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EXECUTIVE SUMMARY

Money Laundering and tax evasion go hand in hand. While originally Money Laundering was meant for combatting drugs, its scope broadened over time from drugs to terrorism financing and lately also to tax. The following paper wants to give an overview over the development and relation between money laundering and tax evasion. What is money laundering, which techniques are they and how are they related to tax evasion and offshore centres. How is it distinguished from tax evasion and tax avoidance? Which problems of definitions do still exist in order to link money laundering and tax evasion consistenlty among Member States?

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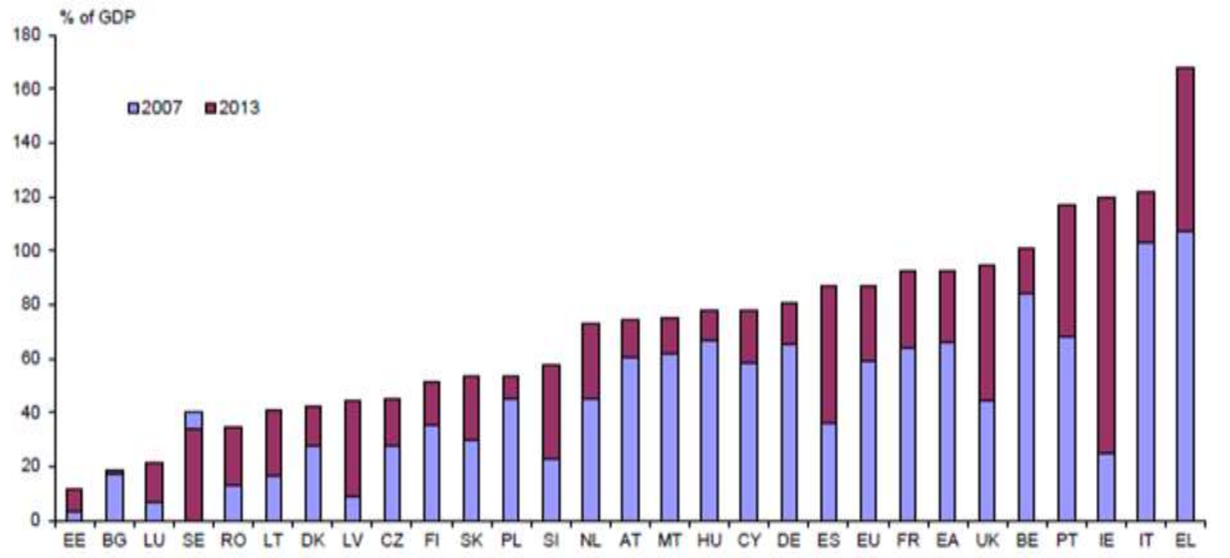
1. WHY MONEY LAUNDERING IS AN ISSUE

The financial crisis of 2008 has increased public debt in many countries in the world. All European countries (except Sweden) were hit quite severely. As Figure 1 shows, in some countries, like Ireland, Spain, Slovenia, Estonia and the UK public debt more than doubled between 2007 and 2013. Greece's public debt rocketed towards 180 percent of Gross Domestic Product. On average, public debt within the EU Member States increased by one fourth (see Figure 1).



Notes: 2012 and 2013 are forecast data. Differences between the sum and the total of individual items are due to rounding.
Source: Commission services.

Figure 1. *Public debt in % of Gross Domestic Product before and after the financial crisis in the EU Member States*

1.1 The financial crisis and some leaks

Many countries focused now on the tax revenue side in order to serve the increased public debt and the need of the population for public non-bank expenditures like infrastructure, housing and education. Many citizens had noticed this extreme and visible shift of spending from public goods towards the financial sector and perceived it as unfair. Whistle-blowers, some for moral reasons a la Robin Hood (like whistle-blower 'John Doe' of the Panama papers) some for commercial reasons a la Dagobert Duck (like the list of clients of Julius Bär Bank sold to German tax authorities) became active. Leaks in the internet repeatedly showed abuse of the tax system. The German tax authorities of North Rhine Westphalia bought up several CDs with the information of thousands of German 'Steuersünder' (tax sinners) in Switzerland and Luxembourg, Thomas Piketty's book, 'The Capital of the 21st century' showing extreme inequalities between financial capital and the real world, also raised the awareness that something seriously and systematically went wrong in the global financial system.

In 2011, the non profit organisation Tax Justice Network announced, that 3.1 trillion USD were lost annually by tax evasion and by tax avoidance of large companies due to secrecy havens (see www.taxjustice.net November 2011).

In the US, the Internal Revenue Service (see www.fortune.com from 29th of April 2016) calculates that tax evasion costs the US Government 458 billion USD a year.

In 2015, University of California, Berkeley professor Gabriel Zucman, published a widely noticed book 'The Hidden Wealth of Nations - The Scourge of Tax Havens '. He concluded that as of 2014, at least 7.6 trillion of world's total financial wealth of 95.5 trillion USD was 'missing'. Countries' national balance sheets recorded much more liabilities than assets. This means that the difference must be hidden somewhere. Zucman calculated that 2.6 trillion USD of financial wealth in Europe is held offshore, leading to tax revenue losses of 78 billion USD annually. Worldwide, 8% of financial wealth is held offshore, leading to global tax revenue losses of 190 billion USD (see Table 1). Next to the loss of tax income of 190 billion USD through tax evasion, he estimated losses of 130 billion USD through tax avoidance by US corporations (Zucman 2015). Inequality is rising, since especially less developed countries, in particular Africa, are over proportionally hit (see Table 1, where 30% of African financial wealth is held offshore leading to tax revenue losses of 14 billion USD). Zucman expressed his shock about what was going on globally by exclaiming: 'As if planet earth were in part held by Mars'.

His suspicion was definitely confirmed when the International Consortium of Investigative Journalists (ICIJ) in April 2015 revealed the 'Panama Papers' , consisting of 11.5 million leaked documents that showed financial and attorney–client information for more than 214,488 offshore entities. The documents belonged to the

Panamanian law firm and corporate service provider Mossack Fonseca. ICIJ compiled the 2.6 terabyte leak in comprehensive overviews per country and made large parts publicly available, so that today every student and person interested can 'play' detecting offshore connections and networks by clicking https://offshoreleaks.icij.org.

Zucman's Martian men systematically were revealed: heads of governments, top politicians, football players and football managers, actresses, film makers; an elite which had apparently stopped paying taxes by making use of loopholes emerging in an unregulated global world. These elites used apparently the same offshore channels as drug dealers and human traffickers.

Table 1. *Offshore wealth and tax evasion 2014 –* ***Source:*** *Zucman, Gabriel (2015)*

Region	Offshore Wealth in billion USD	Share if Financial Wealth held Offshore	Tax Revenue Loss in billion USD
Europe	2,600	10%	78
United States	1,200	4%	35
Asia	1,300	4%	34
Latin America	700	22%	21
Africa	500	30%	14
Canada	300	9%	6
Russia	200	52%	1
Gulf countries	800	57%	0
Total	7,600	8%	190

It was this latter clientele, drug dealers, fraudsters, human traffickers, to which the money laundering debate referred to. In 1995, the Australian criminologist John Walker estimated that 2.85 trillion USD is laundered globally, of which almost half (46%) in the US. In 1998, Michel Camdessus from the IMF guessed that around 2-5%

of GDP worldwide are lost annually through money laundering. Camdessus' estimate amounts to 1.5 trillion USD. worldwide (see Unger et al 2006, Walker and Unger 2009). Many estimates followed. Though no calculations of Camdessus could be found, his 'wet finger' approach has turned out valid and could not be rejected by far more sophisticated measures.

Since money launderers and tax evaders both used offshore centers to hide their identity and business, it was only a matter of time that the two fields – tax evasion and money laundering – would merge.

1.2 From a cold to a hot phase of regulation

The regulation of both money laundering and tax evasion started both in the 1990ies and were both pushed by the United States. Money laundering regulation originally was meant as an alternative to fight drugs. Before 1922, the use of drugs was not criminalized in the US. Coca Cola, for example, contained – as the name coca still indicates - cocaine in order to cheer you up. However, the criminalization of drug abuse in the US in 1922 was followed by several decades of unsuccessful efforts to reduce drug trafficking. In a renewed attempt to win the 'war on drugs', the Clinton regime focused on a new strategy: following the drugs money and stripping criminals of their proceeds from crime. *"If one could not get at drug dealers [...], then at least they should be discouraged by the realization that they could not reap the monetary benefits of their acts."* (Unger, 2013, p.53). In 1986, the US established the first Money Laundering Control Act (1986) that established money laundering as a federal crime.

Already in 1989 the Financial Action Task Force was founded at the pressure of the United States. The EU so far only transposed the recommendations of the Financial Action Task Force (FATF) - an inter-governmental organization created by the G-7 in 1989 to coordinate global efforts on money laundering. Contrary to other policy fields (e.g. food standards) Europe did not take a lead here but was a follower.

For Europe the following EU Directives show the enlargement of scope of anti money laundering regulation from combating drug offences (1st AML Directive in 1991), to including other crimes like fraud and corruption (2nd AML Directive in 2001), to terrorist financing (3rd AML Directive in 2005) and tax crime (4th AML Directive in 2015).

- EU Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering defined **money laundering in terms of drugs offences** and imposed obligations solely on the financial sector. (1st AML Directive)
- Directive 2001/97/EC of the European Parliament and of the Council **extended the scope** of Directive 91/308/EEC both **in terms of the crimes covered and**

in terms of the range of professions and activities covered. (2nd AML Directive). Reporting requirements were expanded to include trust companies, financing companies, and commercial dealers of high-value goods. Also notaries, lawyers, real estate agents/intermediaries, accountants, business economic consultants, independent legal advisers, trust companies and other providers of trust related services, and tax advisors were added. In the Netherlands, reporting entities that fail to file reports could be fined 11,250 Euros, or be imprisoned for up to two years.

- Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (2005) included the FATF recommendations of 2003 and **included terrorist financing**. (3rd AMl Directive)
- Commission Directive 2006/70/EC of 1 August 2006 laying down **implementing measures** for Directive 2005/60/EC of the European Parliament and of the Council as regards the definition of politically exposed person and the technical criteria for simplified customer due diligence procedures.
- Directive (EU) 2015/849 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing. This 4th AML Directive takes into account the latest recommendations of the Financial Action Task Force (''FATF') from 2012. Point 11 of the Directive stresses that it is important expressly to highlight that **'tax crimes' relating to direct and indirect taxes** are included in the broad definition of 'criminal activity' in this Directive, in line with the revised FATF Recommendations.

Tax regulations happened slightly later. From 1996 to the Financial Crisis in 2008 a 'cold area of regulation' took place. Many initiatives were taken but did not really work out. The initiatives were driven by the G7 and delegated to international organizations such as the OECD and the International Monetary Fund (IMF). The OECD developed its campaign against harmful tax competition. The Financial Stability Forum tackled financial stability.

Parallel to the OECD's report on harmful tax competition, the EU agreed in 1997 to a package of measures to tackle harmful tax competition within the Union, including a Code of Conduct on business taxation (Sharman 2006, Catttoir 2006, Radaelli 2003).What followed was action on the taxation of savings income.

Figure 2 shows initiatives for tax fraud regulation initiated both from civil society, like the Tax Justice Network, and from regulators from 1996 till 2016. Starting on the left we have the initial interventions from the EU with the formation of the Code of Conduct group and from the OECD with the launch of the Harmful Tax Competition report. These initiatives attracted heavy criticism from civil society and led to the launch of the Financial Secrecy Index, which proved powerful for transparency. The initial Savings Tax Directive, although path-breaking, was considered flaw by design. Given the shift to a fast-burning and hot policy environment, disappointment with the impact of Savings Tax Directive and the hypocrisy of some EU members led to a push from civil society for more effective Automatic Exchange of Information (AEoI).

Ultimately, the United States made the first move with the Foreign Account Tax Compliance Act (FATCA). However, this was a limited and unilateral initiative designed to protect US revenue and required multilateral development. EU Member States were quick to sign up to FATCA and a conjuncture between the US move and rising concerns within the EU led to the adoption of more comprehensive AEoI in a reinforced Savings Tax Directive and then a multilateral instrument promoted by the OECD. Next, is the innovation of a template for Country-by-Country Reporting (CBCR) by the Tax Justice Network, which in the slow-burning phase, met on deaf ears. Under pressure from the G8, when the issue of corporate tax abuse had become a hot political issue, CBCR was adopted by the OECD in its Base Erosion and Profit Shifting (BEPS) initiative and pushed into EU legislation targeting banks and the extractives sector. This provides only a snapshot of some recent initiatives, but this brief illustration of the evolutionary patterns of policy development, from slow to fast and cold to hot. At the moment, many initiatives are present at the same time. The EU Horizon Project COFFERS (2016) analyses whether they are compatible and which new loopholes might emerge.

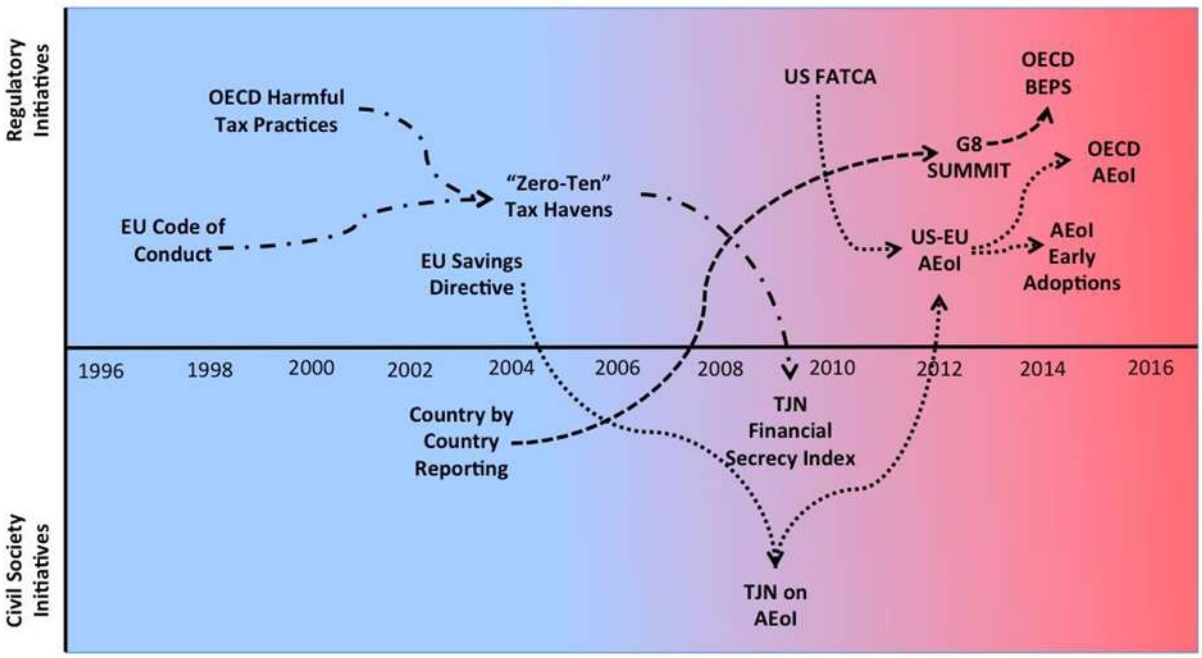


Figure 2. *The evolution of tax evasion regulation 1996-2016, CBS in COFFERS proposal*

The financial crisis of 2007-8 stimulated the development of a second, intensive phase in the battle against tax abuse. Mass protests in the USA, UK and other cities had popularized and politicized sentiment on corporate tax avoidance. The onset of austerity in the wake of the on-going impact of the global financial crisis had made tax revenue a scarce and desirable commodity to politicians around the world, especially if recoverable from outside their own jurisdictions, and the impact was seen in the agenda of the G8. A new era of measures aimed at targeting tax abuse had begun[1]. With the Fourth EU AML Directive in 2015 anti tax evasion and anti money laundering policy merged.

2. HOW MONEY IS LAUNDERED

2.1 Where the criminal money goes

Criminal activities and illegal money can be produced domestically (in Figure 4 the Netherlands stands for the 'domestic' country) and they can come from foreign countries. Money from the domestic criminal economy can be hoarded as cash, can be used for expenses within the criminal economy (for buying drugs or weapons), and can be smuggled to foreign countries, either by transportation of cash by couriers or by underground banking. In the latter case, the criminal brings the cash money to an underground banker in the Netherlands. One phone call of an underground banker in the Netherlands to an underground banker in Suriname is sufficient to pay the money there out in cash. This takes less than a minute. (see Unger et al 2006, The Dutch Suriname Corridor, World Bank Study). The criminal money can also be invested in the real economy. By setting up business in the transport sector in order to transport drugs, or in the restaurant sector to mix legal proceeds with criminal money, criminals can undermine the real economy. They do not have to make profits and can compete out honest business.

Criminal money coming from abroad (see Figure 4 right top)can either flow through the financial system of the country, by using for example the financial services of the respective country, or it can settle down. Organized crime from abroad can infiltrate the real economy of a country. As long as money laundering consists only as through flow for a country, it is difficult to convince politicians that this is a problem that has to be tackled. The country itself does not bear the burden, or it might even profit from the through flow (for example jobs for the financial service sector, tax receipts from the through flow money). One problem in the money laundering debate is that many countries (EU Member States) think that the harms of money laundering are small and

[1] For the development of the international fiscal regime see Eccleston, R. (2012). The Dynamics of Global Economic Governance: The OECD, the Financial Crisis and the Politics of International Tax Cooperation. Cheltenham: Edward Elgar; Palan, R. and D. Wigan (2014). Herding Cats and Taming Tax Havens: The US Strategy of 'Not In My Backyard', Global Policy, 5, 3, 334-343.

that the through flow of criminal money does not bring harm to them. However, the financial system risks ruin of reputation and once criminals invest in the domestic economy, this becomes a domestic problem as well.

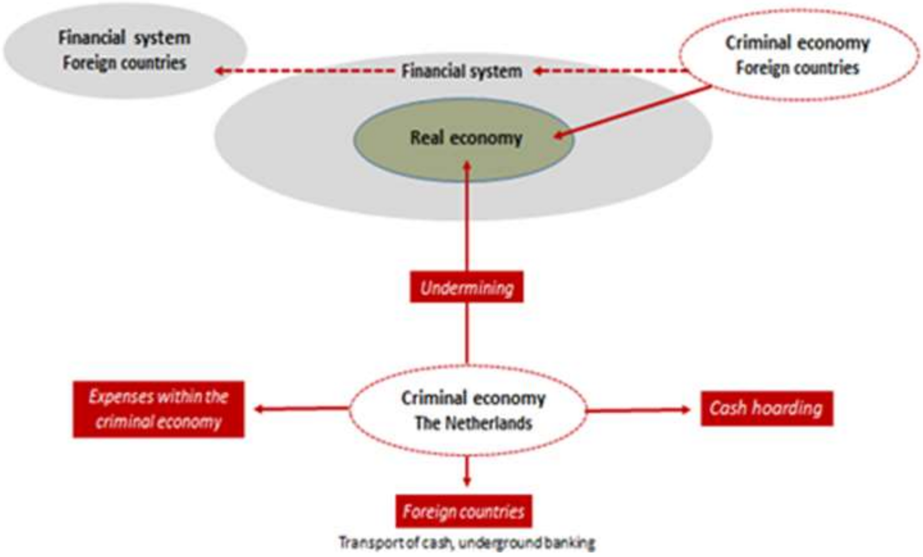


Figure 3. *Where the criminal money goes. –* ***Source:*** *WODC Project (2017)*

2.2 Money Laundering Techniques

The FATF has identified three main methods by which criminal organizations and terrorist financiers move money for the purpose of disguising its origin and to integrate it into the formal economy. These methods involve:

- the use of the **financial system** (either the formal one, like banks or money transfer offices or by use of informal ones such as 'hawala')
- the **physical** movement of cash such as by the use of cash couriers or shipping containers
- what may be described in general terms as **'trade-based money laundering'**, disguising the origin of criminal money by hiding it in legal exports and imports of goods and services.

Money laundering techniques can be distinguished according to **the phase of laundering**. Figure 4 describes a simple laundering scheme. In the top left it shows a drug dealer sitting in his car and collecting small bills of money from his drug sales. He has to manage to bring these bills to a bank without raising the suspicion that it is drug money, or he can smuggle it out of the country, or he can mix it with legitimate business. (Al Capone used to mix his illegal proceeds from alcohol during the prohibition in the US with income from launderettes, that's where supposedly the expression 'money laundering' comes from (see Unger 2006). With this the drug dealer enters the first phase of money laundering

The first phase of money laundering occurs at placement where the proceeds of crime are deposited at a bank, smuggled over a border or infused with the turnover of a legitimate business. This phase can be called the placement or pre-wash phase. The second phase is the layering phase (the main wash) where money is circulated many times, either nationally or all over the globe to hide its illegal source. In this phase complicated financial constructions such as complicated hedging and derivative constructions can occur. It is this second phase where offshore centers play an important role. Our drug dealer in Figure 4 after having successfully deposited the drug money in a bank gets this money transferred to the bank account of company X. The money is then sent via wire transfer to an offshore centre correspondent bank in, say, Panama. The Panama bank gives company Y a loan, which pays for a false invoice from company X. Company X now has a legal receipt from company Y. So now the origin of this money, namely company X itself, is not traceable anymore. The more often the money gets transferred around the globe in the layering phase, the less traceable its criminal origins are. (see Unger et al 2006, Chapter 5)

The third phase is the reintegration phase, where the by now clean money is parked permanently, like in the bond market or in the real estate sector, buying companies or buying expensive cars and jewels. Criminals often like to permanently park their money to close where they live. The Turkish mafia invests at the Turkish Riviera, the Chinese mafia in China or in Chinese neighborhoods in the US or UK etc.

In the following discussion, a variety of techniques used during these three phases will be described. Quite a lot of techniques are not easily attributed to one laundering phase alone. They might be used in different phases of laundering. If this is the case, it will be indicated in the description of the techniques.

2.2.1 Laundering techniques in the placement phase

Smurfing and Structuring

As a first phase, Smurfing and Structuring (breaking up a large deposit into smaller deposits which helps avoid the currency transaction reporting requirements) takes place. If the reporting limit is say 10,000 Euros, launderers who do not want to risk reporting will smurf, that means put amounts up to 9,990 Euros on their accounts in order to stay slightly under the reporting mark.

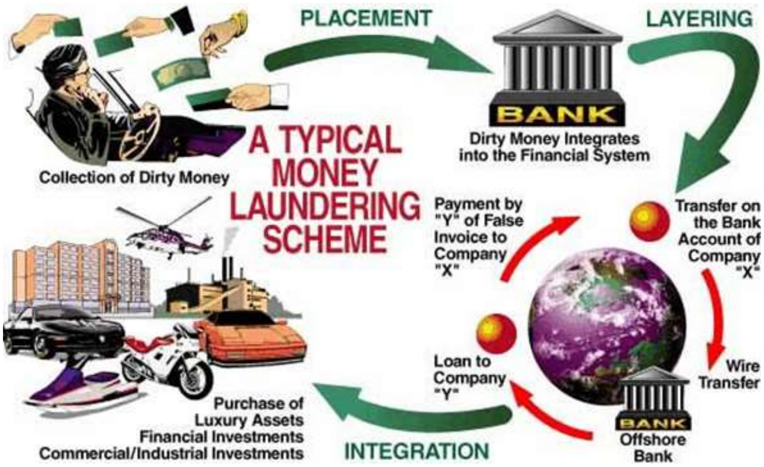


Figure 4. *The three phases of money laundering. –* ***Source:*** *UNODC (2006), http://www.unodc.org/unodc/money_laundering_cycle.html*

Currency smuggling

This method refers to the physical movement of bulk currency across borders in order to disguise its source and ownership. A launderer smuggles ill-gotten cash into a country with lax money laundering laws. He then places it in a bank there. Very often it is deposited in an offshore bank account and eventually wired back at a later date. Smuggled cash has been found in bowling balls, coffins and scuba diving oxygen tanks of supposed tourists. But cash is heavy. If a drug trafficker sells heroin for one million dollars, he or she must transport 22 pounds of heroin, but then ends up with 250 pounds of currency (if there is an equal mix of 5, 10 and 20 dollar bills) (see Cuellar 2003, p.13). This means that there is great incentive to place money into the financial system or to use the cover of an existing cash-intensive business.

Travellers' cheques

The purchase of travellers' cheques with 'dirty money' is quite a lucrative laundering technique. The FATF has reported cases of purchase of large quantities of cheques for cash in several of the FATF member states. (FATF Report on Money Laundering Typologies, February, 2002)

Gambling, casinos

Casinos can be used for the first and third phase of money laundering. A launderer can clean cash by converting it into chips at a casino, and then exchanging it back into cash to deposit at a bank and have a cheque from the casino showing a legitimate transaction. In the third phase of laundering, the launderer can buy a casino. Casinos are a highly cash intensive business. The launderer can own a casino and claim that the large amounts of cash held are profits from the casino.

2.2.2 Laundering techniques in the layering phase

Correspondent banking

Correspondent banking amounts to one bank (the 'correspondent bank') carrying out financial services for another bank (the 'respondent bank'). By establishing networks of a multitude of correspondent relationships at the international level, banks are able to undertake international financial transactions in jurisdictions where they do not have offices. The respondent bank can also be at some offshore centre, such as Cayman Islands; Panama or Seychelles, which are historically known for lax anti-money laundering regulations. Evidently, these relationships are vulnerable to misuse for money laundering. The reason for this is the indirect character of this type of banking where the correspondent bank will carry out services for clients of another bank, the integrity of which it has not had verified beforehand by the correspondent bank. For example, Al Qaeda used the correspondent network of a Sudanese bank for cross border dealings. These cross border dealings included France's Credit Lyonnais and Germany's Commerzbank (see Busuoic 2006 in Unger 2006 Chapter 5)

Loan at low or no interest rates

A very easy method is to give interest-free loans. This allows the launderer to transfer large amounts of cash to other people and so avoid having to deposit the money into a bank or other institution. These loans will be paid back slowly, which avoids deposits hitting the reporting threshold. The receiver of the loan is likely to be aware of the dubious nature of the money, but will be put off from reporting it due to the benefits he receives from the preferential loan rates.

Back-to-back loans

Back-to-back loans are a construction used for currency hedging. They involve an arrangement in which two companies in different countries borrow each other's currency for a given period of time, in order to reduce foreign exchange risk for both of them. This hedging construction can also be used for laundering purposes. In the Netherlands, it is sometimes used when launderers want to buy real estate, which needs a Dutch bank guarantee. For example, a person takes cash to Paraguay and deposits it in a bank account there. This money is then transferred to Switzerland. The person then purchases real estate in the Netherlands using the bank deposit in Switzerland as a guarantee.

Money exchange offices

Money exchange offices are a legal way of exchanging money into the currency of choice.

Money exchange offices can also be abused regarding unauthorized money transfers. Most of the Surinamese Cambios, for example, are only authorized to do money exchange but not international money transfers. However, many of them do (see Unger and Siegel 2006). The drug dealer gives money to the Dutch underground banker in cash. The underground banker calls the Cambio in Suriname, who pays out the money in cash in Suriname. Since the drug business is running both ways quite well (cocaine versus ecstasy pills), clearing is not needed too often.

Money transfer offices

Money transfers via money transfer offices such as Western Union and MoneyGram seem to be important for money laundering, but small in size. The total amount of money transferred by the existing 30 Dutch money transfer offices is €325 million per year. According to Kleemans (2012), these relatively expensive money transfers are mainly used for smuggling illegal immigrants and women.

Insurance market

One way for the launderer to use the insurance market is to arrange insurance policies on assets, either real or phantom, through a dishonest or ignorant broker. Regular claims on this insurance can then be made to return the cash to the launderer.

Fictitious sales and purchases

This method entails the use of false sales and purchase orders. These can be with legitimate organizations that will have no knowledge that these purchase orders exist. Fictitious sales documents are created to explain the extra income showing in the accounts, which has come from illegal activities.

Shell companies

Shell companies are businesses without substance or commercial purpose and incorporated to conceal the true beneficial ownership of business accounts and assets owned (A number of shell companies are set up in countries known for strong bank secrecy laws or for lax enforcement of money laundering statutes. They can also be in the form of Special Purpose Entities (SPE’s) or International Business Companies (IBC’s). The dirty money is then circulated within these shell companies via two methods. The first is the loan-back system and the other is the double invoicing system. In the case of the loan-back method, the criminal sets up an offshore company and deposits the ill-gotten gains with the respective company, which subsequently returns the funds to the offender. Given that the ownership of offshore companies is very difficult to establish, it will appear as if a company is lending money to the criminal while in fact he is lending it to himself. The double invoicing system amounts to keeping two sets of books or false invoicing. Funds can be moved across borders through overcharging or undercharging imports and exports.

Trust offices

The term ‘trust’ refers to the ability of the institution's trust department to act as a trustee– someone who administers financial assets on behalf of another. The assets are typically held in the form of a trust, a legal instrument that spells out who the beneficiaries are and what the money can be spent for. Trust offices in the Netherlands are somewhat different. They provide services in the field of tax and law for foreign companies. The foreign companies do not run businesses in the Netherlands; they are only placed in the Netherlands because of tax advantages on royalties or worldwide dividends. The huge volume of transactions and the little knowledge on beneficial ownership makes these offices suspect of money laundering.

The role of special purpose entities (vehicles)

Special Purpose Entities (SPEs), also known as Special Purpose Vehicles, (SPVs) are companies settled in the Netherlands where non-Dutch resident participants are able to earn foreign income in the Netherlands and then to redistribute it to third countries For example: Esso collects the receipts from all over the world in the Netherlands and then redistributes these to its branches or to financial institutions abroad. This happens in order to reduce global tax exposure. The volume of these transactions is so huge (eight times the Dutch GDP) that if only half a percent of the turnover was used for illegal activities such as money laundering, money laundering would be around 18 billion Euro a year in the Netherlands.

Underground banking

Underground banking can be considered as any financial operation outside the conventional or regulated banking and financial sector. The term ‘hawala’, used for parts of underground banking, means ‘transfer’ in Arab. Ethnic groups often use currency exchange offices in food, telephone, and video shops which deliver local currencies to their relatives. While these systems have been traditionally used by transnational ethnic networks, lately they are being increasingly used by those who would like to be undetected when moving money such as drug traffickers, tax evaders, money launderers and terrorist financiers.

Black market of foreign currency

The launderer uses the foreign currency black market both to remove the risk of transporting large amounts of currency and to avoid depositing large amounts of foreign currency in domestic banks.

2.2.3 Money laundering techniques in the integration phase

In the third phase, money launderers want to park the laundered money safely without being detected and with profit. Offshore centers are only marginally involved in this final phase.

Capital market investments

Capital market investments can happen in all phases of laundering. In the first phase, the launderer uses his ill-gotten cash for buying. The launderer can invest the money into financial assets so as to avoid having large amounts of cash. But he can also use capital market investments in the layering phase or for placing the money in its final spot. These assets, such as shares and bonds, are generally low risk and so the chances of losing money are small. Furthermore, the assets are highly liquid, which means they can be converted back into cash very easily. Laundered funds are co-mingled with lawful transactions.

Derivatives

Derivatives are financial assets and all have in common that they can be interpreted as bets on future events. Their value is intrinsically linked or contingent upon some external item of worth, hence they 'derive' their value from something else. This 'something else' is conventionally referred to as the 'underlying', which, depending on the type of derivative, can be bets on stocks, bonds, currencies, interest rates, energy, third party or instrument credit quality, commodities, the weather, macroeconomic data and mortality rates, for example.

These are financial assets and so can be purchased by the launderer in order to invest the cash in reputable enterprises. Again, a disreputable broker is probably needed. These assets are highly liquid and so can easily be resold in order to return the cash back to the launderer. However, derivatives are much more risky than traditional financial instruments. Biggins (in Unger and van der Linde 2013) calls them dangerous markets.

Credit Default Swaps were mentioned during the Greek financial crisis. Speculators speculating on Greece's default bought Greek government bonds with high interest and parallel bought CDS, a sort of insurance to pay out in case of Greek default. So they had a perfect win-win situation, no matter what happened to Greece. Biggins (2013) shows diverse ways in which derivatives can be used for money laundering. For example 'mirror trading' where two trading accounts are opened, one to receive funds which are laundered and one and the other to receive the 'washed' funds. The broker enters the market and, for example, simultaneously buys and sells some quantity of futures contracts. Later in the day, the broker re-enters the market and repeats this process. The broker has thus, in effect, created four trades. The broker makes it appear as though the account set up for the funds to be laundered has made a loss while the account set up to receive the 'washed' funds has recorded a profit. Put simply, 'framework conditions must be manipulated in such a way that the dirty money is lost on the bet, while winnings are clean money'. 'When considering the potential for money laundering to occur through derivatives, it is important to highlight not only the derivative related strategies themselves, but also the existence of, for example, sham companies and other arrangements, such as the complicity of professionals involved in the derivatives markets. These factors can be crucial, providing necessary infrastructural support in the initiation of the strategy and any results flowing from it'(Biggins 2013).

Real estate acquisition

The launderer can invest the illegal cash into property, which is generally a non-depreciating asset. This would normally require a facilitator. A real estate agent or notary, who is willing to overlook the fact that the launderer wants to pay cash for an expensive asset, or uses a strange mortgage from Switzerland. Real estate is extremely attractive for launderers. It is difficult to estimate the true value of an object. One can use it for criminal purpose. One can use it to derive regular legal income from tenting (see Unger and Ferwerda 2011)

Industries with cash intense business and/or high value

The catering industry, the gold market, the diamond market, buying jewels, the acquisition of luxury goods, cash-intensive business like restaurants, football bet offices etc. all belong to this category

Trade base money laundering

The stricter regulations of financial markets might lead to an increase of trade based money laundering. To overprice imports (for example a cheap watch which is declared a Dior watch and can explain high payments of the importing firm to the exporter) or to underprice exports (the Dior watch is sent as a cheap watch abroad. The importer then sells it expensive. With this the exporter has brought money outside the country).

As Zdanowicz showed in 2016, the amounts of trade based money laundering rise significantly. The cost of false invoicing to the US authorities between 2003 and 2014 was more than $2.3 trillion. Abnormally priced goods were used to mask complex tax avoidance schemes, and that the overall figure had grown by some 30% over the period from $168.3 billion in 2003 to $230.6 billion in 2014, despite improved understanding of the threat and efforts to combat trade based money laundering. (see FIU, Zdanowicz 2016). In June 2016, the US Congressional Research Service published a report highlighting the importance of trade-based money laundering R. Miller et al 2016). Also the Treasury of the Isle of Man (Isle of Man Treasury: Customs and Excise Division 2016) warns from this oldest form of money laundering dating back to ancient Chinese trade, in new disguise.

2.3 New money laundering risks

With the advent of the internet, new forms of money transfers and possibilities for launderers have occurred.

On-line banking

On-line banking makes it easier for the launderer to conduct transactions as they can avoid having to go to banks and being seen or having to complete many forms. Furthermore, it is much more difficult to trace the operators of these accounts if they never go to banks.

E-cash

E-cash, or electronic cash, is even harder to trace than real cash as the ease with which it can flow around the world makes it twice as hard for the authorities to detect. Money becomes not a real commodity, but simply a line on a piece of paper or a computer screen. The launderer then does not have to worry about depositing large amounts of cash, as the money does not physically exist. All payments and receipts are made electronically.

E-gold

One can buy gold on the internet, using addresses such as http://www.e-gold.com/examiner.html or http://goldmoney.com/. These sales and buys still need some identification, one has to register, but when used after having cleaned the money they still guarantee some anonymity.

Pre-paid phone cards

Pre-paid phone cards can be bought on the streets. One can pay with criminal cash for them and use the prepaid phone cards for shopping anonymously on the internet. The possibilities and variety of products for sale increases steadily. The Dutch Banking Association calculated that payments over the Internet valued 2 billion Euros (5-7 million transactions) in 2004. Payments via mobile phones amounted to about 1 billion Euros in the Netherlands (NVB 2006).

Proprietary systems

Proprietary systems refer to a specific set of payment and funds transfer rights owned and patented, with intellectual property protections, to a financial services provider located anywhere in the world. Proprietary systems enable customers to access electronic banking or funds transfer routing systems located offshore and hence avoid local reporting requirements. This does not mean that customers are engaging in money laundering, but it does mean that customers can make undetectable financial transactions that may increase the risk of money laundering. These proprietary systems may include international funds transfers between offshore accounts/entities, cheque writing, trading facilities, letters of credit and securities trading. They also involve alternative payment systems with the conversion of funds into a virtual currency with e-credits, Pay PAL and e-gold. Funds can then be disbursed offshore without triggering the reporting requirements (Hackett 2003: 3).

The use of electronic offshore access and payment methods is related to the growth of proprietary systems that potentially escape reporting requirements and detection strategies. This involves accessing overseas accounts, trusts and companies. Money is permanently kept offshore and shifted between offshore jurisdictions that have a high degree of bank secrecy. These overseas accounts are then accessed at ATMs using offshore debit/credit cards, which can also be used to make local purchases. Entities such as trusts, banks and International Business Corporations, also established offshore, then repay the credit cards and continue to deposit funds into them on a regular basis.

In 2002, the United States Internal Revenue Service (IRS) found that MasterCard alone processed 1.7 million offshore transactions for 230,000 US resident account holders with offshore debit/credit cards issued in 30 countries with bank secrecy and minimal reporting requirements (US Department of Justice 25 March 2002).

2.4 Virtual currencies

Lately, virtual currencies such as BITCOINS and ETHEREUM (the latter can be linked to smart contracts), have shown to be used for laundering. Viruses installed in order to receive Ransom have to be paid in bitcoins. Bitcoins can be used for internet shopping, e.g. Amazon accepts them. Since the owner of bitcoins is almost not traceable, this currency might become attractive for criminals. The EU Working Group on Virtual Currencies (Burkhard Mühl and Sebastiano Tine of DG Home) keeps track of these new events.

3. WHERE THE LAUNDERED MONEY GOES

Not all types of crime necessitate the same amount of laundering. Some crimes, such as proceeds from homicide, usually do not require much laundering, whereas proceeds from drugs need substantial laundering. Drug dealers need laundered money in order to create facades of legal income for their businesses and thus enjoy the profits from their illegal activities. Robberies are quite costly to the community but the amount of money gained from each robbery is usually a small enough amount that it has no need of being laundered. Ordinary theft is similar to robbery (in fact can be the same in some jurisdictions) in so far as there is little need for laundering. Offenders are much more likely to spend any money earned from theft rather than undertake the often complex transactions required to first ‘clean’ their gains through laundering. Drugs and fraud offences, however, are usually associated with money laundering. Large amounts of money are involved (earnings exceed those amounts that could be reasonably spent without detection) which creates an incentive for laundering. Walker (2009) revised the percentage that is likely to be laundered for drug proceeds by lowering it. Before, he assumed that 80 percent or “considerable amounts” of drug proceeds were laundered. In his latest revision he speaks of “medium laundering intensity” and he assumes 60%-70% (see Walker 2009).

Additional income that results from tax evasion can either be immediately spent (as with ordinary theft) or laundered, depending on the amount of money involved. Company fraud can be 100 percent laundered. Social security fraud, wherein social benefits are paid out under false pretences can either be spent immediately or laundered, depending on the amounts involved or the techniques used to achieve the fraud.

3.1 The threat to attract money for laundering

Which countries are attractive for launderers? Launderers prefer countries with solid financial markets, good financial services, not too high corruption, high Gross Domestic Product, high exports and imports, with high secrecy and lax anti money laundering regulations and low fines. They prefer countries which they know or with which they share language, culture, social ties and networks. Figure 5 displays how threatened European countries are from laundering. Big countries are leading. The UK tops the list being threatened by 282 billion Euro of annual laundering, followed by France, Belgium, Germany, Luxembourg, the Netherlands and Austria.

The picture changes, once one corrects for country size (see Figure 5a). Compared to their Gross Domestic Product, the Baltic States, Luxembourg and Cyprus are over proportionally threatened by money laundering. The Baltic States are the entrance port to the Euro for Russia. Also Cyprus was a popular target for Russian oligarchs to park their money outside Russia.

Rank	Country	Threat (€ Million)
1	United Kingdom	282.004
2	France	151.302
3	Belgium	119.896
4	Germany	108.872
5	Netherlands	94.121
6	Luxembourg	93.765
7	Austria	88.810
8	Italy	73.910
9	Denmark	59.177
10	Spain	56.311
11	Ireland	54.439
12	Poland	53.923
13	Czech Republic	51.193
14	Finland	45.104
15	Portugal	43.015
16	Latvia	42.639
17	Estonia	40.074
18	Slovenia	35.106
19	Sweden	26.206
20	Slovakia	23.557
21	Hungary	19.952
22	Cyprus	19.090
23	Bulgaria	18.513
24	Greece	16.598
25	Romania	14.075
26	Lithuania	12.870
27	Malta	8.325

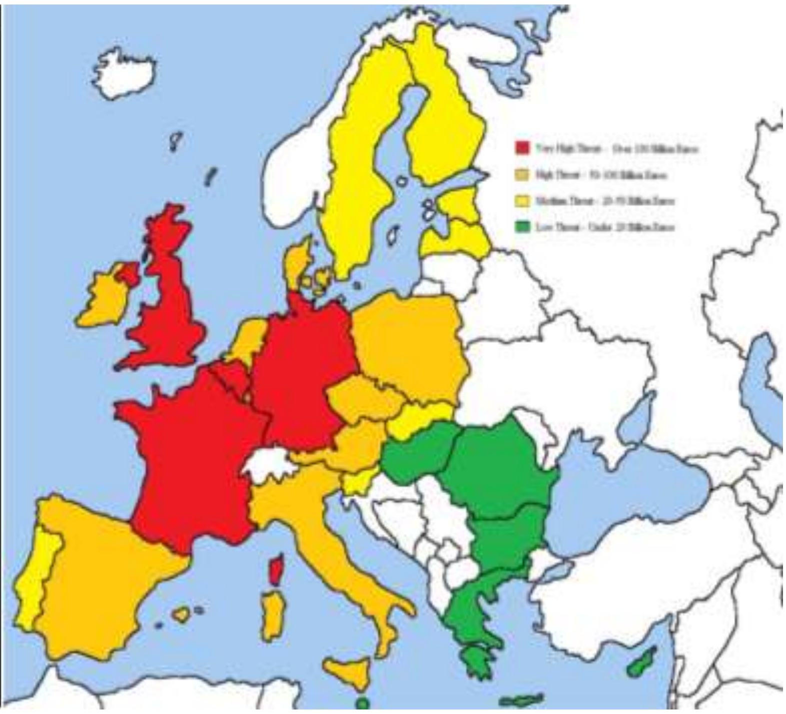


Figure 5. *Money laundering threat in the EU-27 –* ***Source:*** *ECOLEF (2012), Croatia was then not yet member of the EU*

Rank	Country	Threat as % of GDP
1	Estonia	207.7%
2	Latvia	163.2%
3	Luxembourg	155.2%
4	Slovenia	75.3%
5	Cyprus	53.6%
6	Bulgaria	40.2%
7	Czech Republic	30.3%
8	Belgium	27.9%
9	Austria	24.6%
10	Portugal	21.2%
11	Slovakia	21.0%
12	Denmark	20.6%
13	Lithuania	19.5%
14	Finland	19.4%
15	Ireland	18.9%
16	Poland	14.5%
17	Netherlands	14.0%
18	United Kingdom	13.3%
19	Hungary	13.1%
20	Malta	11.0%
21	Romania	9.4%
22	France	7.3%
23	Greece	6.1%
24	Sweden	5.8%
25	Spain	5.4%
26	Italy	4.9%
27	Germany	4.7%

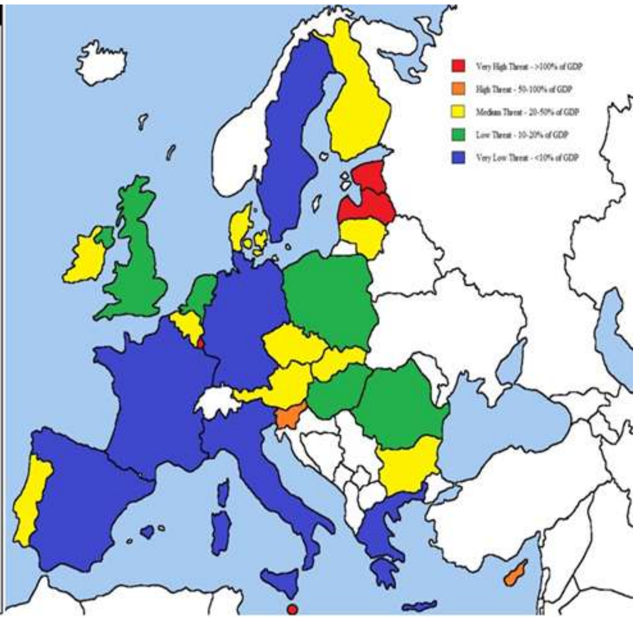


Figure 5a. *Money laundering threat in % of GDP in the EU-27 –* ***Source:*** *ECOLEF (2012), Croatia was then not member of the EU*

3.2 The origin and destination of Offshore activities

Figure 6 shows the origin and destination of wealth held in offshore centres in 2010. (Financial centres like Switzerland, UK and Luxembourg are included here under offshore).

From the 7.8 trillion USD of global offshore wealth, Europe holds by far the most with 3 trillion, followed by Asia Pacific with 1.8, the Middle East and Africa with 1.4. Latin America and North America hold much less offshore and if they do it is in the Caribbean and in Panama. Europeans invest their money mainly in Switzerland 1.04 trillion USD, followed by the UK, Channel Islands and Dublin (0.74 trillion USD) and Luxembourg (0.54 trillion USD). The Caribbean and Panama are less popular among Europeans (0.14 trillion USD).

As Figure 6 clearly shows, offshore wealth is clearly a European problem!

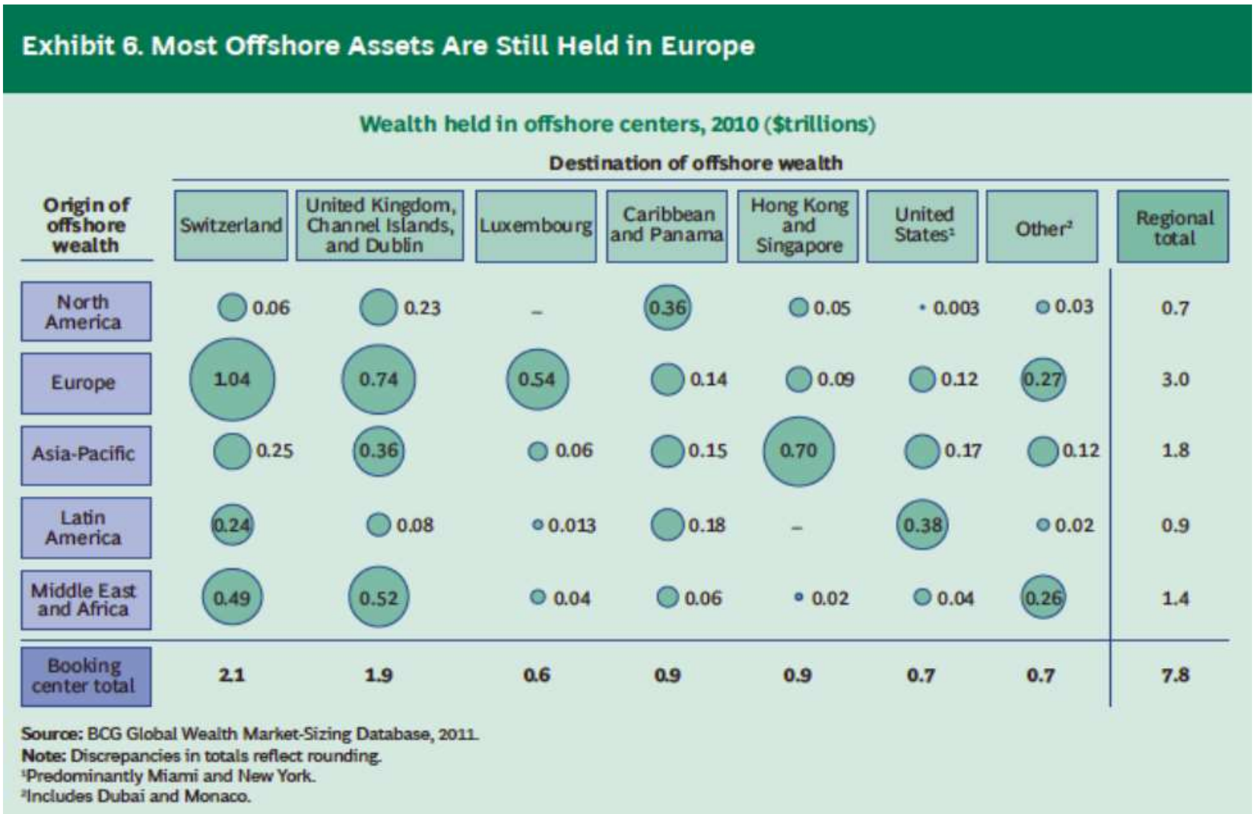


***Figure 6.** Origin and destination of Offshore wealth – **Source:** van Koningsveld (2015)*

3.3 Offshore activities and tax havens

Offshore centres and tax havens are ranked in diverse ways. In Palan, Murphy and Chavagneux (2009) the Bahamas are at the top followed by Bermuda and Cayman Islands. Panama has rank 7. Many European jurisdictions take top ranks or use jurisdictions ranked top in OFC. European countries that top the list are Malta (rank 6), Cyprus (rank 10) Liechtenstein (rank 12), Switzerland (rank 19), Ireland (rank 25) and Luxembourg (rank 26). Many European countries use offshore jurisdictions for their less transparent business, where regulations are laxer than in their home country. The UK uses the Channel Islands (Alderney, Guernsey, Jersey, Sark), Isle of Man, Bermuda, British Virgin Islands, Isle of Man, Gibraltar, Turks and Caicos Islands, Anguilla and Montserrat. France uses Monaco. Italy uses Campione d'Italia and San Marino, the Netherlands use their former colonies Aruba and the Netherlands Antilles, Portugal uses Madeira, Spain uses Melilla. Seen the importance and volume of wealth held in offshore centres by Europeans in Europe, it would already be a milestone for combating tax evasion, if the European OFCs would be regulated or closed.

Table 2. *Top Offshore Centers –* ***Source:*** *Palan, Murphy and Chavagneux (2009)*

	Top OFCs		Consensus Basis				
1	Bahamas	29	St Kitts & Ne.	57	South Africa	86	Sark
2	Bermuda	30	Andorra	58	Tonga	87	Somalia
3	Cayman Is.	31	Anguilla	59	Uruguay	88	Sri lanka
4	Guernsey	32	Bahrain	61	U.S. Virgin Is.	89	Taipei
5	Jersey	33	Costa Rica	62	U.S.A	90	Trieste
6	Malta	34	Marshall Is.	63	Alderney	91	Cyprus (Turk.)
7	Panama	35	Mauritius	64	Anjouan	92	Ukraine
8	Barbados	36	St. Lucia	65	Beligium		
9	British Vir. Is.	37	Aruba	66	Botswana		
10	Cyprus	38	Domnica	67	Camp. D'Italia		
11	Isle of Man	39	Liberia	68	Egypt		
12	Liechtenstein	40	Samoa	69	France		
13	N.L. Antilles	41	Seychelles	70	Germany		
14	Vanuatu	42	Lebanon	71	Guatemala		
15	Gibiltar	43	Niue	72	Honduras		
16	Hong Kong	44	Macau	73	Iceland		
17	Singapore	45	Malasia	74	Indonesia		
18	St. Vin. & G.	46	Monserrat	75	Ingushetia		
19	Switzerland	47	Maldives	76	Joran		
20	Turks & Caicos	48	U.K.	77	Marianas		
21	Antigua & B.	49	Brunei	78	Melilla		
22	Belize	50	Dubai	79	Myanmar		

23	Cook Islands	51	Hungary	80	Nigeria		
24	Grenada	52	Israel	81	Palau		
25	Ireland	53	Latvia	82	Puerto Rico		
26	Luxemburg	54	Madeira	83	Russia		
27	Monaco	55	Netherlands	84	San Marino		
28	Nauru	56	Phiippines	85	S. Tome e Pri.		

3.4 Offshore activities according to the Panama Papers

The information provided by ICIJ shows offshore entities defined as a company, trust or fund created in a low-tax, offshore jurisdiction by an agent. Officers are defined as a person or company who plays a role in an offshore entity. An offshore entity linked to a country means that either the offshore entity is established in this country, or is traceable to this specific country. Officers are active in the country they are linked to.

Appendix 2 gives a complete overview over the number of offshore entities linked to each country and jurisdiction in the world and the number of officers active in the country they are linked to, identified by the Panama Papers. The following table 3 shows in how far EU-28 Member States are linked to Offshore activities. The UK with 17.973 offshore entities displayed in the Panama Papers, followed by Luxembourg (10.877 entities) and Cyprus (6374 entities) are leading. But also Latvia, Ireland, Spain, Estonia and Malta have many offshore entities related to their country. With regard to officers active in offshore entities, Italy and France join the group of Member States active.

Just to give an indication of the importance of the problem, table 4 lists offshore entities and officers related to offshore entities for Panama, and other outstanding countries and jurisdictions, like Hong Kong, Switzerland, Jersey, the United Arab Emirates and also Monaco and Liechtenstein. The British Virgin Islands with 69.902 entities are leading.

Table 3. *Offshore activities of EU-28 Member States in the Panama Papers –* ***Source:*** *ICIJ (2016)*

Country/Area	Offshore Entities	Officers	Country/Area	Offshore Entities	Officers
Austria	76	121	Ireland	1936	261
Belgium	61	363	Italy	347	1196

Bulgaria	50	117	Latvia	2941	162
Croatia	20	38	Lithuania	33	36
Cyprus	6374	3678	Luxembourg	10877	1764
Czech Republic	173	272	Malta	714	351
Denmark	14	65	Netherlands	251	352
Estonia	881	108	Poland	161	146
Finland	66	60	Portugal	246	300
France	304	1005	Romania	8	109
Germany	197	504	Slovenia	21	58
Greece	223	400	Spain	1170	831
Hungary	90	186	Sweden	84	201
Iceland	15	213	United Kingdom	17973	5676

Table 4. *Offshore activities of selected countries in the Panama Papers –* ***Source:*** *ICIJ (2016). I thank my Student Bertram van AA for looking up the data of Table 3,4, and Appendix 2*

Panama	18122	5357	Jersey	14562	7100
Switzerland	38077	4595	Monaco	3168	1398
United States	6254	7325	United Arab Emirates	7772	3397
Hong Kong	51295	25982	Liechtenstein	2070	1147
British Virgin Islands	69092	15211			

4. CONCLUSION

4.1 Searching for the relation between Money Laundering and Tax Evasion

At the moment there is a very diverse understanding of what fighting money laundering and of what fighting tax evasion is. In order to qualify for money laundering, tax evasion must be a serious crime or – in countries which have a list of predicate crimes for money laundering rather than an all crimes approach – it has to be on the listed crimes for money laundering. Otherwise tax evasion could not be treated as laundering.

Already when analyzing the third AML Directive (which did not explicitely point at tax crime, but included tax fraud and other serious crime to not paying taxes) one could see that Member State have a very different understanding of what the goal of AML policy is. Some thought it is mainly for fighting corruption (notably te Greek authorities thought this), others for fighting drugs (many new Member States thought this) and some thought it is for fighting tax evasion (mainly the UK, Ireland and other Northern and Western EU Member states) (see ECOLEF Study 2013).

The first estimates for worldwide tax evasion were done by Friedrich Schneider. His definition of the shadow economy is very broad and changed over time. But it includes activities to evade income tax by individuals as well as money laundering activities by individuals. Walker used this to show a relation between tax evasion and money laundering. Walker in the early 2000 combined Friedrich Schneider's estimates of the shadow economy in percent of GDP of each country with the GDP per capita in USD in each country in order to show that there is a relation between richness of a country and its shadow economy. The rich countries (left side top countries) see money laundering mainly as tax evasion. The poor countries perceive it as fighting drugs. Countries below the convex line are 'suppressed'economies, which face – compared to their GDP – less illicit activities due to strict regimes.

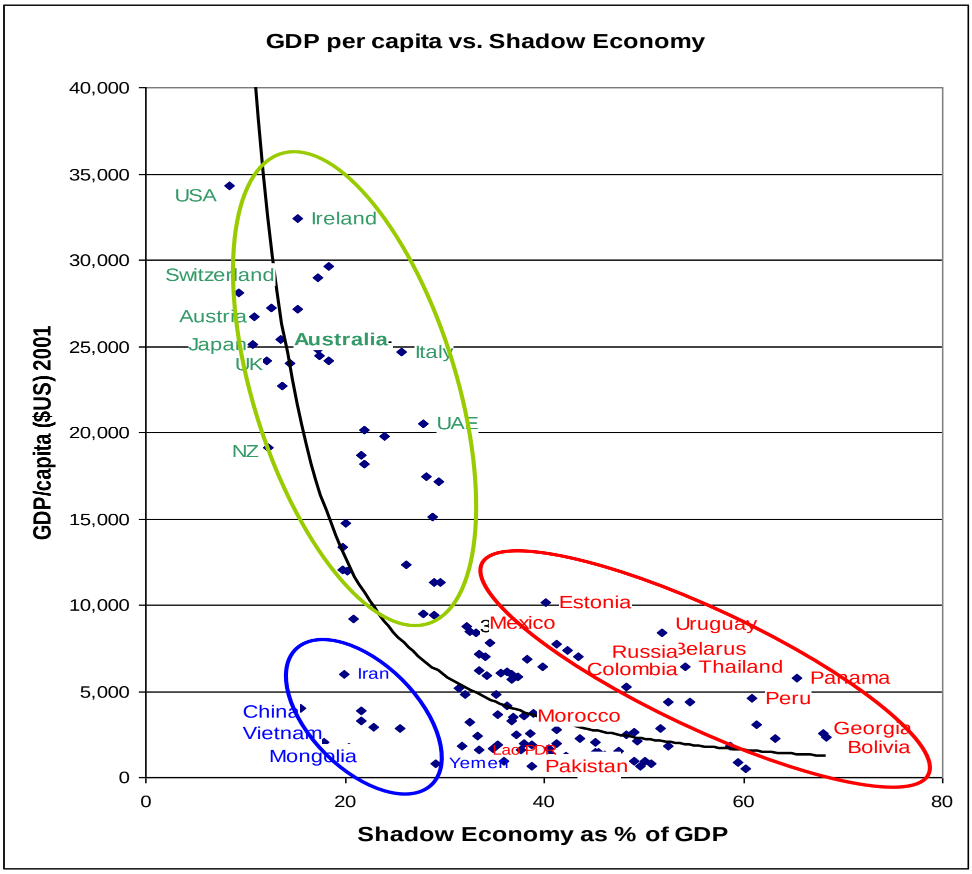


Figure 7. *GDP per capita vs. Shadow Economy –* ***Source:*** *Walker (2002)*

4.2 Searching for a proper definition of Tax crime – tax fraud – tax evasion – tax avoidance

The Fourth AML Directive stresses tax crime as a predicate crime for money laundering. This is tricky. Since tax crime mostly does not exist in EU Member States penal codes. It is a US term which entered the European Directive.

‘It is important expressly to highlight that ‘tax crimes’ relating to direct and indirect taxes are included in the broad definition of ‘criminal activity’ in this Directive, in line with the revised FATF Recommendations. Given that different tax offences may be designated in each Member State as constituting ‘criminal activity’ punishable by means of the sanctions as referred to in point (4)(f) of Article 3 of this Directive, national law definitions of tax crimes may diverge. While no harmonisation of the definitions of tax crimes in Member States' national law is sought, Member States should allow, to the greatest extent possible under their national law, the exchange of information or the provision of assistance between EU Financial Intelligence Units (FIUs).’(see The Official Journal of the European Union L141/73 5.6.2016 http://eur-lex.europa.eu/legalcontent/)

Tax crime is a serious crime in the US and is on the list of predicate crimes for money laundering. Fraud is also a predicate crime for money laundering, hence tax crime is also included there. Tax evasion can be fraud once it reaches a certain amount in some countries (in Germany and Austria the benchmark the judge usually set was tax evasion of 100.000 Euro or more). Tax evasion of smaller amounts can still be not part of the money laundering regulation but is illegal. It is the unlawful way of not paying taxes.

The term tax evasion was sometimes used to define not paying individual taxes (income tax) as opposed to tax avoidance which was associated with companies (not paying corporate tax). However lately these differentiation does not hold. Tax experts advise individuals how to set up more complicated constructions in order not to illegally evade taxes but become tax avoiders.

Tax avoidance was used to distinguish the illicit form of tax evasion from the legal way of finding loopholes for not paying taxes. Hence tax avoidance was considered legal. However the events around the Panama leaks, the Luxembourg leaks and other leaks have revealed that there is a large grey zone when it comes to tax avoidance of large companies. This grey zone has to be interpreted by the judge whether it is considered legal or illegal. The fact that companies were set up in offshore centres without any economic activity shows that the grey zone between legal tax avoidance and illegal activities of tax avoidance which finally can be interpreted as tax evasion or tax fraud is very large.

The Fourth AML Directive came into place before a clear definition of EU Member States' definition of tax crime existed. In Europe there can be tax fraud (for example in the Netherlands and Germany), there can be tax evasion which can be considered not a serious crime but a misdemeanour (like in Switzerland) and tax avoidance of companies which can be legal but includes a large grey zone.

The European Parliament (Panama Committee) made an effort to make a survey among EU Member States what they understood by tax evasion, tax crime etc. Unfortunately this survey was not precise enough. Some Member States thought it had to do with Value Added Tax, others with income tax. Some sent in pages of tax laws, others a short notice. So, the survey did not deliver a comparable outcome.

In order to find out about tax evasion and money laundering , a clear definition of tax crime is urgently needed for EU Member states.

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