

*EUROPEAN PARLIAMENT SPECIAL COMMITTEE ON
FINANCIAL CRIME, TAX EVASION AND TAX
AVOIDANCE (TAX3).*

*FREEDOMPORTS AND SPECIAL ECONOMIC ZONES: RISKS AND BENEFITS FOR THE EU –
Charles Carr: **C AND F PARTNERS LTD***

Response to Questions sent by:**COMMITTEE ON FINANCIAL CRIME, TAX EVASION AND TAX AVOIDANCE (TAX3)****1. Do you have figures of how many free ports or similar entities exist in the EU and globally? Are there estimations of the wealth they store?**

A **freeport** is typically defined as a warehouse facility, located in a tax-free zone and used for the storage of valuables such as artworks, precious metals, diamonds, rare wines and other luxury goods. Freeport is a subcategory of Free Trade Zones (FTZs), one of the six categories of Special Economic Zones (SEZ), or spaces intended to store merchandise in transit. These six categories, established by the World Bank, vary in terms of their economic objective, size, location and market, and are as follows:

- Free Trade Zones (FTZ),
- Export Processing Zones (EPZ),
- Free Economic Zones (FEZ)
- Industrial parks
- Bonded Logistics Parks (BLP)
- Urban enterprises zones

The only freeport in the EU that fits the narrow definition of a free trade zone that specialises in storage of high-value luxury goods is the Luxembourg Freeport, which was inaugurated in September 2014. For instance, “Art & Finance Report 2014” published by Deloitte and the art market research firm, ArtTactic, called the Luxembourg Freeport “the first of its kind in the EU”.

Globally, there are only four other freeports similar to the Luxembourg Freeport, located in Geneva, Monaco, Singapore, Beijing and Delaware, US.¹

Note that the EU has 86 other free zones located in 22-member states, all of which fall into different SEZ categories and approved by the European Commission.² These free zones, however, are mainly used as logistics and trade hubs and not specifically for wealth management or luxury storage purposes – as is the case with the Luxembourg Freeport.

The value of the goods stored in freeports is up to speculation, and estimated to be in billions of euros. Due to strict privacy laws and confidentiality clauses – akin to bank secrecy – owners of freeports do not disclose the value of goods stored on their premises, as declared by customers, thereby making it difficult to give an estimate on the amount of wealth stored in their facilities.

To use Swiss freeports as guidance, in September 2012, *The Economist* estimated that Freeports in Geneva and Zurich were held “well over \$10bn. worth of paintings, sculptures, gold, carpets and other items”³. Four years later, in 2016, the Swiss government estimated that the country’s freeports held more than CHF 100bn in valuables.⁴

2. What practices would you consider as likely to increase money-laundering risks in special economic zones (SEZs)? What good practices would you recommend in order to reduce money-laundering vulnerabilities of the free trade zones?

¹ <https://scholarlycommons.law.case.edu/cgi/viewcontent.cgi?article=2515&context=jil>

² https://ec.europa.eu/taxation_customs/business/customs-procedures/what-is-importation/free-zones_en

³ <https://www.economist.com/finance-and-economics/2012/09/01/paint-threshold>

⁴ <https://www.finews.com/news/english-news/23238-swiss-freeports-move-to-crack-down-on-art,-loot>

The Financial Action Task Force (FATF), the intergovernmental body responsible for developing best AML practices, considers that free trade zones such as freeports boost economic opportunities but lack efficient law enforcement controls and regulatory oversight.

In this context, four risk habits could be addressed through the following regulatory and enforcement improvements:

- a) Prevent “outsourcing” of AML responsibilities: Domestic authorities should not place the entire burden of AML oversight onto private Agreed Free Zone Operators (AFZOs) of Freeports. Although AFZOs in Luxembourg, have the same AML monitoring and reporting responsibilities as banks, lawyers and accountants, it appears that supervisory activities of AFZOs compliance systems – their operations still being in relatively nascent stages (since 2014) – are lacking the rigour established for other traditional similarly regulated actors.

The responsible AML authorities of the state should exercise more stringent controls by enforcing regular and independent regulatory supervision on AFZOs’ internal AML systems, such as spot-checks and specialist audits to ensure compliance with both member state and EU regulations.

Furthermore, UBO and ownership changes information pertain to assets held at freeports, which is collected by Agreed Free Zone Operators, must be available to the relevant AML and tax monitoring authorities of the state where the freeport is located.

- b) Minimise opportunity for opaque transactions: At freeports, transactions can be carried out by fiduciaries and “middlemen” – and can be executed in cash or other untraceable currency - thereby allowing for the anonymity of principals and potentially paving the way for illicit actors to use overvalued assets to launder ill-gotten gains.

Ensuring additional due diligence on transactions within freeports would limit the risks of money laundering at freeports. This can be done through creating records of transaction – through use of a financial intermediary – as well as additional enhanced due diligence requirements for parties involved in high-value transactions.

- c) Setting appropriate time limit on asset storage: Customs controls become inadequate when assets remain within freeports for prolonged period of time. During this time, the assets can be traded, repackaged or experience other changes in their nature.

By establishing reasonable time limits on storage of assets at freeports, controls become more efficient and opportunity for tax evasion, abuse and speculation is minimised. It is, however, recognised that for some industry actors, such as art traders, longer storage times are business crucial. Appropriate time limits should, therefore, be determined in consultation with relevant core customers of the freeport.

- d) Counter weak customs oversight: State and customs authorities are primarily worried about goods when they are entering or leaving freeports – i.e. when they are entering or leaving their own jurisdiction – rather than being concerned with suspicious transactions taking place within the freeport’s “non-jurisdiction”. Customs controls at freeports are typically understaffed and with limited access to information on transactions that take place within the freeports, which are collected by operators of the facility.

An increase in on-site “personpower” and broadening the scope of their access to information on assets held at freeport facilities would limit the possibility for abuses.

3. Have you witnessed any increase in the use of SEZs/free ports following the end of bank secrecy? If this is the case, is there, in your opinion, a link between these two phenomena?

The end of bank secrecy led to a new trend in storing tangible, high-value assets in freeports, as evidenced by the opening of the Luxembourg Freeport in September 2014. Just one year prior to the opening of this facility, Luxembourg signed up to the EU law, which allowed banking information sharing with tax authorities of other member countries.

Since then, freeports have been perceived as facilities used to protect identity and financial dealings of its clients, in a similar way that private banks used to do. The independent international research network, Tax Justice Network Limited (“TJNJ”), shares this perception and considers freeports as a key indicator of financial secrecy in a jurisdiction. Furthermore, TJNJ has described freeports as “institutions” excluded from collecting and reporting information on valuable data related to potential cases of tax evasion, corruption and money laundering.⁵

The development of freeports also increased after the 2008 financial crisis, and with increased international regulatory pressure on lax tax jurisdictions. Both the EU and the OECD led a crackdown on tax havens and promotion of financial transparency which forced Luxembourg and Switzerland to limit their banking secrecy laws.⁶

Although it is difficult to quantify the rise in use of freeports as means of asset protection, the following examples may evidence this pattern:

- ⇒ On 19 September 2014, UK daily newspaper *The Independent* said that “the fall of bank secrecy in places like Luxembourg and Switzerland make of the freeport a place to store goods which offers confidentiality through nominee accounts”⁷.
- ⇒ Similarly, the *Luxembourg Times* reported that Luxembourgish wealth management sector continued to thrive despite the end of banking secrecy, and still managed to attract “high net worth individuals and even ultra-high net worth individuals”⁸.
- ⇒ The “Art & Finance Report 2014” published by Deloitte and ArtTactic states that the Luxembourg Freeport presented an “opportunity to diversify the service offering [for wealth managers] by being able to focus on tangible valuable goods”. The study claimed that 57% of private banks would advise their existing clients to make use of the freeport facility. Also, 37% of private banks also said they were likely to use the freeport facilities in terms of managing clients’ art and collectibles, while 41% said they were likely to create a new or expand existing art service offering as a result of freeports”⁹.

The end of banking secrecy regulations also prompted high-net worth individuals to move their assets to other freeports away from Europe, mainly to Asia, where Singapore and Hong Kong offer superior confidentiality and looser regulation.

4. Are SEZs/ free ports within the EU more regulated than free ports in other parts of the world? Do free ports in the EU need more regulation? Which are the comparative advantages or disadvantages of more or less regulation in this area?

Freeports in the EU are subject to both common EU and their own member state AML regulations, making them highly regulated entities compared to similar institutions in states outside the Union.

⁵ <http://www.taxjustice.net/wp-content/uploads/2013/04/TJN-141124-CRS-AIE-End-of-Banking-Secrecy.pdf>

⁶ <https://uk.reuters.com/article/us-swiss-freeports-idUKKCN11S10L>

⁷ <https://www.independent.co.uk/news/business/analysis-and-features/inside-the-storage-city-where-treasure-is-buried-deep-9745516.html>

⁸ <https://luxtimes.lu/archives/10726-what-effect-the-end-of-banking-secrecy>

⁹ <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Finance/gx-fsi-art-finance-report-2014.pdf>

The major difference among freeports lies in their information disclosure policies, as imposed by local regulations, which are more burdensome in some locations than others.

EU regulations

- ⇒ The EU's legal AML framework transposes the international standards, set by the FATF, while including its own framework set by anti-money laundering directives.
- ⇒ The 5th Anti-money laundering directive ("5AMLD") of 30 May 2018 implements new enhanced due diligence requirements such as the disclosure of beneficial ownership of entities and sources of funds utilised in high-value transactions.
- ⇒ In this context, Rishi Sunak, a British Conservative MP, opined that the highly regulated environment demanded by the European Commission makes these [free trade] zones a pale imitation of their international counterparts and limits their ability to operate in practice"¹⁰.

The **Geneva Freeport** is also an example of reinforced oversight, which followed major regulatory changes of the last four years. Negative assessments by the Swiss Federal Audit Office (SFAO) and the US IRS of the country's financial sector prompted the implementation of new regulatory measures, similar to those implemented in the EU. The more stringent rule followed in Switzerland – compared to the EU – is that to impose a 6-month time limit on storage of goods in freeport, which some critics consider as draconian and harmful to the local art market.

In contrast to the EU and Switzerland, current legislation in Singapore and Delaware favour less regulation, as elaborated below:

- ⇒ In **Singapore**, clients are not obliged to disclose value, origin and ownership of cultural objects stored in the freeports' premises to customs agents.¹¹

Operations in the freeport are now scrutinised by the Steering Committee for Combating Money Laundering and Terrorist Financing. This measure was implemented after the 2013 Singapore's National Risk Assessment identified potential money laundering and terrorist financing risks in transactions taking place at the Freeports.

- ⇒ The **Delaware** Freeport has an additional benefit of not taxing inventory that comes from other US states. The freeport operates within a regulation where there are no state sales tax on the sale of art and no federal customs duty levied on art imported into the US.¹²

Recommended additional EU regulations

There is space for further regulatory improvement at EU freeports (some of which mentioned in question 2), such as the following:

- ⇒ Implement independent, regular AML audits of Agreed Free Zone Operators' compliance functions and ensure adequate and consistent enforcement of the AML procedures and oversights already enshrined in law.
- ⇒ AFZOs should regularly share information with the relevant AML authorities about UBOs and ownership changes of freeport assets.

¹⁰<https://www.cps.org.uk/files/reports/original/161114094336-TheFreePortsOpportunity.pdf>

¹¹<https://economiststalkart.org/2017/09/26/free-ports-or-art-prisons/>

¹²<https://eu.delawareonline.com/story/insider/2017/09/27/delaware-provides-tax-shelter-multi-million-dollar-masterpieces/678385001/>

- ⇒ A reasonable and business-appropriate time limit on storing goods at freeports should be implemented.
- ⇒ The European art market, as one of the main customers of freeports, should be encouraged to self-regulate and increase transparency of its transactions. This especially as art transactions continue to carry high ML risk due to their opacity and subjectivity of asset evaluation.

Advantages of further regulation of freeports in the EU are:

- ⇒ From a soft power perspective, and in the context of recent ML scandals involving the Union's banks, the EU should continue to champion transparency and good governance, and promote the Union's values and the rule of law
- ⇒ Additional regulation would discourage illegal actors from carrying out operations at EU freeports.

Tighter controls on freeport operations has **disadvantages** such as:

- ⇒ It minimised anonymity which is at times sought by freeport clients in high value transactions for legitimate reasons (i.e. privacy and security), and
- ⇒ It increases the costs of operation in these facilities due to stricter DD and control measures that need implementing.

5. Do SEZs/free ports have benefits for the real economy? If so, which are these benefits?

In 2016, warehousing activities accounted for 30% of the global free trade zone activities, storing goods estimated at \$536bn¹³.

Freeports take advantage of the liberalised warehousing arrangements to boost economic development of countries they are located in many ways, as exemplified in the three examples below.

- ⇒ **Development into an art and finance cluster:** Predictions indicate that by 2026, UHNWI will hold an estimated of \$2.7 trillion in assets, thereby increasing the global demand for ultra-safe storing facilities.

Countries in which freeports are located stand to gain from financial activities promoted by UHNWI's private bankers and advisors, insurance companies and asset managers, among others. At the same time, storage of collectables owned by UHNWI at freeports and option to exhibit them in local museums under tax-suspension schemes, enables the countries with freeports to develop into cultural centres, attractive for artists and tourists alike.

With stricter financial regulations, wealth management through art and development of art hubs are becoming "essential driver(s) for the economic development of local communities as well as private companies", as stated by Aurélie Filippetti, the former French Minister of Culture (2012-14).¹⁴

In this context and following the opening of the Luxembourg Freeport, Yves Francis, the CEO of Deloitte Luxembourg, stated that "by making the bridge between the art market and finance, there would be quite a lot of opportunities for Luxembourg"¹⁵.

¹³ <https://www.cps.org.uk/files/reports/original/161114094336-TheFreePortsOpportunity.pdf>

¹⁴ <https://www2.deloitte.com/lu/en/pages/art-finance/articles/art-finance-report.html>

¹⁵ <https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/artandfinance/lu-le-freeport-luxembourg-new-perspectives-01062015.pdf>

- ⇒ **Creation of logistics hubs:** As a centralised warehouse, catering to a wide range of customers from multiple jurisdictions, freeports are a key to building global networks and infrastructures.¹⁶ In the case of Luxembourg, the freeport has had a positive impact on the development of Findel airport and other specialised transport services.
- ⇒ **Stimulation of investment:** Freeports attract companies that look to profit from liberalised warehousing arrangements. Becoming a storage and logistics centre, encourages other corporate activities such as R&D, dynamization of the ICT sector, new business model generation and job creation for qualified and unqualified workers.

6. What is the current level of cooperation between customs authorities and SEZs/free ports owners in the fight against money laundering, tax evasion and tax avoidance? And between SEZs/free ports owners and taxation authorities and financial intelligence units? What about between the different authorities involved?

AML legislation in the EU follows a national approach, with member states supervising regulation and enforcement. A minimum harmonisation of supervisory competences is established, but no harmonisation of the powers of the supervisory authorities exists.¹⁷

Thus, the EU AML directives represent a set of high-level principles and guidance for supervisory authorities. Member states can implement differing national supervisory practices at their discretion, as there is currently no mandatory mechanism to ensure supranational structured cooperation between AML supervisors.

In this context, note that some reforms in this aspect are underway, with the talk of extension of the European Banking Authority's (EBA's) AML mandate and adding to it an ability for EBA to exercise supervisory activities in all EU member states.

The case of Luxembourg

The Government of Luxembourg considers the Luxembourg Freeport a privately-owned venture and seemingly considers itself not fully responsible for the facility's operations. The cooperation between freeports and local authorities is as follows:

- ⇒ **Customs authorities:** Luxembourg customs authorities provide 3 customs officers (over a 24h period) to monitor the goods entering, moving within or leaving the Freeport
- ⇒ **Compliance responsibilities:** Private Agreed Free Zone Operators are responsible for daily AML compliance at the Freeport Luxembourg's AML authority, the Registration and Domains Administration, exercising sporadic supervisory actions and obtaining access to information collected by AFZOs, as required.
- ⇒ **Agreed Free Zone Operators** are responsible to submit suspicious transactions report to relevant authorities. As per the Law of 12 November 2004 on the fight against money laundering and terrorist financing, they have the same monitoring requirement that banks, notaries and lawyers in Luxembourg by state law. The state supervision of AFZOs performance of this activity, however, seems to have so far not been as rigorous and consistent.

¹⁶ Ibid.

¹⁷ https://ec.europa.eu/commission/sites/beta-political/files/soteu2018-anti-money-laundering-communication-645_en.pdf

7. What would be, in your opinion, the consequences of the withdrawal of the UK from the EU in terms of business models and competitiveness in this particular area?

The withdrawal of the UK from the EU will not have a direct impact on competitiveness of freeports in the Union, given this premises' unique nature.

However, certain British conservative actors have called on the British government to create free-trade zones in the UK to attract investors and industries, and create jobs once the UK leaves the EU.

In late 2016, UK MP Rishi Sunak submitted a report to the government proposing to transform current infrastructure hubs into SEZ. Through his strategy, the UK would become a nexus between the Commonwealth countries - which would produce and supply semi-finished goods – and the European market – which has a large demand of finished goods – with future UK freeports serving as places to assemble the goods prior to their export into the EU.¹⁸

This strategy, which currently lacks wide political support in the UK, has an internal UK rather than international consequences, and is rather directed at reducing inequality between UK's regions.¹⁹

8. Are you aware of cases of seizure of goods in any SEZs/owing to suspicions of money laundering or tax evasion?

Freeports have several restrictions that prevent local authorities from investigating property stored at their premises. However, throughout the last decade, authorities have seized goods in the context of money laundering investigations, as detailed below:

⇒ **Looted art case:** In 2015, the Panama Papers leak revealed that David Nahmad, a prominent private art collector, was the ultimate owner of the Modigliani painting, *Seated Man With A Can*. Nahmad acquired the artwork in 1996 at a Christie's auction for an estimated \$25mn through his Panamanian entity International Art Center (IAC) and had it stored at the Geneva Freeport.

This Modigliani painting attracted public attention when the grand-son of Oscar Stettiner, a Jewish antiques dealer, claimed that the art work had been looted by the Nazis during the occupation of Paris in 1939.

The painting, stored in the Geneva Freeport, was initially seized by Swiss authorities and was later returned to Nahmad when the claimant was unable to prove its ownership as the document held was too vague in description of the artwork.

⇒ **Diamond trading:** An October 2013 FATF report entitled "Money Laundering and Terrorist Financing Through Trade in Diamonds" describe how criminals use diamonds as a form of currency to avoid an easy trade in their transactions.

The report provided an example of a €800m diamond fraud case which took place in the Geneva Freeport in 2005. Note that the case refers to the fraud carried out by Monstrey Worldwide Service, an Antwerp-based courier business, which used the Geneva Freeport to smuggle precious Stones, only to later sell in the Antwerp black market via offshore shell companies

Ends.

¹⁸ <https://www.cps.org.uk/publications/the-free-ports-opportunity/>

¹⁹ <https://www.newstatesman.com/spotlight/devolution/2018/06/can-free-ports-save-north-post-brexit>