COLLIDE OR ALIGN?

ACHIEVING THE BALANCE BETWEEN AML/CFT AND TAX COMPLIANCE AND THE COST OF DOING BUSINESS

Increasing the transparency of Beneficial Ownership ("BO"), including identifying controllers of legal entities and legal arrangements, is fundamental to the effectiveness of regulatory measures to comply with Anti-Money Laundering ("AML") and Anti-Tax Evasion initiatives.

Beneficial ownership remains a massive challenge for regulated firms around the world. The stringent requirements create a high compliance burden to identify and verify BOs using independent and reliable sources.

5AMLD AND REGISTRIES

Amendments in the 5th Anti-Money Laundering Directive ("5AMLD") include several measures to achieve this, including the introduction and enhancement of corporate registry information concerning the ultimate beneficial owner(s) of legal entities and, to be introduced soon, legal arrangements such as trusts and foundations. A pan-European registry is also to be introduced by the end of the year, allowing access to Member State registry information from a single source.

This initiative, while providing greater transparency for KYC compliance teams who need to identify and verify a BO, is not without its challenges. Not all Member States provide the same level of access to their registers, with varying levels of fees that must be paid to access information on them. Others are still in the process of setting up their registries, while those Member States with established registries are trying to understand how best to receive and process discrepancy notifications, also introduced under the 5AMLD.

5AMLD AND TAX TRIGGERS

An often overlooked requirement also introduced in the 5AMLD is the new KYC review requirement known informally as the "tax triggers". These relate to the Automatic Exchange of Information ("AEOI") regulations, designed to help deter and detect tax evasion when customers hold financial accounts outside of the jurisdiction(s) in which they are tax resident.

This new requirement appears to have been introduced with the goal of detecting changes to a customer's tax residency that may indicate suspicious activity associated with tax evasion. The idea is not to require that firms treat every change as conclusive indicia that a customer is engaging in tax evasion. Rather, firms would be expected, on a risk basis for AML/CFT purposes, to consider whether a tax trigger may be grounds to further investigate the risk rating assigned to a customer or even whether further investigation of a customer is warranted.

For example, if an existing customer changes their permanent residential address from Italy to France, they need to provide a new self- certification declaration.

On receipt, firms must check the AML information held to ensure there is no reason to doubt the tax residency information provided. For example, if the permanent residential address in the KYC information and the self-certification is in France, but the customer does not declare a French tax residency, this would need to be explored with the customer and trigger a re-evaluation of the customer risk assessment.

Changes to tax residency of an individual or the BO of an entity can happen for a variety of reasons, some of which may be perfectly legitimate. The purpose of the new requirements appears to be intended to build the bridge between information that firms' tax teams may receive about or from customers with AML KYC teams, allowing them to detect when changes to that information may indicate an overall change to a customer's known risk profile.

CHALLENGES AHEAD - NEED FOR ALIGNMENT

From an operational perspective, the AEOI tax requirements are rules based whilst AML is risk based, this can lead to several differences operationally, and ones that will need to be considered when operationalising these requirements. Requiring that customer transaction activity be halted and investigated each and every time a tax trigger is raised, for example, is not ideal either from an operational or customer service perspective. Achieving synergies through proper planning, coordination and rollout of these new tax requirements will ultimately help to work towards the long term aim of aligning these objectives.

CONCLUSION

Thus far, little in the way of regulator guidance has been on offer for Member State firms, despite the replacement of the 5AMLD related Risk Factor Guidelines earlier this year.

However, this should not deter firms from proactively taking the first steps towards planning for their implementation. This could include;

- Conduct an integration assessment of existing AML/CFT and tax compliance processes – do the programs "speak" with one another or are they currently operating in a siloed fashion;
- Data aggregation and access – are the systems used for the above compliance programs designed to capture and store the data needed in separate areas, or can this be searched across both programs to identify discrepancies between the AML KYC and Tax KYC data received;
- Operationalising risk-based treatment – how will existing risk-based alert management and KYC review processes need altering to incorporate these new triggers and ensure that staff responsible for those activities understand how they should be managed; and
- Is your MLRO and its investigation team members trained and well versed in how to investigate cases involving possible tax evasion?

It's a fine balance between AML/CTF and tax compliance and the cost of doing business but taking the first step towards planning for the implementation of tax triggers will help achieve this balance and do so in a way that does not impact on the customer experience.

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