

CORRUPTION, MONEY LAUNDERING AND TAX EVASION: THE INTER-RELATIONSHIPS BETWEEN COMMON FACTORS TO ILLICIT FINANCIAL FLOWS

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Abstract

Corruption is a major impediment to sustainable development in African countries. Corrupt acts result in revenue losses to the fiscus at the expense of society, and the proceeds of corruption then are hidden through money laundering and tax evasion. The purpose of acts of corruption, money laundering and tax evasion generally are aimed at achieving a financial gain in a manner which aims to hide that gain – this often manifests in capital outflows. The obstacles to different government agencies in addressing this objective are the same, namely, a lack of transparency, excessive secrecy and a lack in institutional responsiveness through coordinated action. Because of the impact of acts of corruption, laundering and evasion on sustainable development, measures to address such acts necessarily are intertwined. It is shown that an institutional response which recognises this inter-relationship is more successful in harnessing a cross-selection of preventative measures available to government agencies in dealing with these diverse crimes – thus placing institutions in a better position to address illicit financial flows.

1 Introduction

Corruption is described as ‘a major impediment to sustainable development for mineral, oil and gas producing countries’ in Africa.¹ In the extractive sector, revenue losses at the expense of society most often are due to corrupt acts in all parts of the extractive value chain. The proceeds of corruption then are hidden through money laundering and tax evasion. The purpose of acts of corruption, money laundering and tax evasion generally are aimed at achieving a financial gain in a manner which aims to hide this gain. The obstacles to different government agencies in addressing this objective are the same, namely, a lack of transparency, excessive secrecy and a lack in institutional responsiveness through coordinated action. Due to the impact of corruption, money laundering and

1 New Partnership for Africa's Development (NEPAD) (2002) 4; OECD *Corruption in the extractive value chain* (2016) 10.

evasion on sustainable development, measures to address such acts necessarily are intertwined. From the perspective of illicit financial flows (IFFs), many bribes result in capital outflows to tax havens, which are useful for hiding embezzled payments or to syphon off revenue intended for the fiscus.

It is shown that an institutional response which recognises this inter-relationship is more successful in harnessing a cross-selection of preventative measures available to government agencies in dealing with these diverse crimes – thus placing institutions in a better position to address IFFs. In this regard, it should be pointed out that anti-money laundering (AML), for example, is a major element in the standard list of interventions available to countries with the potential to reduce IFFs, both into and out of developing countries. AML interventions are also powerful tools to address other elements of IFFs, such as corruption and tax evasion. However, this potential is largely dependent on the implementation of the relevant Financial Action Task Force (FATF) Recommendations, the level of reporting in administrations and the level of inter-agency cooperation and international cooperation.

Corruption, estimated at USD40 billion dollar per year,² is given as a primary reason for the weak economic performance of resource-rich countries, because it manifests in rent seeking and patronage.³ According to Kolstad and Søreide,

resource rents induce rent seeking, as individuals compete for a share of the rents rather than use their time and skills more productively, whilst resource revenues induce patronage as governments pay off supporters to stay in power, resulting in reduced accountability and an inferior allocation of public funds.⁴

The possibility for both tax avoidance and tax evasion is created with the negotiation of contracts with companies seeking a favourable investment climate, and where contractual arrangements are the consequence of corruption (such as payments by companies to public officials to secure better terms). Tax havens become useful for hiding embezzled payments or to syphon off revenue intended for the fiscus.

The FATF is of the view that

[t]he fight against corruption is inextricably intertwined with that against money laundering in that the stolen assets of a corrupt public official are

2 World Bank *A call for action: No safe havens: A global forum on stolen asset recovery and development* (2010) 3.

3 I Kolstad & T Søreide 'Corruption in natural resource management: Implications for policy makers' (2009) 34 *Resources Policy* 214.

4 As above.

useless unless they are placed, layered and integrated into the global financial network in a manner which does not raise suspicion.⁵

The FATF also highlights the role of politically-exposed persons (PEPs) in money-laundering schemes. PEPs are deemed a high risk due to the positions they occupy in government, where they have access to public funds and contractual information.⁶ PEPs can also influence the way in which contracts are awarded and, therefore, can award contracts for personal financial reward.⁷

The level of governance, the strength of legal controls and cultural aspects can influence the degree to which corruption is present in a country.⁸ The FATF identifies the most prevalent forms of proceeds in the grand corruption context as those resulting from accepting bribes; various forms of extortion; self-dealing and conflict of interest; and embezzlement from the treasury through fraud.⁹ From a tax perspective, two important concerns arise: first, tax revenue due to the fiscus is diverted, which affects public spending; and, second, the proceeds of corruption in the hands of corrupt officials escape taxation should they remain undetected.

The focus of this chapter, therefore, is on the inter-relationship between corruption, tax crimes and money laundering. The first part examines the dynamics of corruption, money laundering and tax evasion and how these impact on society. The second part of the chapter examines regulatory issues, barriers thereto and different preventative measures available to address different aspects of these crimes.

2 Dynamics of corruption

The World Bank describes corruption as a ‘complex phenomenon’,¹⁰ because its roots may lie deep in government institutions. How corruption affects development is influenced by country conditions and the interventions governments make on policy and contractual levels. For example, in pursuit of financial gain, government officials may intervene in areas where no intervention is required, or they may fail to enact or implement policies.¹¹ The term ‘corruption’,¹² covers a broad range of

5 FATF *Laundering the proceeds of corruption* (2011) 5.

6 As above.

7 FATF (n 5 above) 9.

8 As above.

9 FATF (n 5 above) 16.

10 UNODC ‘New UNODC campaign highlights transnational organised crime as a USD 870 billion a year business’ (not dated); World Bank ‘Helping countries combat corruption: The role of the World Bank’ (not dated).

11 World Bank ‘Measuring regulatory quality and efficiency’ (2016) *Doing Business* 5.

12 According to the *Online etymology dictionary* ‘corrupt (adj)’ takes its meaning from old French *corrupt* which means ‘unhealthy; corrupt; uncouth’ and directly from Latin *corruptus*, meaning ‘to destroy; spoil’ or figuratively ‘corrupt, seduce, bribe’.

human actions.¹³ The World Bank defines it as the ‘abuse of public office for private gain’,¹⁴ and primarily included in this definition are bribery and theft.¹⁵ Bribes can be intended for the bribe taker himself or for a third party – the relationship of the public official to the beneficiary and the reasons why the official might want to benefit the third party is of no relevance.¹⁶ The link between the bribe and the action or omission on the part of an official is inherent in the definition of bribery. However, the requirement of a causal link between the bribe and the specific action or omission by the official could be extremely difficult to prove. Furthermore, an act or omission by an official does not have to be illegal *per se* or in breach of the official’s duties – if the bribe is aimed at inducing a breach in an official’s duty, it implies that there is a duty on public officials to exercise their judgment or discretion impartially.¹⁷ For a corrupt act to constitute active bribery of a foreign public official, the goal of the bribe ‘must have been to obtain or retain business or other undue advantage in relation to the conduct of international business’.¹⁸ Undue advantage (meaning that the company or person has no legitimate right to it) in the context of business includes the relaxation of regulatory standards or granting undue tax breaks.¹⁹

It is interesting to note that acts of bribery of foreign public officials for non-business purposes are not covered by the definition of transnational bribery and, therefore, are not criminalised in international law. An example of non-business purposes includes the bribery of an official so that an unqualified person is hired and appointed in a position where that person could advance the agenda of the briber. This can be in the form of allowing the briber to evade taxes in return for some personal or political favour, often with the tacit approval of the tax administration or finance ministry.²⁰ According to article 4 of the African Union (AU) Convention,²¹ the scope of application explicitly covers such instances where there is

13 There is no internationally agreed definition on corruption; furthermore, a different meaning is attached to the term depending on the discipline (eg political science, economics, legal or sociological) with which it is approached. Corruption also occurs in business and corporate relationships which exist between private businesses and suppliers. It may also involve illegal behaviour by corporate officials for private monetary gain.

14 World Bank (n 11 above).

15 The World Bank (n 11 above) states that ‘bribery occurs in the private sector, but bribery in the public sector, offered or extracted, is the Bank’s main concern, since the Bank lends primarily to governments and supports government policies, programmes, and projects’.

16 JB Terracino *The international legal framework against corruption. States’ obligations to prevent and repress corruption* (2012) 103.

17 Terracino (n 16 above) 104 107.

18 Terracino (n 16 above) 108.

19 Terracino (n 16 above) 108 109.

20 M Everest-Phillips ‘The political economy of controlling tax evasion and illicit flows’ in P Reuter (ed) *Draining development? Controlling flows of illicit funds from developing countries* (2012) 74.

21 African Union (AU) Convention on Preventing and Combating Corruption 7.

the offering or granting, directly or indirectly, to a public official or any other person, of any goods of monetary value, or *other benefit*, such as a gift, *favour*, *promise or advantage* for himself or herself, or for another person or entity, in exchange for any act or omission in the performance of his or her public functions.

Illicit enrichment²² is a criminal act that is only indirectly related to an illegal act by a public official, but which manifests through a variety of criminal acts such as accepting a bribe or embezzlement. In the case of illicit enrichment, it is not the act as such, but the use of the proceeds from the illegal acts. The reason for the existence of the criminal act of illicit enrichment lies in the difficulty of proving corruption in a court of law and, by focusing on the unexplained wealth accrued through the illicit enrichment, the burden of proof can be discharged with lesser difficulty.²³

The government benefits purchased with bribes can vary from large contractual awards to petty corruption such as that found in the issuing of licences or fast-tracking services.²⁴ Grand corruption typically is associated with international business transactions which involve government officials, and these are usually concluded outside the official's home country.²⁵ While instances of grand corruption capture the world's attention, the World Bank cautions that 'the aggregate costs of petty corruption, in terms of both money and economic distortions, may be as great if not greater'.²⁶

Corruption flourishes in environments that are characterised by abuse of office.²⁷ Some 2 000 years ago, Caesar Augustus recognised that the efficient and honest collection of taxes is of no lesser importance than the tax structure for the fairness of a financial system. Consequently, Augustus attempted a rationalisation of tax collection techniques by making the provincial governors salaried imperial employees, thereby lessening their exposure to the temptation of diverting tax income of their provinces for their personal benefit.²⁸

22 According to art 20 of the United Nations Convention against Corruption (UNCAC), it is provided that '[s]ubject to its constitution and the fundamental principles of its legal system, each State Party shall consider adopting such legislative and other measures as may be necessary to establish as a criminal offence, when committed intentionally, illicit enrichment, that is, a significant increase in the assets of a public official that he or she cannot reasonably explain in relation to his or her lawful income'.

23 Most acts of corruption are consensual and there are no 'direct' victims – it is society that is affected, but because society is not aware of the corruption, it can be said that it is a victimless crime. The absence of direct victims defies traditional procedures of starting with a complaint by a victim, and in many instances there are no witnesses, documents or other means of evidence available.

24 World Bank (n 10 above).

25 As above.

26 As above.

27 FATF *Corruption: A reference guide and information note on the use of the FATF Recommendations to support the fight against corruption* (2012) 3.

28 K Loewenstein *The governance of Rome* (1973) 304.

From a governance perspective, the absence of knowledge of economic causation saw to it that the ancient Roman Empire overextended its state activities to a degree that was never matched by public income. In many instances, public income was recklessly used for the maintenance of a sumptuous establishment of the imperial court; more and better equipped and paid armed forces; and an immensely wasteful bureaucracy which depleted general resources. The conspicuous consumption of the upper classes contrasted with the desperate plight of the masses. The never-mastered economic imbalance grew into a chronic crisis of society at large, while a relentless tightening of the tax screw exacerbated the plight of the common people.²⁹

Whilst the latter contributed to the fall of the Roman Empire, Roman state practice provided the intangibles for good governance: patriotism; civic virtues of dedication to the community; honesty; probity; and disinterested service for the nation.³⁰ Today it is accepted that 'tax systems in developing countries perform poorly due to weak capacity, corruption and the lack of any reciprocal link between tax and public and social expenditures'.³¹ Moore³² proposes that

political regimes are the outcome of tension and conflict between (a) elites who control the state, and wish to remain in power and to exercise that power as freely as possible; and (b) societal actors who want to place restraints on the power of a potentially overweening state.

In this 'conflict', revenue is central for two reasons: First, it represents a 'key strategic resource for state elites' and 'if non-state actors can limit and control elites' access to revenue, they enjoy countervailing power in relation to the state'.³³ Secondly,

if state elites need to depend on general taxation because they lack alternative, easier revenue sources, they generally have to put considerable organisational and political effort into obtaining the revenue, and face strong incentives to bargain and negotiate, directly or indirectly, with at least some taxpayers, rather than simply to extract revenue forcibly.³⁴

Moore concludes that 'dependence on general taxation provides incentives for state elites and taxpayers to resolve their differences through bargaining'.³⁵

29 Loewenstein (n 28 above) 473.

30 Loewenstein 488.

31 OECD 'Illicit financial flows from developing countries: Measuring OECD responses' (2014) 59.

32 M Moore 'How does taxation affect the quality of governance' (2007) 14.

33 As above.

34 Moore (n 32 above) 15.

35 As above.

Encouraging constructive state-society engagement around taxes is one of four channels by which tax reform contributes to state building.³⁶ This implies the prominence of taxation issues on the public political agenda, and the levying of taxes as ‘consensually and as transparently as possible’.³⁷ This means that assessments should be raised objectively and there should be equal and fair treatment of taxpayers in the recovery of debt.

According to the World Bank, the causes of corruption are ‘always contextual, rooted in a country’s policies, bureaucratic traditions, political development and social history’.³⁸ Corruption tends to flourish in the presence of weak institutions and where policies are designed to generate economic rents. According to the World Bank, the dynamics of corruption in the public sector may be depicted in a simple model where ‘the *opportunity* for corruption is a function of the size of the rents under a public official’s³⁹ control, the *discretion* that official has in allocating those rents, and the *accountability* that official faces for his or her decisions’.⁴⁰ The level of discretion of public officials may be too wide (due to a lack of explicit regulations), which in turn can be ‘exacerbated by poorly-defined, ever-changing, and inadequately disseminated rules and regulations’.⁴¹ The World Bank identifies several characteristics associated with a lack of institutional integrity:

- weak accountability with ethical values eroded or never having been established;
- rules regulating the conduct of officials and management of conflict of interest are not enforced and financial monitoring systems (for instance, mechanisms for recording revenues collected and budgeted expenditures) are dysfunctional;
- formal mechanisms for holding public officials to account for achieving specific results, are not in place or not applied;
- oversight institutions (for instance, press, external auditors or ombudsmen) responsible for scrutinising government performance are ineffective;

36 O Fjeldstad & M Moore ‘Taxation and state-building: Poor countries in a globalised world’ (2008) 242 255.

37 Fjeldstad & Moore (n 36 above) 255.

38 World Bank (n 11 above).

39 According to sec 2(a) of UNCAC, ‘[p]ublic official’ shall mean ‘(i) any person holding a legislative, executive, administrative or judicial office of a State Party, whether appointed or elected, whether permanent or temporary, whether paid or unpaid, irrespective of that person’s seniority; (ii) any other person who performs a public function, including for a public agency or public enterprise, or provides a public service, as defined in the domestic law of the State Party and as applied in the pertinent area of law of that State Party; (iii) any other person defined as a ‘public official’ in the domestic law of a State Party. However, for the purpose of some specific measures contained in Chapter II of this Convention, “public official” may mean any person who performs a public function or provides a public service as defined in the domestic law of the State Party and as applied in the pertinent area of law of that State Party.’

40 World Bank (n 11 above).

41 As above.

- divergence between the 'formal' and 'informal' rules in the public sector;⁴² and
- special anti-corruption bodies are used as partisan instruments whereby those in government are protected, opposition members are harassed and fraud detection is not prioritised.⁴³

In South Africa, such actions are described as 'state capture', and these actions are evidenced in the appointment of public officials for the sole purpose of promoting the interests of those who appointed them.⁴⁴

The presence of these characteristics requires the recognition by governments that a strong legal framework to control corruption is required, and that institutional strength is returned to departments by placing renewed emphasis on the 'formal' rules.⁴⁵

Reuter states that 'it is fanciful to imagine that Marcos, Mobutu or Suharto would have allowed the operation of an effective domestic AML, whatever laws they might have permitted to be placed on the books'. This predicament repeats itself continuously, as is reflected by recent reports from South Africa relating to delays by the President's office in passing the Financial Intelligence Centre Amendment Bill, which is aimed at bringing greater transparency to the financial system, and complementing government's objective to fight corruption. It gives banks powers to perform due diligence on politically-exposed persons or, as termed in the Bill, 'prominent influential persons'. The Bill was unanimously adopted by parliament in May 2016.⁴⁶ In November of the same year, the Bill was referred back to parliament due to the wide formulation of searches without a warrant.⁴⁷ Although the amendments are in line with legislation

42 The World Bank (n 11 above) describes situations where corruption is systemic as one where the 'formal rules remain in place, but they are superseded by informal rules: Thus it may be a crime to bribe a public official, but in practice the law is not enforced or is applied in a partisan way, and informal rules prevail.'

43 World Bank (n 11 above).

44 *Daily Maverick* 'gupta-leaks.com: Everything you ever need to know about #GuptaLeaks in one place' (2017).

45 World Bank (n 11 above).

46 S Mkhwanazi 'FICA Bill in line with Global Standards' (2016).

47 Amendment of sec 45B of Act 38 of 2001, as inserted by sec 16 of Act 11 of 2008 proposes under (1C) that 'an inspector otherwise required to obtain a warrant under subsection (1B) may enter any premises without a warrant (a) with the consent of the owner or person apparently in physical control of the premises after that owner or person was informed that he or she is under no obligation to admit the inspector in the absence of a warrant; or (b) if the inspector on reasonable grounds believes that (i) a warrant will be issued under subsection (1B) if the inspector applied for it; and (ii) the delay in obtaining the warrant is likely to defeat the purpose for which the inspector seeks to enter the premises. (1D) Where an inspector enters the premises without a warrant, he or she must do so (a) at a reasonable time; (b) on reasonable notice, where appropriate; and (c) with strict regard to decency and good order, including to a person's right to (i) respect for and the protection of dignity; (ii) freedom and security; and (iii) personal privacy.'

in other jurisdictions it was restricted by the courts.⁴⁸ In the context of political events⁴⁹ in South Africa, the referral would have been of serious concern, had the President found the provision relating to, for example, 'politically-exposed' persons (or 'persons in prominent positions', as referred to in South African legislation) to be unconstitutional.⁵⁰

3 Dynamics of money laundering

IFFs are said to 'often leave developing countries via the commercial financial system' through which 'funds are laundered to disguise their origin'.⁵¹ Anti-money-laundering (AML) and counter-terrorist-financing (CFT) regimes are potentially effective tools to identify and prevent illicit funds from being 'held, received, transferred and managed by major banks and financial centres'.⁵² The latter actions, whereby IFFs are facilitated, can be damaging not only to the financial sector, as far the reputational risk of financial institutions is concerned, but also to entire economies which are dependent on a well-functioning financial sector.⁵³

In many countries, money laundering is rarely successfully prosecuted, due to the difficulties in proving the offence, capacity constraints and the like.⁵⁴ Money laundering refers to any act that aims to disguise the illicit nature or the existence, location or use of the

48 *Federation of Law Societies of Canada v Canada* (Attorney-General) [2013] BCJ No 632. The issue revolved around whether Canada's anti-money-laundering and anti-terrorist-financing legislation, as it applies to the legal profession, infringes on the right to be free of unreasonable searches and seizures; and whether legislation infringes on the right not to be deprived of liberty otherwise than in accordance with principles of fundamental justice and, if so, whether the infringements are justifiable. The court argued that these provisions had a predominantly criminal law character, rather than an administrative law character. They facilitate detecting and deterring criminal offences, and investigating and prosecuting criminal offences. There are penal sanctions for non-compliance. These provisions authorise sweeping searches of law offices which inherently risk breaching solicitor-client privilege. The provisions in question were unconstitutional insofar as they applied to lawyers and law firms only.

49 At the time, various allegations of bribery and accepting kickbacks were made against the president resulting from the so-called Gupta leaks. The leaks consist of a few hundred gigabytes of information containing between 100 000 and 200 000 unique e-mails and a host of other documents. The e-mails portray members of government, a substantial number of ministers and senior state employees illegally sharing confidential state information with members and associates of the Gupta family. *Daily Maverick* (n 44 above).

50 The Bill has since been passed and it is now known as the Financial Intelligence Centre Amendment Act 1 of 2017.

51 OECD (n 31 above) 15.

52 As above.

53 As above.

54 B Schlenther 'The taxing business of money laundering: South Africa' (2013) 16 *Journal of Money Laundering Control* 23 reveals that 927 confiscation orders under ch 5 and 6 of the Prevention of Organised Crime Act were made in South Africa amounting to ZAR 577 million from 1 April 2003 to 1 April 2008. The confiscation data reportedly does not show whether the confiscations were related to money laundering *per se*. It is, therefore, not known whether these figures are representative of the pervasiveness of money laundering in South Africa. Based on reports for later years, it can be assumed that a small number of confiscations related to money laundering took

proceeds of crime.⁵⁵ Money-laundering legislation typically provides for three substantive offences in respect of the crime of money laundering. These offences are the concealment of criminal property; arrangements made with regard to criminal property; and the acquisition, use and possession of criminal property.⁵⁶ For money-laundering schemes to achieve their objective, De Koker⁵⁷ identifies criteria which they must meet, namely, that 'they must appear to make commercial sense, be structured in a tax efficient way,⁵⁸ have the appearance of legitimacy and be transnational in nature'. The aid of professional advisors (also referred to as gatekeepers) in accounting, banking, law and financial services is integral to the success of sophisticated laundering schemes. The socio-economic and political environment also plays a role, and a greater incidence of money laundering will be present in countries with high levels of corruption⁵⁹ and with a high prevalence of organised crime, specifically through the production or distribution of prohibited goods.⁶⁰

Experience across the globe shows six general money-laundering techniques used: (i) the investment of proceeds of crime in a legal business

place in the years 2009-2010 and 2010-2011. The National Prosecuting Authority (NPA) reported success in 192 trial cases for the latter year, which included five racketeering convictions and 25 counts of money laundering. The year 2009 only delivered six finalised money-laundering cases. In addition, the FIC Annual Report for 2014-2015 makes no mention of successful money-laundering prosecution in South Africa for the year under review. However, the NPA's report for the same period indicates that 11 cases involving racketeering and/or money-laundering charges were finalised with verdicts (eight of these cases were finalised with guilty verdicts, and the remaining three were acquittals). Five cases involving money laundering were finalised with verdicts (all were finalised with guilty verdicts). In its 2015/16 Annual Report, the FIC makes mention of the number of investigations they assisted in with no reference to successful prosecutions. For the same period, the NPA reported only three money-laundering convictions, namely, *S v Hinzelman*; *S v Norman and Hendricks* and *S v Letsie & Others*.

55 L De Koker *South African money laundering and terrorism financing law* (2007) 1-4.

56 According to De Koker (n55 above) 4, 'three stages are generally distinguished in the money laundering process, namely placement, layering and integration. During the placement stage, money enters the financial system. The aim of the layering process is aimed at separating the illicit proceeds from their criminal source, which may entail a complex series of transactions which are solely aimed at blurring the money trail. The last stage involves the integration of all the funds – the original amount minus the costs of the laundering process, is amassed and controlled as apparent legitimate business funds.'

57 De Koker (n 55 above) 7.

58 Schlenther (n 54 above) argues that 'tax efficiency may not necessarily be a requirement, as paying taxes timeously creates the perception of a compliant taxpayer and with that, brings legitimacy to the criminal enterprise'.

59 The Transparency International Corruption Perception Index ranking provides a breakdown of the country perception of that country which is likely to be most/least corrupt.

60 The *CIA world factbook* (not dated) classifies countries' attractiveness to criminal activity. Eg, Ghana is identified as a 'major transit hub for Southwest and Southeast Asian heroin and, to a lesser extent, South American cocaine, destined for Europe and the US; widespread crime and money-laundering problems, but the lack of a well-developed financial infrastructure limits the country's utility as a money-laundering centre'. South Africa is described as 'an attractive venue for money launderers, given the increasing level of organised criminal and narcotics activity in the region and the size of the South African economy'.

venture, either through shell or fictitious companies or in genuine companies under a false identity; (ii) the acquisition of assets accompanied by payment of the requisite taxes; (iii) the deposit of money in tax havens or in banks in non-cooperative countries, and remittances back to the host country through normal banking channels; (iv) the use of underground banking channels for the transfer of funds; (v) the over-invoicing of goods in import or export transactions; and (vi) the routing of funds through safe tax haven countries.⁶¹ These forms of financial systems and corporate vehicle abuse can cause extensive reputational damage to institutions, damage the investment climate and ultimately can weaken the financial system.⁶²

Money laundering has numerous underlying predicate offences, which need to be established before a charge of money laundering can be pursued – thus the removal of the predicate offence (for example, tax evasion or corruption) may provide a better long-term solution. The FATF recognises the ‘link between corruption and money laundering’ and takes into account compliance by countries with the FATF Recommendations.⁶³ Some compliance measures include:

- the degree to which the FATF Recommendations are implemented;
- implementation measured against the number of money-laundering investigations, prosecutions and convictions, as well as the value of assets confiscated as a result of money laundering or a predicate offence;
- measures to prevent and combat corruption.⁶⁴

Several indicators are used to measure the strength of the anti-corruption framework. These are the level of transparency; the presence of good governance principles and ethical codes of conduct for officials; as well as the efficiency of the courts and the degree to which court decisions are enforced.⁶⁵ These indicators are regarded as significant because, where they are absent or weak, the effective implementation of the FATF Recommendations may be jeopardised.⁶⁶

4 Dynamics of tax evasion

Considerable evidence is available that tax evasion depends on opportunities for successful evasion and these differ widely, depending on

61 UNAFEI ‘Resource Material Series No 59’ (2000).

62 As above.

63 FATF/OECD (n 27 above) 2.

64 As above.

65 As above.

66 As above. The FATF views the presence of ‘a proper culture of compliance with AML/CFT standards’ as a key component to detect and mitigate corruption.

the circumstances of the taxpayer.⁶⁷ Tax compliance, therefore, is not solely reliant on the taxpayer's analysis of the benefits and costs of evasion, but also on the presence of a belief that the state lacks legitimacy.⁶⁸

International initiatives to limit tax evasion and address the proceeds of crime are ongoing and are led by the Organisation for Economic Co-operation and Development (OECD) Global Forum on Taxation, the FATF and the United Nations Office on Drugs and Crime (UNODC). However, these efforts in curbing IFFs are still being evaluated, but it is clear that any approach will require greater co-ordination and cooperation around key issues and stakeholders, such as the private sector, government, international organisations and civil society.⁶⁹

The predicament posed by tax evasion is well phrased by Everest-Phillips, who states that

effective states require effective, efficient, and equitable tax systems. Creating the commitment of citizens not to evade taxation is a political process central to state building; cajoling elites to pay taxes has always been an essential step to any state becoming effective. Bad governance manifests itself through an unjust tax system and rampant tax evasion.⁷⁰

The latter then becomes or remains a trigger for or indicator of political instability. Tax evasion, corruption and criminality as the main drivers of illicit capital flows at the same time are 'both causes and effects of the fragility of state institutions, and in this sense, are challenges to state legitimacy'.⁷¹ Everest-Phillips draws an important correlation between tax evasion and corruption. He states that tax evasion undermines the funding of the state and, therefore, the legitimacy associated with the state through the delivery of public services. Corruption, in turn, affects the moral legitimacy of the government, and criminality becomes a challenger to the legitimacy of the government.⁷² It is evident that good governance is an essential element to addressing IFFs and, therefore, remedies should be more than 'technocratic solutions'.⁷³ This requires that the correlations or inter-relationships between tax evasion and corruption are recognised, but also those that include money laundering, and other financial crimes over and above evasion and corruption must be recognised.

67 J Slemrod & J Bakija *Taxing ourselves: A citizen's guide to the great debate over tax reform* (1998) 149.

68 Everest-Phillips (n 20 above) 73.

69 World Bank (n 11 above).

70 Everest-Phillips (n 20 above) 70.

71 Everest-Phillips (n 20 above) 71.

72 As above.

73 Everest-Phillips (n 20 above) 72.

5 Inter-relationship between corruption, money laundering and tax evasion

Examples of the inter-relationship between corruption, money laundering and tax evasion may be drawn from the extractive industries. To illustrate, the risk of corruption in the extractive sector already appears in the tender process, where bidding companies in which public officials or their affiliates have a stake may receive preferential treatment, or where the potential for bribes for bid exclusion exists. In some instances, the awarding of a bid may require a joint venture between a foreign entity and a local company or a state-owned enterprise. This obligation, however, can be diverted from the initial objective of empowering the local entity to one where companies owned by or connected to public officials are favoured.⁷⁴ The OECD identifies forms of corruption risks in contract negotiation as trading in influence, political capture and interference. Trading in influence is described as ‘the process or act by which a person who has real or apparent influence on the decision making of a public official, exchanges this influence for an undue advantage’.⁷⁵ Political/state capture or interference refers to situations where private interests significantly influence decision-making processes of public officials for private gain.⁷⁶

In contract negotiations, the typology of corruption risks includes exercising undue influence to obtain favourable contractual terms, to get access to otherwise restricted or commercially-sensitive information, or to obtain permit approvals. Often ‘influencing’ can be in breach of legislation in that a royalty rate is agreed to, which it is not provided for in law, or a permit is granted in a protected area.⁷⁷ In exercising undue influence, companies may

offer or be solicited to provide improper advantages in the form of anything of value, such as illegal commissions, gifts and entertainment (ie, first class flights, expensive hotels, dining, school fees), job or business opportunities to public officials and politicians or their family members, with a view to unduly influencing the negotiation process.⁷⁸

During contract negotiations, funds intended for public use can be diverted to benefit private individuals. Such misappropriation of public funds or embezzlement often is exacerbated by a lack of transparency in the contract negotiation phase. This then creates an environment conducive to corrupt activities, which are intended to circumvent or violate existing legal provisions for the payment of taxes and royalties.⁷⁹

74 OECD *Corruption in the extractive value chain* (2016) 43.

75 OECD (n 74 above) 37.

76 As above.

77 As above.

78 As above.

79 OECD (n 74 above) 39.

With regard to the latter, provisions negotiated in a non-transparent way may set inappropriately low corporate tax rates in comparison to the standard national rates.⁸⁰

Kick-backs and bribes received during the negotiation phases can easily be routed to foreign jurisdictions through corporate vehicles. The use of corporate vehicles and trusts are established means of money laundering and are addressed in FATF Recommendations 33 and 34. Because shell corporations provide advantages in concealing the identity of the beneficial owner, they often are used by politically-exposed persons (PEPs) to hide wealth, since their careers and reputations may be at stake if they are found to be in possession of unexplained wealth.⁸¹ In this sense, 'shell companies ensure that specific criminal assets cannot be identified with or traced back to them'.⁸² The Panama Papers again confirmed the trend.⁸³ Corporate vehicles, therefore, are a preferred and effective means of separating the origin of the illegal funds from the PEP who controls it.⁸⁴

Those wishing to hide proceeds from corruption or other crimes make use of gatekeepers or skilled professionals to establish corporate structures in offshore jurisdictions, with the sole purpose of disguising the source and ownership of the funds. With the focus on foreign PEPs and the requirements of enhanced due diligence regarding the source of funds deposited into financial institutions, corporate vehicles are in high demand.⁸⁵

6 Overview: Regulatory measures to address corruption, tax evasion and money laundering

Corruption today is classified as a category of transnational crime (other crimes in this category include drug trafficking, human trafficking and the

80 As above. Examples of such practice are cited in the UNECA Report, where one company negotiated a corporate rate of 1.43% and another whereby the royalty rate on mining was set at only 20% of the rate prescribed in legislation.

81 Due to the high visibility of their office, both in and outside their country, PEPs frequently make use of nominees (middlemen or other intermediaries such as close associates, friends and family) to conduct financial business on their behalf. According to the FATF (n 5 above) 19, the use of middlemen is aimed at sheltering or insulating the PEP from unwanted attention. The use of intermediaries can also serve as an obstacle to customer due diligence where the individual acting on behalf of the PEP has special status such as diplomatic immunity.

82 FATF (n 5 above) 19.

83 International Consortium for International Journalists (ICIJ). The ICIJ describes the Panama Papers as 'a global investigation into the sprawling, secretive industry of offshore jurisdictions that the world's rich and powerful use to hide assets and skirt rules, by setting up front companies in far-flung jurisdictions. Based on a trove of more than 11 million leaked files, the investigation exposes the use of offshore companies to facilitate bribery, arms deals, tax evasion, financial fraud and drug trafficking.'

84 FATF (n 5 above) 19.

85 FATF Recommendation 6.

financing of terrorism).⁸⁶ The emergence of the international framework against corruption is the result of the convergence of a combination of values (moral and religious) and interests (economic and development). Terracino describes the highly-political processes of the negotiation of international anti-corruption instruments as a response of traditional normative values and the interests of global players to corruption. On the African continent, this is reflected by two anti-corruption treaties adopted in 2003: the Southern African Development Community (SADC) Protocol against Corruption; and the Economic Community of West-African States (ECOWAS) Protocol on the Fight against Corruption. Later, in 2003, the AU Convention on Preventing and Combating Corruption was adopted, while in the same year the UN adopted the United Nations Convention against Corruption, which is the most recent and significant international law instrument against corruption.⁸⁷ The latter includes provisions on the recovery of stolen assets, and establishes various measures for international cooperation for the purpose of detecting the transfer of proceeds of crime, determining the ownership of assets, as well as their confiscation, return and disposal.⁸⁸

While current international instruments against corruption require state parties⁸⁹ to establish a number of offences as crimes of corruption in their domestic laws, the same instruments have taken different approaches to the criminalisation of corrupt acts. Some call for the criminalisation of the act of bribery, and some are broader in scope, requiring the criminalisation of embezzlement; the trading in influence; the abuse of functions, and illicit enrichment. Under the United Nations Convention Against Corruption (UNCAC), it is mandatory to criminalise bribery and embezzlement in domestic law, while the criminalisation of the second group of acts is not mandatory, but preferred.⁹⁰ The SADC Protocol deals with both the primary and secondary acts, while the ECOWAS Protocol covers the same, but without the inclusion of 'abuse of function'. The immediate concern flowing from the above is that where acts other than the prescribed ones are not accepted by countries party to the UNCAC, their acceptance as corrupt acts at the international level is not clear and can complicate judicial processes. An additional feature to the AU Convention is a monitoring role constituted as the African Peer Review Mechanism (APRM), which is a mutually-agreed upon instrument to which member states can voluntarily accede as a means of self-monitoring to ascertain whether they are in conformity with the agreed political, economic and corporate governance values.⁹¹

86 Terracino (n 16 above) 3.

87 Terracino (n 16 above) 19 51.

88 Terracino (n 16 above) 52.

89 A 'state party' to a treaty is a country that has ratified or acceded to that particular treaty, and therefore is legally bound by the provisions of the instrument.

90 Terracino (n 16 above) 82.

91 As above.

Other international instruments, such as the OECD Anti-Bribery Convention, establish legally-binding standards to criminalise the bribery of foreign public officials in international business transactions, and are focused on the supply side of bribery transactions. The US Foreign Account Tax Compliance Act (FATCA) targets the non-compliance by US taxpayers using foreign accounts. The FATCA requires foreign financial institutions (FFIs) to report to the Inland Revenue Service (IRS) information about financial accounts held by US taxpayers, or by foreign entities in which US taxpayers hold a substantial ownership interest.⁹²

The criminalisation of corrupt offences in domestic legislation is the first step towards ensuring the ability of states to prosecute and sanction offenders. Part of this obligation is the obligation to criminalise money laundering that has its origins in corrupt acts.⁹³ Countries accordingly have to apply the money-laundering offences to the proceeds of corrupt acts. Therefore, there are two distinct crimes, namely, (a) the corrupt act, which is the predicate offence by which the proceeds are generated; and (b) the laundering of such proceeds. As most money-laundering cases involve an international element, countries are required to establish the extraterritoriality of predicate offences.

In keeping with the inter-relationships between corruption and money laundering, both the regulatory measures aimed at the proceeds of corruption and the AML measures applicable to the diamond value chain are highlighted below.

The following FATF Recommendations are applicable to diamond dealers: Recommendation 22 mandates that customer due diligence and record-keeping requirements set out in Recommendations 10, 11, 12, 15 and 17 apply to dealers in precious stones when they engage in any cash transaction with a customer equal to or above the applicable designated threshold (US dollars/EUR 15 000). Recommendation 28 requires that dealers in precious stones be subject to effective systems for monitoring and ensuring compliance with AML/CFT requirements, which should be

92 IRS 'Summary of FACTA reporting' (not dated).

93 This obligation is covered in specific terms in the UNCAC. Art 23(1)(a) provides for '(i) the conversion or transfer of property, knowing that such property is the proceeds of crime, for the purpose of concealing or disguising the illicit origin of the property or of helping any person who is involved in the commission of the predicate offence to evade the legal consequences of his or her action; (ii) the concealment or disguise of the true nature, source, location, disposition, movement or ownership of, or rights with respect to property, knowing that such property is the proceeds of crime; (b) subject to the basic concepts of its legal system (i) the acquisition, possession or use of property, knowing, at the time of receipt, that such property is the proceeds of crime; (ii) participation in, association with or conspiracy to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the offences established in accordance with this article'.

performed on a risk-sensitive basis by a supervisor or by an appropriate self-regulatory body.⁹⁴

In some instances, countries without national AML/CFT regulations regarding diamond dealers may have national legislation in place for sector regulation. South Africa, for example, does not have industry-specific AML/CFT regulations directed at diamond traders, and diamonds are only covered under the Diamond Act, which deals with the regulation of the diamond industry in its entirety.⁹⁵

The inherent involvement of public officials in corrupt activities in many instances entails jurisdictional privileges and immunities, which can impede efforts to combat corruption. Where immunities are abused by those in public office, immunity becomes impunity and the international legal framework does not adequately address the issue of immunities.⁹⁶ According to article 30 of the UNCAC, jurisdictions

shall consider establishing procedures through which a public official accused of an offence established in accordance with this convention may, where appropriate, be removed, suspended or reassigned by the appropriate authority, bearing in mind respect for the principle of the presumption of innocence.

In short, countries are only required to apply an appropriate balance between immunities and adjudication.⁹⁷

Bank secrecy typically is aimed at protecting the financial privacy of citizens from unauthorised access, and its foundation lies in the right to privacy. A different meaning is attached to the protection afforded by bank secrecy laws. On the one hand, it is regarded as a private law issue (breach of contract or delict⁹⁸ where false reporting of corruption is made) and, on the other, it is seen as a public interest matter, and a breach of secrecy constitutes a criminal offence. From a transnational investigative perspective, jurisdictions cannot deny mutual legal assistance to another jurisdiction on the grounds of bank secrecy.

After the financial crisis of 2008/2009, the G20 countries compelled tax havens to sign bilateral treaties providing for the exchange of bank information. Policy makers reportedly celebrated this as the momentum required to end bank secrecy. Johannesen and Zucman assessed the impact of tax treaties on bank deposits in tax havens, and found that rather than

94 FATF 'Money laundering and terrorist financing through the trade in diamonds' (2013) 36-37.

95 FATF (n 94 above) 38.

96 Terracino (n 6 above) 195.

97 Terracino (n 16 above) 212.

98 According to art 5(7) of the AU Convention, provision is made for the adoption of national legislative measures in order to punish those who make false and malicious reports against innocent persons in corruption and related offences.

repatriating funds, tax evaders merely moved deposits to tax havens which are not covered under a treaty with their home countries. What is celebrated as a crackdown, thus, is merely a relocation of deposits to the benefit of the least compliant havens.⁹⁹

The liability of legal persons is highly relevant to corruption cases, since these are frequently committed through or under cover of legal entities. With corporate structures becoming increasingly complicated, holding individuals to account for a particular decision has become progressively more difficult. Legal persons have elaborate financial structures (especially in the case of corporates) and accounting practices, making it easier to conceal corrupt acts and the identity of decision makers.¹⁰⁰ The attribution of responsibility to legal persons is possible through three major approaches. The first is the identification theory, which assigns liability to the individual who is in a leading position; the second approach is based on the agency principle which attaches vicarious liability (that is, an employee acting within the scope of his or her duties and for the benefit of the company). The third approach relates to corporate culture, where ‘the legal person fails to create or maintain a corporate culture that requires compliance with the relevant laws’.¹⁰¹

A legal person is only held responsible for corrupt acts committed by its employees when there is a connection between the act and the legal person – the act must have been committed ‘for the benefit of the legal person and not in the interest of the employee’.¹⁰² When assessing the liability of the legal person, a key test is whether the legal person has exercised due diligence in supervising and controlling its employees.¹⁰³

From a tax perspective, the greatest weapon in the arsenal of the tax authority no doubt is its ability to tax *all* income – including that generated through illegal means, for example, section 1 read with section 23 of the South African Income Tax Act 58 of 1962, which respectively deal with gross income and non-allowable deductions. ‘Trade’ is widely defined to include ‘every profession, trade, business, employment, calling, occupation or venture’, while section 23(o) does not allow for deductions ‘where the payment of that expenditure or the agreement or offer to make that payment constitutes an activity contemplated in Chapter 2 of the

99 N Johannesen & G Zucman ‘The end of bank secrecy? An evaluation of the G20 tax haven crackdown’ (2014) 6 *American Economic Journal* 65.

100 Terracino (n 16 above) 255.

101 Terracino (n 16 above) 258.

102 As above.

103 Due diligence requires steps such as the implementation and application of a code of conduct, an efficient internal audit control system, compliance programmes as well as effective training and enforcement. In some jurisdictions, effective due diligence constitutes a defence (eg in Italy and Korea), while in others it is only a mitigating factor in sentencing (eg the US).

Prevention and Combating of Corrupt Activities Act 12 of 2004'. Similar provisions are contained in the new Ghana Income Tax Act,¹⁰⁴ which defines income in section 2(1) as 'the assessable income from employment, business or investment'.¹⁰⁵ Excluded deductions specifically include bribes and expenses incurred in corrupt practices, as well as interest, penalties and fines paid or payable to a government or a political division of a government of any country for breach of any legislation.

Preventive measures have the potential to make corruption riskier where these are targeted at systemic weaknesses that facilitate corrupt practices. Their successful implementation could significantly reinforce institutions necessary to prevent corruption. Such measures can include, for example, (a) increased transparency (through initiatives such as the Extractive Industry Transparency Initiative (EITI); (b) approaching treaties as mechanisms that can police interactions between countries;¹⁰⁶ (c) establishing effective anti-corruption and anti-money laundering bodies; (d) implementing sound risk management policies; (e) implementing beneficial ownership requirements; and (f) implementing a legislative and regulatory environment that is conducive to revenue collection.

7 Conclusion

The underlying conditions that create incentives for corrupt activities are diverse and can manifest in rent seeking through payoffs and kickbacks. In order for bribery to be worthwhile to public officials, they must be in a position to create or distribute rents. The economics approach predicts that the higher the rent, the higher the incentive for corruption, and the more managers will be prone to corrupt behaviour.¹⁰⁷ Good governance requires the implementation of measures that improve the external environment in which enterprises operate, and that improve the effectiveness of institutions which regulate, facilitate and enforce regulations. As acts of corruption, money laundering and tax evasion generally are aimed at achieving a financial gain¹⁰⁸ in a manner which aims to hide that gain, they are necessarily intertwined. An institutional

104 Act 896 of 2015.

105 Business income includes income from a trade, profession, vocation or isolated arrangement with a business character; gains from the realisation of capital assets and gifts received in respect of the business.

106 A Campbell 'Riding a friendly elephant'? How African nations can make the best of economic partnership with China' (2016) 49 *Vanderbilt Journal of Transnational Law* 540.

107 Y Jeong & RJ Weiner 'Conflict and corruption in international trade: WHO helped Iraq circumvent United Nations sanctions?' in S Rose-Ackerman & T Søreide (eds) *International handbook on the economics of corruption* (2011) 381.

108 The gain could be legal or illegal. Where the gain is legal but the entity attempts to hide the gain from the tax authorities, it becomes tax evasion and, therefore, is illegal.

response should recognise this aspect, in order to successfully deal with these diverse crimes.

Taxation is a key shaper of accountability relationships between citizens and government,¹⁰⁹ and the anti-money-laundering framework can further delineate this relationship by highlighting agreements which are opaque and where beneficial ownership is not transparent. For a tax administration, this may mean better revenue collection, and for tax policy greater transparency in the design of, *inter alia*, incentive and/or exemption regimes.

In addressing money laundering and tax evasion, cognisance should be taken of the fact that anti-money-laundering and counter-terrorist-financing regimes support economic development through three primary roles:

- (a) by serving as an additional tool in combating and preventing crime and tax evasion;
- (b) by protecting the financial system from criminal influences and by preventing tainted money from being injected into the economies of countries; and
- (c) by contributing to good governance and by promoting the rule of law to the benefit of society as a whole.¹¹⁰

The different regulatory frameworks aimed at fighting corruption, evasion and money laundering are complementary and provide diverse options to enforcement agencies. For instance, instead of pursuing embezzlement under anti-corruption laws, it may be better for tax authorities to pursue tax evasion charges, as unexplained wealth forms the basis of the embezzlement crime and life style audits are the bread and butter of revenue agencies. Strong sanctions of the AML Framework, coupled with a wealth of financial information, puts it in a formidable position to assist tax administrations with up-to-date information, where the tax authority is hampered by a lack of updated, comprehensive and comparable data.

109 S Knack *Sovereign rents and the quality of tax policy and administration* (2008).

110 S Yikona et al 'Ill-gotten money and the economy: Experiences from Malawi and Namibia' World Bank Open Knowledge Repository (2011) 5.

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