# *Indicators concerning the taxpayer's transactions*

## Introduction

In this chapter, the indicators surrounding the transactions a taxpayer is party to are discussed. In particular, these concern the parties to transactions, including intermediaries and consultants, and the terms of transactions. There are many sound business reasons why a company operating in a foreign jurisdiction should make use of external consultants, to gain access to knowledge of local law and business practices and particular features of the local industry. Consultants can also be used to facilitate business contacts for new entrants to a market. However, cases of bribery often involve the use of consultants to negotiate arrangements and also to facilitate execution of the illicit transaction. For example, the payment of bribes is often characterised as a fee to the consultant, part of which is then used to pay the bribed official. Therefore, when found together with other indicators, close relationships between a taxpayer and external consultants may be a flag that further enquiries into possible corruption should be considered, bearing in mind that the tax examiner and auditor's predominant purpose is the determination of civil tax liability.

Tax examiners and auditors should pay particular attention to any unusual transactions they come across, that could indicate a greater risk of possible bribery or corruption. The circumstances that make a transaction unusual are very wide, but some of the main characteristics of an unusual transaction include:

- a transaction which does not fit with a person's background or circumstances;
- a transaction which has no logical economic or practical explanation;
- a transaction where the identity of the parties is unclear; and
- a transaction where the origin or destination of the funds is unclear.

The OECD *Money Laundering Awareness Handbook for Tax Examiners and Tax Auditors*[1] includes the following description of an unusual transaction.

> Unusual means that a transaction differs from the norms of a certain industry or the habits of an individual, taking into account their background, normal activities or declared income. Deviation from normal or expected behaviour may indicate risk. The greater the deviation in behaviour and the more frequent the occurrence of unusual situations, the greater the risk.

## Indicators

### Indicators concerning parties to transactions

- Identity of parties involved in a transaction is not clear.
- Party to contracts with companies or service providers that are unexpected, or not typically involved in the taxpayer's industry.
- Party to contracts with a company owned or controlled by a PEP (or relative of a PEP), in particular where the PEP is authorised to grant contracts or licenses relevant to the taxpayer's business.
- Party to transactions with offshore companies, especially those located in high risk countries.
- Intermediary or consultants are located in a high risk country or a country where the taxpayer's business is not active.
- Intermediary or consultants are used which provide services to only one customer.
- Party to a transaction with a company registered (or with directors that are registered) at the address of an offshore company service provider.
- Party to large or significant transactions with newly established, non-transparent or unidentifiable companies.
- Issues credit notes to entities or branches located in high risk countries.

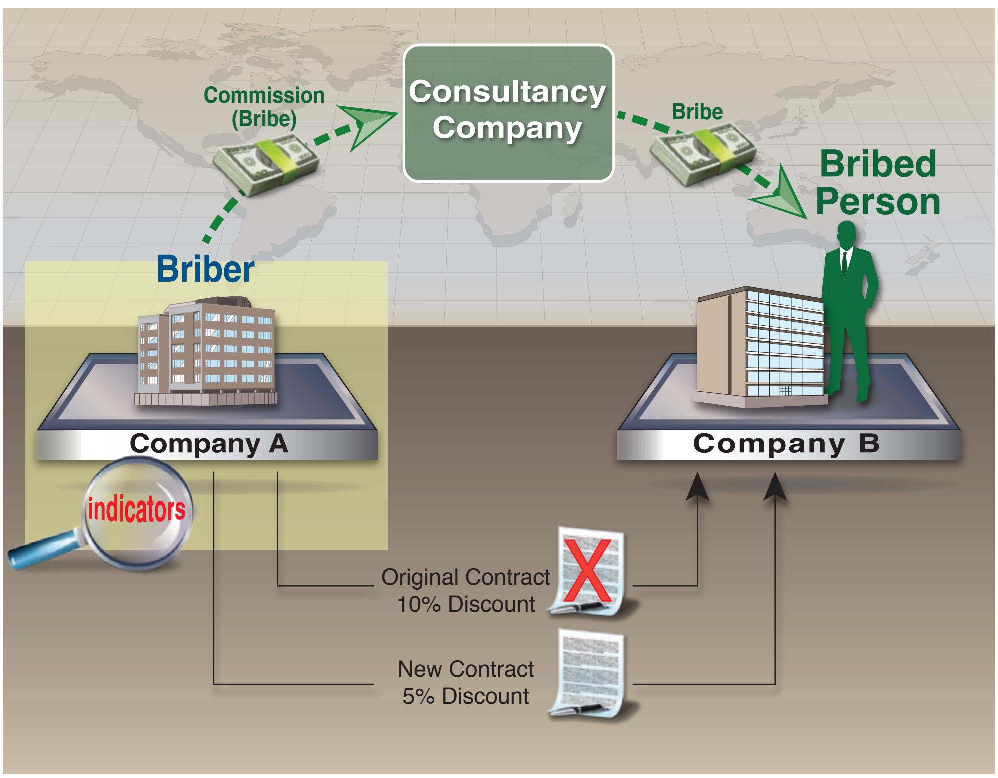
### Indicators concerning the terms of transactions

- Party to contracts or loans which have no underlying documentation.
- Party to contracts where the documentation does not clearly set out key terms, such as the goods or services to be provided, payments to be made etc.
- Party to contracts that do not appear to reflect the reality of a transaction (for example, where goods provided or payments made differ from those set out in the contract and there is no documentation to explain this difference).
- Party to contracts that appear to have no reasonable commercial basis, such as:
  - loans on particularly favourable or unfavourable terms; or
  - contracts where the payment for goods or services appears insufficient or excessive.
- Actions outside the terms of a contract (for example, making additional payments).
- Changes to contracts, such as price increases, with no commercial justification.
- Key terms differ from the taxpayer's other transactions or industry norms (for example, acquiring goods or services that are not typically used by the taxpayer).

- Contract provides for payments which are contingent on the outcome of agreements with other parties.
- Normal procurement procedures are not followed (for example, it has not obtained multiple quotes that would usually be required).
- Under-qualified people in senior positions or fictitious employees on the taxpayer's payroll.
- Transactions cannot be clearly explained by the taxpayer.

## Examples

### *Unexplained renegotiation of contracts*



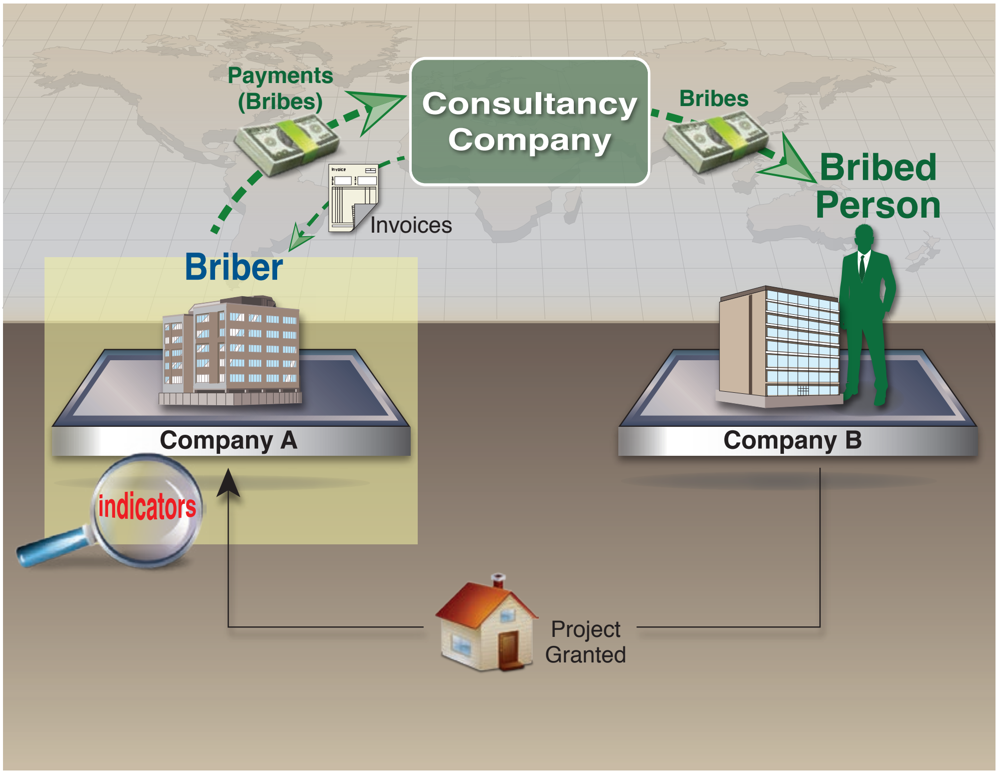

Company A (Briber) provided maintenance services to an oil and gas contractor, Company B which is located in Country X. Country X receives a low score on the Transparency International Corruption Perceptions and Bribe Payers Indices. These services were provided under a long-standing contract under which Company A invoiced Company B for its services at a discount of 10% compared to its normal rates. During the course of an audit of

Company A, the tax auditor discovered that during the period in question Company B had terminated this contract. Further enquiries revealed that, in order to negotiate a new contract with Company B, Company A had been encouraged to contact a Consultancy Company, which would be responsible for concluding contracts on behalf of Company B.

Company A was granted a new contract with Company B to provide the same services. However, under this contract Company A invoiced Company B for its services at a discount of only 5%. Therefore, under the new contract, Company B was paying more for the same services. Company A also paid a commission to Consultancy Company, which was roughly equal to the increased amount paid by Company B under the new contract. The tax auditor managed to obtain information that showed that the individuals who owned Consultancy Company were related to the head of Company B (Bribed Person), who was also a senior government official in Country X. This lead the tax auditor to suspect that, Company B was over-paying for services under the new contract with Company A, and this amount was being paid as a bribe to the head of Company B via the Consultancy Company.

In this case, the key indicator that caused the tax auditor to suspect possible corruption was that the tax auditor could not receive a clear explanation for why Company B terminated an existing contract with Company A, and then negotiated a new contract via a consultant under which Company B paid a higher price for the same services. Other indicators include the fact Company A operated in a high risk industry, Company A was doing business with a company in a high risk country, the head of Company B was a PEP, and the owners of Consultancy Company and the head of Company B were related.

## *Transaction does not fit taxpayer's profile*



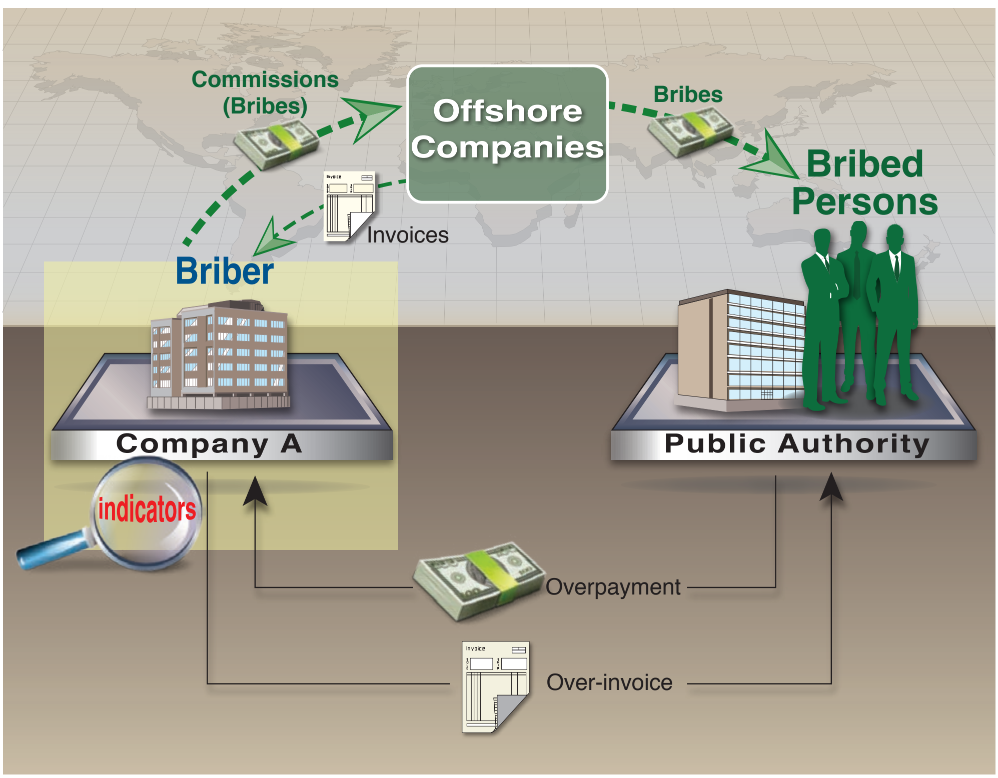

During a tax audit of Company A (Briber), a property development company, invoices for consultancy services totalling USD 500 000 were discovered. These payments were unusual as Company A did not typically spend large amounts on consultancy contracts. When asked to provide supporting documentation for these invoices, management at Company A said that none existed.

The tax auditor decided to conduct a third party check of Consultancy, the professional services provider, named in the invoices. Consultancy was a small, newly established company with few clients, owned by Mrs J. Generally, Consultancy issues invoices for small amounts of around USD 1 000. Mrs J was unable to answer any questions regarding the invoices sent to Company A. Instead, Mrs J relied on her husband, Mr J, to respond to the tax auditor's enquiries. Mr J was not employed by Consultancy. Mr J explained that Consultancy provided Company A with information and advice with respect to properties that were available to buy through public tender. However, the tax auditor established that Company A did not participate in any public tenders during the period in question. In addition, one invoice was for USD 200 000, which seemed very high for the information supposedly provided.

The tax auditor conducted further enquiries and discovered that Mr J (Bribed Person) in fact worked for Company B, a company which was involved in a large commercial development. Company B had recently granted Company A a number of contracts to design and build properties. This led the tax auditor to suspect that the payments made to Consultancy were in fact bribes from Company A intended for Mr J, in order to secure the contracts with Company B.

The key indicators that had led the tax auditor to suspect possible bribery in this case were large consultancy payments made by Company A which did not fit the company's profile and could not be explained. Other indicators include the fact that Company A was operating in a high risk industry, invoices for large amounts were being paid without detailed supporting documents, and Mrs J was unable to provide the tax auditor with information about services her company was supposedly providing.

## *Contracts that lack detail*



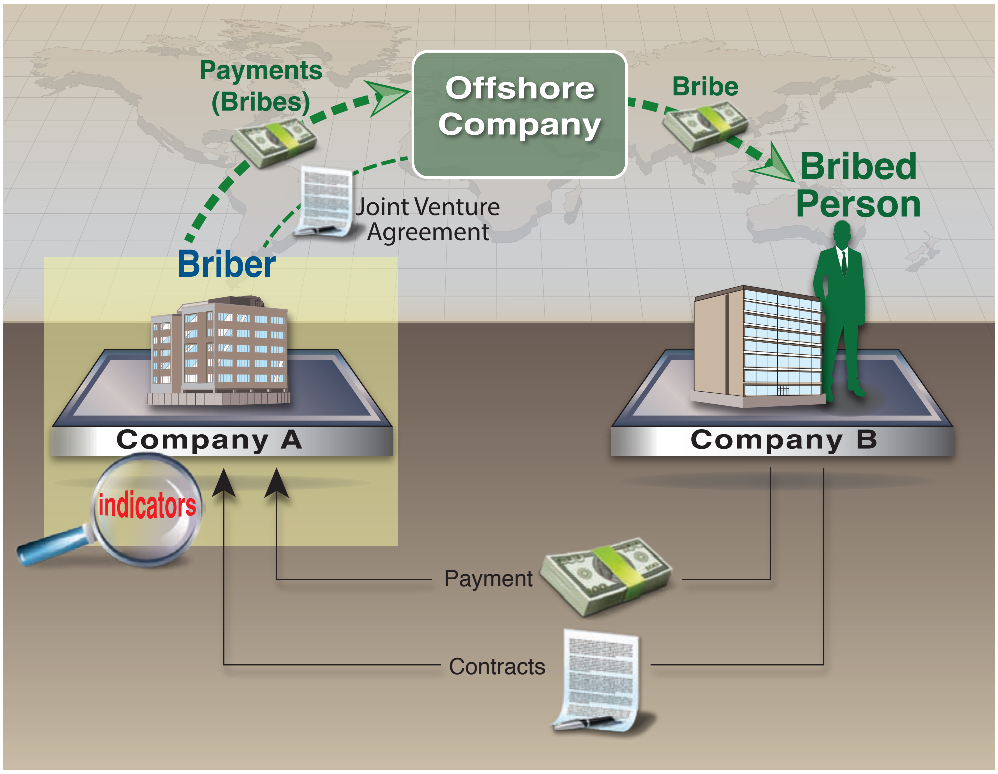

While performing a tax audit of a nuclear energy company, Company A (Briber), tax auditors identified a large number of payments for "consultancy fees". Further enquiries revealed that these payments were made to consultancy companies under a series of "business consultant agreements". It appeared that Company A had entered into one business consultancy agreement with respect to a number of the countries in which it had built or planned to build a nuclear power station. In each case, payments under the relevant business consultancy agreement equalling around 5% of the value of that country's contract. However, all of the agreements were very vague and did not contain much detail about what the payments were in return for.

Further audit work, including internet searches and foreign information requests, revealed that the consultancy companies were in fact Offshore Companies (or in some cases branches of law firms) located in countries which did not routinely share tax information and in which Company A did not have business activities. A review of bank statements led the tax auditor to suspect that these payments were in fact being used to pay bribes to foreign public officials (Bribed Persons) in Public Authorities, who were able to influence the awarding of contracts in their country.

Once a contract was awarded, Company A would over-invoice the Public Authority under the contract. This excess amount would be paid as a "commission" to the Offshore Company and used to pay the bribe to the foreign public official. In this particular case the tax auditor was particularly suspicious as the arrangements were entered into shortly after a change in law in Company A's home country, to make bribery illegal.

In this case, the key indicator that caused the tax auditor to suspect possible corruption was the fact that Company A frequently paid significant consultancy payments under agreements that lacked detail and did not fully set out the services that were being provided. Other indicators included the fact that these payments were being made to Offshore Companies and law firms in high risk countries in which Company A did not operate.

## *Joint venture with no commercial substance*

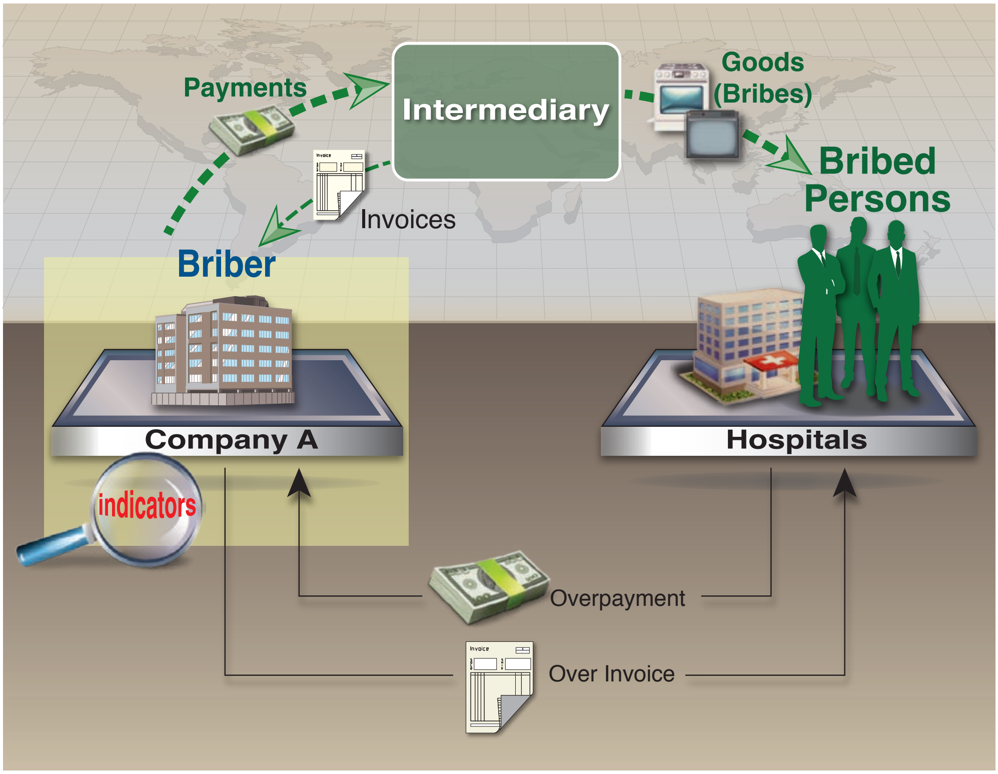



A building contract was concluded between a construction company, Company A (Briber), and a sports venue operator, Company B, to construct a new sports stadium. During a routine tax audit, the tax auditor found that Company A had signed a "joint venture agreement" with an Offshore Company. Under this agreement, Company A is to build the sports stadium while Offshore Company is not required to carry out any activities or undertake any risk. However, the agreement provides that Company A must pay an amount equal to 5% of the contract value to Offshore Company.

The terms of this agreement triggered the tax auditor's suspicions and so she carried out further enquiries. These uncovered that Offshore Company was in fact a newly-established shell company, owned by the son-in-law of the managing director of Company B (Bribed Person). The arrangement appeared to be a mechanism to enable Company A to pay a bribe in return for securing the contract.

In this case, the key indicator that caused the tax auditor to suspect possible corruption was that Company A was party to a joint venture agreement that lacked commercial substance, in that Offshore Company did not undertake any activities but still received payment. Other indicators included the fact that Offshore Company was located in a country which had no connection with the contract, and the close family relationship between the owner of Offshore Company and the managing director of Company B.

## *Contract terms do not reflect reality*

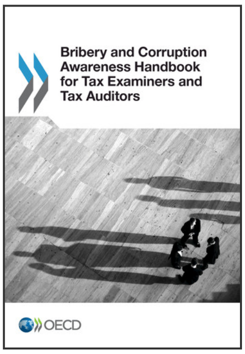



While auditing a medium-sized company selling medical equipment, Company A (Briber), tax auditors discovered invoices totalling around USD 3 million in respect of medical equipment and accessories acquired by the company. However, the invoices did not tie in to equipment actually held or sold by Company A. Further enquiries and auditing of money flows demonstrated that the payments were made to an Intermediary, but Company A did not receive any goods in return. Instead, Intermediary used the money to acquire goods including cars, hi-fi equipment, television sets, mobile telephones and kitchen appliances, which it gave to management and doctors at hospitals (Bribed Persons). In return for these bribes, these individuals ensured that Company A was used as the hospitals' supplier of medical equipment and the hospitals overpaid for that equipment.

In this case, the key indicator that caused the tax auditor to suspect possible corruption was that Company A was incurring large expenses under contracts to buy equipment that did not correspond to the equipment it held.

## *Note*

1. The OECD *Money Laundering Awareness Handbook for Tax Examiners and Tax Auditors* was published in 2009 and is available in several languages on the OECD website at www.oecd.org/tax/crime/money-laundering-awareness-handbook.htm.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