



Munich Personal RePEc Archive

**Bank secrecy laws and tax  
havens: Expanding areas and possible  
roles for computer forensic accounting**

DiGabriele, Jim and Ojo, Marianne

Montclair State University, George Mason University

August 2017

Online at <https://mpa.ub.uni-muenchen.de/80707/>

MPRA Paper No. 80707, posted 09 Aug 2017 23:22 UTC

## **BANK SECRECY LAWS AND TAX HAVENS:**

### **Expanding areas and possible roles for computer forensic accounting?<sup>1</sup>**

#### **1) Introduction**

Over the years, forensic accounting has expanded not just in respect of investigative accounting, but also in relation to areas which encompass forensic valuation studies and computer forensics.

Whilst fraud detection has continued to constitute a vital element which links forensic accounting and auditing – particularly in matters relating to audit trails, new possibilities and roles continue to emerge in relation to forensic accounting – and in view of greater manipulative and innovative areas which have been fostered by improved, sophisticated and advanced technologies.

Such technologies facilitating highly innovative criminal cover-ups which have continued to prove invaluable for the set-up and facilitation of fraudulent and fictitious accounts which have not only encouraged money laundering activities, but also criminal engagement in bank secrecy and transfers involving tax havens.

#### **2) Definition of Computer Forensics**

*“ The use of scientifically derived and proven methods towards the preservation, collection, validation, identification, analysis, interpretation, documentation and presentation of digital evidence derived from digital sources for the purpose of facilitating or furthering the reconstruction of events.”*

Challenges presented by the digital economy – as well as the retention and retrieval of timely, relevant and high quality data and information will be discussed later during the presentation.

#### **3) Reforming Bank Secrecy Laws**

It is widely known and accepted practice that bank secrecy laws have always served to protect legitimate – as well as unlawful sources of funds. Hence whilst some sources of funds are perfectly legal and owners of certain private accounts may wish for privacy – for valid and justified reasons, other sources of funds may require greater scrutiny in respect of their origins, intents – rationales for which such funds will eventually be diverted. The origins, use of, and means of dissipating such funds involving highly sensitive ethical and practical implications.

---

<sup>1</sup> Prof James DiGabriele and Prof Marianne Ojo

#### 4) Computer Forensics and Procedures

According to the White Paper “ Computer Forensic Services and the CPA Practitioner (2010/2012)”,

*“ computer forensic commonly is performed during a fraud investigation because the results can provide a roadmap in respect of what the key players involved likely knew, when they were likely to know it, the documents to which they had access, actions taken, with whom they communicated, and whether they appeared to hide their actions.”*

#### 5) Data generation: Three key elements

- Source of Information
- Timing, Pace of Data Collection
- Preservation of Data Integrity

#### 6) Incorporating the computer forensic accountant’s expertise

Hence tracing:

- i) The origins of the financial transactions
- ii) Intentions – Rationales, reasons and motivations for which such funds were transferred and for which they will eventually be used (whether for criminal, philanthropic causes)
- iii) As well as ethical and practical implications,
  - Constitute some areas where the computer forensic accountant’s expertise will be of much invaluable source of contribution.
  - Further, in respect of tax havens, the impact of Base Erosion and Profit Shifting activities – a practice which also embraces hybrid mismatch arrangements, as well as efforts and recent initiatives which have been undertaken to address such activities, will also be discussed.

#### 7) Addressing Base Erosion and Profit Shifting Activities: Recent Initiatives and Progress in Addressing Bank Secrecy and Aggressive Tax Planning Activities

The following constitute the fifteen action points which are highlighted in the OECD’s 2015 Final Reports:

- **Action 1 Addressing the Tax Challenges of the Digital Economy**
- **Action 2 Neutralizing the Effects of Hybrid Mismatch Arrangements**
- **Action 3 Designing Effective Controlled Foreign Company Rules**

- **Action 4 Limiting Base Erosion Involving Interest Deductions and Other Financial Payments**
- **Action 5 Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance**
- **Action 6 Preventing the Granting of Treaty Benefits in Inappropriate Circumstances**
- **Action 7 Preventing the Artificial Avoidance of Permanent Establishment Status**
- **Actions 8-10 Aligning Transfer Pricing Outcomes with Value Creation**
- **Action 11 Measuring and Monitoring BEPS**
- **Action 12 Mandatory Disclosure Rules**
- **Action 13 Transfer Pricing Documentation and Country-by-Country Reporting**
- **Action 14 Making Dispute Resolution Mechanisms More Effective**
- **Action 15 Developing a Multilateral Instrument to Modify Bilateral Tax Treaties**

## **8) Financial Instruments which Support Aggressive Tax Planning Schemes, Hybrid Mismatch Arrangements**

According to the 2015 OECD Executive Summaries, OECD/G20 Base Erosion and Profit Shifting Project 2015 Final Reports (2015:15):

- As well as hybrid mismatch arrangements, financial instruments can also be used to make payments which are economically equivalent to interest but have a different legal form, therefore escaping restrictions on the deductibility of interest.

It is further added that : Base Erosion and Profit Shifting (BEPS) risks in this area may arise in three basic scenarios:

- Groups placing higher levels of third party debt in high tax countries.
- Groups using intragroup loans to generate interest deductions in excess of the group's actual third party interest expense.
- Groups using third party or intragroup financing to fund the generation of tax exempt income.

## **9) Addressing BEPS Risks**

To address these risks, Action 4 of the *Action Plan on Base Erosion and Profit Shifting* (BEPS Action Plan, OECD, 2013) called for recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense.

Action 2, is also aimed at addressing hybrid mismatch arrangements – such instruments being defined as arrangements which “exploit differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to achieve double non-taxation, including long-term deferral” (BEPS, 2015: 9).

## **10) Jurisdictional and Governing Laws**

In determining the rationale behind the set-up of private, fictitious accounts, the sources of funding – as well as the involvements resulting in such set-ups will be vital to determining the nature, rationale and purpose for establishing such funds – whereby it can be determined whether criminal or non-criminal, legitimate or non legitimate reasons exist behind such set-ups.

Whilst it serves the interest of certain individuals who may have deposited their funds in jurisdictions which have stringent bank secrecy legislation – for example Swiss bank accounts, to protect their identity, the same cannot be said of all holders of such accounts.

And whilst this is true of private or secret bank accounts, it is also true in respect of tax havens.

## **11) Audit Trails: Cash Transactions and Money Laundering**

In legitimizing the establishment of such accounts, the forensic accountant may therefore be engaged in laws which are multi jurisdictional – and which may require access to highly sophisticated software – since the audit trail for certain jurisdictions may prove difficult to establish in respect to tracing the origins of such funds. This is particularly the case in cases involving money laundering – and particularly financial fraudulent transactions which involve cash.

## **12) Timing, Nature and Scope of Investigations**

Whereby it can be said – as is the case with the planning of an audit and engagement procedures, that the nature, timing and scope of the investigation is also crucial in ascertaining and ensuring that vital and crucial evidence is not destroyed, deleted or manipulated prematurely – before their discovery - or through passage of time, or as a result of inadequate and proper preparation of investigation procedures.

## **13) Improving Information Quality, Exchange and Flow of Information through Vital Data Channels**

As well as its acknowledgement of challenges presented by :

- lack of timely, comprehensive and relevant information on aggressive tax planning strategies as constituting one of the main challenges faced by tax authorities worldwide;

And the importance of:

- Early access to such information as providing the opportunity to quickly respond to tax risks through informed risk assessment, audits, or changes to legislation or regulations;
- Action 12 of the *Action Plan on Base Erosion and Profit Shifting* (BEPS Action Plan, OECD, 2013) recognizes the benefits of tools designed to increase the information flow on tax risks to tax administrations and tax policy makers (OECD, 2015:33).

#### 14) Benefits of Computer Forensics and Data Analysis

Such benefits include the following (Computer Forensic Services, 2012):

- The ability to reduce or even eliminate sampling risk
- The comparison of relevant types of data from different systems or sources to show a more complete picture
- The ability to easily trend relevant data over periods of time; fluctuations in trending lines can be analyzed further for false positives and potential risk factors
- Quick identification and extraction of certain risk criteria from the entire data population for further analysis
- Testing for effectiveness of the control environment – as well as policies in place – through the identification of attributes which violate rules

#### 15) Impact of BEPS and the Role of Computer Forensics

Why do BEPS activities need to be addressed?

- Based on OECD Final Report (2013:31):  
Even though evidence has shown that tax planning activities of some multinational enterprises (MNEs) take advantage of the mismatches and gaps in the international tax rules, separating taxable profits from the underlying value-creating activity, the *Addressing Base Erosion and Profit Shifting* report (OECD, 2013) recognized that the scale of the negative global impacts on economic activity and government revenues have been uncertain.
- ***Fiscal effects of BEPS are known to be significant - even though measuring the scale of BEPS proves challenging given the complexity of BEPS and the serious data limitations***

The Final Report also highlights that findings of the work performed since 2013 highlight the magnitude of the issue, with global corporate income tax (CIT) revenue losses estimated between 4% and 10% of global CIT revenues, i.e. USD 100 to 240 billion annually. Given developing countries' greater reliance on CIT revenues, estimates of the impact on developing countries, as a percentage of GDP, are higher than for developed countries.

## Conclusion

In addition to significant tax revenue losses, BEPS causes other adverse economic effects, including tilting the playing field in favor of tax-aggressive MNEs, exacerbating the corporate debt bias, misdirecting foreign direct investment, and reducing the financing of needed public infrastructure (OECD, 2013:31).

Given such impacts, the importance of engaging computer forensics to address BEPS related activities – as well as practices which facilitate money laundering through bank secrecy laws is further accentuated. Nevertheless, computer forensic experts also face challenges relating to compliance with privacy laws – particularly those which are foreign based - as well as in obtaining personal and confidential information.

The role of computer forensics also penetrates towards the heart of its ability to facilitate timely exchange of relevant – as well as accurate data which will be of use to tax authorities – as well as other involved parties in facilitating the exchange and flow of vital information through relevant data channels. Crucial to such role is the need to ensure that safeguards operate to facilitate procedures aimed at preserving the integrity of collected data.

Faced with the demands, challenges and risks of an ever evolving and complex digital economy, there remains a formidable position – and possibly more formidable one in the years to come, to be assumed by computer forensics – and particularly in respect of combatting aggressive tax planning schemes, base erosion practices, and other fraudulent related schemes involving the use of financial instruments. It also needs to be highlighted that privacy laws and legislation – whilst subject to manipulation and cover up schemes designed to facilitate illegal activities such as money laundering, are also very much needed in certain cases. In other words, lack of adequate bank privacy legislation – as well as manipulative use of such laws, could be channeled towards illegal and criminal purposes.

Hence bank privacy legislation and rules which are not only aimed at protecting appropriate classes of funds or those requiring such protection or privacy, but also designed to minimize or deter inappropriate use of such legislation, should be introduced and implemented – also bearing in mind the need to strike an appropriate balance between private matters and public interest.

## References

- AICPA (2006), *Forensic Procedures and Specialists: Useful Tools and Techniques*
- AICPA (2010-2012), *Computer Forensic Services and the CPA Practitioner*, Forensic Technology Task Force
- OECD/G20 Base Erosion and Profit Shifting Project 2015 Final Reports Executive Summaries
- OECD (2011), *Corporate Loss Utilization through Aggressive Tax Planning*, OECD Publishing. <http://dx.doi.org/10.1787/9789264119222-en>
- US Dept of Justice, United States Attorney Bulletin January 2008*