

A man in a dark suit and glasses is walking through a large, circular opening in a dark wall. The opening is framed by a glowing green binary code (0s and 1s) that flows like a stream of light. The floor is also covered in this glowing binary code, creating a sense of depth and digital space. The overall atmosphere is futuristic and technological.

Do Digital Economies Facilitate Illicit Financial Flows?

@LylaALatif

**7th Pan African Conference on Illicit
Financial Flows and Taxation - AFRODAD
Side Session**

3rd October 2019

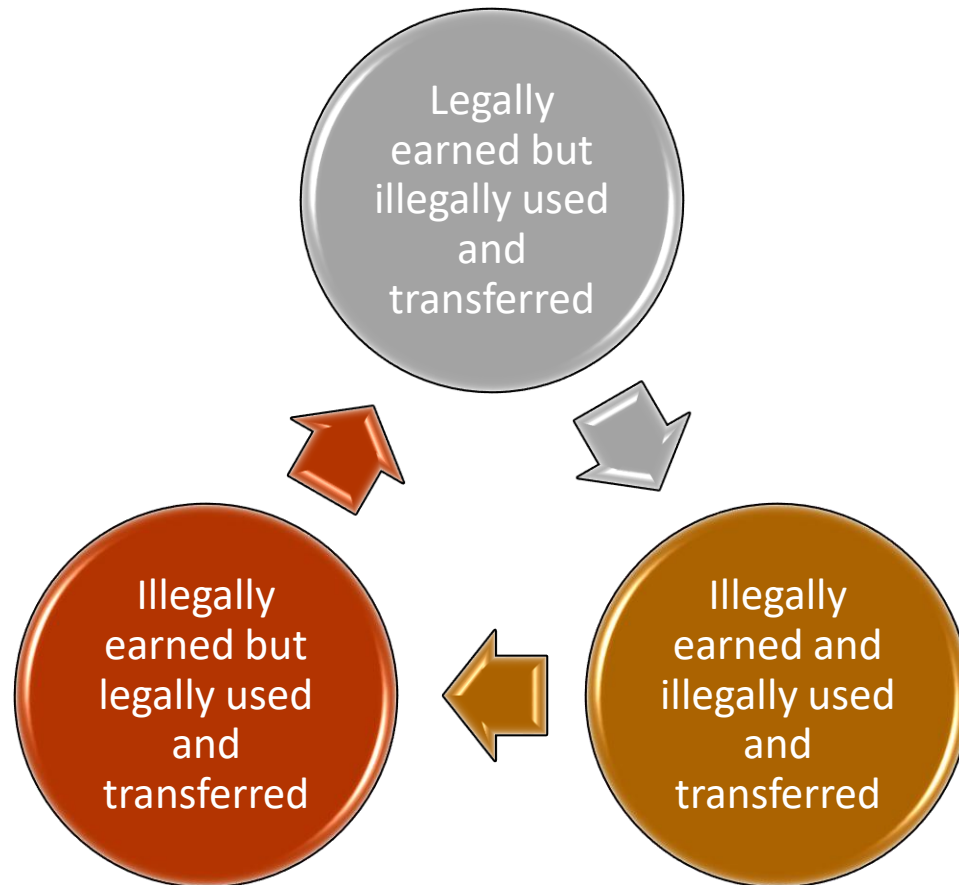
Nairobi, Kenya

- Financial flows can only be illicit when and as specified by the law.
- It must be proscribed – internationally and/or domestically.
- The digital economy isn't a new phenomenon- though recently with advancements in globalization and technology (FinTech, Big Data, AI) its beginning to demand attention at business, legal and political levels.
- The digital economy and how it operates has to be understood if meaningful discussion of IFF is to be effective.

Three issues to reflect on

- In the absence of tapping DRM through the digital economy, any revenue that is generated, is it necessarily taxable? Does it fall within any category of IFF if it is not declared or reported?
- AML is proscribed. There are FATF recommendations in place. Do they apply to laundering money through blockchain in the absence of regulation and enforcement?
- Are the legal principles and current laws 'as is' effective for digital regulation?

What are Illicit Financial Flows?



Funds with criminal origin, such as proceeds of crime

Funds with a criminal destination, such as bribery, terrorist financing or conflict financing

Funds associated with tax evasion

Transfers to, by, or for, entities subject to financial sanctions

Transfers which seek to evade anti money laundering/counter terrorist financing measures or other legal requirements (such as transparency or capital controls)

Illicit Financial Flows at the *'click of a mouse'*?

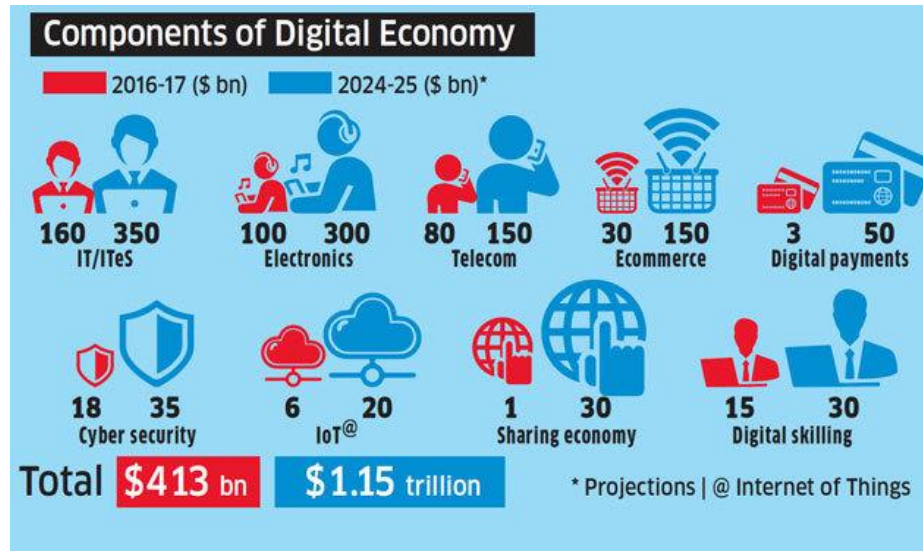
- IFF remains a development challenge for sub-Saharan African countries

Organisations	Tax Loss Estimates per year
AfDB	>USD 1trillion in corporate tax losses since 1980 from Africa
TJN	USD 500billion in corporate tax losses globally
IMF Fiscal Affairs Department	USD 200billion in corporate tax losses globally
HLP Report	USD 50billion in IFF from Africa
ECA	USD 100billion through mis-invoicing from Africa
AU	USD 67billion in IFF from Africa – of which 5% lost through corruption

- Digital economy and technology: *a facilitative opportunity for IFF at the click of a mouse?*



What is the Digital Economy



1. **Dematerialized** – shift away from traditional brick and mortar companies, cross border transactions in real time
2. **Disintermediation** – removal of financial intermediaries, direct P2P transactions
3. **Disruption**
4. **Convergence** – FinTech as part of B2C
5. **Enablers** – mobile, regulation, Big Data, Internet, blockchain
6. **Characteristics** - transnational, borderless, broadened customer base, dependent on enabling infrastructure, creator of the gig economy, *unregulated (?)*, new business models, tax implications?, promotes AI, dependent on Big Data.

Its Scope

- **Transforming how people transact**

Service	Digital payments	Digital providers
Receiving Payments	Salary Remittances Government Subsidy	Bank Payment provider Telecom
Making Payments	Utility bill School fees Convenience store	Bank Retailer Fintech

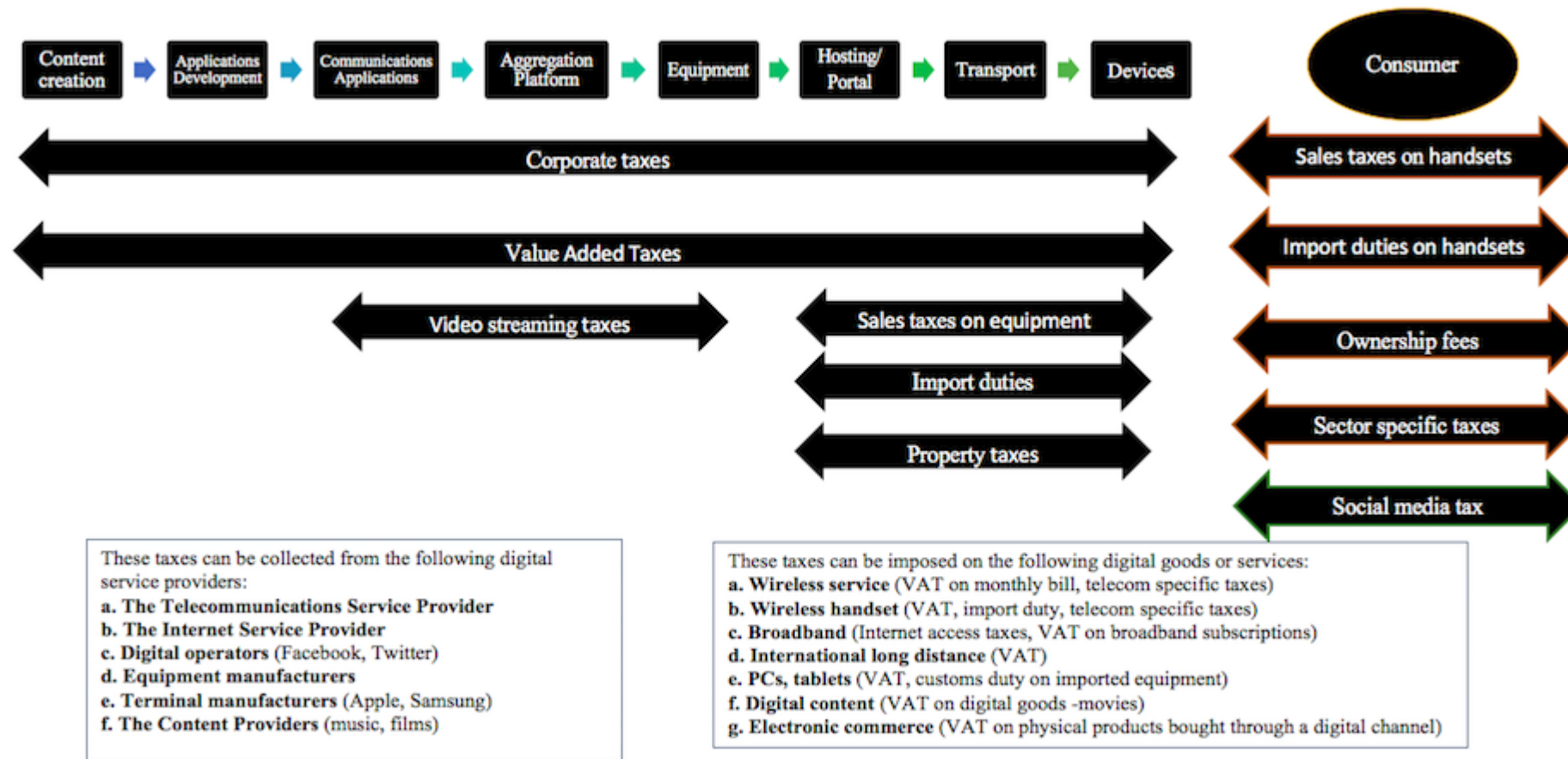
- **The potential economic impact**

- 1.6 billion newly included individuals - \$4.2 trillion in new deposits - \$2.1 trillion in new credit – 95 million new jobs - \$110 billion annual reduction in government leakage

- **Dependence on building blocks**

- Widespread digital infrastructure – dynamic financial services market – new digital products

Potential of the Digital Economy for Domestic Resource Mobilisation



Different Approaches to Taxing the Digital Economy – Africa

Country	Type of digital activity taxed	Tax Details
Uganda	Social media	0.5% transaction tax to access social media.
Tanzania	Online content creation	Registration and license fees for online content creators.
Benin	Communication	5% fee on texting and calls (for using over the top services).
Mozambique	Online media	Media fees for local and foreign journalists.
Zambia	Communication	Daily tariff rate on internet calls.

Different Approaches to Taxing the Digital Economy – Asia/Middle East

Country	Type of digital activity taxed	Tax details
Saudi Arabia and Kuwait	Online trading	Introduced the concept of virtual PE – any services performed for a period longer than the tax treaty threshold (183 days) under cross border agreements between a non-resident and consumers in SA/Kuwait will create a virtual PE.
India	Online advertising	Equalization levy on online advertising revenue earned by non-resident e-commerce companies introduced in 2016. Tax base is the value of transactions, not the profits.
Taiwan	Digital services	All foreign businesses that supply digital services to Taiwan residents to pay VAT effective 2017.
Turkey	E-Business	WHT on payments made through e-business and other online activities effective 2016. Introduced the concept of an electronic PE.
China	E-Commerce	Import of retail goods through e-commerce subject to customs duty, VAT and consumption tax.

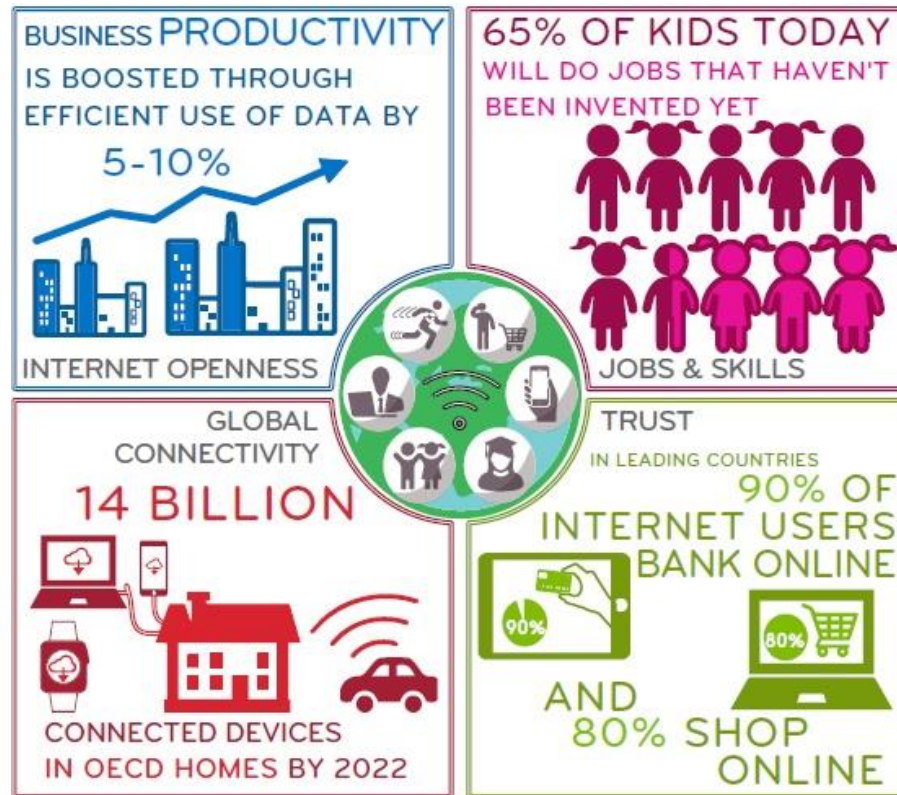
Different Approaches to Taxing the Digital Economy – Europe/Pacific

Country	Type of digital activity taxed	Tax details
France	Online content distribution	2% tax on distribution of audio-visual content introduced in 2016 (referred to as the YouTube tax).
Italy	Digital transactions	3% levy on digital transactions based on value of taxable transactions effective 1.1.2019. Less than 3000 taxable transactions exempted.
Hungary	Online advertisement	5.3% advertisement tax for entities exceeding HUF100million introduced in 2014.
Australia	Online advertisement	3% levy on advertising revenue from 'globally significant enterprises' with annual turnovers of more than AUD1 billion.
New Zealand	Online services	Extended the scope of its GST to digital 'remote' services provided off shore.

Financing for Development using the Digital Economy

- Key ingredient to stimulate technological innovation and services
- Internet based applications and technologies will continue to be an essential driver of productivity growth
- High speed internet, mobile networks and cloud computing are priority areas for the financial sector
- **Priority area for financing the SDGs:**
 - **Kenya:** Kilimo Salama
 - **Ethiopia:** M-Birr
 - **Bangladesh:** Mama Bangladesh
 - **Tanzania:** Digitising national park entrance fees (reduced leakages by 40%)
 - **Mexico:** Digitizing government social transfer payments saves around \$1.3 billion annually
 - **Georgia:** Digital tax payments yielded \$4 billion in additional revenue

Policy Framework



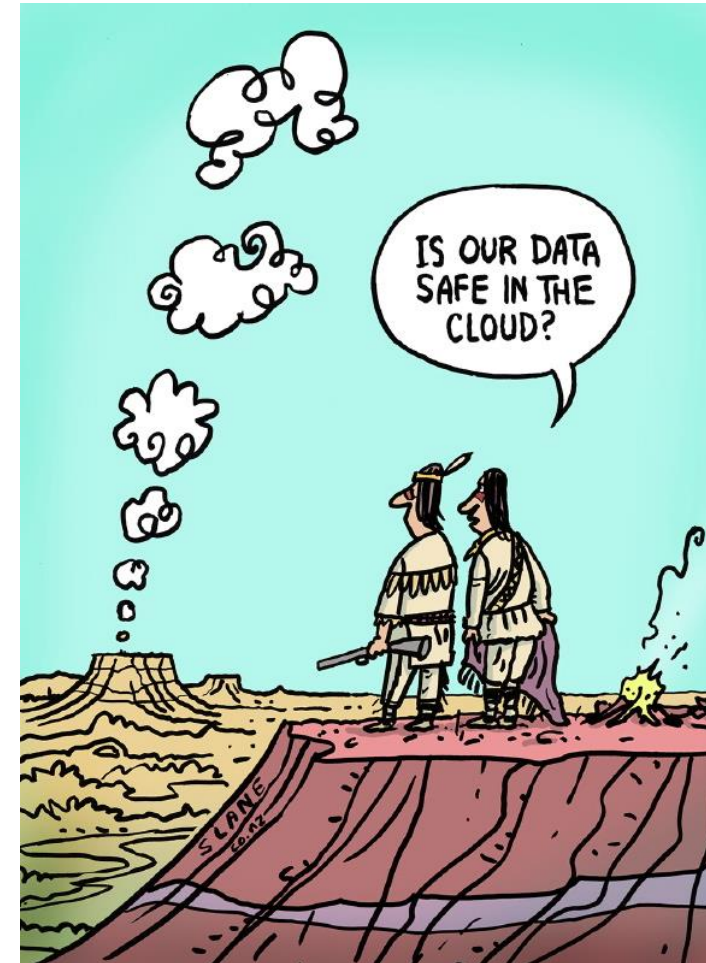
Picture Source: OECD Observer



Picture Source: International Tax Review, 2017

Does the Digital Economy Provide a Facilitative Opportunity for IFF? *If the system is abused, yes*

- You can earn money illegally and transfer illegal funds
- Can lead to the creation of underground illegal markets of cybercrime and cyber related crime
- Traditional organised crime can find its way online
- A number of opportunities arise for fraud and tax evasion
- Creation of fake e-commerce companies and offshore online businesses
- Lack of clarity on tax rules promotes BEPS



Does the Digital Economy Provide a Facilitative Opportunity for IFF? *Maybe?*

- The system can also be a tool for tackling the problem of IFF but this is currently problematic
 - Proper legal framework?
 - International cooperation?
 - Public – private collaboration?
 - Capacity to understand the technological and organisational components of the digital architecture
 - Account privacy issues
 - Human rights safeguards

Where to tax?

Under the proposed new rules, companies would have to pay tax in each Member State where they have a significant digital presence, reaching **one** of the following thresholds:

- ✓ Revenues from supplying digital services exceeding €7 million 
- ✓ Number of users exceeding 100,000 
- ✓ Number of online business contracts exceeding 3,000 

What to tax?

The attribution of profit will take into account the market values of:

- ✓ Profits from user data (e.g. placement of advertising) 
- ✓ Services connecting users (e.g. online marketplace, platforms for "sharing economy") 
- ✓ Other digital services (e.g. subscription to streaming services) 

Digital Economy has led to the creation of an underground economy – direct link between digital technologies and IFF

- Offers *crime as service* business model
 - Botnets (networks of compromised computers that can be remotely controlled by perpetrators and used as ‘zombies’ to launch large scale denial of service attacks on computer systems, disseminate malware and look for system vulnerabilities)
 - Trading in botnets is a lucrative business based on offering service such as hacking and carding, and tools to commit cybercrime for sale or rent.
 - Purchased at \$10 to \$1000 per day (Europol, 2011)
 - June 2013 Dutch based drug smuggling ring hacked into system controlling shipping information, manipulated data and collected cargo before legit owner was able to collect
 - Terrorist financing
 - ISIS using bitcoins and digital wallets, e.g. Russian based QIWI to collect money online (e-commerce scheme for selling books and promotional material)
 - Social media and crowdfunding whether legit or not raises money not subjected to taxation (decentralised)

Example 1: Kenya

Money laundering through M-Pesa

The US State Dep't says diaspora remittances to Kenya totalled \$1.55 billion in 2015 and \$862 million between January and September 2016. It points to the 159,000 mobile-money agents in Kenya, mostly working on the dominant M-Pesa system as well as the over 10 million accounts on M-Shwari, Safaricom's online banking service.

Source: The US State Department 2017, International Narcotics Control Strategy Report.

“These services remain vulnerable to money laundering activities,” the report states. This is backed up by Kenya’s standing as “a transit point for international drug traffickers and trade-based money laundering.”

“For example, criminals could potentially use illicit funds to purchase mobile credits at amounts below reporting thresholds.”



Example 2: Ghana *Hacking into banking software*

According to charges filed by the state at the Accra Circuit Court, the 26 accused persons, mainly made up of Ghanaian and Nigerian nationals, **plotted to attack some major banks in Ghana in July.**

“The attack began on the midnight of Sunday, July 22nd, 2018, when the plotters hacked into the banking software of Universal Merchant Bank Limited (UMB) in Ghana.”

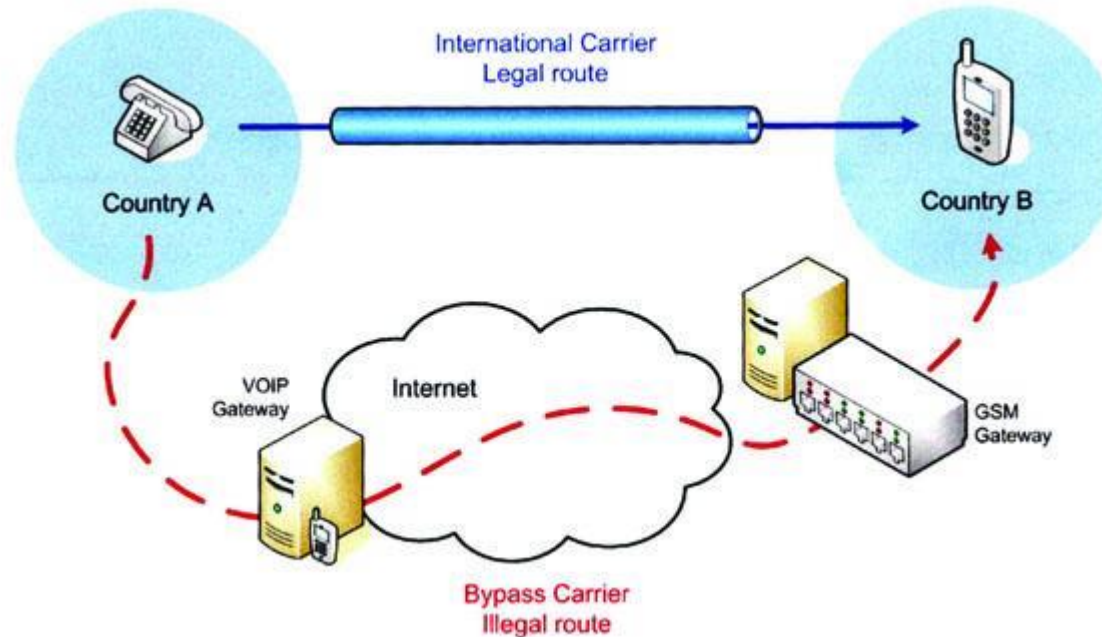
“The accused persons succeeded in debiting UMB’s income surplus account with GHC 326, 120,000 (\$70m) and posted credit to eighteen bank accounts specifically opened for the purpose of facilitating the attack,” according to the charges filed.



Picture Source: Quora

Source: Sarpong, G. Modern Ghana 4 Dec, 2018.

Example 3: Uganda *SIM box fraud*



- Estimated tax losses: Uganda US\$ 144 million, Kenya US\$ 440,000, Ghana US\$5.8 million and DRC US\$ 90 million

Example 4: (*Digital*) Phantom Firms

ONE

- ONE, an international campaigning and advocacy organization, estimates that “at least \$1 trillion is being taken out of developing countries each year through a web of corrupt activity that involves shady deals for natural resources, the use of anonymous shell companies, money laundering and illegal tax evasion.”
- Factors
 - Cross border digital trade
 - Speed of digital communication
 - Possibility of opening up phantom companies without presenting ID documents or without a physical presence
 - Research around the role that digital transactions can play in such models is lacking

Example 5: Digital Currencies

Zerocoin and Darkcoin



Picture Source: Coin Payments Blog

- Decentralised
- Anonymous
- Encrypted transactions and anonymous block transactions
- Untraceable
- Allows for laundering



Picture Source: 99Bitcoins, 2018

Example 6: Electronic Sales Suppression

Zappers



- Zappers allow the user to delete individual sales records altogether and also to substitute the sales amounts to a lower figure and thereby reducing the overall sales. Because of their concealed nature, the cash register appears to users to operate normally and poses a challenge to tax auditors to detect.

Key Drivers of IFF in the Digital Economy



1. Criminal activities
2. Traditional tax rules for brick and mortar companies applying to digital business
3. Intellectual property
4. Value creation

Key Digital Tools Facilitating IFF

- Online banking
- Mobile banking
- Electronic payment systems via unregulated financial intermediaries
- Cryptocurrencies
- Online services
- Trading platforms
- Online gambling

All these represent legal services and technologies that can be abused

Digital Economy: The Double edged sword

It's like finding a needle in a haystack



www.jolyon.co.uk

But also making it easier to trace movement of money



Key Takeaways for Policy and Law Makers

- **Create the enabling environment**
 - Legal and regulatory framework for the digital economy
 - Monitoring and detection of movement of wealth (AML, FATF)
 - Accountable and transparent system to trace movement of wealth (CBCR, applicable software to identify online revenue generation streams)
 - Responsive digital infrastructure
 - Department within the revenue authority to detect movement of digital wealth
 - Training and capacity building for auditors and revenue authority officers

Key Takeaways for Civil Society

- Country specific research into forms of inbound and outbound IFF through the digital tools
- Review current tax and IP legislation to identify provisions that need reform/amendments to respond to digital businesses, or to recommend bespoke legal provisions to capture the digital economy and digital technologies
- Cross border regional collaboration on identifying the presence of online criminal activities and fake e-commerce companies and compile compendium
- Detection of individuals listed on social media trading through unregistered companies and not declaring income or gains made

Key Takeaways for Researchers

More than
6% of Africa's
GDP today
comes from
the **digital economy**.



- Helping with understanding how the digital economy operates, its nature and potential.
- Identifying its enablers, example FinTech, AI, Big Data
- Help in understanding how money moves digitally and how value is created
- Clarifying tax aspects of the digital economy
- Informing regulation.

#Ansipblogs



Picture Source: Serprix

Thank you for listening to me 😊
To continue this discussion you can write to me on:
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