifically on tax, the MONEYVAL assessment team recommended the following:

> Monaco should conduct an in-depth analysis of the risk related to income tax fraud and other types of tax offences committed abroad and not punished by the laws of Monaco by (i) examining and assessing the scale of the related ML threat; (ii) considering the non-criminalization may be an inherent vulnerability; and (iii) providing an exhaustive analysis of national and sectoral vulnerabilities of relevance to this type of offence..

Led and Coordinated by Strategic Committee

2023 Tax Related ML Risk Assessment

Methodology

Review Threat of Foreign Tax Evaded Funds being Laundered Through Monaco

→

Examine inherent ML/TF/PF risks

(Most likely scenario of how foreign tax related proceeds may be moved through Monaco's System)

→

Assess risk mitigation measures that were put in place

→

Calculate residual risk based on inherent risk and mitigation measures

Data sourced from DSF, AMSF (FIU), AMSF (Supervision), DSP, GPO, and open source specifically in relation to tax related links

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Contextual Legal Setting in Monaco

- Foreign predicate offences are included as predicate offences for money laundering in Monaco, in line with the FATF Recommendations, subject to the condition of **dual criminality**.
- The foreign conduct must therefore be criminalized in the country where it was committed and in Monaco if it had been committed there.
- There is no personal income tax (PIT) in Monaco, which we can speculate is one of the reasons that the FATF recommended that Monaco more closely looks at its tax related ML risk exposure.

Contextual Legal Setting in Monaco

- However, like under the French system, not only legal entities (corporations) but also individuals (sole traders) are subject to taxation in Monaco if they carry out industrial or commercial activities.

- Hence, where industrial and commercial activities are concerned, foreign income tax evasion may be classified as tax fraud under Monegasque laws and thus be a predicate offence to investigate and prosecute money laundering committed in Monaco.

- **Conclusion: Even though PIT evasion is not criminalized, dual criminality is met in many instances involving foreign income tax evasion due to the wide application of VAT and CIT obligations in Monaco. The ML offense applies accordingly.**

Threat arising from tax related criminality

- Monaco's risk enhancing factors:
  - Higher levels of cross-border business
  - Financial services are provided to non-resident foreigners, including many high-net-worth individuals (HNWIs) and ultra high-net-worth individuals (UHNWIs)
  - Extensive and diverse investment opportunities
  - Easy airfare connections to many destinations worldwide, open land borders
  - Monaco's taxation regime as explained earlier.
- STRs, police investigation cases, prosecutions, incoming MLA requests for the years 2020-2022 were examined in relation to any existing tax links.

Threat arising from tax related criminality

- Monaco's AML framework significantly reduced tax-related money laundering activities during the risk analysis period. During the period of review, only three cases were determined to be clearly related to tax offences. Two cases occurred in a purely domestic context and one case involved foreign taxes.
- In the distant past, Monaco was exposed to misuse as a destination for tax-related money laundering, particularly with regard to cash deposits in Monegasque bank accounts but Monaco has made considerable efforts to overcome these deficiencies by strengthening its AML legislation.
- Monaco's AML framework significantly reduced tax-related money laundering activities during the risk analysis period.
- Very few cases were identified with some limited tax-related money laundering scenarios.
- Example: A large number of transfers were received from a foreign company into its accounts in Monaco. Large sums of cash were withdrawn from these accounts and the accounts were also used to purchase substantial amounts of artwork. The amounts withdrawn and the works of art acquired were in fact intended for the private benefit of the president of the foreign company and his family members, who in turn had no links with the company. The system identified served to avoid income taxation on the individuals' directors' fees abroad.

Inherent Risks of Tax Related ML

- Inherent risk assessed via five risk scenarios:

1. Fund transfers to/from Monegasque bank accounts

2. Tax Residency in Monaco

3. Beneficial Ownership of Monegasque Legal Entities

4. Customers of Monegasque FIs/DNFBPs

5. High-Value Goods

Inherent Risks

Scenario 1: Fund transfers to/from Monegasque bank accounts

- **Funds transfers through bank accounts for the years 2020-2022 were analyzed according to geographic linkages**
- Strong links between Monaco and France and Italy were identified, which is rather unsurprising
- The total volume of funds flowing between Monaco and France and Italy is considerable but of course funds flows also take place to a significant extent from other countries.
- The identified cases of tax-related money laundering in the threat analysis but also globally demonstrate that wire transfers are the preferred means of transferring tax fraud related assets.
- Such a risk therefore clearly exists in Monaco.

Residual Risks

Risk Mitigation Measures for Scenario 1: Fund transfers to/from Monegasque bank accounts are STRONG

- AML/CFT requirements for all banks
- Wire transfer rules apply according to international standards
- DSF exchange of information system in line with international standards
- AMSF serves as strong supervisors and in its capacity as FIU also receives tax related STRs.
- Where needed, Monaco seeks to assist trough formal mutual legal assistance and applies the dual criminality requirement in the broadest manner possible to minimize the legal gap created through the lack of personal income tax obligations.
- In sum, a residual risk of **medium-low** was assigned to this scenario.

Inherent Risks

Scenario 2: Tax Residency in Monaco

- Monaco does not impose a PIT in the traditional sense, although the Monegasque ISB also covers activities that would be subject to PIT in other countries. Tax residents in Monaco are therefore generally not subject to income taxation on their Monegasque source revenues.

- Risk is that individuals may establish their tax residence in Monaco to not being subject to income taxation in their actual country of tax residence but in practice reside outside to avoid the higher costs of living in Monaco. This may be particularly facilitated by the open land borders with France and Italy and thus with the rest of the EU.

- For the risk analysis period from 2020 to 2022, three such cases are reported in the form of MLA requests from other countries to the GPO.

Residual Risks

Risk Mitigation Measures Scenario 2: Tax Residency in Monaco are STRONG

- Applicants for tax residence must comply with the stringent criteria and residency requirements, and also declare that their main place of residence (more than 183 days in the calendar year), their home or the main centre of their activities is in Monaco.

- The tax residency application is processed by the DSP and was found by the OECD to reflect a robust process with clear criteria according to internationally accepted standards. For example, unlike in many other countries, in Monaco the tax residency permits are not linked to local investments or flat fees but exclusively based on the actual time spend in the country, which is verified through different means.

- FIs, including banks and wealth management firms, conduct thorough due diligence on their clients to ensure they are genuine residents of Monaco. They verify the source of funds and report any suspicious transactions to the competent authorities.

- AEOI is applied by Financial Institutions in conformity with the OECD standards.

- In conclusion, the residual risk for risk scenario 2 is **low.**

Inherent Risks

Scenario 3: Beneficial Ownership of Monegasque Legal Entities

- Risk is that Monegasque legal entities are misused to commit tax offences or as a vehicle to hide the proceeds from tax offenses.

- In many cases, false invoices are used to reduce the tax base in another country to avoid foreign personal or corporate income tax (i.e. to commit foreign tax evasion), or to claim VAT refunds (i.e. to commit VAT fraud).

- In such cases, (foreign) income could be shifted to Monegasque legal entities by using false invoices and then be withdrawn in the form of non-taxable income (e.g. directors' fees). Subsequently, part of these fees are redistributed to non-Monegasque tax residents, i.e. the foreign originators of the payment of the false invoices. Since the redistributed fees are in fact taxable income in the originator's country of tax residence, these fraudulent invoicing schemes amount to (foreign) PIT evasion.

- Italian and French nationals account for a high proportion of shareholders in commercial companies and partners in civil law partnerships in Monaco. It is therefore not surprising that most of the cases analyzed involve links to Italy and France.

- However, as indicated in case study 8 (Belgium), the risk of misusing Monegasque legal entities to commit tax offences or to hide their proceeds is not limited to these countries. This risk scenario can thus materialize in relation to any country and nationals of all types.

Residual Risks

Risk Mitigation Measures for Scenario 3: Beneficial Ownership of Monegasque Legal Entities are STRONG

- In Monaco, the setting up of commercial companies is subject to tight verification and scrutiny checks by the Business Development Agency (DDE). In addition, checks are carried out over the life of the company.
- Throught a company's lifespan, the DSF carries out tax compliance checks on applicants, including, for example, filing of tax returns, compliance with the submission deadlines, payment of taxes, taxes and duties due.
- In addition, the DSF systematically examines all requests for refunds of VAT credits.
- In sum, Monaco's corporate sector is not easily accessible for foreigners. But even after accessing it, effective and fast cross-border cooperation instruments are in place to prevent and detect the misuse of Monegasque legal entities for tax-related money laundering.
- In combination, the result is a **medium-low** residual risk for this scenario.

Inherent Risks

Scenario 4: Customers of Monegasque FIs/DNFBPs

- This risk scenario covers situations where a customer enters into a business relationship with local FI or DNFBP with the intention to use the relationship for tax-related money laundering.
- The analysis is based on AML/CFT related data collected by AMSF for the years 2020 to 2022 and also takes into account cases of tax-related money laundering detected in Monaco to date, including the extent to which the suspects in these cases were serviced by Monegasque FIs and DNFBPs.
- For the entire risk analysis period from 2020 to 2022, banks and credit institutions filed the vast majority of suspicious transactions reports (STRs) involving tax offences, followed by trust and company service providers (TCSPs).
- Monaco recognizes that this risk scenario may likely be material and used for tax-related money laundering. This particularly concerns the real estate sector and the banking sector, as for the latter demonstrated by the fact that many tax-related MLA requests in the entire risk analysis period involved Monegasque bank accounts.

Residual Risks

Risk Mitigation Measures for Scenario 4: Customers of Monegasque FIs/DNFBPs

- All FIs and DNFBPs are required to comply with the full range of preventive AML/CFT measures as prescribed by international standards, including customer due diligence, transaction monitoring, suspicious transaction reporting and record keeping.
- Strong supervision by AMSF for all sectors.
- Monaco's FIs are also subject to checks on compliance with due diligence and reporting obligations related to the Automatic Exchange of Financial Account Information (AEOI) by the DSF. These controls relate to the clients of these FIs or the persons who control them, in accordance with the provisions set out in the OECD CRS.
- Good awareness of FIs and DNFBPs in relation to exiting risks
- Residual risk rating was determined to be **medium-low.**

Inherent Risks

Scenario 5: High-Value Goods

- Monaco offers a wide range of high-end commodities and luxury goods. It is home to luxury yacht and car sellers, high-end jewellery stores, watchmaking brands and diamond traders, antique and arts dealers, as well as all kinds of luxury brands for clothing and interior design.

- From a money laundering perspective, high-end commodities and luxury goods may be used to disguise the illegal origin of funds (e.g. from tax evasion) by converting proceeds into high-value goods and then selling or trading them.

- High-value and easily transportable commodities and goods such as watches or cars may be subject to VAT fraud by claiming large VAT refunds for items that were never purchased.

- Some cases exist in Monaco for these scenarios for the period 2020-2022. Given the vast number of dealers in this sector, coupled with the high-profile and high-value profile of many customers, both established and walk-in, such risk clearly exists.

Residual Risks

Risk Mitigation Measures Scenario 5: High-Value Goods are MODERATE

- High-end commodities and luxury goods dealers are subject to the full range of AML/CFT obligations and supervised by AMSF for compliance with these obligations.
- A cash threshold is set at EUR 30.000 for purchases of all types and applies cumulatively to transactions that appear to be linked, looking at a period of six calendar months.
- DSF has also focused its off-site and on-site control operations on the car and watchmaking sector. And, in order to continue and strengthen these operations, its workforce will be reinforced from 2024.
- The effectiveness of these instruments is demonstrated by the efficient cooperation between the Monegasque authorities and their foreign counterparts in the detected cases.
- A **high** residual risk is nevertheless attributed to this scenario.

Thank you for your time

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Next Session:

31.10.2023

Topic:

Legal Entities Risk Assessment

Today's Host and Presenter: Gabriele Dunker