

## **EAG WORKING GROUP ON TYPOLOGIES**

### **Study Report**

#### **"International trade-based money laundering"**

(December 2009, Guilin)

This study on "International trade-based money laundering" was carried out in accordance with the decision of the Ninth Plenary Meeting of the Eurasian Group on Combating Money Laundering and Terrorism Financing (hereinafter "EAG").

The fact that money laundering in the present-day context can no longer be viewed as an isolated threat to the economic security of one given country ensures the relevance of this issue. The majority of financial crimes tend to be transnational in nature. A criminal capital cycle is formed, resulting in the expansion of the shadow and criminal economic activities, which only increase the extent of economic damage caused to various countries.

Foreign trade-based transactions, as is well known, are responsible for the lion's share of the money channeled abroad. The scope of foreign economic activities is highly diverse. The subject of international trade-based money laundering was identified as one of the most interesting, in our opinion, for the study.

According to the IMF data, the aggregate volume of all money laundering operations is 2-5% of the world gross product. It can be said with a high degree of probability that money laundering is not confined to individual countries, and that all countries in the world, at least to some extent, are involved in this criminal process. It is, therefore, necessary to study this problem, take steps towards countering and preventing the development of this process, work on minimizing its negative impact on countries and, generally, devise common approaches to the composition and content of the measures necessary to effectively identify and prevent the instances of the use of international trade transactions for money laundering purposes.

The study, based on the generalized findings of the national studies that were conducted by the countries participating in the studies, is devoted to exploring the ways of using foreign trade transactions to launder the proceeds of crime.

The data for the study was provided by the financial intelligence units (FIU) of the Russian Federation (EAG member), Belarus (EAG member), Kyrgyz Republic (EAG member), Ukraine (EAG observer), Turkey (EAG observer), Slovenia and Estonia.

One important feature of this study focuses on identifying the legal aspects of business regulation that affect the development of various mechanisms for using international economic and, especially, trade-based activities for money laundering. Within the framework of the study, an attempt was made to analyze the legal standards of national legislations governing the conduct and control of

foreign trade-based transactions. A brief comparative analysis is given in the first section of the study. Unfortunately, a detailed understanding of this issue, for a variety of reasons, was not possible. However, the findings obtained in the course of the writing of this study show, once again, its great complexity and diversity.

The study is devoted to identifying the ways and methods (schemes) used for international trade-based money laundering; making recommendations conducive to identifying the signs of criminal transactions related to international trade-based money laundering; summarizing most common features of such transactions, i.e. indicators for identifying suspicious financial transactions; identifying the factors influencing the effectiveness of activities directed at the detection and investigation of these types of criminal acts.

## **Section 2. Methods and schemes of money laundering through international trade transactions**

First of all, it is worth noting that that all countries have pointed to the importance of conducting a study concerning the issue of "Use of International Trade Transactions for Money Laundering". The international trade domain, with its high decree of state regulation, has always been regarded as an attractive option for transferring financial resources abroad for the purpose of either hindering the efforts aimed at tracking down and confiscating the criminally obtained funds or for their subsequent reinvestment into the legitimate economy under the guise of a legally obtained income. Economic and political integration of countries contributes, in some cases, to the process of simplification of trade relations between countries, inevitably resulting, however, in the creation of new criminal schemes.

At the same time, the sources of illegal revenues may also be the proceeds derived from traditional forms of criminal activity (e.g. drug and human trafficking), as well as the proceeds originating from unauthorized use of state budgetary and public borrowing funds, bank loans obtained using documents containing deliberately misleading information. Part of the funds defined as criminally derived income is generated through illegal trade transactions and subsequently invested into the maintenance and expansion of a business entity that receives a legitimate income. Such foreign trade transactions may be used with the aim of disguising the real financial and business transactions, including smuggling, the income from which is transferred to foreign companies or accounts in foreign banks.

In addition to that, illicit funds may be channeled to finance the founding of new business enterprises, which help to run criminal schemes and allow the organizers to obtain a legitimate income in the form of cash dividends.

It should also be noted that a considerable number of criminal cases involving money laundering through international trade transactions in the countries participated in the study, and where tax evasion is the predicate offense were related to tax evasion or obtaining illegal tax refunds.

The countries participating in the study have practical experience in detecting the cases involving laundering of the proceeds of crime through international trade transactions. The current study consolidates the data produced by the national studies on the principal methods used for laundering the proceeds of crime, identifies ways and schemes used for money laundering. We believe that this study will be of particular benefit to the financial intelligence units in the countries that are still in the process of gaining experience in the field of working with reports of suspicious financial transactions.

The issue of using alternative electronic payment systems, in particular WebMoney system, for payment for foreign trade-related purchases remains open (not covered). The problem related to the functioning of this payment system was identified in the 2008 study, conducted by EAG and dedicated to the topic of "Cross-Border Money Transfers Involving Private Individuals". It was pointed out that the WebMoney system was widely used in various countries, but remains outside the legal framework of financial markets. Due to limited resources and limited time available for the study, we believe that, for the purpose of a more extensive research, this topic may be used as the subject of a separate study. Transactions involving Promissory Notes were not included into the study either. They are also used to terminate the obligations related to international trade contracts and may be part of money laundering schemes.

Based on a comprehensive study of the materials submitted by the participating in the study countries, it was concluded that the international trade domain might be exploited for the purposes of money laundering activities in the following ways:

**1) through export transactions:** non-return of export currency revenues, understating/overstating the value of exported goods, fictitious export involving forged documents, export involving lost documents;

**2) through import transactions:** fictitious import (import involving forged documents, advance payments and import of goods without bringing them into the country), overstating the value of imported goods, import involving forged documents;

**3) through export-import and transit transactions:** "carousel fraud", transit payments for fictitious import and export, transit of goods through the country's customs territory.

## 1. EXPORT TRANSACTIONS

### 1.1. Non-return of export currency revenues into the country

This offense is not seen as a predicate to money laundering in a number of countries. It includes incomplete or untimely return of currency revenues.

### 1.2. Overstating/understating the value of exported goods:

Exports at reduced or over inflated prices is carried out either by documentarily understating/overstating the customs value, or through transit of one type of goods under the guise of another (according to the classification of goods under the HS Code).

As a rule, export at over inflated prices is aimed at receiving an unlawful compensation for the paid VAT, and often features as a part of the "carousel fraud".

### **Example 1 (Ukraine)**

*While analyzing the available data, it was found that several business enterprises located in three regions of Ukraine exported, through a contract holding company "B" LLC, to a US-based non-resident "L" crudely processed oil filters for VAZ vehicles under the guise of water purification systems for an amount totaling UAH 280.7 million (US 36.5 million). The value of goods was, in this case, overstated by 50 times.*

*This criminal scheme was aimed at obtaining illegal VAT refund totaling \$ UAH 56 million (US 7.3 million).*

### **Example 2 (Ukraine)**

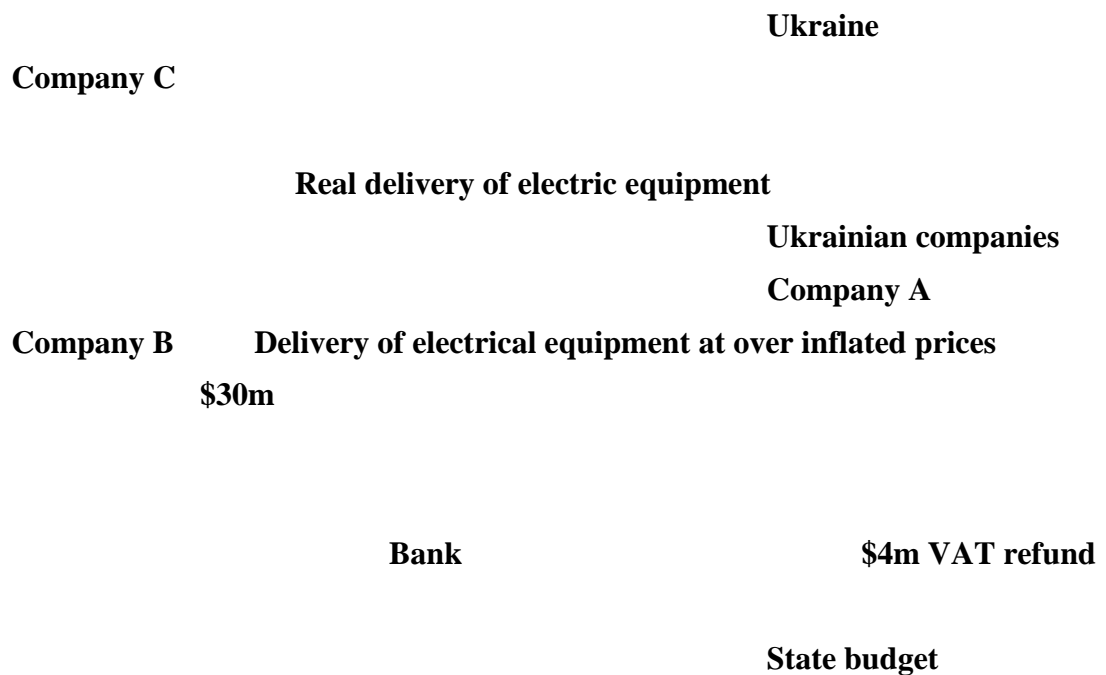
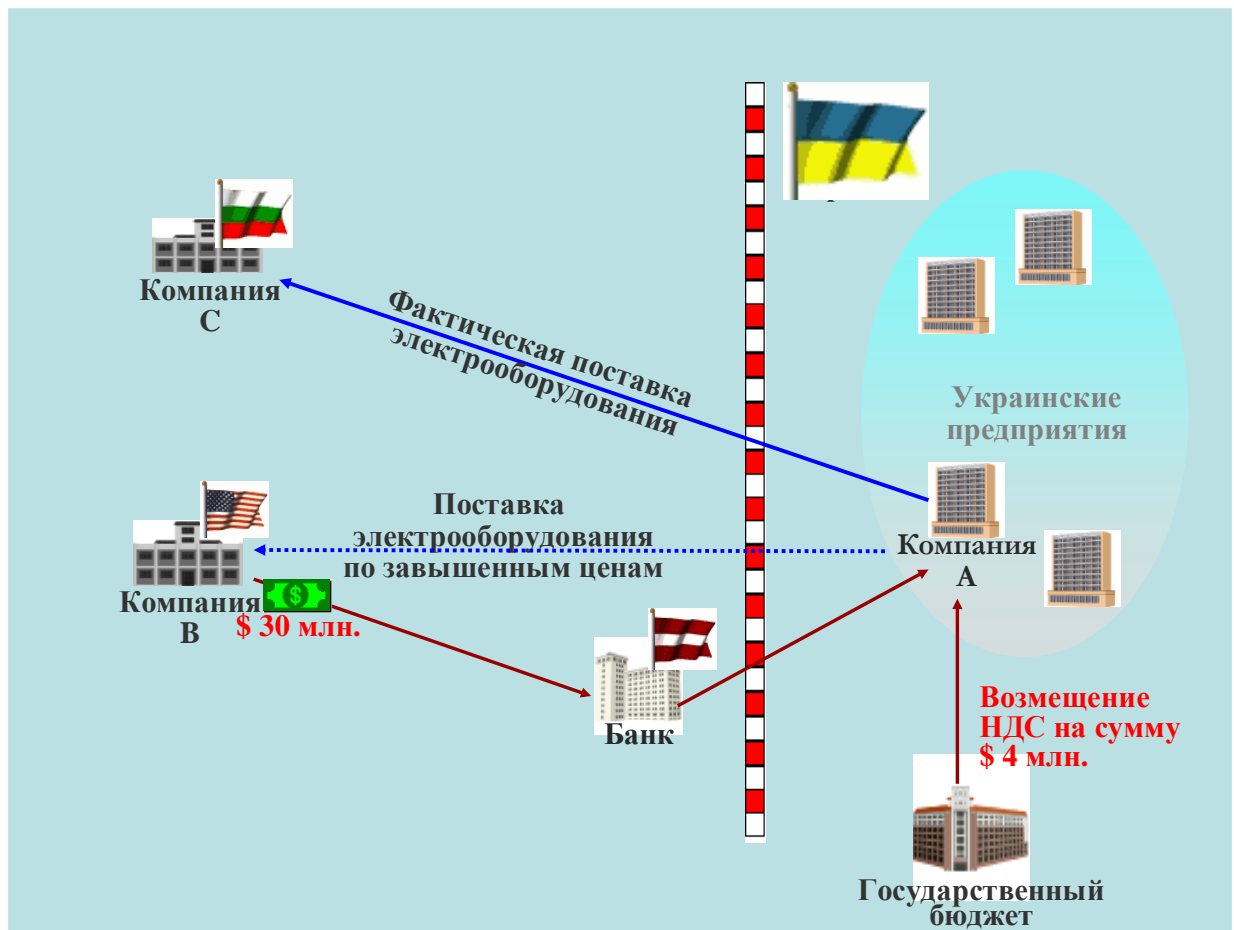
*A group of Ukrainian companies was part of an arrangement involving resale of electronic equipment for export.*

*Company "A" exported electronic equipment at over inflated prices to a US-registered company "B". The goods, however, were delivered to Bulgaria.*

*VAT refund is subject to the payment for the exported goods. To this end, company "B" made a transfer of more than US\$30 million to company "A" via a Latvian bank.*

*Thus, having exported goods at over inflated prices, their VAT was offset at the expense of the state budget. The total amount of compensation was US\$4 million.*

*It was found out during the investigation that company "B" owned a Ukrainian company "A". Furthermore, company "B" had already been involved in various other illegal schemes and was owned by companies registered in offshore areas, such as Belize and Niue.*

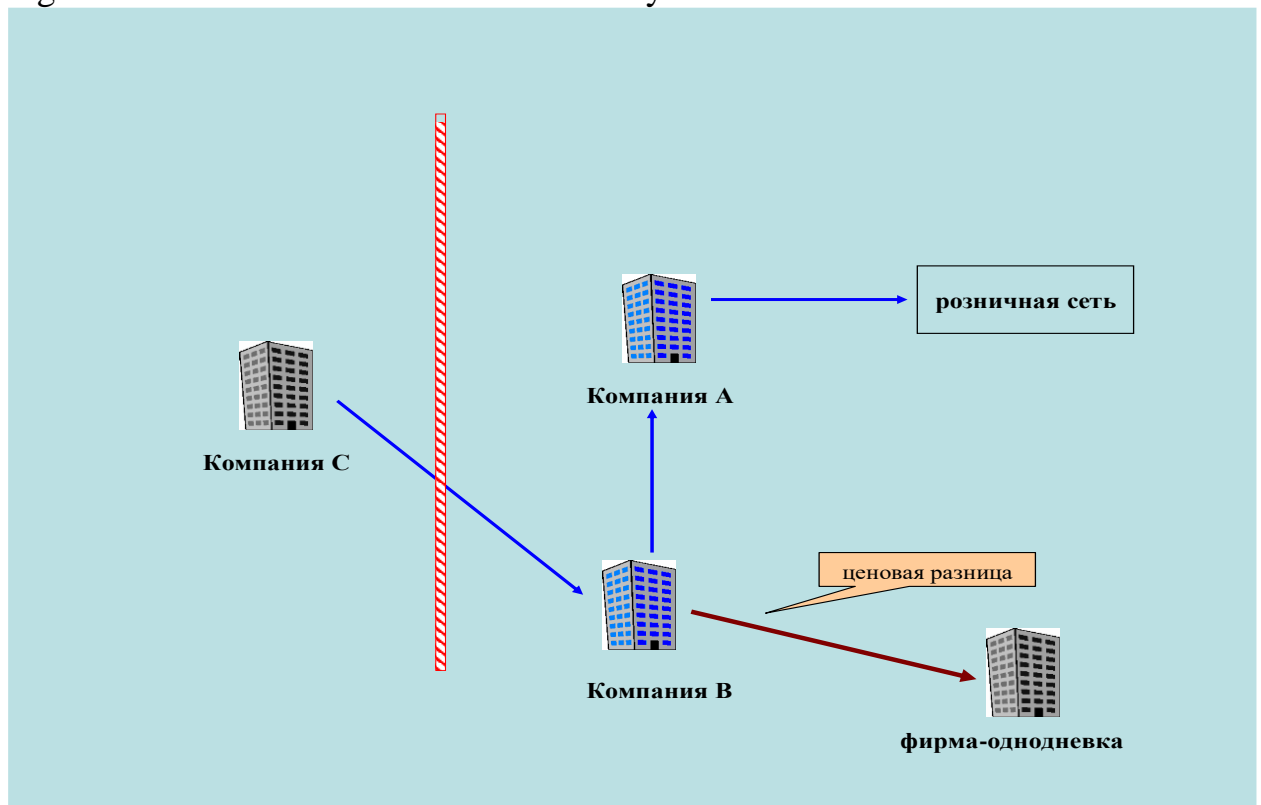


**Scheme involving contacts with understated value of goods:** Company "A" (resident) registers company "B" in the name of a fictitious person. The objective of company "B" is to launder a considerable amount of money in a short

period of time for company "A", playing the role of a "go-between". Both companies are legal and officially registered.

Company "B" officially imports goods, priced at \$10 apiece, acquiring them from a foreign company "C". It uses genuine forwarding documents and receives official customs markings at the boarder. Next, company "B" sells the acquired goods to company "A" at \$100 apiece. Company "A" disposes of the goods either through its own network (if it has one) or through intermediaries at \$101 apiece, while paying the minimum tax. The 90-dollar-per-item difference created as a result of this transaction is cashed through a bank or through one-day firms.

One of the advantages of using this scheme lies in the fact that company "B", given its previous import experience, earns itself a positive reputation, becomes eligible to a bank loan and, therefore, can continue further funding of its activities already on it own. In addition to that, company "B", may apply the same scheme to other illegally imported lots of similar goods by using the officially registered documents from the first delivery.



retail chain

Company A

Company C

price difference

Company B

one-day-firm

Transactions involving reduced export prices are used to artificially reduce the taxable base used for calculation of tax and customs payments.

One such typical approach used in the schemes involving reduced price contracts is when goods are shipped to "their own" (i.e. controlled and often set up by fraudsters) offshore companies, to be later sold by them at normal, market prices. All the difference in the amounts ends up in the bank accounts belonging to such companies before being distributed among the parties concerned. It is almost impossible, however, to obtain any information about such transactions.

Another way, which is used to reduce the export prices, involves export of finished products under the guise of raw materials or the goods of low/substandard quality. This scheme is also used to cover foreign trade contracts with a dual source of funding.

It is also quite common in the schemes involving reduced price export contracts to use "one-day firms", or special arrangements allowing one such "one-day-firm" to receive a large loan.

### 1.3. Fictitious export

#### **Example 3 (Turkey)**

*A consignment of underwear, produced in Turkey, was exported from the country under fictitious documents with the aim of receiving a VAT refund. The goods sent abroad were, in fact, nothing more than shredded cloth. It was established that the company, the recipient of the goods, had been set up to create the illusion of international sales.*

#### **Example 4 (Turkey)**

*One company purchased a certain quantity of sugar for processing and further export. In order to evade payment of VAT and to create an illusion of performing its export obligations, a number of fictitious documents were prepared to be used to carry out export operations, obtain the customs export certificate and prepare invoices and declarations for purchase of foreign currency. The submitted fictitious documents were used to claim a VAT refund.*

*It was found out in the course of the investigation that the sugar had been disposed of in Turkey and was never exported. Thus, the income received as the result of a VAT evasion was legalized through a fictitious export operation.*

*In another case, the subject of a similar contract was wheat, purchased for production and export of flour. The flour was also disposed of inside the country. The income received as the result of this criminal activity was transferred through endorsed cheques, payable to certain individuals.*

### 1.3. Export involving forged documents

#### **Example 5 (Ukraine)**

*One Ukrainian limited liability company "M", in the period between 2006 and 2008, carried out several export transactions involving a sale, totaling*

*UAH725,000 (\$94,200), of used water pipes to a foreign-based company "O" . A zero VAT rate was used in this scheme, resulting in a VAT refund totaling UAH122,000 (\$16,000).*

*The ensuing investigation revealed that no company "O", with the registration details used in the documents, had ever been registered and, therefore, the VAT refund was obtained through fraud.*

### **Example 6 (Ukraine)**

*Committee for Financial Monitoring of Ukraine was notified by the Customs Service of Ukraine of the contracts concluded by and between a Ukrainian company "A" and a British company "C".*

*Under the contracts, company "A" acts as a party responsible for financial regulation, while company "C" acts as a buyer of goods.*

*The goods are exported by Ukrainian companies, while the actual recipient of the goods is company "K", operating in Poland.*

*What attracted attention in those contracts was not only the amount of €108.5 million, but also the volume of goods shipped – 106,500 ton of berries and mushrooms.*

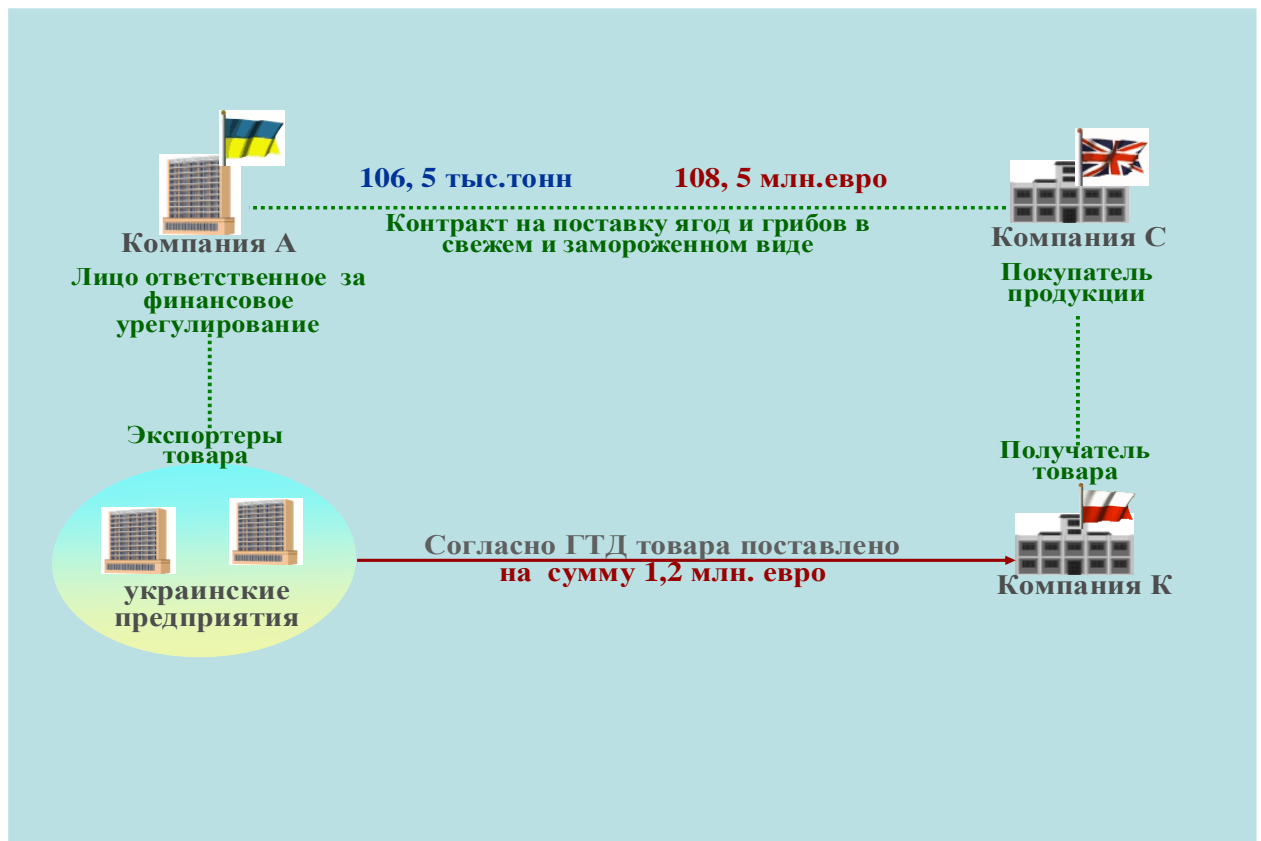
*A close examination revealed that the majority of companies in Ukraine are involved in production of bread and flour.*

*According to the data received from the FIU of Poland, company "K" was registered in London (U.K.).*

*According to the data made available by the Law Enforcement Authorities of Ukraine, company "K" was, in fact, registered in the offshore area of Niue, the fact later confirmed by the FIU of that country. Moreover, company "A" was a party to an arrangement, under which the berries were exported from Ukraine, priced €10.5 per kilogram, while in Poland the declared price was €1.1 per kilogram.*

*In accordance with copies of the cargo customs declarations, €1.2 million worth of goods was shipped from Ukraine to Poland.*





<p><b>106,500 ton</b></p>	<p><b>€108,500m</b></p>	
<p><b>Contract for delivery of fresh and frozen berries and mushrooms</b></p>		
<p><b>Company A</b>          Person responsible for          financial regulation</p>		<p><b>Company C</b>          Buyer of goods</p>
<p>Exporters of goods          Ukrainian companies</p>	<p>€1.2m worth of goods was delivered (according to CCD)</p>	<p>Recipient of goods          Company K</p>

#### 1.4. Export transactions involving lost documents

##### Example 7 (Ukraine)

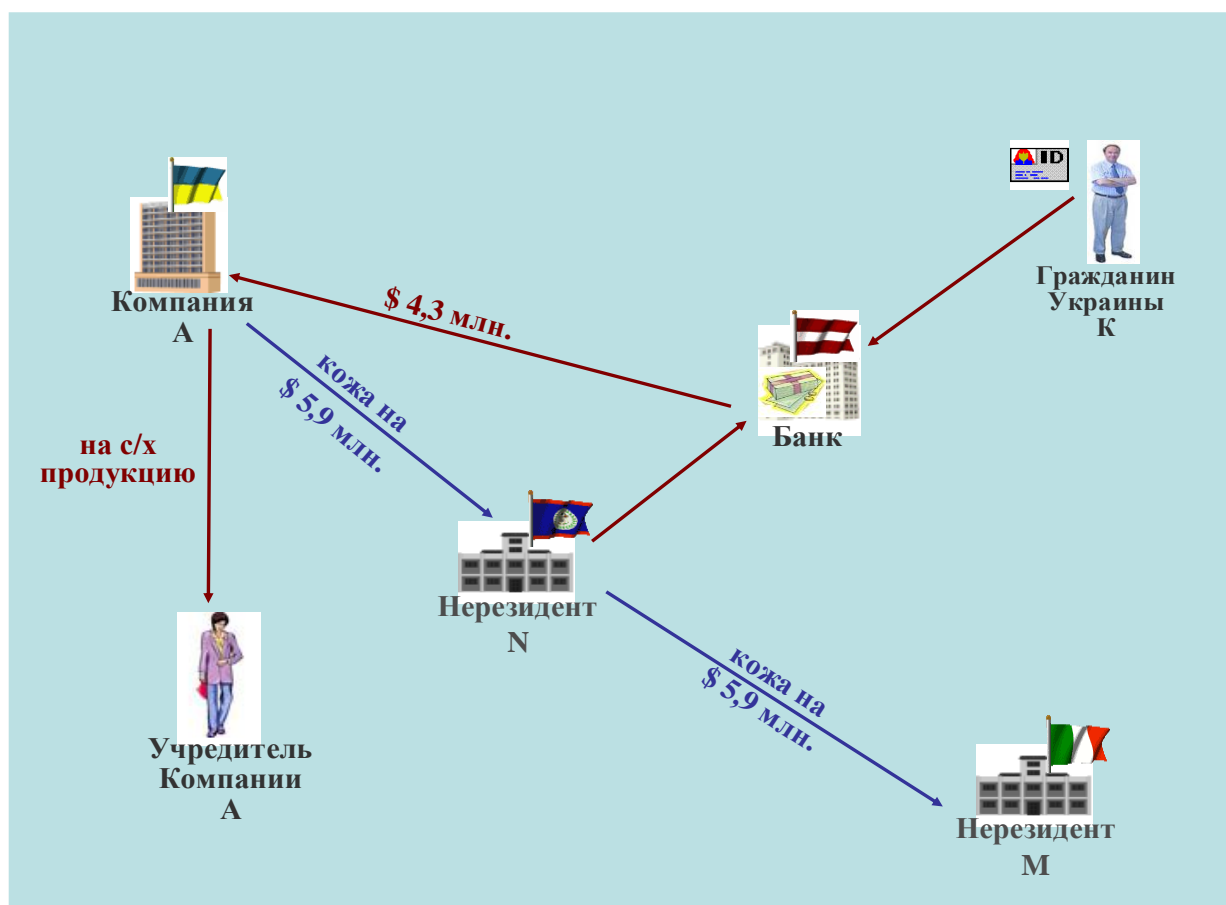
The FIU was informed by the State Taxation Service of Ukraine that Ukrainian company "A" was involved in exporting semi-completed leather products valued at \$5.9 million to a Belize-registered non-resident "N". The factual recipient of those goods was, however, a non-resident "D" from Italy.

It was ascertained that \$4.3 million was transferred from a bank account located in a Latvian bank and belonging to a non-resident "N" to this Ukrainian company "A".

Almost immediately, the incoming funds were withdrawn by the founder of company "A" in cash and used to finance the purchase of agricultural products.

The data received from the Latvian FIU helped to reveal that the bank account used to transfer the funds had been registered by a Ukrainian citizen "K".

*According to the Law Enforcement Authorities of Ukraine, the passport used to open that bank account was listed as lost.*



Company A

Citizen of Ukraine K

\$4.3m  
leather (\$5.9m)

Bank

for agricultural products

Non-resident N

leather (\$5.9m)

Founder of Company A

Non-resident M

## 2. IMPORT TRANSACTIONS

2.1. Fictitious import (payments involving forged documents, advance payments and import of goods without their arrival at the country's customs territory)

Unfounded advance payments made under fictitious contracts is one of the most common schemes used for illegal transfer of funds abroad. So-called "one-day-firms" are set up and used for this purpose most often.

The most typical are the cases when a company enters into a contract containing a provision for advance payments with a maximum allowed under the law deferral period for the termination of obligations relating to delivery of goods (if such restrictions are provided for in the law). During this period, the company-payer goes into liquidation, and it becomes impossible to find the individuals responsible for establishing the company, managing the account during the transactions along with the accounting and other records. In another scenario, a non-resident company responsible for the delivery of goods on account of completed advance payments can no longer be contacted and may have de jure or de facto ceased to exist. The completed advance payments are, obviously, never returned. Companies registered in offshore areas are considered to be most suitable for such schemes.

Another scheme involves a termination of a contract following the fulfillment of the obligations relating to the advance payment for goods.

#### **Example 8 (Ukraine)**

*The data supplied by one Ukrainian bank revealed that a Ukrainian company "A", arranged, according to a copy of the Cargo Customs Declaration (CCD), a delivery of goods valued at \$2.3 million to the customs territory of Ukraine.*

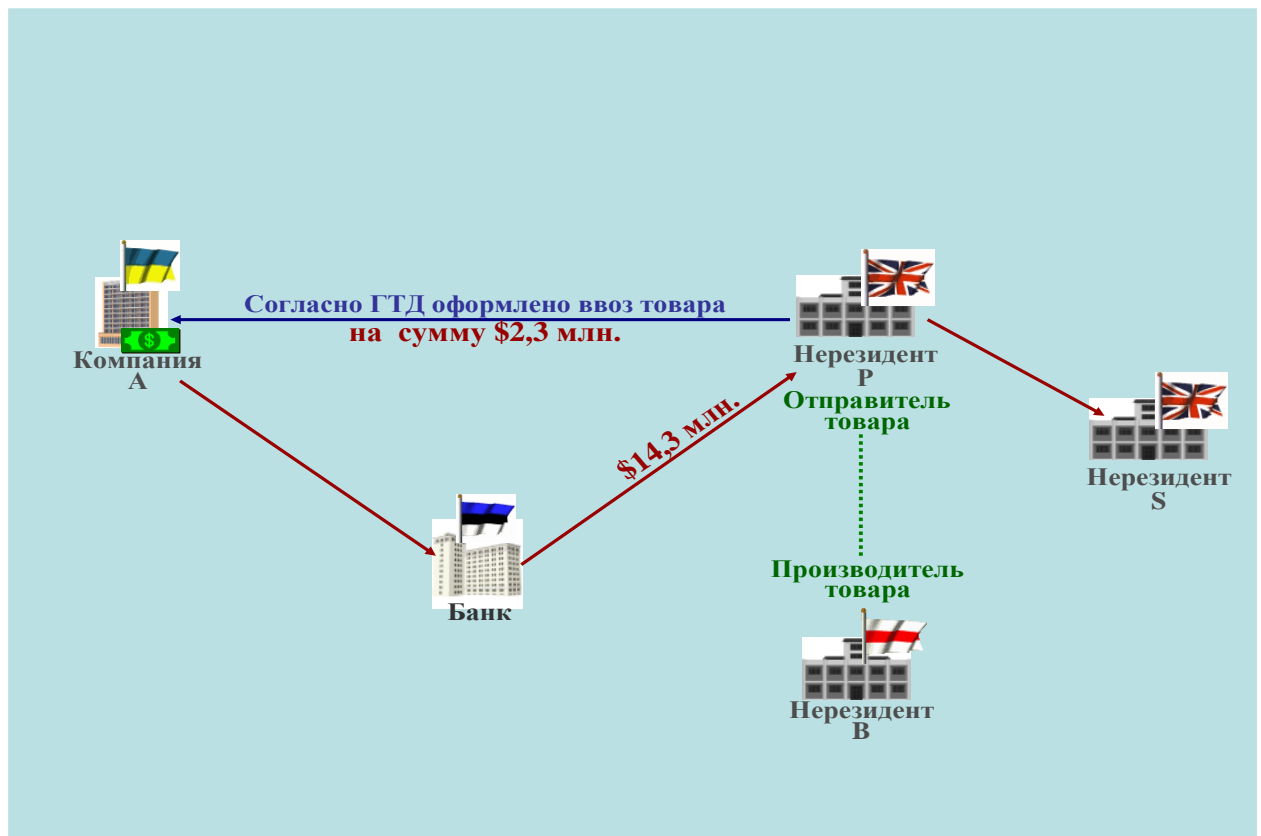
*Company "P" (resident of U.K.) was listed as the sender of the goods. A Belarus-based company "B" acted, according to the same CCD, as the producer of the goods.*

*It was revealed that Ukrainian company "A" transferred the funds in foreign currency to a bank account of a UK company "P", held in an Estonian bank. According to FIU of Estonia, altogether \$14.3 million was transferred. These funds were further transferred to a bank account held by a UK company "S" on the same day.*

*It was also revealed that the individuals authorized to carry out transactions involving the bank accounts belonging to non-resident companies "P" and "S" were, in fact, citizens of Ukraine. According to the Customs Authorities of Ukraine, the records detailing the export-import transactions carried out by a Ukrainian company "A" are absent, including the CCD that was submitted to the Ukrainian bank.*

*In addition to that, according to the FIU of Belarus, no deliveries of goods to a Ukrainian company "A" were declared with the Customs Authorities of Belarus.*

*All these findings are now being investigated as part of a criminal case initiated on charges of fictitious entrepreneurship.*



Delivery of goods worth \$2.3m (according to CCD)	
Company A	Non-resident P
	Sender of goods
	\$14.3m
	Non-resident S
	Producer of goods
Bank	Non-resident B

### Example 9 (Ukraine)

*Committee for Financial Monitoring came across several financial transactions involving large cash withdrawals made by natural persons from their own bank accounts. The funds in the accounts of those natural persons were deposited by a large number of different companies.*

*Following an extensive examination of the case, the Committee launched an investigation into the activities of a criminal group that included fictitious companies and individuals with a criminal record. In 2005, the group created a scheme that enabled it to convert non-cash resources into cash.*

*The criminals later turned that nation-wide scheme into a transnational one and channeled the funds abroad, including to offshore areas.*

*In one such example, the bank accounts of several Ukraine-based private enterprises were used by certain Russia-registered companies to deposit large funds in Russian rubles as a payment for goods, and as a construction-related investment. The incoming funds of UAH 2,225 billion (\$445 million) in Russian rubles were later converted into the Ukrainian national currency and cashed out by proxies.*

*Later, the bank accounts of two such companies involved in converting non-cash resources into cash were used to channel funds abroad in the following way:*

*The bank accounts of certain Ukrainian companies were credited, as a payment for goods, and as a construction-related investment, with 14,150 billion Russian rubles (\$566 million). This money was later converted into US dollars and transferred to non-residents registered in Belize, Panama, Cyprus, India and the British Virgin Islands. The vast majority of non-residents were based in offshore zones.*

*Foreign currency funds were deposited into the non-residents' bank accounts held in banks of Latvia, Lithuania, Estonia, Cyprus and the Netherlands.*

*The total amount of transferred abroad funds was valued at UAH1,569 billion (\$313 million). No goods were expected to be delivered to Ukraine under this scheme.*

*The data supplied by the FIU of other countries revealed the following:*

- the non-resident accounts at the banks of Lithuania and Estonia were opened by Ukrainian citizens using passports listed as lost;*

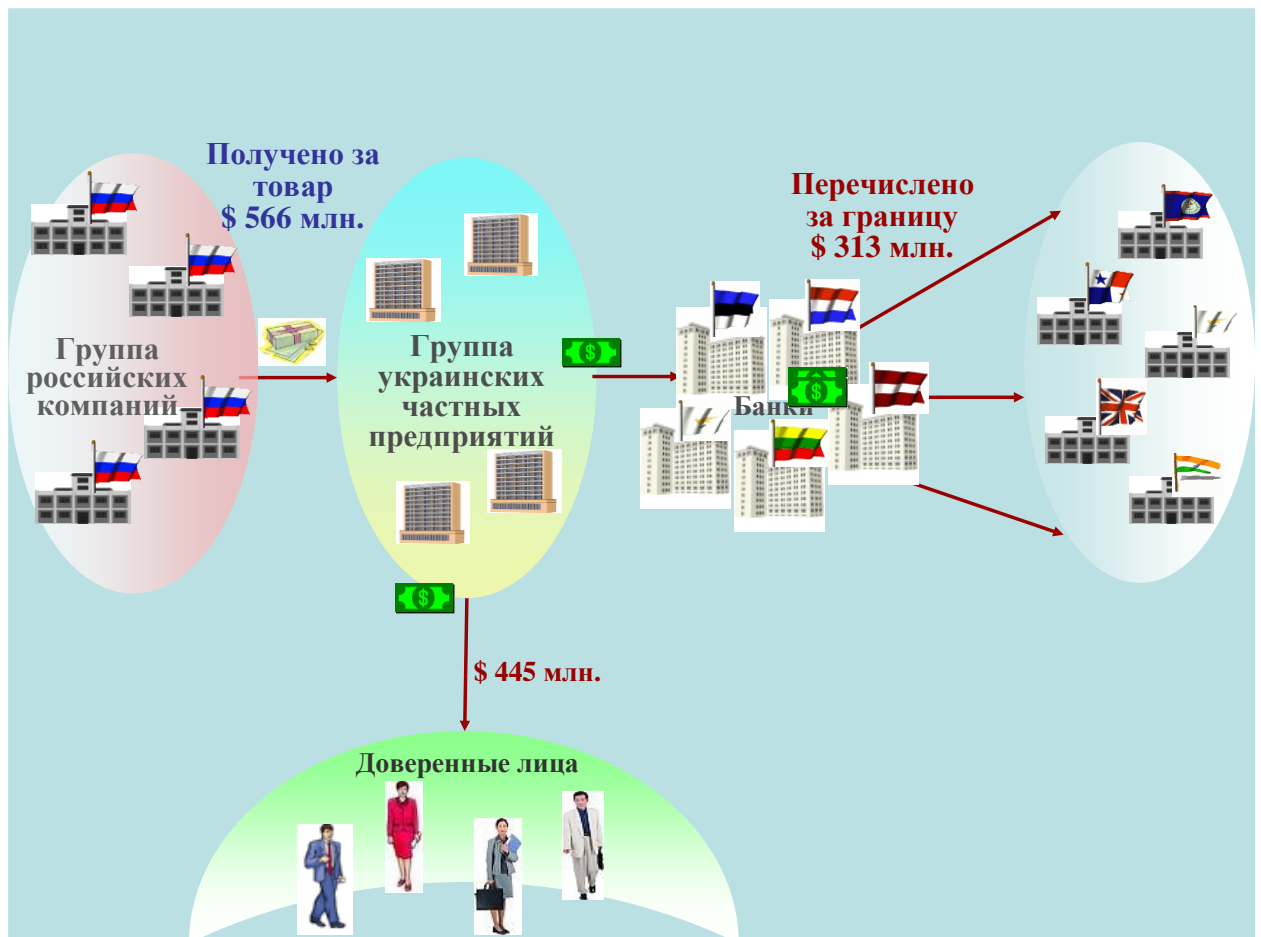
- The three companies registered in the British Virgin Islands had the same registered agent;*

- The Bulgarian FIU and the Embassy of Germany in Venezuela had shown interest in one of these companies before.*

- The FIU of Lithuania became interested in the activities of another member of this scheme, non-resident company registered in the British Virgin Islands.*

*As the result of the investigation carried out by the Law Enforcement Agency of Lithuania, criminal proceedings were initiated on charges defined in Article 216 of the Criminal Code of Lithuania "Laundering of Funds or Assets Obtained by Criminal Means". \$2.7 million worth of assets held in the account of this non-resident company were arrested.*

*According to the same data, charges were also brought against companies and natural persons in Ukraine.*



Received for goods (\$556m)

Transferred abroad (\$313m)

Group of Russian companies

Group of Ukrainian private enterprises  
Bank

\$445m  
Proxies

### Example 10 (Belarus)

The FIU of Belarus was regularly (almost annually) informed of some suspicious financial transactions involving one Belarus-based company "A" that was transferring funds (for step-ladders) to an account held by a UK-based company in one Latvian bank. In a short period (about two months), the amount of the transferred money reached \$1 million. The received data showed, however, that the incoming transactions made through this account involved payments for different types of goods: construction materials, tools, metal, computer parts, electrical appliances, hardware products, etc.

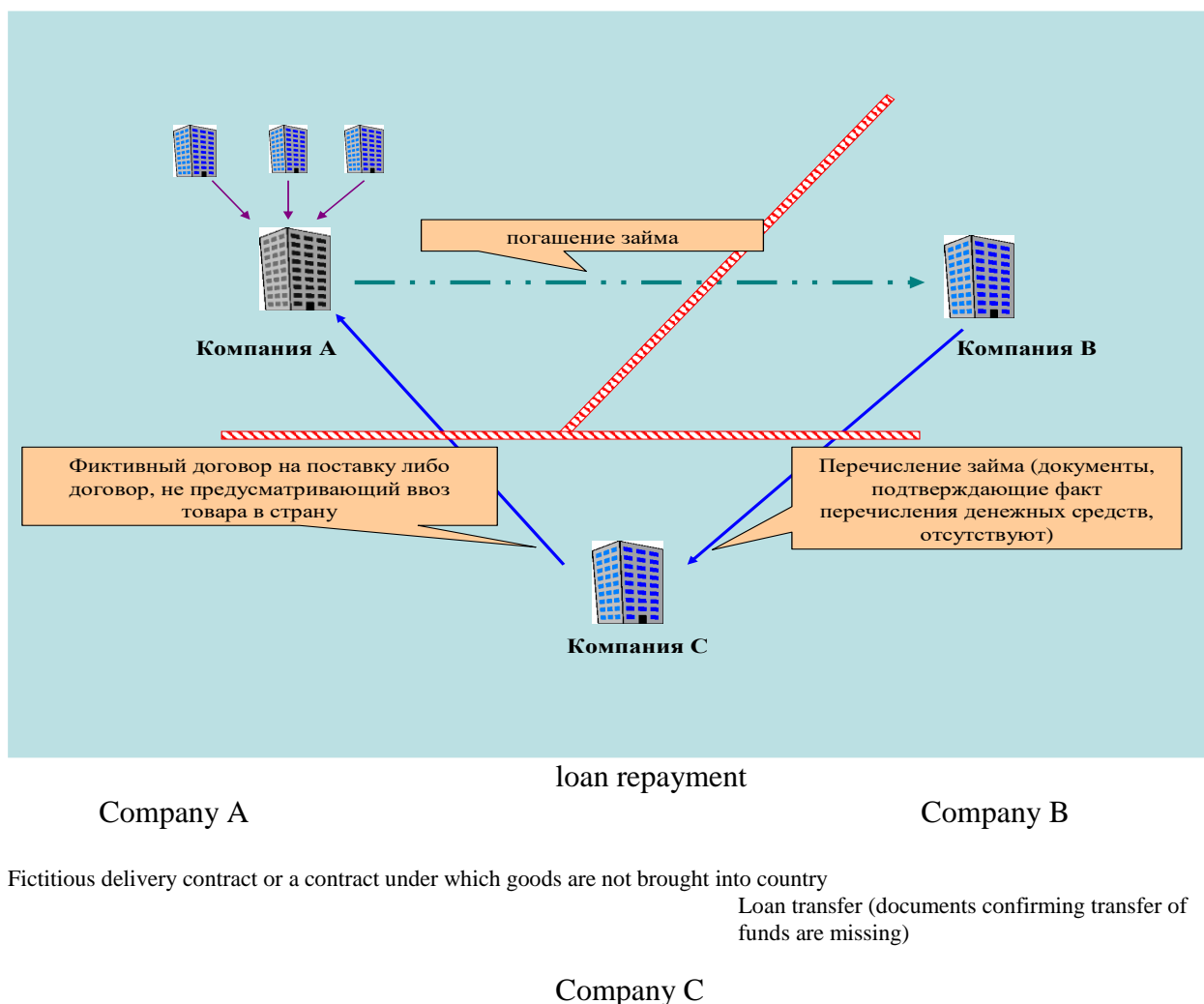
According to the Customs Authorities database, company "A" filed a statistical declaration for the import of goods (step-ladders) originating in Russia, without importing them into the customs territory of the Republic of Belarus. It was revealed that the goods sold by this Belarusian company were supplied by several also Belarusian companies, believed to be fictitious. The criminal proceeds (in

large amounts) were legalized through import contracts without actually importing the goods into the country.

In addition to this scheme that was taking advantage of certain legal exemptions (special procedures for registering the goods that originate in and are imported from Russia), there was another one involving withdrawal of funds through import contracts (without importing the goods into the country) by using loan agreements.

### Example 11 (Belarus)

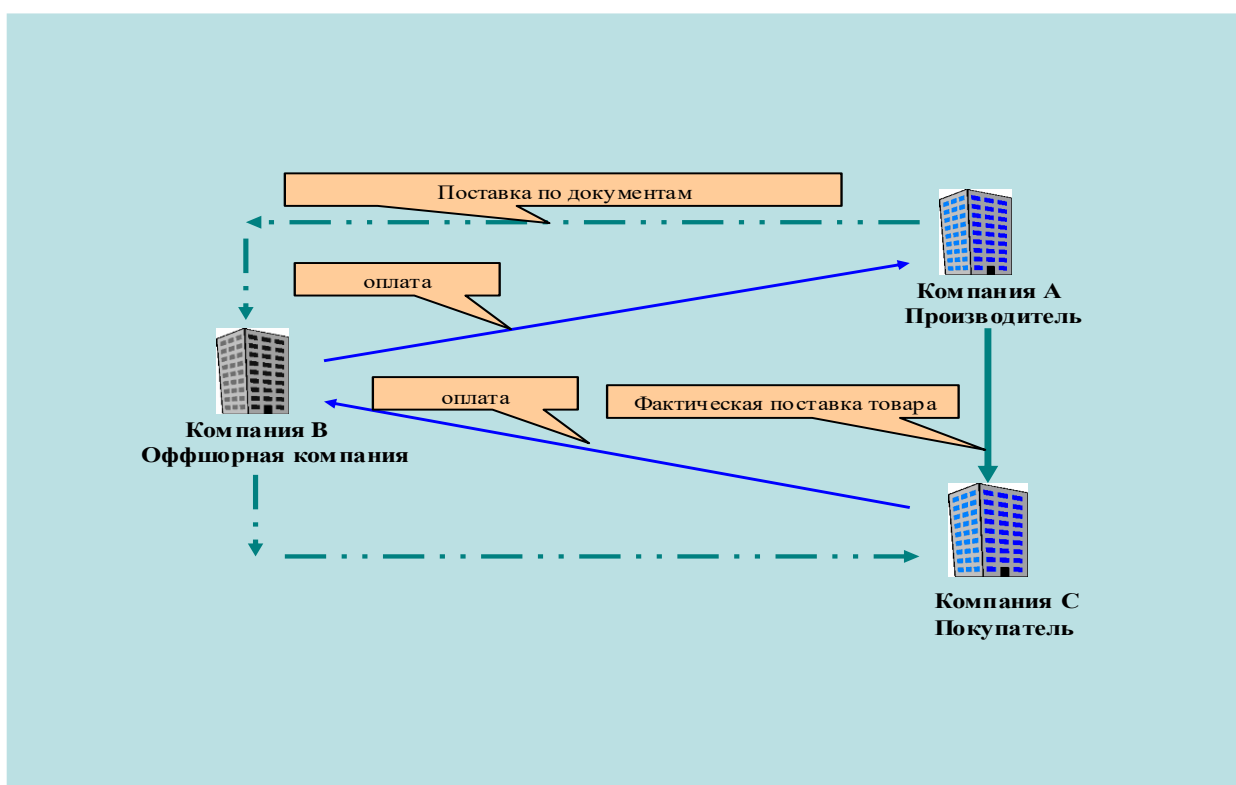
A Belarusian company "A" was found to be behind numerous transfers of funds (related to loan repayment) to a bank account held by a Russian company "B" at one financial institution in Latvia. However, there was no data confirming the arrival of any loan funds to the account held by company "A" from this non-resident. One of the provisions of the loan agreement stipulated that the loan was offered on condition of payments made to company "C". The following investigation revealed that company "A" had filed a statistical declaration for import of goods from company "C", without actually importing the goods into Belarus.



## 2.2. Overstating the value of imported goods

One type of the **scheme** involving overstating the value of imported goods is a so-called "**transferpricing**" (involving an offshore company in transaction with the aim of deliberate pricing distortion and tax evasion.

Company "A", a goods manufacturer, sells company "C", a direct buyer (or the owner of a retail chain), certain goods through an offshore company to evade paying taxes. However, the documents show that company "A" sells these goods to an offshore company "B" with a minimum markup on net cost and, as a result, evades the income tax. The offshore company "B", in turn, registers the delivery of the very same goods to company "C" at the highest price allowed and, as a result, company "C" is entitled to receive a refund for the overstated VAT and other indirect taxes. This transaction results in offshore company "B" having to pay most taxes. However, one of the particularities of the taxation system used by offshore areas lies in the fact that transit business (conducted outside the territories of the offshore areas) is not taxable. As a consequence, the difference created as the result of pricing distortion is not taxable and is disbursed among the parties involved in the transaction on a cash or non-cash basis. The goods, in reality, are delivered directly, bypassing the offshore company.



Delivery (according to documents)  
payment

Company A /Producer

payment  
Company B/Offshore company

Real delivery of goods

Company C/Buyer

### 2.3. Import involving forged documents



There were also cases involving imports of goods for the purpose of tax evasion (goods with higher rate of tax were passed for lower by using forged documents, i.e. household appliances for sawn lumber), with their subsequent sale through a leased warehouse without appropriate documents or using the documents relating to similar kind of goods.

Forged documents are used particularly often in schemes involving smuggling. Such schemes are used to legalize imported goods (material assets, not monetary).

### **Scheme 1 (Russia)**

Based on the agreement concluded between a foreign supplier and a major Russian retailer, goods arrive from abroad destined for so-called "customs dumps". Forged invoices, CCD, etc. are used in the scheme. These forged documents, submitted by the sender, as a rule, contain the details of a shell offshore company and incorrect information about the goods.

A "Customs dump" arranges customs clearance through these forged documents paying customs duties on non-existent goods. It later "sells" the goods to a first-level fictitious laundering company and receives money from it to pay the duties.

The first-level laundering company draws up a delivery note and sells the goods, as its own and at a higher price, to a second-level laundering company. There can be up to 4 intermediary levels involved in the laundering of goods. Not only payment for goods, but also payment for various services (consulting, marketing, etc.) are cited as payment details in settlement transactions at these intermediary laundering levels. The payment amounts increase from level to level. The accumulated difference is channeled abroad through both fictitious Russian companies and foreign ones (usually in offshore areas) to a shell company that had "sold" the goods to the "customs dump" and eventually ends up being transferred to a perfectly legal foreign exporter to be used in the further transactions performed under an official contract and with real prices.

At the last stage of the legalization process, the aforementioned large Russian retailing company, having concluded an official agreement with a foreign supplier (without, obviously, disclosing its existence to the tax and other government agencies), acts as a "bona fide purchaser of the goods" from a Russian "supplier", paying the prices almost matching its own. This criminal scheme achieves the following objectives:

- the smuggled into Russia goods are legalized;
- customs and other duties are reduced to the minimum.

A so called "Chinese" scheme uses a different mechanism.

### **Scheme 2 (Russia)**

Articles of popular consumption (clothing, shoes, stationery, etc.) are smuggled into Russia to be later marketed in the country by either Chinese citizens or people working for them.

The generated revenues are channeled through money transfers containing no payment details to the bank accounts (so-called "settlement centers") held by several Chinese citizens in Russian banks.

These "monetary accumulators", having supplied to the bank fictitious, including customs, documents, transfer the funds already in their own name to the manufacturers of goods in China, thereby laundering the proceeds obtained from the sale of smuggled goods in Russia.

Predicate in the above schemes are the following offenses: smuggling, pseudo-entrepreneurship, illegal banking activities (in the case of Chinese "financiers").

### 3. EXPORT-IMPORT TRANSACTIONS

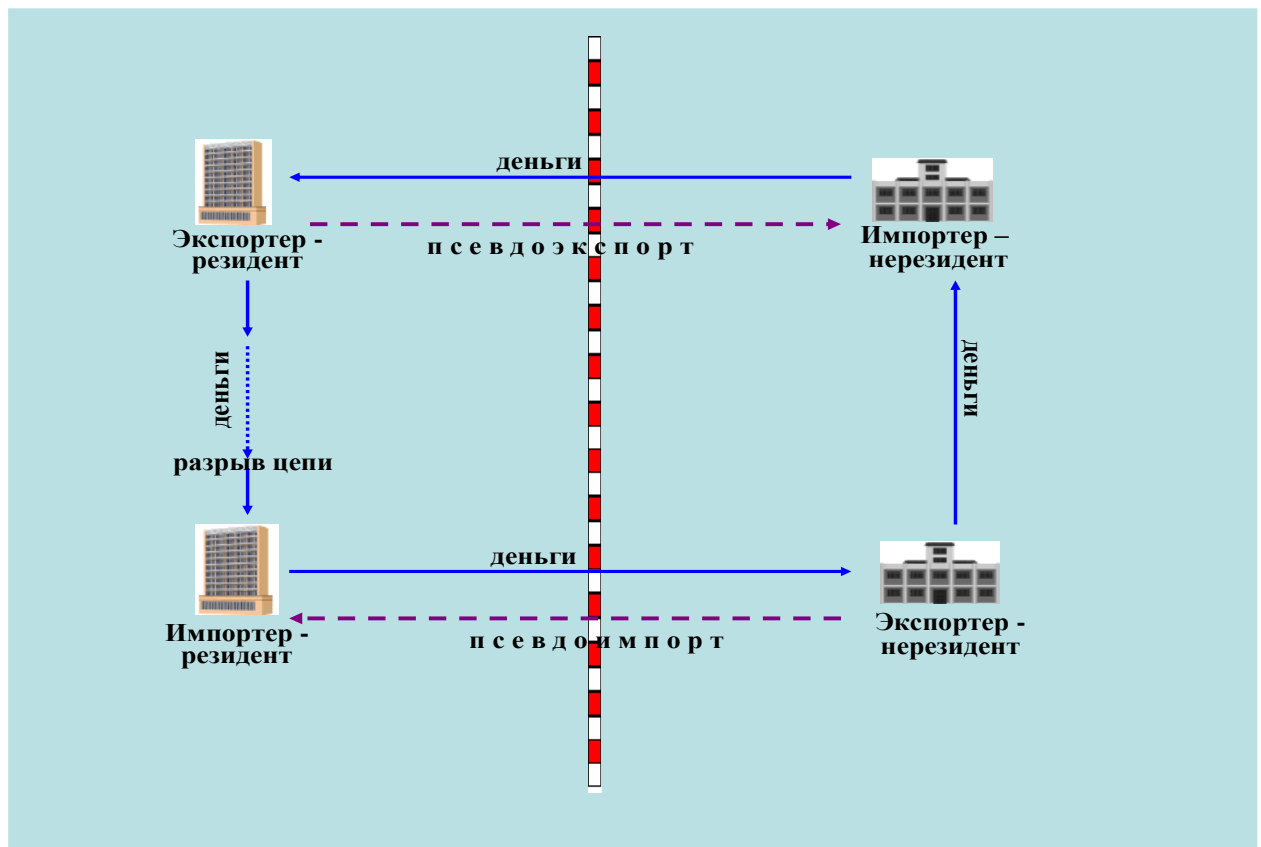
#### 3.1. Carousel fraud

Carousel fraud is characterized by a cyclical nature of almost identical transactions executed by the participants of a scheme in a very short period (often within one day).

The economic objective of the scheme is to receive a VAT refund for the exported goods while being paid for it in cold hard cash. To this end, fraudsters use fictitious documents to register various export and import transactions and distort their value.

The initial funding for the scheme tends to come from offshore companies, or in the form of a bank, or other type of loan received from a legal entity. The amount of the loan tends to be equivalent to the VAT refund.

Under this scheme, an exporter receives money from a non-resident importer and transfers it to an importer. The importer channels the money to the non-resident importer, who starts the cycle anew. One crucial element used in the concealment of the scheme is to break the chain of transactions within the scheme at the stage when the funds are being transferred to the importer. To make this scheme work, there must be one fictitious company that disappears once the transaction cycle has been completed along with all the documents.



money		
Resident exporter	pseudo export	Non-resident importer
money		money
break in the chain		
	money	
Resident importer	pseudo import	Non-resident exporter

### Example 12 (Ukraine)

Two Ukrainian import companies transferred \$28 million, as a payment for goods, to a non-resident company located abroad.

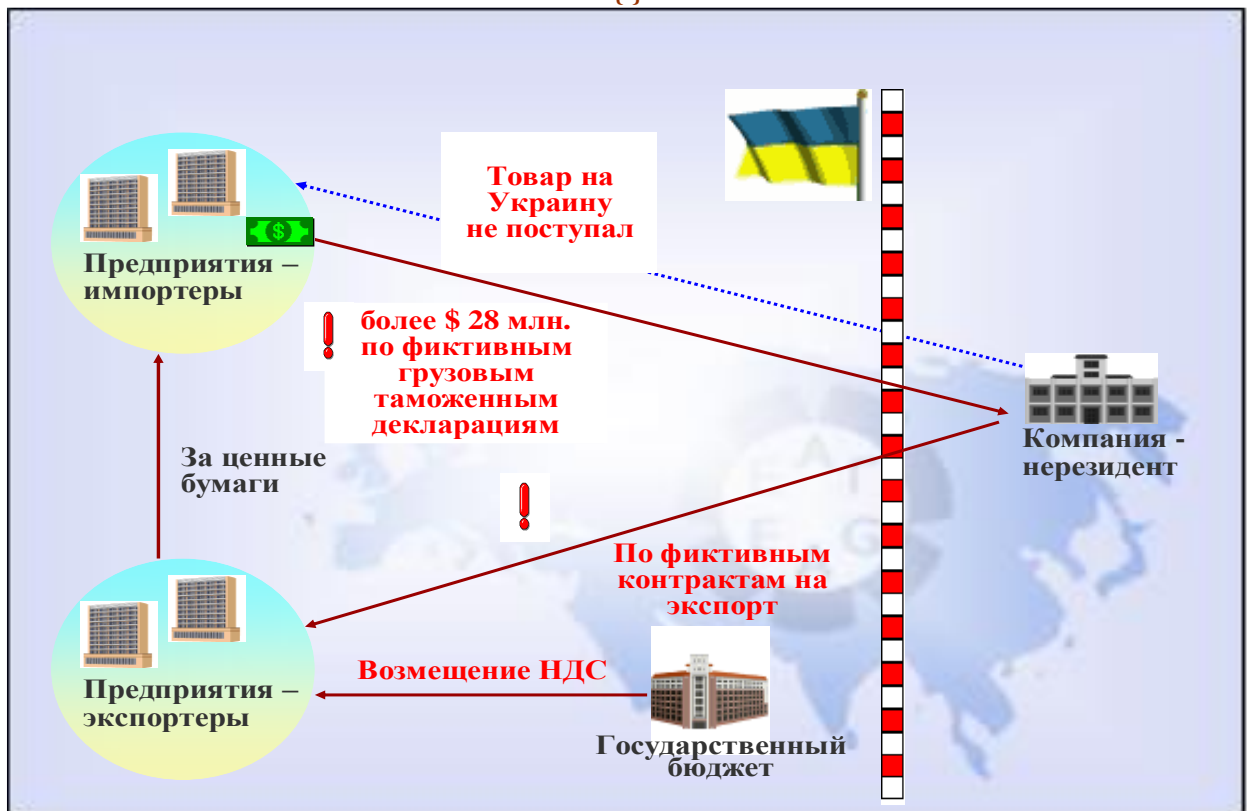
They submitted to the bank the Cargo Customs Declarations. In the course of the investigation carried out by the FIU of Ukraine, it was revealed that no such cargo customs declarations had ever been registered with the Customs Authorities of Ukraine. The goods had never even crossed the Ukrainian boarder.

Under the guise of the activities relating to the fulfillment of the terms of foreign trade contracts, the money ended up back in Ukraine in accounts held by two Ukrainian exporting companies. The scheme involved the use of fictitious contracts and filing for VAT refund.

Then, through the sale and purchase of promissory notes and saving certificates, the Ukrainian export companies channeled the funds again to the bank accounts of the importing companies.

In this way, the money was moved around in circles several times.

As a result, the accounts with \$830,000 belonging to the Ukrainian company, a member of the scheme, were frozen.



Goods did not enter Ukraine

Ukraine

Importing companies

more than \$28m through fictitious CCD

For securities

Non-resident company

Through fictitious export contracts

Exporting companies

VAT Refund

State budget

### 3.2. Transit payments

The cases involving funds transiting through the country with a help of fictitious import and export contracts have also been registered.

#### Example 13 (Ukraine)

*The State Financial Monitory Authority of Ukraine identified several financial transactions carried out by a recently created Ukrainian company "A", founded by an eighteen-year-old citizen of Ukraine.*

*It was revealed, that this company entered into contracts with several Russian non-resident suppliers of goods, with bank accounts in Russian banks. The said non-resident companies transferred funds, in Russian rubles, to the bank account held by company "A".*

*Company "A" converted the received Russian rubles into US dollars and transferred the funds (through foreign trade supply agreements) to the bank accounts of other non-resident companies held in the banks of the Baltic States, Cairo and Switzerland.*

*The study of the bank documents revealed, however, that the goods had always remained on the territory of Kazakhstan.*

*The inquiry made to the FIU of Russia revealed that funds received by the non-resident companies with bank accounts in Russian banks were transferred by the Russian resident companies that had been set up to perform the role of "accumulators" of crime proceeds (one-day-firms). According to the FIU of Russia, the Russian bank in question had its banking license revoked in connection with the violation of the requirements provided for in the Federal Law on "Anti-Money Laundering and Counter-Terrorism Financing".*

*The investigation also identified several other newly created Ukrainian resident companies, which were using the same as company "A" bank, and exploiting the same scheme.*

*In this way, \$756,400 million was transited through Ukraine in less than 9 months.*

*The companies beneficiaries held bank accounts in six EU countries.*

*The investigation resulted in criminal proceedings and a court decision to freeze a bank account containing \$17,000.*

### 3.3. Transit of goods through customs territory of a country

The scheme most often used for smuggling, along with the traditional fake documents schemes, involves a legal entity (resident or non-resident) filing documents for a transit of goods through the country's customs territory. Following the arrival of the goods into the country, the previously used for transit documents are destroyed, and the goods of criminal origin, or those used in criminal activities (such as smuggling) are legalized through fictitious companies. The documents for the dispatch of goods are issued through a fictitious company, and all payments are also carried out through it. The funds are later illegally converted into foreign currency and transferred abroad to the supplier of the goods.

Of all the above-mentioned schemes, the most relevant to the subject of the study is a combination of two methods: creating a false paper trail and channeling of criminal proceeds abroad.

In addition to the above, criminals use the methods involving the following: bank accounts held by a foreign or a joint venture company; seizing control over financial institutions; "collective" and transit accounts; smurfing (converting cash resources into financial instruments); loan guarantee mechanism; illegal use of law exemptions; merger of legal and illegal funds; acquiring property with cash, etc.

The following **instruments** are used for laundering the proceeds of crime through international trade transactions:

- fictitious export and/or import transactions (almost always involve the use of fictitious document);
- contracts and other documents containing deliberately misleading information;
- legal entities and their bank accounts;

- shell companies and companies with signs of fraudulence (residents and non-residents),
- non-cash bank transactions;
- offshore companies;
- cash resources, promissory notes and ("junk") securities;
- fake loans;
- lost or forged ID papers.

Use of fictitious contracts involving purchase and sale of goods is the principal **mechanism** for laundering the proceeds of crime **through international trade transactions**.

Other common mechanisms used for laundering the proceeds of crime are the following:

- submitting documents containing false information to the Customs Authorities
- declaring or non-declaring of goods under their proper name;
- inconsistencies between declared and factual quantities of goods;
- providing false information regarding the recipients of the goods and the conditions of entry (with temporary imports);
- providing false certificates of origin;
- redirecting goods and "interrupted" transit;
- avoiding customs clearance and placement of goods outside the location of checkpoints.

Having studied the data provided by the countries participating in this study, we have identified at least three groups of **entities** most often involved in the legalization process used to conceal the existence, illegal origin or illegal use of the international trade-based proceeds.

**Group 1:** business entities with signs of fraudulence; one-day-firms; shell and transit companies (companies displaying no visible signs of fraudulence in their activities. They are usually used to carry out transactions aimed at concealing the criminal trails; there can be several levels of such companies either accumulating or disbursing the funds at their levels); the companies with accounts opened with the passports listed as lost; companies registered in the name of a front man, relatives, etc. (affiliated companies).

This group of entities involved in suspicious financial transactions may include the participants of financial transactions, whose involvement in money laundering schemes or predicate offenses has already been confirmed by the Law Enforcement Agencies.

It is not uncommon for fraudsters to use companies where the responsibilities of the founder, managing director and the accountants are performed by one and the same person, or groups of companies with a joint

organizational structure. Sometimes companies change their legal and actual address shortly after the registration, or register their legal address in places with high density of legal registrations. Undoubtedly, a simplified registration procedure only contributes to that, along with the rights given to representatives to act on behalf of founders and to manage the accounts. Such companies were often involved in short (between one week and one year) series of transactions, or in one or several transactions involving sufficiently large amounts.

In this regard, for the purposes of financial monitoring, one should pay attention to the newly created entities with a "sudden" period of high account activity that follows a long (i.e. 6 months) period of no activity, especially if the amounts involved in the transactions are unusually large and untypical of other members of the international trade, or there is a series of transactions involving similar round amounts, including several transactions per day. Typical characteristics of suspicious transactions will be presented in one of the sections below.

**Group 2:** offshore companies and companies registered in prestigious jurisdictions (such as USA, U.K.), in organizational and legal forms offering the lowest level of taxation or tax-exempt (typically, limited liability companies). Such companies are used not only for crime-related reasons or concealment of criminal activities, but also as a way to optimize tax payments.

The most common forms of business ownership in the identified money laundering schemes are the following:

- LTD (Private Limited Company; different countries use their own abbreviations: Gmbh, Sarl, Co, Corp, Inc, 有限公司, Pte Ltd, Sdn Bhd, N.V,...) – restricted liability society that issues its shares to nominee shareholders to preserve confidentiality of the real owner. The shares are transferred to a trust or a private fund to achieve even greater confidentiality. The company carries out its commercial activities (contracts, invoices, other documents and correspondence) through a representative acting under Power of Attorney. At the request of the owner, the company can appoint anyone to this position. For even greater confidentiality, all the company's activities can be conducted through nominee directors.

- LLC (Limited Liability Company) – a very typical for US mixture of a partnership and a corporation. The liability of the members of such a company is limited, just like in a corporation. The income, however, is disbursed among its members, like in a partnership. The income tax is not paid by the company itself (the company is "transparent" from the taxation point of view), but by its members: the natural persons who add the profit they make to their taxable base. Only for such American-style companies as LLC, the law contains the following provision: if a company belongs to and managed by a non-resident of U.S., operates outside the U.S., no U.S. taxes can be levied on it. Accordingly, the owners must pay tax at

their place of residence. Therefore, when creating LLC, it makes sense to involve nominee shareholders from countries where there is no income tax.

- LLP (Limited Liability Partnership) – this kind of a partnership that allows for both partners to be legal entities is very typical for the U.K. A partnership has limited liability. It is not, however, regarded as a separate subject of taxation: the income tax is paid not by the company itself but by its members, who include this income into their taxable base. In many respects, LLP is very similar to American LLC. The difference lies in the fact that the British limited liability partnerships allow for the corporate tax not to be paid. If two members of a limited liability partnership are registered in tax-exempt jurisdictions and the partnership itself is not engaged in any business activities on the territory of the U.K., it is not subject to corporate tax. Although the responsibility to file its financial statements remains, it does not entail the need to pay taxes, even if the company makes profit (outside the U.K.).

It should be noted that the abovementioned particularities of corporate taxation are, in many cases, applicable to companies registered in offshore jurisdictions in the form of companies, partnerships and limited liability partnerships (LTD, LLC, LLP, etc.), if they do not operate on the territory of the country they are registered in.

There are also other types of companies (they are less common, however) that are involved in offshore business, such as: companies limited by guarantee; unlimited companies; protected cell companies or segregated portfolio companies.

Currently, there is a tendency for the companies involved in money laundering schemes (including companies registered in offshore jurisdictions) to open their bank accounts in the lending institutions of third countries (i.e. Russia, the Baltic States) and not in the countries of their registration.

**Group 3:** lending institutions offering illegal banking services; qualified financial professionals (lawyers, accountants, economists, etc.).

Taking control of financial institutions - a method involves a criminal gang establishing its control over the activities of the staff of a financial institution, or over the financial institution itself. It is not uncommon for investigations into criminal schemes involving international trade transactions to detect signs pointing to the involvement of bank employees. Banks, or their individual units involved in money laundering are used, for example, to quickly buy foreign currency for such transactions; to set up, or select already established companies to be used as a channel for withdrawing or converting the funds into cash; transfer the funds through the "right" correspondent accounts. The involved employees of banks, as well as lawyers, accountants and economists (usually highly qualified professionals) are used to develop new schemes (based on the legal requirements for international trade transactions) aimed at an unhindered channeling of funds abroad, or its reinvestment into the country's economy.



Separately, we can mention a situation when the personnel of the customs authorities, including those working with smuggling of goods, become involved in criminal activities.