

# Combating Money Laundering, Terrorist Financing and Tax Crimes

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**Abstract.** Money laundering refers to the conversion or transfer of property, knowing that such property is derived from criminal activity; for the purpose of concealing or disguising the illicit origin of the property. The Financial Action Task Force on Money Laundering (FATF), a 36-member inter-governmental body established by the 1989 G-7 Summit in Paris, was set up to define standards for combating money laundering and terrorist financing (MLTF). Over 180 countries around the world, including Malaysia and China, are members of FATF and they adhere to the global standards. All member countries have passed suitable legislation to counter money laundering and terrorism financing. The FATF has issued 40 recommendations to guide international action against money laundering, and nine Special Recommendations on Terrorist Financing. On 29 August 2012, the Malaysian Inland Revenue Board (MIRB) released a media statement advising the public that the revenue authority will take appropriate action for tax offences under the Anti-Money Laundering and Anti-Terrorism Financing Act (AMLATFA) 2001. This study traces the history of money laundering and outlines Malaysian laws related thereto. It also endeavours to highlight the link between tax evasion and crimes, and money laundering'. It questions whether "failure to furnish return or give notice of chargeability" and "submitting incorrect tax returns are serious enough offences that warrant for their inclusion in the Second Schedule of AMLATFA.

**Keywords:** Money laundering, Terrorism Financing, Tax crimes

## 1. Introduction

Money laundering refers to the conversion or transfer of property, knowing that such property is derived from criminal activity; for the purpose of concealing or disguising the illicit origin of the property. It also encompasses assisting any person who is involved in the commission of such activity to evade the legal consequences of his or her action.<sup>1</sup>

Laundered income is not the same as "hidden income" but they could overlap. The term "hidden income" is used interchangeably with 'underground', 'unofficial or 'submerged' income and associated with 'black' or 'grey' labour or moonlighting. Essentially, the designation "hidden income" refers to those economic activities that should be reported or measured by the techniques, currently used for measuring economic activity, but are not. These gains may take the form of evaded taxes, non-compliance with costly regulation, income from prohibited and criminal activities or fraudulent receipt.

### 1.1. Money laundering and terrorism activities

Money laundering is a major threat and can pose devastating economic, social and political consequences especially to developing countries. Initially money laundering was associated with drug trafficking and organized crimes. After September 11, 2001<sup>2</sup> when the link between money laundering and terrorism activities was recognized, countries around the world shifted to an aggressive drive to implement laws to combat money laundering and terrorism financing. The number of cases prosecuted under this crime is minimal but the revenue loss for governments, in terms of tax evasion, around the world is enormous.

### 1.2. Financial Action Task Force on Money Laundering

The Financial Action Task Force on Money Laundering (FATF), a 36-member inter-governmental body established by the 1989 G-7 Summit in Paris, was set up to define standards for combating money laundering and terrorist financing (MLTF). It also carried out mutual evaluation studies to ensure that the legislative

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<sup>1</sup> This definition is found in Article 1 of the 1990 Council of Europe Convention

<sup>2</sup> The September 11 attacks (also referred to as 9/11) were a series of four suicide attacks that were committed by *Al Qaeda* in the United States on September 11, 2001.

arrangements made by a country comply with the standards. Over 180 countries around the world, including Malaysia, are members of FATF and they adhere to the global standards. All member countries have passed suitable legislation to counter money laundering and terrorism financing (Sathye, 2012). The FATF has primary responsibility for developing a worldwide standard for anti-money laundering (AML) and combating terrorist financing (CTF). It works in close cooperation with other key international organizations, including the International Monetary Fund (IMF), the World Bank and the United Nations. The FATF has issued 40 recommendations to guide international action against money laundering, and nine Special Recommendations on Terrorist Financing (FATF, 2012). These recommendations set the international standard for AML/CTF regimes.

This article traces the history of money laundering and outlines Malaysian laws related thereto. It also endeavours to highlight the link between tax evasion and crimes, and money laundering.

## **2. Tracing Money laundering**

Money laundering can also be referred to as “cleaning monies that which is dirtied due to illegal and/or a criminal element”. Therefore, the task of the money launderer is to make the proceeds of crime appear to be legal so that any attempt to link it with criminal behaviour would be futile.

One of the first prescribed definitions of money laundering is that found in the 1988 Vienna Convention. Article 3(1) of the Vienna Convention states that money laundering refers to:

- (i) conversion or transfer of property, knowing that such property is derived from any offence or offences established in accordance with sub-paragraph (a)<sup>3</sup> of this paragraph, or from an act of participation in such offence or offences for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such offence or offences to evade the legal consequences of his actions, and
- (ii) concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property knowing that such property is derived from an offence or offences established ...or from an act of participation in such offence or offences.

### **2.1. Laundered monies and hidden income**

The International Monetary Fund has placed the value of globally laundered monies to be between two to five per cent of the world’s GDP, which is estimated to be US\$3.61 trillion (Rueter and Truman, 2004).

Kasipillai (1997) used the monetary demand approach of Tanzi (1982) to develop estimates of the size of the hidden income and tax evasion in Malaysia for the period 1971 to 1994. The estimates are indicative of the hidden economic activity and tax evasion which declined since the mid-1990’s with decreasing income tax rates, a booming legal economy and deregulation in many sectors which enhanced the attractions of working “above ground”. The research findings show that over the period 1983 to 1994, there was a gradual decline in the size of hidden economy and the level of tax evasion. For instance, in 1994, the hidden economy and tax evasion are estimated at 3.73 per cent and 0.5 per cent of gross national product respectively. The ratio of tax evaded to total income tax collections stood at 5.8 per cent in 1994 and a high of 27.2 per cent in 1974. To our knowledge, similar tax data for the post-1994 era is not available.

## **3. Malaysian Laws on Money Laundering**

Malaysia passed the Anti-Money Laundering Act (AMLA) in 2001. The act was amended in 2003 to encompass terrorism financing within the realm of the anti-money laundering regulatory system. The AMLA was re-named Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (AMLATFA) and it became effective from 6 March 2007.<sup>4</sup>

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<sup>3</sup> Sub-para (a) criminalizes the various aspects of illicit traffic in narcotic drugs and psychotropic substances.

<sup>4</sup> Gazette Order P.U. (B) 66/2007

### **3.1. Standard Guidelines for Designated Non-Financing Business and Professions**

On 2 February 2012, Bank Negara Malaysia issued Standard Guidelines for Designated Non-Financing Business and Professions relating to Anti-Money Laundering and Counter Financing of Terrorism.

The primary offence of money laundering and the offence of attempting or abetting the commission of money laundering are found in sec 4(1) AMLATFA. Section 4(1) states the following:

Any person who-

(a) engages in or attempts to engage in; or

(b) abets the commission of,

money laundering, commits an offence and shall on conviction be liable to a fine not exceeding RM5 million ringgit or to imprisonment for a term not exceeding five years or both.

### **3.2. Penal Code and AMLATFA**

In order to assist in the interpretation of sec 4(1) of AMLATFA, we have to refer to other statutes such as Penal Code (Act 574). Section 107 of the Penal Code defines 'abetment' as the conduct of a person who engages with one or more other persons in any conspiracy for the doing of a thing. Section 120A of the Penal Code defines 'conspiracy' as the agreement of two or more persons to do, or cause to be done, an illegal act or an act by illegal means.

## **4. Stages of Money Laundering**

There are three basic stages to money laundering:

(i) In the initial or placement stage, the launderer introduces the illegal funds into the financial system.

Introducing illegal funds into the formal financial system (for example, making 'structured' cash transactions into bank accounts).

(ii) In the next phase, known as layering the launderer moves the funds to distance it from its source.

Moving, dispersing or disguising illegal funds or assets to conceal their true origin (for example, using a maze of complex transactions involving multiple banks and accounts, or corporations and trusts).

(iii) In the final stage known as integration, the funds re-enter the launderer's portfolio as legitimate

money. Investing these now distanced funds or assets in further criminal activity or legitimate business, or purchasing high-value assets and luxury goods. At this stage the funds or assets appear to have been legitimately acquired.

It can, however, be problematic to differentiate and distinguish each of these three processes. Money laundering tends to occur in countries with low risk of detection but in places where there are stable financial systems.

## **5. Sources of money laundering**

The international community is increasingly concerned about the growing incidence of money laundering activities. Such illegal activities divert resources, encourage crime and corruption, slow growth and distort international trade and capital flows in a country. Money laundering is not restricted to the proceeds of drug trafficking. It includes proceeds from other criminal activities such as armed robbery, tax evasion, smuggling, prostitution, terrorism, arms dealing, fraud, forgery and counterfeiting, bribery and corruption.

### **(i) Drug trafficking**

Drug trafficking is the production and transit of illegal drugs such as heroin, methamphetamine and marijuana. Heroin and marijuana form the highest share of drug earnings. The 1995 report, *Estimates of the extent of money laundering in and through Australia* (Walker, 1995) suggested that around \$3.5b per annum were believed to be generated by crime in Australia and laundered either in Australia or elsewhere, with the bulk generated by fraud and then drugs. The *BBC* reported that Mexican drug cartels have so much cash at their disposal that they have managed to consistently infiltrate police, from the grassroots level to the very top (Williams, 2011).

### **(ii) Human trafficking**

Human trafficking continues to be a problem on a global scale and particularly acute in Southeast Asia. There is growing evidence that criminals are turning to human trafficking and the smuggling of migrants to a greater extent as these crimes are seen as highly profitable. According to the United Nations Office on Drugs and Crime (UNODC), this is the third largest source of income for the organised crime groups after drug and arms trafficking (FATF, 2011).

International 'sex tourism' is another form of generating illegal wealth, where wealthy men visit countries with widespread prostitution and child-sex and this leads to huge amount of illegal money being transacted. However, domestic prostitution markets account for considerably higher amount of revenue than the international flesh trade.

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### **(iii)Corruption**

This unhealthy practice provides cover for other criminal activities. The issue of corruption can be divided into the following:

- (a) Bribery: Payments demanded in return for being allowed to do business. The payment is the license to do business.
- (b) Election corruption: Illegal payments made during elections to gain continuous support from voters.
- (c) Protection: Authorities accepting payments from criminal bodies in exchange for permitting them to carry out illegal businesses.
- (d) Systematic top-down corruption: National wealth is systematically siphoned off or exploited by ruling elites.

### **(iv)Smuggling activities**

Arms trade is one of the biggest revenue generating smuggling activities. The size of the armed forces and its access to weapon systems may encourage such activities, particularly where the accounting and inventory standards are easily exploited. Such case can be seen in the states of former Soviet Union, whereby illegal sales of arms have formed a significant component of the economic base of the armed forces within the services.

### **(v) Fraudulent practices**

Fraudulent practices come in a variety of forms and it is a fast growing source of criminal revenue globally. Credit card fraud has seen remarkable growth in East Asian mainland and Asia-Pacific's leading financial centers. The emergence of new fraud phenomena – internet stock promotions, particularly in the Asian countries highlights the lack of supervisory and regulatory guidelines in these stock markets.

## **6. Tax Evasion and Tax Crimes**

Basically, criminal organizations avoid paying tax because the perpetrators are able to elude revenue from tax authorities. The other issue which is a hotly debated topic relates to whether money-laundering laws do or even should relate to tax crimes. The issue here revolves around two main areas. The first of which is whether tax offences are a "predicate crime" within any particular jurisdiction. In some countries, governments do not necessarily raise tax revenue through income tax; hence evasion of income tax cannot be a crime.

Secondly, a basic principle of international law is that one country cannot enforce the tax laws of another. The former is not applicable to the European Union (EU) as all the governments of the EU do raise tax revenue through charging income tax. The latter does pose a problem, though the question of whether tax laws are a predicate offence for the purposes of money laundering laws is a question of the express position of the anti-money laundering laws, or the interpretation of those laws by the Court. In most countries, including the EU, that have 'all crimes' anti-money laundering laws, it is almost certain that tax crimes fall within the catchall provisions.

Tax offences fall on the border of what is and what is not considered as laundering. This is due to the fact that the money a person lawfully receives cannot be laundered. Let us look at the following example. If a person receives a sum of RM1,000 (from an illegal source) and is liable to pay a 20 per cent marginal tax

rate and the taxpayer chooses not to declare the income, the RM200 is considered as tax evaded. In order to retain the RM200, the individual could place the whole amount of RM1,000 through the laundering process. The individual has to show that he or she received RM1,000 legitimately. The evaded sum of RM1,000 could be concealed through offshore financial centers; disguised as earned income, and by the use of other money laundering techniques.

The Financial Action Task Force on Money Laundering has in 2012 recommended that the scope of money laundering predicate offences be expanded to include tax crimes. This effectively means that a person found guilty of tax evasion may be charged with money laundering. In this regard, Hong Kong has included tax crimes within the scope of money laundering predicate offences some years ago whereas Singapore has formally committed in adopting the latest FATF recommendations (Monetary Authority of Singapore, 2012).

## 7. Money Laundering and Terrorist Financing

After the September 11, 2001 episode, terrorist financing was closely watched and monitored by government authorities. Consequently, the United States passed the USA PATRIOT Act to ensure that both combating the financing of terrorism and anti-money laundering was given adequate focus by US financial institutions. After the 9/11 incident, it has become more difficult for terrorists to raise funds from charities and as such they have resorted to money laundering. Terrorists are now working with drug traffickers and criminals to make and launder the proceeds of crimes.

Malaysia was among the top countries which received huge sums of illegal money from the Al-Qaeda group (US\$2.2 billion) in 2001 (see Table 1). According to the US Department of Justice, the *Al-Qaeda* group has laundered a total of US\$4.3 billion in the year 2001 alone, thereby denying the US government huge amount of tax revenue.

**Table 1: Movement of money from US to Al-Qaeda watch list countries (2001)**

Country	Funds Moved (US\$) Billion
Malaysia	2.221
Indonesia	0.565
Saudi Arabia	0.487
United Arab Emirates	0.233
Egypt	0.148
Total Top-5 countries	3.653
Other countries (20)	0.619
<b>Total</b>	<b>7.926</b>

Source: US Department of Justice, 2001

## 8. Inland Revenue Board and AMLATFA

On 29 August 2012, the Malaysian Inland Revenue Board (MIRB) released a media statement advising the public that the revenue authority will take appropriate action for tax offences under the Anti-Money Laundering and Anti-Terrorism Financing Act (AMLATFA) 2001.

The AMLATFA (Amendment of Second Schedule) Order 2010<sup>5</sup>, has included the following tax offences as “serious offences” in the Second Schedule of AMLATFA:

- Failure to furnish return or give notice of chargeability [sec 112 Income Tax Act 1967 (ITA)];
- Submitting incorrect income tax returns [sec 113, ITA]; and
- Wilful tax evasion [sec 114, ITA].

<sup>5</sup> [P.U.(A) No. 343/2010], gazetted on 7 October 2010

Any person who is found guilty of the above offences shall be liable to a fine not exceeding RM5 million and/or jailed for up to five years. The MIRB can freeze, seize or confiscate the person's property during investigation. The MIRB informed that in the year 2011, 1389 bank accounts had been frozen under this law.

It is questionable as to whether "failure to furnish return or give notice of chargeability" (sec 112 ITA) and "submitting incorrect tax returns (sec 113 ITA) are serious enough offences that warrant for their inclusion in the Second Schedule of AMLATFA. To our knowledge, we are not aware of other countries having taken such harsh measures in their respective legislations.

## 9. Conclusion

The AMLATFA (2001) (as amended) is a legal document that enables measures to be taken by the government for the prevention of money laundering and terrorism financing offences. It also provides for the forfeiture of terrorist property and property involved in, or derived from, money laundering and terrorism financing offences. This Act applies to any property, whether it is situated in or outside Malaysia.

According to sec 3 AMLAFTA, the "enforcement agency" includes a body of agency that is responsible in Malaysia for the enforcement of laws relating to the prevention, detection and of investigation of any serious offence. In this context, the Inland Revenue Board is also an enforcement agency for the implementation of AMLAFTA.

However, in order to be an effective enforcement agency, the Malaysian government has to ensure the transparency and good governance of its agencies. Malaysia slipped four places to the 60<sup>th</sup> spot out of 183 countries in Transparency Internationals (TI) Corruption Perception Index 2011. This is a decline for the third consequent year.

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