



WORLD CUSTOMS ORGANIZATION

Illicit Financial Flows via Trade Mis-invoicing

Study Report 2018



Disclaimer

This Study Report contains input from a multitude of Organizations, individuals and Customs administrations, each of whom are credited as co-authors throughout the Report. The views and opinions presented herein are those of the authors and do not necessarily reflect the views or policies of the WCO or of its Members.

Table of Contents

Foreword	1
Contributors	3
Executive Summary.....	4
 Part 1. Introduction.....	6
1. Introduction	7
2. Conceptual Basis of Illicit Financial Flows, Trade Mis-invoicing and Trade Discrepancy	14
 Part 2. Estimating Illicit Financial Flows (IFFs) via Trade Mis-invoicing (TM)	30
3. Estimating IFFs/TM: Partner Country Method	31
I. Introduction	31
II. The PCM in Principle	31
III. The PCM in Practice	33
IV. Conclusions for Identifying TM Risk with the PCM Approach	42
4. Estimating IFFs/TM: Price Filter Method	48
I. Price FilterMethodology (PFM)	48
II. PFM Estimates of Trade Mispricing from Existing Literature	52
III. PFM Estimates of Trade Mispricing in the U.S. Export and Import Data, 2012-2016	55
IV. Summary	62
V. Bibliography	63
5. Cross-reference of PFM and PCM: Analysis of South African TM Risks – Imports, 2010-2015	65
I. Data & Methods	65
II. Estimation Results.....	69
6. Cross-reference of PFM and PCM: The U.S. Trade with its Partner Countries.....	75
I. Introduction	75
II. Summary of Findings.....	76
III. Data Source and Methodology	76
IV. Comparison of Misinvoiced Import Amount Estimated by PFM and PCM	78

V. Appendix	82
VI. Bibliography	87
7. Cross-reference of PFM and PCM: Three case studies	90
I. Introduction	90
II. Overview of PCM and PFM	91
III. Data and Methodology	92
IV. Result	95
V. Conclusion	101
Part 3. Best Practices in Combating Illicit Financial Flows via Trade Mis-invoicing	107
8. Use of Customs Valuation Risk Management Techniques.....	108
9. Inter-Agency Cooperation: Focused On, But Not Limited To, Customs-Tax Cooperation	111
I. Introduction – Importance of Inter-Agency Cooperation	111
II. Collaboration Opportunities Against Trade Mis-invoicing	114
III. OECD Survey: Institutional Frameworks for Inter-Agency Co-Operation between Tax and Customs Authorities	115
IV. WCO Survey: Exchange of Information and Co-Operation in Practice.....	119
V. WU Global Tax Policy Center: Lessons from the Tax and Good Governance Project	125
10. Combating Illicit Financial Flows: Practice of Korea Customs Service	139
I. Background	139
II. Legal Instruments and Administrative Tools.....	139
III. Case Studies	142
IV. Conclusion.....	144
11. Customs-Customs Exchange of Information	146
I. Introduction	146
II. WCO Instruments and Tools	147
III. Globally Networked Customs.....	147
IV. WTO Agreement on Trade Facilitation (TFA)	149
12. Potential Use of Technology: Blockchain.....	153
13. WCO Members’ Best Practices	157
I. Briefing on China Customs’ Crackdown on Illegal Money Transfer	157

II. Combatting IFFs: The Success Story of the Norwegian Currency Register.....	158
III. Illicit Financial Flows (IFFs): Guardia di Finanza	161
Part 4. Conclusion	163
14. Policy Recommendations.....	164

V. WU Global Tax Policy Center: some lessons from the Tax and Good Governance Project

Clement Migai and Jeffery Owens

The significance of IFFs problem for Africa was highlighted by the UN High Level Panel on Illicit Financial Flows from Africa report “Track it! Stop it! Get it!”¹³ IFFs were also a focal point of the Third International Conference on Financing for Development in Addis Ababa which appealed for efforts to eliminate IFFs to be redoubled (Addis Ababa Action Agenda)¹⁴ and the Agenda 2030 for Sustainable Development.¹⁵

Considering this, from March 2015, the WU Global Tax Policy Centre at the Institute for Austrian and International Tax Law at WU - Vienna University of Economics and Business, in partnership with the African Tax Institute at the University of Pretoria, with the support of UNODC and the World Bank, cooperated together in a project that brought together government officials, business, academics, and international and regional organisations to discuss and identify solutions to IFFs from Africa.¹⁶

The project involved research, workshops, seminars and conferences and training, all aimed at providing practical solutions that the participating countries can use to counter IFFs. It examined how to strengthen tax policy and administration, promoted effective implementation of international standards and supported enforcement and investigations. It particularly emphasised the role of good practices for cooperation between financial intelligence units, Customs and tax administrations, and law enforcement agencies. It identified improvements that are required for enabling the domestic and international legal and institutional framework to facilitate cooperation between different government agencies.

A. Necessity for inter-agency cooperation

IFFs (including trade mis-invoicing) and other financial crimes may involve a broad range of activities and multiple actors who may be spread across various sectors. Activities perpetuating IFFs can also violate a number of different laws. As a result, different government agencies, including tax administrations, Customs authorities, anti-money laundering authorities (including financial intelligence units/centres), the police and other specialised law enforcement agencies, the public prosecutor’s office and financial regulators may be involved in the different stages to facilitate effective detection, prevention, investigation and prosecution as well as the recovery of the proceeds thereof.¹⁷

Given the mosaic of agencies involved in detection and investigation of different types of IFFs, each of these agencies may hold some operational and strategic information relevant to the activities of other agencies.¹⁸ Some of these agencies may have exclusive access to information not held by other agencies. Yet some may possess peculiar investigative and enforcement powers. The fragmented yet inter-connected and inter-dependent roles and

powers of these agencies involved in combating IFFs may lead to a silo mentality, if not carefully managed. It therefore calls for a unified strategy and closer coordination, cooperation and collaboration by all concerned agencies if they are to be effective at both the domestic and international level.

B. Forms of inter-agency cooperation

The Tax and Good Governance Project conducted a survey amongst twelve Africa countries, namely Botswana, the Gambia, Ghana, Kenya, Liberia, Mali, Morocco, Niger, Nigeria, Sierra Leone, South Africa and Zambia, for the purposes of a training workshop on inter-agency cooperation in March, 2016.¹⁹ It identified several models for cooperation in these countries which echoes the recommendations by OECD and the Financial Action Task Force (FATF). These included but were not limited to:²⁰

- a) Information sharing
- b) Joint investigation teams²¹
- c) Inter-agency centres of intelligence²²
- d) Secondments and co-location of personnel
- e) Other models: use of multi-agency task forces to combat financial crimes, having centralised structures for inter-agency cooperation, granting tax and Customs access to STRs, inter-agency meetings and training sessions.²³

C. Some best practices from the Tax and Governance Project

The Tax and Good Governance encountered different models for deepening inter-agency cooperation in the participating countries. As pointed above, these models mostly aligned with the recommendations by the OECD and the FATF and covered information sharing, joint investigation teams, inter-agency centres of intelligence, secondments of personal as well as other models such as multi-agency task forces.

1. Information Sharing

Information is usually shared on a bilateral basis as provided by legislation and supplemented by bilateral MOUs. However, rather than establish bilateral MOUs, Sierra Leone put in place a multilateral MOU for the exchange of information between several law enforcement agencies, tax and Customs administrations and security agencies in December 2015. This was done under the umbrella of the “AML/CFT Inter-Agency Intelligence Coordination Committee”.²⁴

This Committee is composed of the National Revenue Authority, the Financial Intelligence Unit, the Police, the Central Intelligence and Security Unit, the Republic of Sierra Leone Armed Forces, the Immigration Department, the Anti-Corruption Commission, the National Drug Law Enforcement Agency and the Transnational Organized Crime Unit.

The multilateral MOU has brought all the relevant agencies, including Customs authorities which is a part of the national Revenue Authority to one table rather than have a series of bilateral MOUs that deals with only two agencies at a time. This has greatly reduced bureaucracy that may hinder efficient and timely information sharing. It has also, in one go, enlightened the participating agencies of each other's mandate and shared common objectives, broken down organisational silos, and established a one-stop shop for sharing information but with the usual limitations on use of such information for purposes outlined in legislation, international agreements and treaties.

2. Joint Investigation Teams

The South African Revenue Service (SARS) has identified the illicit economy and illicit financial flows as one of the strategic risks facing SARS over the years 2015/16 -2020/21.²⁵ SARS has therefore earmarked increased Customs compliance as one of its priority areas²⁶ and proposes to achieve this by engaging with other "state enforcement agencies such as State Security Agency and Police to agree on Memoranda of Understanding (MOU's) for establishment of dedicated resources for fighting illicit trade" and "enhance the inter-agency co-operation in fighting tax and other financial crimes."²⁷ The strategic plan also proposes the adoption of a whole of government view in managing the Customs border environment through collaboration with other government agencies.²⁸ These capture its spirit and need for inter-agency cooperation.

The ability of Customs to conduct joint investigations is covered by legislation.²⁹ Hence joint investigations between the Directorate for Priority Crime Investigation (Hawks) and SARS are common place and are focussed on any fraud or revenue related matters.³⁰ However, although SARS may participate in joint investigation teams³¹ effective participation is hampered by the fact that the officials assigned are prevented from using any special legislative powers held by virtue of their position as a tax administration employee. As a result parallel investigations are usually run by SARS but information is shared with the joint investigation team.³²

3. Multi-agency Task Forces

A presidential directive established a task force in Kenya in March 2015 to review the existing legal, policy and institutional framework for economic crimes (including corruption); determine why the institutions were not adequately responding to the challenges; and make recommendations for improvements. It came to a conclusion that: (a) there were many agencies each playing a different role; (b) despite interlinked and interdependent mandates most of the agencies acted in isolation and failed to cooperate, coordinate and or collaborate with one another; (c) and since most of the agencies acted in isolation, this had led to mistrust and failure to share intelligence and information which created loopholes with the system.³³

It therefore recommended that in order to enhance coordination and cooperation, a Multi-Agency Team on Enhancing the Investigation and Prosecution of Corruption and Economic Crimes in Kenya ("MAT") should be established. The MAT was set up in November 2015 and its principal terms of reference included; (a) enhancing cooperation, coordination and

collaboration among the member agencies; and (b) engaging other relevant agencies to enhance the effectiveness of the war on corruption and cases of organized crimes.

The principal members include the Office of the President; the Ethics and Anti-Corruption Commission; the Office of the Director of Public Prosecutions; the Directorate of Criminal Investigations; the National Intelligence Service; the Financial Reporting Centre; the Asset Recovery Agency; and the Kenya Revenue Authority. On a need basis, it incorporates the Communications Authority of Kenya; the Kenya Wildlife Services; the Kenya Forestry Services; the Anti-Counterfeit Agency; and the National Transport and Safety Authority. It operates at several levels with a *High Level Consultative Team* composed of the heads of the agencies with the EACC as the convener and the Office of the President serving as the secretary; a *Technical Committee* of nominees from each agency to facilitate liaison on technical matters; and a *Secretariat*.

Since its formation it has developed, inter alia, information and intelligence sharing guidelines and criteria for determining cases suitable for investigation and prosecution. It holds regular meetings that enable members to share information and intelligence on a real time basis a practice that has cultivated closer coordination and collaboration. The MAT has also conducted joint investigations and joint sting operations. For example, by using shared intelligence; the KRA was able to nab twenty-one, forty foot stuffed with new clothes but declared in import documents as coolers while the other three contained powder milk.³⁴ Another example includes nabbing luxury cars declared as personal effects and household goods.³⁵ Joint training has also increased the members awareness of each agencies mandate and how their agency can assist to fulfil this mandate. Other cases have seen the office of the Director of Public Prosecution, the Ethics and Anti-Corruption Commission and the Asset Recovery Agency refer cases to KRA for tax investigations. In other case KRA's statutory powers have been leveraged to aid in prosecuting cases and obtaining preservation orders.

However, a main challenge is that the MAT is not anchored in law and relies on the statutes for each agency. The legality of joint operations can therefore arise. The formation and ongoing operations of the MAT are also based on the political will of the current leadership as a result of the presidential directive. Further, the Mat has to rely on the budgetary allocation from member agencies which can be impacted by individual institutional constraints.

4. Secondment of personnel

Nigeria reported since 2004 it has been seconding staff from the Nigerian Customs Service to the Economic and Financial Crimes Commission and the FIU. It had also received forensic officer seconded from the Independent Corrupt Practices and Other Related Offences Commission to help in detection of duty evasion. Secondment of specialised staff has been used extensively in Ghana.³⁶ This practice has deepened ties between the tax administration and the other law enforcement agencies which has facilitated better cooperation.

5. Joint compliance and advance pricing agreements

Customs authorities and tax administrations do have some shared and often overlapping objectives. This is more evident in the linkages between transfer pricing and Customs valuation which calls for closer cooperation amongst Customs authorities and tax administrations. Joint compliance programs and advance pricing agreements that involves both Customs and tax could therefore be another way of preventing trade mis-invoicing since they reduce the risk of manipulating the prices.

D. Conclusion

Whilst inter-agency cooperation is possible in most countries, agencies still need to overcome legal, regulatory, cultural, and operational barriers which may prevent the sharing of specialist information with other law enforcement agencies. Administrative and cultural barriers may inhibit closer working relationships even where this is enabled and supported by legislation. Complex or lengthy processes and/or procedures for obtaining information from another agency, a lack of awareness of the availability of information or other mechanisms for co-operation, or a lack of specialist training which reduces the effectiveness of existing legal gateways may also act as barriers. Further, the lack of political will from the political leadership and heads of various agencies that can provide crucial impetus for the agencies to adopt a whole-of-government approach, or to make the changes required to remove or reduce legal and operational barriers may also be another impediment. If these can be addressed adequately then inter-agency cooperation can be an effective barrier against trade mis-invoicing. It is a low hanging fruit which does not require legislation or extra resources – only willing agencies and leadership from the top.