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Wolfsberg Guidance on Customer Tax Evasion

1. Introduction

The Wolfsberg Group[1] is pleased to publish guidance on how Financial Institutions (FIs) can mitigate and manage the risks associated with money laundering in the form of customer tax evasion ('Guidance'). For the purposes of this guidance, tax evasion relates to tax related criminal offences prescribed by laws of a jurisdiction and considered to be a predicate offence to money laundering. Tax evasion generally includes the deliberate concealment or misrepresentation of beneficial ownership of assets, income and gains, or otherwise fraudulent conduct, designed to divert money from the public revenue.

Other forms of tax related risks, such as tax planning, avoidance and non-compliance falling short of criminal liability, will not be covered in this paper. Tax planning involves organising one's affairs in the most tax efficient manner within the intent of the law and, typically, with an honest belief that it is a legal method of reducing a tax liability. Tax avoidance refers to conduct that, while still within the letter of the law, generally involves the deliberate exploitation of weaknesses in the tax system.

In recent years, tax evasion, and the facilitation thereof, have gained greater global prominence from tax authorities, regulators and the public. This increase in prominence has led to FIs seeking to enhance their focus on their customers' tax affairs, as well as conduct by persons acting on the FIs' behalf that may constitute the facilitation of tax evasion. While tax evasion facilitation risk is distinct from the underlying predicate offence (i.e. not governed by money laundering regulations), Anti Money Laundering (AML) controls and procedures play an important role in the identification of tax evasion facilitation and it may, therefore, be fitting to consider both in tandem. Furthermore, in order to ensure compliance with all applicable laws and regulations, FIs may need to consider developing an overarching approach that is organisationally broader than the AML framework. This approach may entail recognising, leveraging and enhancing existing controls across the organisation (predominantly

[1] The Wolfsberg Group consists of the following international financial institutions: Banco Santander, Bank of America, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, J.P. Morgan Chase, MUFG Bank, Société Générale, Standard Chartered Bank and UBS.

AML, tax and conduct-related controls) and appropriately deploying specialist resources (e.g. in-house tax experts) to support the implementation and on-going maintenance of such a programme.

This paper is designed to provide guidance to the broader financial services industry on how to develop, implement and maintain an effective anti-tax evasion compliance programme, and should be read in conjunction with applicable guidance issued by authorities in jurisdictions where an FI conducts business. The overall objective of the Guidance is to promote a culture of ethical business practices and compliance with legal and regulatory requirements related to the prevention of tax evasion, including the facilitation thereof, and to help FIs prevent the use of their operations for criminal purposes.

As FIs operate under a wide range of legal and regulatory environments, and have differing risk appetites and business structures, this Guidance should not be read as recommending a mandatory approach for all elements contained herein. Where the Wolfsberg Group is of the view that a unified industry requirement is appropriate, it is made clear by use of the term 'must.'

Although tax evasion and money laundering are operationally distinct processes, they share similar sophisticated obfuscation techniques and the success of each crime depends on the ability to hide the financial trail of the income. Money launderers seek to transform illegally gained proceeds of crime into legal forms, while tax evaders seek to conceal income and assets, either legally or illegally earned or derived, from detection by the tax authorities.

Tax evasion risk within an FI can arise in several ways, but can be broadly categorised as stemming from:

- Management of the FI's own activities and tax affairs, including failure to comply with requirements under customer tax legislation/regulations, such as Foreign Account Tax Compliance (FATCA) provisions and the Common Reporting Standard (CRS) developed by Organisation for Economic Co-operation and Development's (OECD)
- Failure to comply with money laundering laws and regulations, given that tax evasion is considered a predicate offence to money laundering in most countries
- The introduction of tax amnesty programmes
- Facilitation of tax evasion by an FI's customers (as well as by non-customers, such as suppliers and employees) and by persons acting on the FI's behalf. This risk includes the impact of laws which create corporate criminal liability for the FI's failure to prevent the facilitation of tax evasion.

The scope of this Guidance is limited to mitigating the risks of customer tax evasion as outlined in the last three bullets above, including tax evasion risks, and the facilitation thereof, which manifest from customer tax information compliance regimes, such as the FATCA provisions and CRS.

2. Risk Based Procedures

An effective compliance programme should leverage existing financial crime compliance, conduct and tax (including tax transparency regimes) procedures and controls, in order to address the risks of customer tax evasion, and the facilitation thereof.

An FI must ensure that it has documented risk based procedures, supported by Senior Management, outlining the FI's measures for identifying and mitigating these risks. These can be part of the FI's broader suite of Anti Money Laundering / Counter Terrorist Financing (AML/CTF) procedures, or other risk and control procedures, depending on the preference or organisational structure of the FI.

These will vary across FIs, depending on the nature, scale and complexity of activity, but as a guide they might include:

- A top-level commitment to preventing tax evasion alongside other predicate offences
- An articulation of the risk assessment on which the procedures are based
- The approach to mitigating risks arising from the nature of the FI's services and areas of operation
- The determination of how customer account activities will be subject to first line monitoring for tax evasion risks

The AML/CTF procedures should consider whether to state explicitly that tax evasion is a predicate offence to money laundering. As such, where the FI suspects that a customer has evaded or is intending to evade taxes, this will be considered as an indicator of potential money laundering, in most cases triggering an investigation, any Suspicious Activity Report (SAR) filing requirements and, where appropriate, termination of the customer relationship.

The procedures should also make it clear that while relevant members of FI staff (whether relationship managers, other staff members, agents or intermediaries) are not tax experts, such staff should be supported so as to be able to identify FI-specified indicators of tax evasion. FIs should also seek to ensure that their banking products and services are not knowingly associated with any arrangements which are known or suspected to be used for the facilitation of tax evasion by a customer.

Procedures should be periodically reviewed against guidance from relevant national and international organisations, as well as local regulators.

3. Risk Assessment

As noted above, an FI should be able to demonstrate that it has assessed and understood the potential risk and exposure it faces in relation to money laundering in the form of tax evasion, and the facilitation thereof. The risk assessment may require a staged approach, commencing with a high level risk assessment of business units across the FI (reflecting the nature of the business and underlying risks), before proceeding to detailed reviews for higher risk areas. The scale and detail of methodologies used to assess the risk should be proportionate to the level of risk and nature of the business. For example, a predominately cross-border Private Banking business may require a substantially more detailed approach as compared to that of a domestic Retail Banking business.

For higher risk areas, specialist tax knowledge may be required in the development of risk assessment methodologies to ensure specific tax factors and their interconnectedness are appropriately considered in the design stage (for example, considering the impact and efficacy of various tax transparency regimes in particular business lines and geographies). The risk assessment may also consider key risk indicators specifically addressing tax evasion facilitation risks. The assessment may be embedded within a broad-based money laundering risk assessment, or via a standalone risk assessment. If using an existing money laundering risk assessment, the FI will need to ensure that the risk assessment captures the key inherent tax evasion risks and relevant controls. As a result, and particularly if the FI is carrying out a risk assessment including tax evasion for the first time, a standalone risk assessment may make more sense.

While these risk assessment methodologies will evolve, and given that there is not yet an industry standard, existing risk assessment methodologies[2] are considered appropriate and fit for purpose once tailored towards the risks and associated controls deployed to detect and prevent tax evasion.

4. Customer Due Diligence (CDD)

An FI should accept only those customers whose source of wealth and source of funds can reasonably be expected and/or established to be legitimate, and with respect to whom the FI has neither knowledge nor suspicion of money laundering, including any form of tax evasion.

FIs should be sensitive to risk indicators and/or red flags that may suggest an increased risk of tax evasion and, taking a risk based approach to the extent practicable or considered appropriate, utilise such risk indicators and/or red flags within the FI's customer risk assessment processes, and/or otherwise consider how the FI's CDD controls can be enhanced towards identifying and mitigating tax evasion. However, the presence of one or more risk indicators and/or red flags may not necessarily elevate tax evasion risks, if a legitimate explanation is evident and assessed in the context of the wider information available.

Many jurisdictions have in recent years adopted transparency measures in the form of Automatic Exchange of Information (AEOI) regimes and other tax information reporting and withholding regimes (e.g. FATCA and CRS). These regimes mandate the identification and reporting of non-resident account holders to tax authorities, and require FIs to obtain the tax identification numbers of customers and identify the beneficial owners of entities (including trusts).

FIs' existing due diligence policies and procedures (including AOEI/tax information reporting and withholding compliance requirements) will apply and assist in mitigating risks posed by customers, including those with tax evasion risks. As part of CDD and during on-boarding and periodic reviews, FIs should seek to understand the customer's tax evasion risk profile (e.g. assessing the commercial rationale for complex or opaque structures). In certain circumstances, where no other risk factors are present, the effective reporting of customers who provided self-certifications under CRS and/or FATCA may be considered as a mitigating factor, as these customers' identity and financial activity are reported to the relevant tax authorities. The FI should also consider requesting additional tax related information, if insufficient data exists to assess tax evasion risks (including obtaining corroborating tax statements and/or third party confirmations from tax advisors) and further validate information or representations provided, as appropriate.

High risk cases may be those more likely or reasonably expected in certain international Private Banking customer relationships. Higher risk cases in corporate customer relationships are more likely to manifest where operating entities are incorporated in high tax risk jurisdictions or through related-party dealings (e.g. misinvoicing).

In high risk cases, the FI should consider developing criteria and processes for obtaining more information as to the customers' tax compliance status. Some FIs request written customer confirmations as to their tax status being compliant, while others request confirmation from the customers' independent tax advisers and/or evidence in the form of tax returns or statements. Many FIs request confirmations from customer relationship managers working in areas identified by the FI

[2] See *Wolfsberg Frequently Asked Questions on Risk Assessments for Money Laundering, Sanctions and Bribery & Corruption* (2015), https://www.wolfsberg-principles.com/sites/default/files/wb/pdfs/faqs/17.%20Wolfsberg-Risk-Assessment-FAQs-2015.pdf

as high risk that they have no information which would indicate potential tax evasion by their customer. This may be in the form of a tax questionnaire or tax risk assessment, which should be completed before a customer is on-boarded and updated at periodic/trigger review for existing customers. The questionnaire should assist relevant staff in identifying customer tax evasion risk factors, when to obtain further information from customers and when to escalate customers for further investigation, where such risk factors exist.

FIs should also consider updating terms and conditions for account opening to make any account relationship and product usage dependent upon the customer being tax compliant and maintaining tax compliance throughout the wider relationship.

5. Monitoring and Screening

The FI's existing Financial Crime Compliance (FCC) monitoring framework will play a part in mitigating customer tax evasion risks too, although there is limited evidence that transaction monitoring, through the deployment of automated detection scenarios generating alerts and cases for investigation, is effective in identifying tax evasion.

Existing screening controls, especially customer name screening at on-boarding and/or periodic name screening, may generate results where, for example, material negative media reports are available from credible sources, describing a customer’s potential exposure to tax evasion or a tax related investigation in the public domain.

The Wolfsberg Group notes that there is an opportunity for national governments to aid in the efforts to prevent tax evasion by publishing or permitting access to information on prosecutions and settlements for tax evasion by both individuals and companies. This would allow FIs to identify potentially undetected accounts which would be of direct interest to the relevant tax authorities.

6. Control Responsibilities

Where tax evasion is a predicate offence to money laundering, an FI should have a policy and procedure on the identification of, and follow up on, unusual or suspicious transactions or activities. Where an FI has a suspicion of tax evasion, it must file SARs in line with local regulatory obligations.

The core role of an FI should be to seek to identify indicia of tax evasion based on known risk indicators and/or red flags. It is not expected that an FI will routinely conduct an extensive analysis of a customer’s tax affairs and/or audit their tax compliance at a transactional, domestic or international level. Where a tax related risk indicator and/or red flag is identified, an FI should investigate, as appropriate, to understand whether it is indicative of money laundering through tax evasion. An FI will not necessarily have a complete picture of a customer’s banking portfolio, transactional history or tax affairs and such a limitation should be recognised in the role the FI is able to play in detecting tax evasion. Furthermore, where technical tax expertise is required in interpreting a fact pattern, an FI should consider liaising with tax professionals or, alternatively, requesting confirmation from a customer’s tax advisor.

An FI should file a SAR, if and as required by applicable laws and regulations, and measure the appropriateness of terminating a customer relationship, where knowledge or suspicion of money laundering, including by reason of tax evasion, is established. An exception to this may be where customers voluntarily avail themselves of Tax Amnesty Programmes. For more details see Section 10 below.

FIs will have a policy and procedure on managing and responding to Legal Production Orders with respect to tax evasion received from a tax authority with powers to investigate and compel delivery of information. The FI should not automatically treat the receipt of any such Production Order as amounting to a de facto suspicion, although clearly this may also constitute a potential risk indicator and/or red flag.

7. Reporting and Management Information

An FI will report periodically to its Senior Management on the design and operational effectiveness of the control environment designed to mitigate tax evasion risk, whether as part of overall reporting on fighting financial crime, or on a standalone basis. Reporting should address:

- The results of any risk assessment, including identification of what constitutes high risk from a customer tax evasion perspective
- The status of actions designed to mitigate inherent risk and improve relevant controls
- Significant deviations from relevant internal policies and procedures by employees
- Updates on internal reviews (e.g. audits, compliance testing, ongoing investigations)
- Relevant legal and regulatory developments
- Relevant results from internal whistleblowing and/or other disclosure mechanisms
- Any other significant issues, such as material regulatory reporting or SAR filings.

8. Communication and Tone from the Top

An FI should expressly consider including tax evasion, and the facilitation thereof, in its Group Code of Conduct or other relevant conduct-related standards and/or polices. While FIs normally require staff to recommit annually to compliance with all applicable laws, regulations and Group standards, the inclusion of an explicit reference to laws and regulations and Group-wide policies on detecting, preventing and reporting customer tax evasion would serve to demonstrate a clear stance towards combating tax evasion. Including clear statements in an FI's Group FCC Policies that the FI considers tax evasion to be a predicate offence to money laundering and, therefore, suspicions of tax evasion are subject to escalation, investigation and, where appropriate, SAR filing and/or termination of the customer relationship, is useful in reinforcing the importance of the FI’s anti-tax evasion compliance programme.

Beyond formal inclusion in corporate documents, policies and standards, FIs should not underestimate the value of Senior Management clearly communicating through established channels to all staff the FI’s approach to financial crime compliance, including the prevention of customer tax evasion, and the facilitation thereof, in fostering a corporate culture in which the facilitation of tax evasion is understood to be unacceptable.

9. Training and Awareness

FIs should provide regular mandatory training to all staff on fighting financial crime. Development of the training should consider the inclusion of specific material relating to tax evasion risks, as well as seeking out the appropriate escalation channels (e.g. whistleblowing procedures). For staff working in areas identified by the FI as high risk, targeted tailored training on risk indicators and/or red flags and common tax evasion typologies must be established.

Awareness programmes should cover, where appropriate, tax evasion as a predicate offence to money laundering, including tax evasion facilitation risks.

10. Tax Amnesties

Tax Amnesty Programmes are intended to encourage taxpayers who are not tax compliant to remediate/regularise their tax affairs. This is usually achieved by full disclosure of previously unreported income and assets, and by the settlement of an amount as defined by terms of the Amnesty. Taxpayers, by duly complying with the terms of the Amnesty, are thereby absolved of the tax, penalties and interest relating to the status of non-compliance. Customers who participate in a Tax Amnesty should provide FIs with sufficient evidence of the complete resolution of their legacy tax positions and the regularisation of their tax affairs within a reasonable time frame (generally expected to be aligned to the specific tax amnesty administrative requirements). FIs may seek internal and/or external tax specialist guidance to assist in managing the impact of Tax Amnesties on their compliance programme effectively.

The Wolfsberg Group supports the introduction of Tax Amnesty Programmes, and encourages any customer who is not tax compliant to avail themselves of any applicable programmes to regularise their tax status. For customers availing themselves of such programmes and to the extent the FI has knowledge or requisite suspicion of the customer's behaviour, the requirement to file a SAR may be triggered, if and as required by applicable laws and regulations. Notwithstanding the filing of any SAR in such a case, and provided there are no material aggravating negative factors, the FI may reasonably decide to maintain that customer relationship, in accordance with its policies, procedures and risk appetite.

Appendix: Geography/Country Risks

All Customers will have jurisdictional exposure which may indicate increased tax evasion risks. The principal jurisdictional exposure of relevance is the Customer's country of tax residence, followed by the booking centre for the Customer's accounts, as well as any other countries relevant to incorporation/location of corporate vehicles, assets and/or transactions. In recent years, tax transparency and exchange of information developments have become central to the global effort aimed at tackling tax evasion. The Global Forum on Transparency and Exchange of Information for Tax Purposes (the Global Forum) is tasked with the widespread and effective implementation of agreed international standards that currently include the exchange of information on request (EOIR) and the automatic exchange of information (AEOI). An additional planned area of focus for the Global Forum is to agree standards ensuring the availability of beneficial ownership information (e.g. beneficial ownership registers). FIs may consider the work undertaken by the Global Forum, as well as other national or international bodies, in assessing country risk relevant to tax evasion. For these purposes, the following country lists and rankings, while not exhaustive, may be considered as potentially relevant to help identify tax evasion risk by customers through residence or other material jurisdictional exposure.

- **Common Reporting Standard ("CRS")**

The CRS is an initiative by the Organisation for Economic Cooperation and Development (OECD), undertaken through the G20 and adopted by over 100 jurisdictions to facilitate the automatic exchange of information and promote cross-border transparency in tax affairs. The CRS is the first initiative that globalises the automatic exchange of information without requests by authorities. FIs resident in countries that have not adopted CRS will not exchange information with other countries. Tax residents of countries that have not adopted CRS, even if booking into an FI in a country that has, would not have information exchanged with their local tax authorities.

- **Foreign Account Tax Compliance Act (FATCA)**

The FATCA provisions were the first major international initiative to prompt a global effort for exchanging information, including through the signing of bilateral agreements (Intergovernmental Agreements, or IGAs), and an extraterritorial reach of U.S. tax laws on U.S. source income that includes taxation on U.S. dividends and U.S. interest, where non-U.S. FIs do not comply. In certain structures that pose a higher risk of tax evasion, FIs are required to collect and report on the substantial U.S. owners and U.S. controlling persons of non-U.S. entities.[3]

[3] FATCA treats as U.S.-owned any foreign entity that has at least one "substantial United States owner." Substantial ownership is defined by the bill as any U.S. person who owns, directly or indirectly, a 10% or greater interest in a corporation or partnership.