

Recent Instruments to Address Financial Crime. The Case of Romania

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Abstract

In recent years, the financial crime became a matter of major concern in the European Union and at the level of the Organization for Economic Cooperation and Development (OECD). The phenomenon of financial crime evolves in close connection with the development of society from a technological and economic point of view, permanently adapting and integrating within the rapid advancement of digital technology.

The present paper explores a recent instrument that addresses financial crime, namely the BEPS Action Plan, an initiative of OECD/G20, that through its set of 15 actions, focuses on the tax avoidance strategies used by multinationals on corporate tax planning, to erode the tax base of higher tax level jurisdictions by shifting profits to jurisdictions with lower tax level.

The case of Romania is presented, a country not yet member of OECD, that is participating in the BEPS Plan as Associate Member. Romania assumed to work on the development of standards and to monitor the implementation of the entire package, beginning with the four minimum BEPS standards on: harmful tax practices, abuse of tax agreements, country-by-country reporting requirements and dispute resolution mechanisms.

Key words: financial crime, tax evasion, money laundering, BEPS

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1. Introduction

Economic and financial crime has a devastating impact that is felt at all levels of society, negatively affecting both the individual, singularly, as well as institutions, organizations as a whole. The very large gains of an illicit nature and the fact that guilty fraudsters often remain unpunished create anguish, frustrations, tensions and dissatisfaction in society.

The globalization, the constant development of the economic phenomenon, indirectly determine the existence of gaps and imperfections in the legal and economic systems, so that they become lever speculated by individuals or groups with concerns in committing financial frauds. Those illicit operations are performed transnationally and in order to prevent detection, miss-appropriate funds often cross several borders, both physical but also virtual, before reaching their final target.

According to INTERPOL's Director for Organized and Emerging Crime, Mr. Paul Stanfield, "Almost everyone is potentially at risk from Financial crime today, and the effects on victims are often traumatic psychologically, as well as financially".

2. Literature review on financial crime

An important feature of today's global economy is the growing process of globalization. The economic benefits resulting from the globalization process are obvious. Thus, accelerated market liberalization, access to technology, vertically developing e-commerce and informational economies are positive elements following the phenomenon of globalization. Another feature is the growing mobility of financial services and activities. All of these are just as many sources of economic progress but they are also new and important challenge for authorities, whether national or

international. In particular, internationalization of economies and progress in information and communication technology facilitates the proliferation of economic and financial crime and other similar phenomena. In their attempt to make the most of the new realities of the global economy, the world's states have set the fight against economic and financial crime as one of the priorities.

In what concerns the definition, since economic and financial crime has not an internationally accepted one, different dimension were given, depending on the jurisdiction and legislative and economic context.

To assure clarity, it shall be mentioned that financial abuse has a broadest understanding including not only criminal activities that may cause losses to financial systems, but also other types of activities conducted in order to take advantage of the tax and regulatory structures in an illegitimate manner. In a broad sense, financial crime, that is a subdivision of financial abuse, is interpreted as including nonviolent offenses that cause financial and economic losses. These losses are usually caused to financial-banking institutions, whether state-owned or private.

Of the many types of abuses circumscribed to the notion of financial crime, in the present paper tax evasion and money laundering are selected as the most representative.

2.1 Tax evasion

One type of financial crime frequently found in this area is tax evasion (often with international implications). It is the most common offense committed both by individuals and by commercial companies. It often involves the use of illegal complex international tax planning structures as well as numerous financial flows that usually transit several countries in order to minimize the tax burden.

For example, a company, based in a low-tax country, owns a subsidiary in a country with a high level of taxation. In order to minimize the tax burden (the transfer of revenue to the lower tax jurisdiction), the parent company imposes an advantageous transfer pricing system. It could consciously and without any economic basis amplify the services as well as the goods that the parent company would invoice to the subsidiary and understate the services and / or goods that it will import from the subsidiary. These variations in transfer prices affect deceitfully the level of income taxes to be paid by both companies involved, as well as the level of customs duties to which the customs authorities of the two countries are entitled to collect.

When these methods and techniques have the purpose of eluding tax law, we are facing tax fraud or tax evasion.

In general, tax fraud involves either (1) camouflaging legally obtained income, or (2) distorting it in order to illegally avoid taxing it (for example, by illegally turning it into a non-taxable income).

As mentioned above, there are sometimes difficulties in detecting cases of tax fraud from legal evasion, the latter being cases where economic agents use legal "loopholes" to avoid paying taxes and duties, through various methods and techniques of tax planning. In some cases, as the one of Switzerland, tax evasion is just a contravention, the penalty being civil and not criminal.

2.2 Money laundering

According to the International Monetary Fund (2011), money laundering is generally defined as the transfer, through a third party, of funds previously obtained by illegal means, in order to hide their true source. Money laundering works in the opposite direction to tax evasion / evasion. This operation gives an appearance of legality to the funds obtained illegally.

The revenues of a legally established entity have mainly two major destinations: one part is directed to cover the expenses of the entity, while the other part represents the profit of stakeholders. This profit can be, in turn, reinvested or distributed as dividends.

Therefore, when we talk about illegal activities, the income obtained can be recycled in the legal sector of the economy and part can remain in the illegal one. From the illegal income payments to suppliers could be performed, as well as investments, legal or not. One fact is obvious, the part of the income that enters in the legal sector of the economy will gather the attention of tax authorities.

Although those involved in illegal activities will try to minimize tax burden, a minimum tax must be paid to save appearances.

In other words, tax fraud generally minimizes the tax burden. On the other hand, money laundering means introducing in the legal circuit some pre-won money through illegal means.

The frequency and variety of transactions used for money laundering has become increasingly complex, involving many financial-banking and non-financial institutions (insurers, foreign exchange offices, various intermediaries, etc.) from different countries. In addition, laundered funds are not converted into non-cash products at once, they could be transformed in assurances policies, shares. In addition, the types of entities used in these kind of transactions include post office box companies - with no economic substance, but also solid societies with a well-known reputation, where illicit funds are mixed with legitimate ones. Other types of illegal activities in the field of economic-financial crime, that can be associated with money laundering, are corruption, drug trafficking, fraud or organized crime. The funds obtained by those means are then washed through the financial system (or non-financial), and the money laundering can serve to commit other financial crimes (falsification, corrupting the officials of the financial institutions), thus creating a vicious circle.

In an in depth analysis performed by the International Monetary Fund (2000) is stated that as long as there is no uniform set of laws applicable worldwide, we will have a potential conflict of laws and therefore an offshore industry.

To address those issues, the Base Erosion and Profit Shifting (BEPS) is a recent initiative of OECD and G20, that targets tax avoidance schemes that exploit gaps and mismatches in tax regulations with the purpose to artificially transfer profits to jurisdictions with inexistent or very low level of taxes, where the actual economic activity is minimum or non-existent. Although some of the strategies used are not legal, most of them are, multinational corporations having the possibility to legally avoid paying income taxes.

The BEPS package includes 15 Actions that provides governments with instruments to address tax avoidance, at both domestic and international level. This comprehensive package of actions constitutes the first substantial review of the international tax rules in almost one century. According to OECD (2013), the objective is to have the profits taxed in the jurisdictions where the economic activities that generated the profits are conducted and where the value is actually created.

While some actions address the double non-taxation issue and the development of the mechanisms for settling double taxation cases, it should be mentioned that the proposal is oriented towards the allocation of profits between jurisdictions and not focused to change the tax rates.

OECD's Secretary-General report on BEPS to the G20 Finance ministers and Central Bank Governors (2018), another component of the BEPS Action Plan is to "increase the exchange of information on two levels: by increasing the transparency and reporting of information by taxpayers to tax authorities, as well as between tax authorities of different states. This component of the Plan is in line with the proposal to amend the Information Exchange Directive in order to extend the automatic exchange of information for cross-border tax decisions".

A significant component of BEPS actions is dedicated to transfer pricing, since 5 out of the 15 actions refer explicitly or implicitly to transfer prices.

3. Data and method

As the chosen topic of the paper is recent and currently under development at both national and international level, for a comprehensive understanding of the case, a number of written documents from various sources have been analyzed. Secondary data collection method was used, in particular official reports published by OECD, but also studies performed by two of the big accounting firms: Ernst&Young and Deloitte, the most relevant data was selected to increase the research reliability and validity.

The analysis was performed through a process of iterative readings of the texts, the interpretations being further refined during the analysis. At the level of the theoretical research, generally a deductive approach was used, starting from existing concepts, theories and regulations, that were particularized to emphasize the impact of BEPS action plan measures for Romania.

4. Findings on BEPS implementation in Romania

On March 15, 2016, Mr. Pascal Saint-Amans, Director of the OECD Center for Taxation and Administration, sent the Minister of Public Finance the invitation to Romania to participate as a member in BEPS. The OECD Secretariat presented this new framework to the G20 finance ministers at the meeting held in Shanghai on 27-28 February 2016.

G20 Finance Ministers encouraged the initiative to invite countries and jurisdictions as associates to implement the BEPS provisions.

A country or jurisdiction becomes associated within BEPS by sending the acceptance of participation to the OECD Secretariat. Romania submitted the acceptance of participation on June 7, 2016, based on the Government's approval in the meeting on 2 June 2016. The contribution of Romania to OECD as Associate Member is 20.000 Euros per year. Based on Government approval, Romania was represented at the first meeting held in Kyoto between June 30 and July 1, 2016.

At that meeting an Inclusive Framework on BEPS was established, by means of which, the interested countries and jurisdictions are able to support OECD and G20 members on reviewing and monitoring the implementation of the 15 actions. The states members of the IF, that are currently more than 124, including Romania, accounting around 95% of the global GDP, have agreed to start implementing the minimum standards in four key areas: on harmful tax practices (Action 5), on tax treaty abuse (Action 6), on country-by-country reporting (Action 13) and on improving dispute resolution mechanisms (Action 14). Even if the recommendations included in the minimum standards are not legally binding, it is expected that they will be implemented properly by the countries and jurisdictions that are part of the consensus.

Taking into account the status of Romania as an EU Member State, as well as the conclusions of the Council of the European Union that highlighted the need to identify common solutions at EU level, in line with the BEPS conclusions, but also coordinated, effective and rapid implementation measures, the Council Directive (EU) 2016/1164 have been adopted regarding rules against tax evasion with a direct bearing on the functioning of the internal market, which provides a coherent and coordinated common framework for the implementation of Actions 2, 3, 4 and 5 for the substance of the transactions.

This approach at Member State level also ensures legal certainty that these measures are compatible with European Union law and also that the functioning of the internal market is improved and the positive effects of the BEPS initiative are maximized.

Romania, participating in the BEPS Plan as Associate Member, will be involved in activities related to technical issues, in particular in the area of tax treaties and transfer pricing. This includes efforts on the development of transfer pricing guidelines and double taxation avoidance conventions. Also Romania committed to Implement the four minimum standards of BEPS (Action 5 on harmful tax practices, Action 6 on tax treaty abuse, Action 13 on country-by-country reporting and Action 14 on dispute resolution mechanisms); It was assumed by Romania that it will monitor the evolution of taxes in the context of the challenges that the digital economy (Action 1) brought. Romania joined key decision-making bodies in the international tax area, such as the OECD Taxation Committee and its subsidiary bodies and participates in the OECD working groups.

According to Deloitte (2018), the impact of the 15 actions of BEPS is felt by Romanian companies on two main areas. First, the tax authorities will perform in depth analyses on the economic substance of transactions to the detriment of their form. Secondly, tax transparency will be increased. Therefore, the Romanian tax authorities are able to access the financial and tax information of all the entities within a group, that parent companies report in their jurisdiction, including their permanent branches / headquarters in Romania.

One of the areas of significant changes to businesses following BEPS is that smaller economies might become less attractive destinations for multinational enterprises as global tax rules tend to be uniform. In this context, Romania should consider analyzing the implications of international tax initiatives for its own economy and take the necessary measures to maintain its attractiveness to investors at the global level.

Another point of interest for Romanian companies would be that the leaders of the multinational groups are looking for a clear overview of the activity performed in each jurisdiction in which they operate, including the revenues, profits and taxes paid. This has emerged from the public pressure

for transparency, materialized in increased reporting requirements and increased tax controls. Thus, taxation begins to be considered a matter of corporate responsibility, and not viewed just as compliance with local or global rules.

5. Conclusions

Financial crime impacts each of us and, in particular since 90's, became a main concern to governments, as the development of economies are threatened by this phenomenon.

The cost of economic and financial crime is enormous, sometimes slowing down or hindering economic progress in general, but especially in the less developed countries, where it causes dysfunctional economic and financial flows and, in particular, the judicious allocation of resources for development. Moreover, they undermine confidence in democratic institutions and in the market economy.

In the context of the increased mobility of capital and intangible assets, and considering the new business models of this century (the digital economy), the BEPS plan makes recommendations for legislative improvements in both national tax laws system and international regulations to prevent situations arising from the use by the multinational enterprises of the unintended legislative gaps provided by the national tax systems of the countries in which these enterprises extend their activities. BEPS Action Plan, through its set of 15 actions, addresses the tax avoidance strategies used by multinationals on corporate tax planning, to erode the tax base of higher tax level jurisdictions by shifting profits to lower tax jurisdictions.

Romania, as a BEPS associate member assumed to work with the OECD and G20 members to develop standards and to monitor the implementation of the BEPS set of measures, beginning with the four minimum BEPS standards on: harmful tax practices, abuse of tax agreements, country-by-country reporting requirements and dispute resolution mechanisms;

The allocation of profits considering the place where the economic activities are mainly carried out will lead to the increase of the taxable base in Romania, especially regarding the areas of digital economy and auxiliary activities, financing and intangible assets. The profits generated by companies operating on Romanian territory exclusively by digital means, without physical presence (headquarters or employees), will be taxed taking into account sales generated to customers in that state. Also, new stricter rules for deducting funding costs will be introduced. Remuneration of intangible assets should be correlated with the place where activities that create added value are generated. Thus, taxation will be based on the economic substance, not just the ownership of intangible assets.

In order to respond to the BEPS Action Plan, a Chief Finance Officer / tax manager must identify the BEPS actions that target its company, should estimate how the changes proposed by the BEPS Action Plan will impact its company, should prioritize the BEPS actions and rank them by importance, should make the stakeholders (eg shareholders) aware of the impact of the BEPS Action Plan and should find the best ways to respond to the BEPS Action Plan.

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