EPRS

EUROPEAN PARLIAMENTARY RESEARCH SERVICE

European Parliament

# Money laundering and tax evasion risks in free ports

**Ron Korver**

18 October 2018

# Introduction

- Defining free ports
- Increase in popularity
- Money laundering and tax evasion risks
- Free ports from a legal perspective
- The case of the Luxembourg Freeport

# Defining free zones, free ports, customs warehouses

Free ports are warehouses in a free zone, which - originally - were intended as spaces to store merchandise in transit.

Free ports have become popular for the storage of valuables, including art, precious stones, gold, antique and wine collections – often on a permanent basis.

They are similar to 'customs warehouses', which can offer the same tax advantages and levels of secrecy.

# Rise in popularity, inter alia because of:

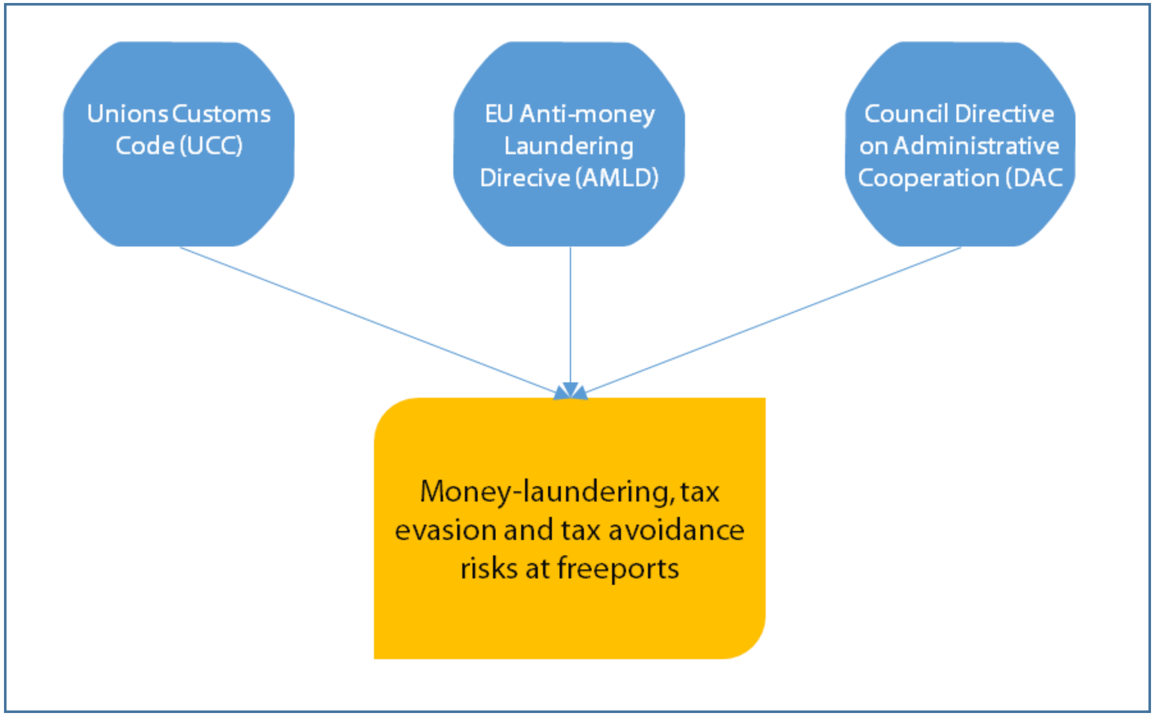
- increasing crackdown by governments on bank secrecy and tax evasion (FATCA, CRS, DAC); wealthy individuals looked for alternatives and invested in substitute assets such as art and antiques
- an unprecedented art boom, fuelled by the expansion of private collections and a worldwide expansion of museums
- the entrance of new market players such as new multimillionaires from China, the Middle East and Russia;
- Owners do not have to pay import or export taxes when they ship to and from free ports and sales on free ports are free of tax.
- Free ports add an extra layer of secrecy

European Parliament

# Money laundering and tax evasion risks

- Free ports are conducive to secrecy, allow transactions to be made without attracting attention of regulators and direct tax authorities
- value is generally declared by the owner or a representative ("self-declaration") and is in most cases not checked
- art is still one of the few unregulated markets, it can be a means of tax evasion and capital flight
- enforcement agencies are often unfamiliar with values of works of art
- high level of monetary or "in kind" transactions in arts market
- the portable nature of art itself
- connection between the international art trade and offshore secrecy

# Free ports and customs warehouses from a legal perspective



# The Union Customs Code (UCC)

- sets rules for the establishment of "customs warehouses" and "free zones (freeports)"
- allows for deferral of indirect taxes and import duties under these procedures as the goods are formally "in transit"
- sets no limits to duration of goods under a free zone or customs warehousing procedure
- almost anyone can present goods to customs
- emphasis of customs is on "identification of <u>the goods</u> placed under that procedure, their customs status and their movements, <u>not on the UBO</u>"

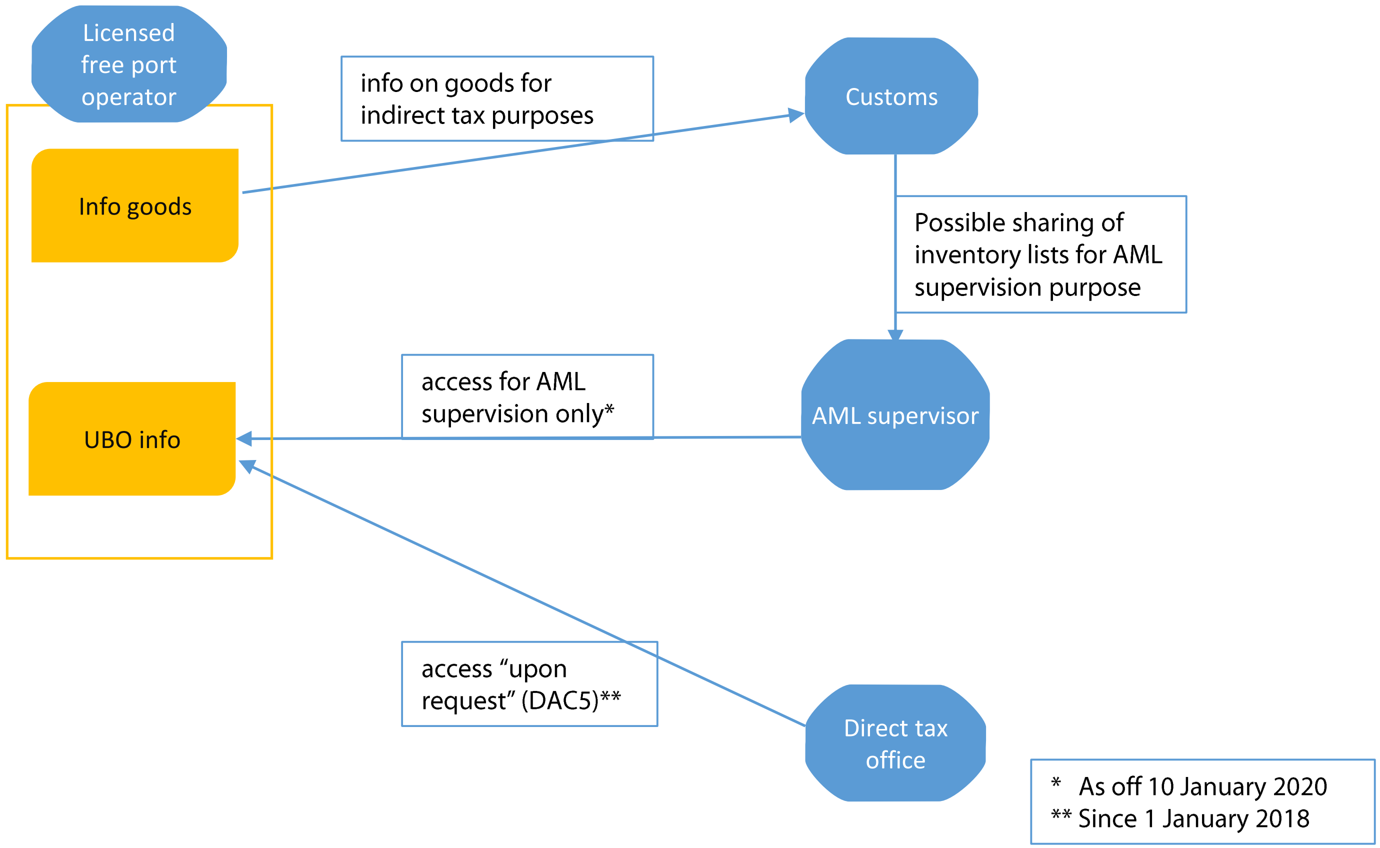
# Conclusions

- The UCC provides the legal basis for (indirect) tax deferral as it allows for the permanent storage of goods under "special storage procedures"
- If goods are sold in a free port, indirect taxes have 'de facto' been avoided
- Almost anyone can bring in goods, as far as the UCC is concerned. UBO info is not required for indirect tax purposes.
- Free zones (free ports) on equal legal footing with customs warehouses

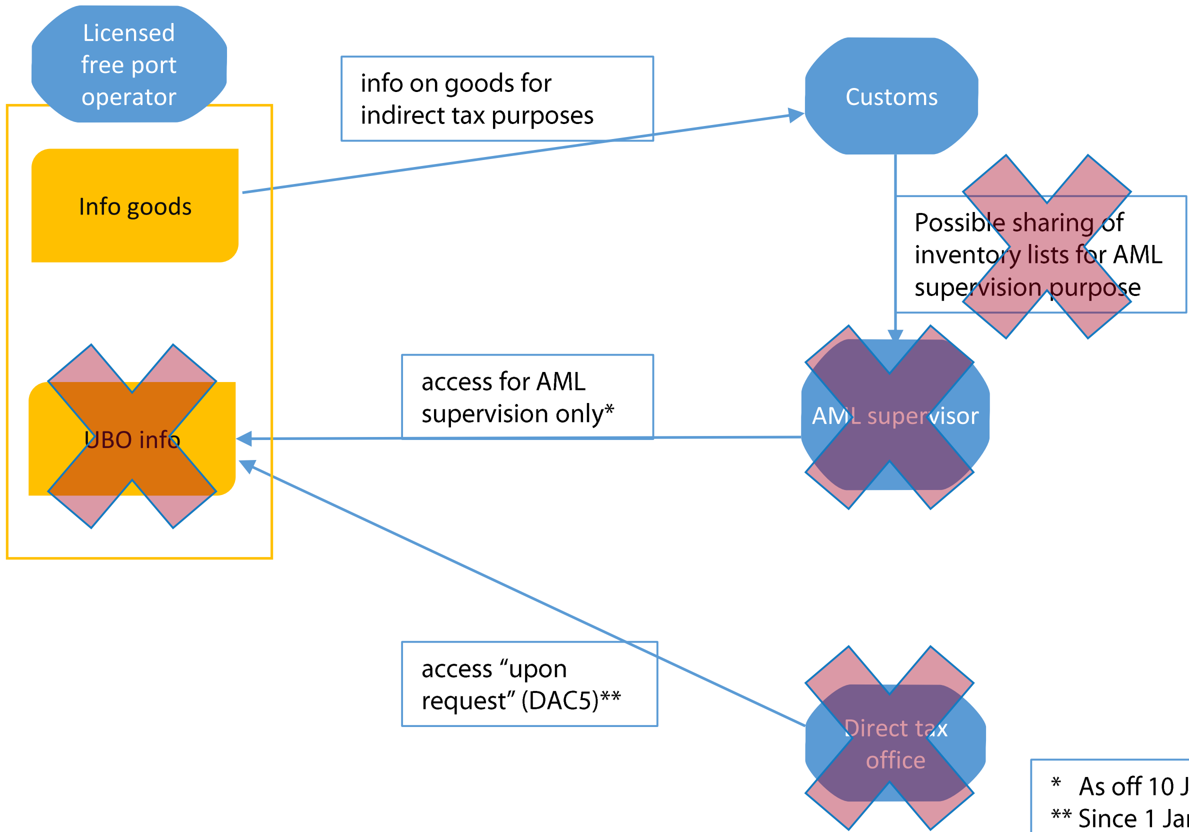
# The Anti-money Laundering Directive (AMLD)

- AMLD5 will enter into force on 10 January 2020, will explicitly include free ports, free port operators and actors in the art market such as galleries and auction houses in the scope
- Free port operators will then be subject to the same CDD requirements, as current non-financial obliged entities and will also have to report suspicious transactions (STRs) to FIUs
- AMLD4 entered into force on 16 June 2017, added "tax crimes" as a predicate crime for money laundering and thus for STR reporting
- Direct tax authorities will have access "upon request" to CDD data based on DAC5

# Availability and accessibility of information after entering into force of AMLD5



# Current availability and accessibility of information




* As off 10 January 2020
** Since 1 January 2018

# Conclusions

- The wording in the AMLD5 is not consistent with that of the UCC. "Free ports" are not recognised as such in the UCC, but are formally considered as any other "free zone".
- Free ports fall under the so called 'free zone procedure' , which is almost equal to the "customs warehousing procedure". Customs warehouses also under AMLD5?
- EU AML legislation is built on the trust in good faith of obliged entities, not on systemic exchanges, which would require automatic data sharing (AEOI)
- future success of AMLD5 in the arts market depends to a high degree on the deterrent effect of future supervision as well as on prosecution and possible sanctions

# Directive on Administrative Cooperation (DAC)

- DAC1 provides for "automatic exchange" between direct tax authorities of predefined tax data on a regularly basis on residents in a given member state, who have reportable income and capital in another

- DAC1 also provides for "exchange upon request" and "spontaneous exchanges" between direct tax authorities

- DAC5 enables direct tax authorities since 1 January 2018 to have "access upon request" to UBO information collected under AML

# Conclusions

- Proceeds of sales of goods in free ports constitute a “grey area” as wealth or capital gains are not taxed everywhere in the same manner, if at all
- Capital gains on sales of art or other moveable property do not fall within any category for automatic exchange of information
- Customs warehouses under AMLD?
- Direct tax offices  are not allowed to “fish” in UBO data. They will have “access upon request” under DAC5 when these data are available. This makes access in practice very difficult.
- Exchanges of tax information related to goods in free ports highly unlikely, even as off 2020 when AMLD5 enters into force

# Luxembourg

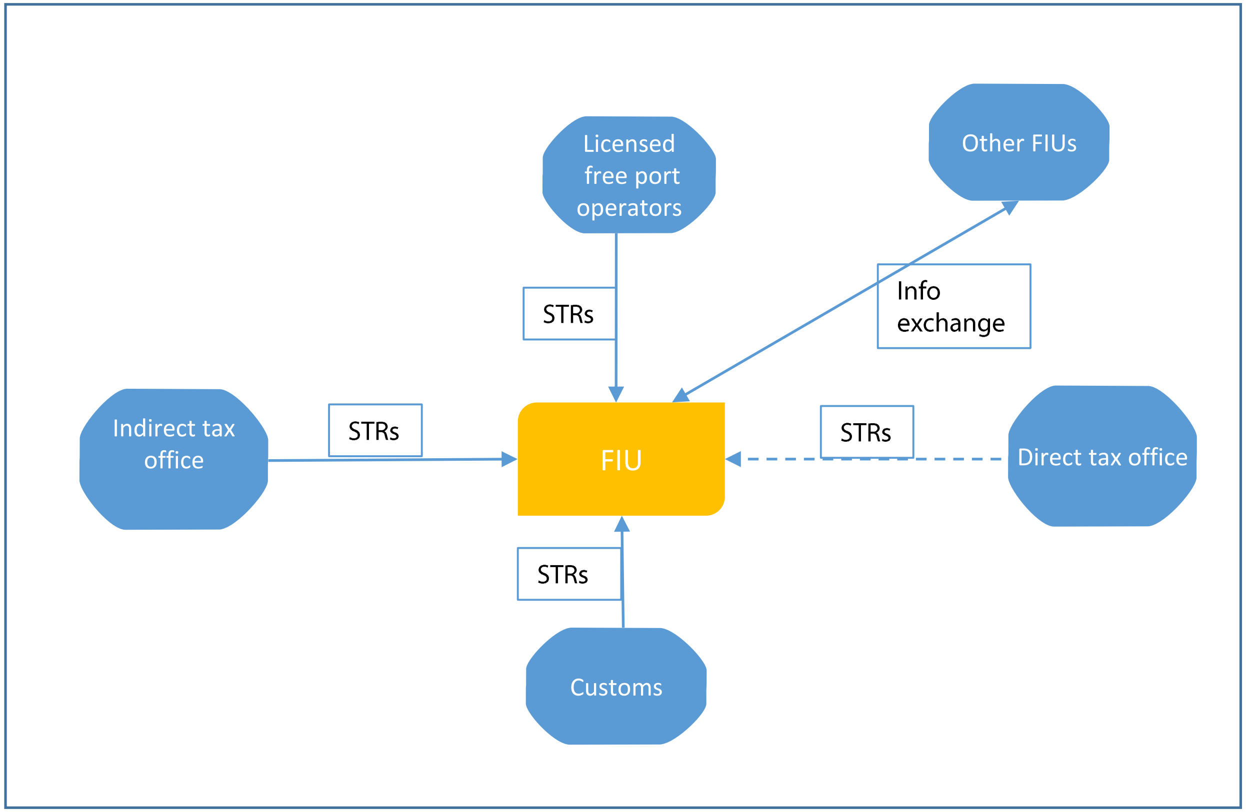
- Has brought the free port under AML-law in 2015

- Interesting test case for future implementation of AMLD5

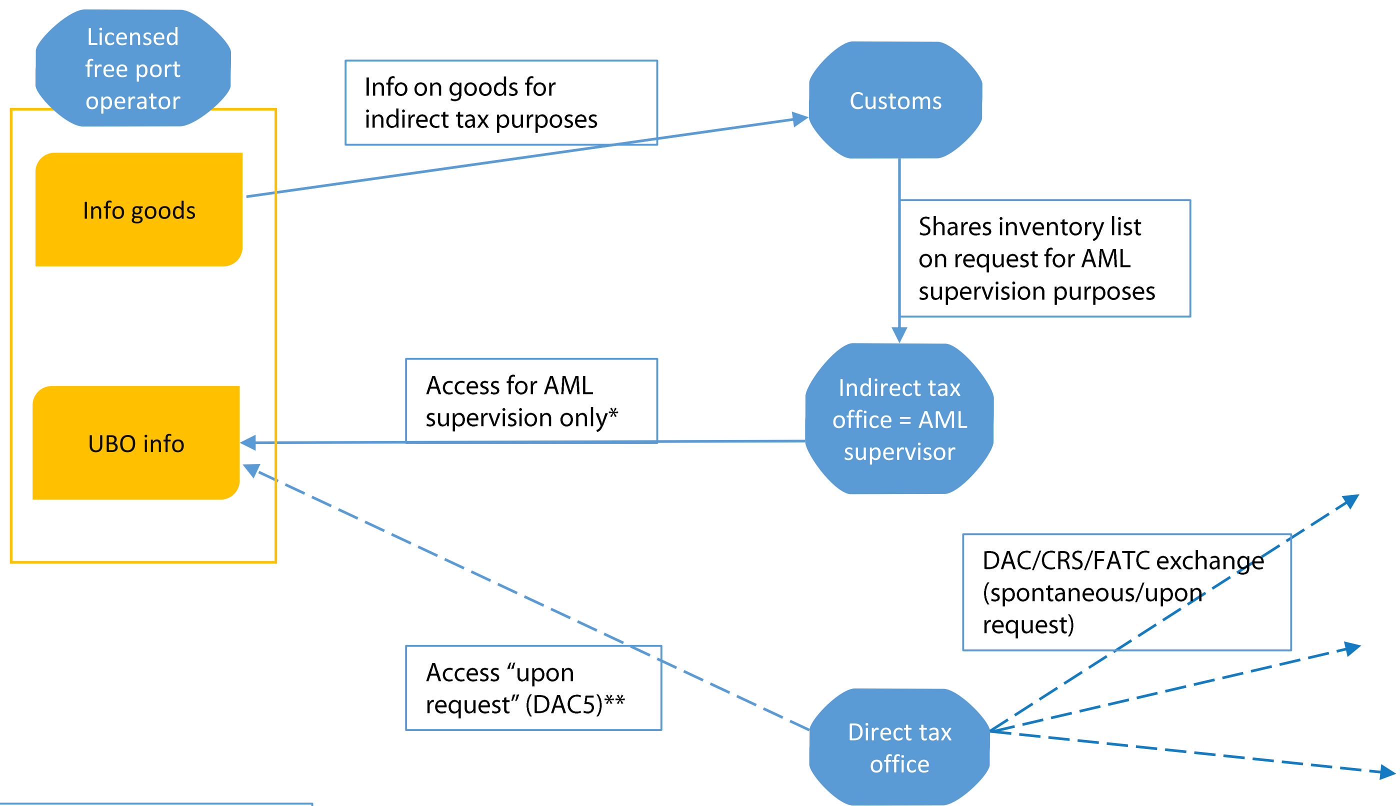
- Is the first EU free port aiming at (semi-) permanent storage of art and other high value assets, importing the business model of the Geneva free port

# Relevant actors

# Reporting of suspicious transactions



# Availability, accessibility and sharing of information




*Since 24 July 2015 (national AML law)*
*** Since 1 January 2018*

# Conclusions

- Main focus authorities is on indirect taxes related to the stored goods
- Customs procedures at the Freeport are strict
- Customs has info about goods but has no legal basis to share this info systematically with other authorities
- Freeport Luxembourg is the only one in the world currently under AML regime
- AML regime heavily depends on reporting discipline under authorities and licensed operators

- Indirect tax office is AML supervisor and has, for supervision purposes, access to UBO info held by the licensed operator (obliged AML entity)
- Direct tax office has access to UBO info held by licensed operators, but only “upon request”, so they have to know beforehand what to ask for
- Sharing of direct tax information with other tax authorities therefore highly unlikely
- The decision to bring Freeport under AML, has led to loss of clients who refused to disclose the UBO. “On-boarding new clients has also become more difficult as clients want to stay under the radar of authorities.