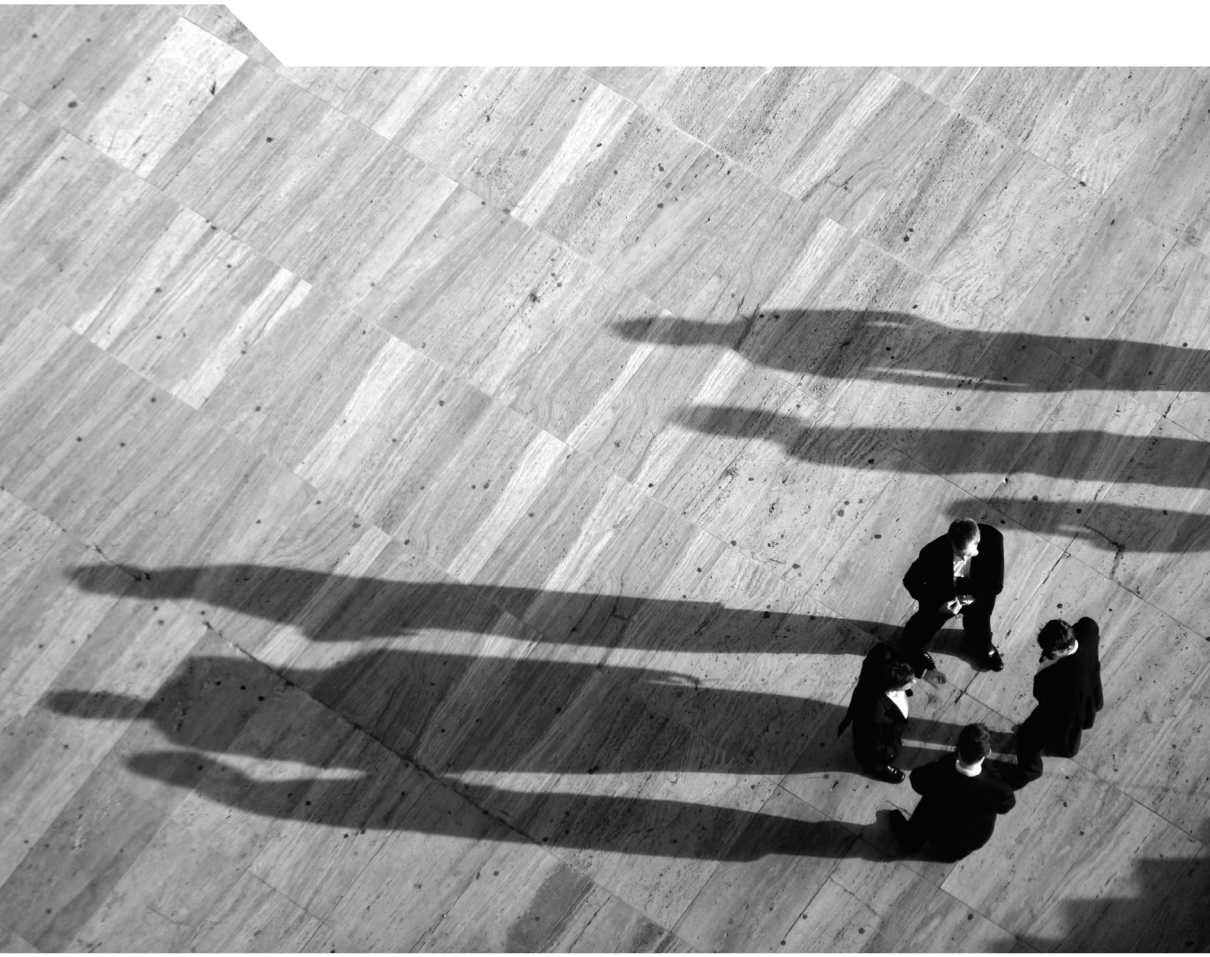
Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors



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Preface

In today's interconnected world, corruption's damaging effects spread throughout the global economy and society far beyond where the corrupt act is committed. In order to effectively fight corruption – both at home and internationally – transparency, accountability and integrity in the public and private sectors are necessary. The OECD has been a global leader in the fight against corruption for 15 years since the adoption of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Our multidisciplinary approach addresses corruption in business, taxation, development aid, and governance in member countries and beyond as part of its mission to build a stronger, cleaner and fairer world economy.

In 1996, the *Recommendation on the Tax Deductibility of Bribes to Foreign Public Officials in International Business Transactions* was adopted. The implementation of this recommendation sent a clear message that bribery would no longer be treated as a business expense and that it is a criminal offence subject to serious penalties. Building on the 1996 Recommendation and on the experience in its application, in 2009 the *Recommendation on Tax Measures for Further Combating Bribery of Foreign Public Officials in International Business Transactions* was adopted. This requires countries to explicitly prohibit the tax deductibility of bribes to foreign public officials and promotes enhanced co-operation between tax authorities and law enforcement agencies both at home and abroad to counter corruption.

Strengthening the legal framework to counter corruption is important, but ensuring effective and vigorous application of those laws is essential to detect, deter and prosecute corrupt practices. Thus, the OECD developed the *Bribery Awareness Handbook for Tax Examiners*. The Handbook, first issued in 2001, provided practical guidance to help tax examiners identify suspicious payments likely to be bribes so that the denial of deductibility could be enforced, and bribe payments detected and reported to the appropriate domestic law enforcement authorities. Given the interest in the Bribery Awareness Handbook, it was made available in 18 languages.

In 2010, the *Recommendation to Facilitate Co-operation Between Tax and Other Law Enforcement Authorities to Combat Serious Crimes* was adopted. This requires countries to put in place legal and administrative frameworks, and provide guidance, to facilitate reporting by tax officials of suspicions of all serious crimes arising out of the performance of their duties to the appropriate law enforcement authority. This was followed in 2011 by the launch of the Oslo Dialogue at the the first Forum on Tax and Crime, held in March 2011 in Oslo, Norway. The Oslo Dialogue encourages countries to adopt a whole of government approach to combating all forms of financial crime, including tax crime, money laundering and corruption. To support these developments, this new *Bribery and Corruption Awareness Handbook for Tax*

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Examiners and Tax Auditors considers the various types of corruption that a tax examiner or auditor are most likely to encounter in their work, and not just the bribery of foreign public officials, so that tax officials can better understand how their contribution can assist criminal investigators and law enforcement authorities in countering these crimes.

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Introduction

The first OECD *Bribery Awareness Handbook for Tax Examiners* was launched in 2001 and updated in 2009 to support the implementation by countries of the 1996 *Recommendation on the Tax Deductibility of Bribes to Foreign Public Officials in International Business Transactions* and the 2009 *Recommendation on Tax Measures for Further Combating Bribery of Foreign Public Officials in International Business Transactions*. The 2009 Recommendation requires that OECD member countries and other parties to the OECD Anti-Bribery Convention explicitly disallow the tax deductibility of bribes to foreign public officials in an effective manner, and the Handbook provided practical guidance to help tax examiners identify suspicious payments likely to be foreign bribes so that the denial of deductibility could be enforced, and bribe payments detected and reported to the appropriate domestic law enforcement authorities. In 2010, the OECD issued a *Recommendation to Facilitate Co-operation between Tax and Other Law Enforcement Authorities to Combat Serious Crimes*. This Recommendation required countries to implement effective legal and administrative frameworks and provide guidance to facilitate reporting by tax authorities of suspicions of all serious crimes arising out of performance of their duties. This covers all forms of corruption, including that arising in a domestic or international context, and by private and public officials. To support the implementation of the 2010 Recommendation, the latest version of the Handbook considers various types of corruption that a tax examiner or auditor are most likely to encounter in their work, including different forms of bribery, and not just the bribery of foreign public officials. This wider focus also reflects the fact that, in the course of their activities, tax examiners and auditors may find indicators of possible corruption but may not be in a position to determine whether or not it concerns foreign public officials. This version of the Handbook was developed by a team comprising specialists from Austria, Canada, Germany, the Netherlands, Norway and the United States and includes input from the OECD Task Force on Tax Crimes and Other Crimes and the OECD Working Group on Bribery.

The purpose of this *Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors* is to raise the awareness of tax examiners and auditors with respect to issues regarding bribery and other forms of corruption.[1] This Handbook provides guidance to tax examiners and auditors on how to recognise indicators of possible bribery or corruption that they may come across in the course of regular tax examinations and tax audits. The key instruments for tax examiners and auditors to deter taxpayers from participating in bribery and corruption are *(i)* the ability to reduce the benefits of bribery and corruption by denying a tax deduction for bribes and other payments associated with these crimes, and taxing any proceeds from the crime, in accordance with domestic tax legislation, and *(ii)* referring suspicions of possible bribery and corruption to the appropriate law enforcement authority or public prosecutor, for investigation and possible prosecution. While this Handbook does not detail criminal investigation methods, it does describe the nature and context of

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bribery and corruption so that tax examiners and auditors can better understand how their contribution can assist criminal investigators as well as other law enforcement authorities in countering these crimes.

It is hoped that tax administrations will provide copies of this Handbook to tax examiners and auditors as a reference tool for use in their work, and will integrate it into their training programmes. While the purpose of this Handbook is to raise the awareness of tax examiners and auditors concerning transactions and activities related to bribery and corruption, this Handbook is not meant to replace domestic rules and procedures. Tax administrations can adapt this Handbook to suit their particular circumstances and may wish to add details of specific domestic rules and procedures in an annex to their own version. It is also important to note that the various lists of indicators of possible bribery or corruption presented in this Handbook are not intended to be exhaustive and should be expanded upon as necessary, depending upon a country's circumstances and experience.

A list of useful websites and resources, as well as other relevant publications, is included in Annex A. An outline of the types of information that should be included in a referral to the appropriate law enforcement authority or public prosecutor of a tax examiner's or auditor's suspicions of possible bribery or corruption is set out in Annex B. Annex C includes a compilation of the indicators of possible bribery or corruption contained in various chapters of this Handbook.

The text of this Handbook will be amended from time to time to ensure it is kept up to date. The latest version is available in several languages on the OECD website at www.oecd.org/tax/crime/bribery-corruption-awareness-handbook.htm.

Note

1. Bribery is a form of corruption which involves a person intentionally offering, promising or giving an undue advantage to an official or decision maker, with the intention that the official or decision maker acts or refrains from acting in relation to the performance of their duties. In practice it is the form of corruption that tax examiners and auditors are most likely to encounter in the course of their work. Therefore, in this Handbook, the term "bribery" is used to refer specifically to this offence, while "corruption" is used to refer to forms of corruption *other than bribery*.

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What are bribery and corruption?

The same justifications and excuses for bribery and corruption, like other white collar crimes, are heard time and time again. "Everybody does it", "it's a cost of doing business", "it doesn't really matter", "nobody gets hurt". This is not true. The corruption of public or private officials and decision makers, and the payment of bribes, raise serious moral and political concerns. These are not victimless crimes, and in fact exact a heavy economic and social cost. Bribery and corruption create an unlevel playing field for honest businesses, and cut deep into the social fabric of developed and developing countries alike. They can translate into inferior and dangerous products allowed onto the market place, substandard building materials used in infrastructure projects that can endanger people's health and welfare, and the diversion of vital money required for education, health and welfare services. In the end, we all pay the bill.

Corruption can take many forms, but all involve the abuse of public or private office for personal gain. A corrupt official may exercise his or her authority in a way they should not (for example, where a purchasing manager grants a contract to a supplier that has paid a bribe) or fail to exercise authority in the way they should (for example, where a building inspector ignores the use of sub-standard building that should be reported). Other parties to corruption may act for a variety of personal or business reasons. Corrupt transactions can be extremely simple or incredibly complex, involving companies in many different countries. Corruption can take place at the highest levels of government and at the top of large multinational companies. It can also happen at a local level, wherever somebody has the power to influence decision-making.

Corruption is one of the main obstacles to sustainable economic, political and social development for developing, emerging and developed economies. Overall, corruption reduces efficiency and increases inequality. Estimates show that the cost of corruption equals more than 5% of global GDP, or USD 2.6 trillion (World Economic Forum), with over USD 1 trillion paid in bribes each year (World Bank). The costs of corruption can be felt in many different ways. Investors are often unwilling to invest in countries where systems are perceived to be corrupt, because they are less able to assess the likely risk or return on their investment. Bureaucratic processes may be slowed down, both by corrupt officials and by mechanisms introduced to identify and combat corruption. Corruption may also be linked with other criminal enterprises, such as tax evasion, money laundering and serious organised crime.

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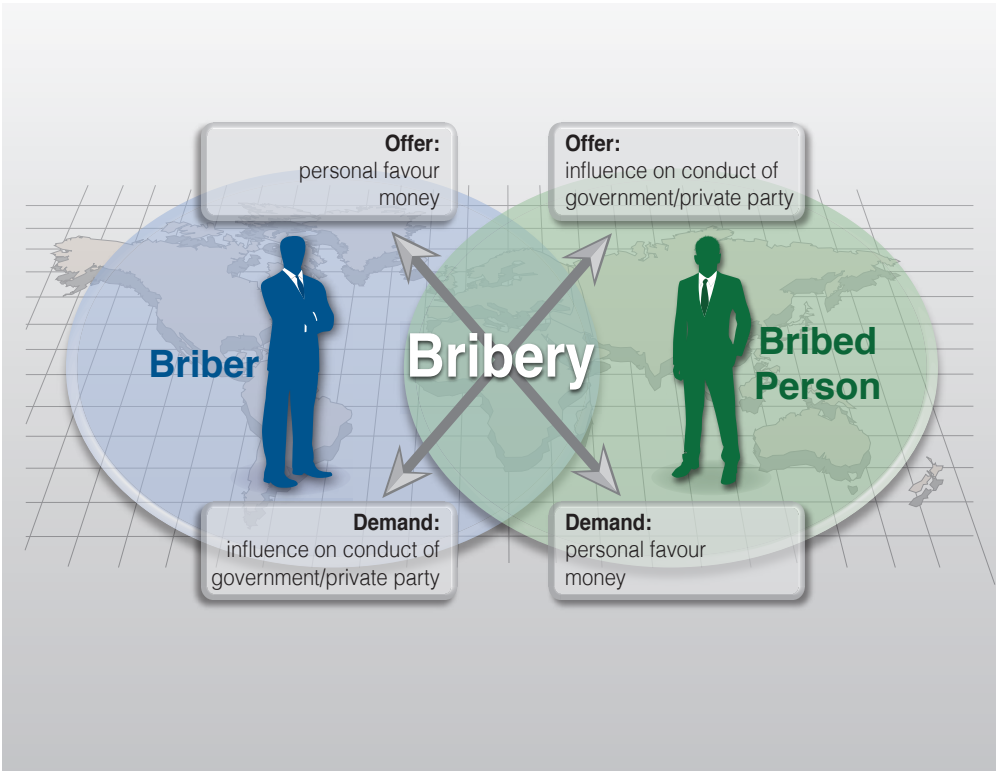
Categories of corruption

Corruption can be found in many different forms, including cronyism, nepotism and patronage. The types of corruption that a tax examiner or tax auditor is most likely to encounter in their work include bribery, embezzlement and extortion.

Bribery

Bribery involves intentionally offering, promising or giving any undue pecuniary or other advantage to an official or decision maker, with the intention that the official or decision maker acts or refrains from acting in relation to the performance of their duties. This can be seen in the illustration below.



Generally, in any business related bribery transaction there are four main parties: the briber; the bribed person and their respective organisations. While it is not always the case, these organisations are sometimes a direct victim of the bribery, for example, the government agency that over-pays for services as part of a kickback scheme or the private organisation that enters into contracts on unfavourable terms as a result of the actions of the briber and bribed person. There may also be many indirect victims of bribery, including individuals who suffer when funds are diverted from public services and law-abiding businesses that miss out on contracts because they refuse to pay bribes.

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Different types of bribery include:

- *Kickbacks* – A kickback is a form of bribe paid to a person of influence within an organisation, in return for them securing some kind of benefit from their organisation for the person paying the bribe. Commonly, kickbacks are paid by companies seeking to secure profitable contracts or contracts on favourable terms. In return for their assistance, part of the benefit from the contract is paid (or "kicked back") to a decision maker within the organisation granting the contract. The organisation granting the contract is not aware of the payment to its official.
- *Secret commissions* – Companies often use agents to enter into contracts on their behalf, for example to make sales in an overseas market. Secret commissions are a form of bribery whereby an agent requests or accepts a payment to influence these contracts for the benefit of the payer, without the knowledge or consent of their principal. This may be to secure a contract, to gain favourable terms, or even to prevent a contract being entered into with a competitor.
- *Facilitation payments* – Facilitation payments are made by a business to a government official in order to encourage or ensure that the official performs his or her normal duties. An example of such a case might be where a company makes a payment to a customs official to avoid unnecessary delays on clearing a shipment of goods. Facilitation payments are made in order to influence the behaviour of an official, but in many countries these particular payments are not illegal, therefore tax examiners and auditors should familiarise themselves with their own country's treatment of these payments.
- *Influence peddling* – Also known as "trading" or "trafficking in influence", influence peddling occurs where an official seeks to obtain payment in return for using their influence to secure an undue advantage or favour for the payer. The term is also used where it is the payer who solicits an official to use their influence to secure an undue advantage or favour in return for payment. Influence peddling is most often seen in the world of politics, but does also occur in business.
- *Electoral bribery* – In some countries it is a crime to make a donation for the purpose of promoting a candidate or a political party, where the intention is to influence the result of an election and so secure or retain a contract with the government.

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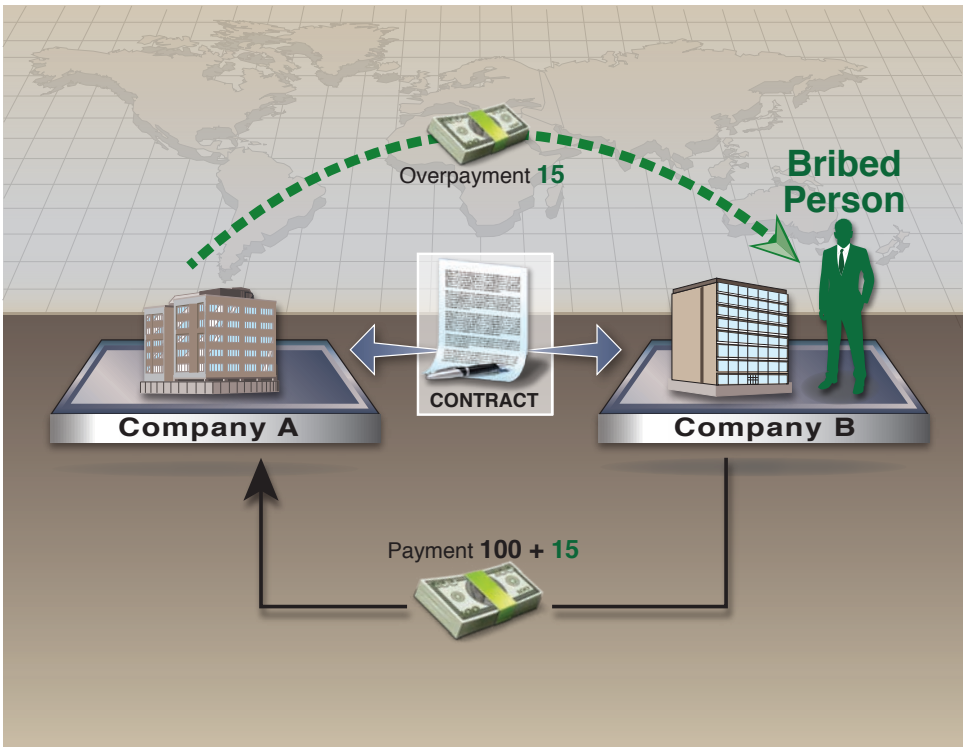
Simple example of bribery in the form of a kickback



Company B is a government-owned company responsible for co-ordinating the renovation of the state-owned railway, including the granting of contracts. It has invited tenders from a number of companies to conduct the work. Company A (Briber) is a privately owned company that is bidding for the contract. The contract has a value of USD 100 million. Company A comes to an agreement with a corrupt official (Bribed Person) at Company B, whereby Company A is awarded the contract and is paid USD 115 million. In return, Company A pays a 'kickback' of USD 15 million to the corrupt official.

Embezzlement

Embezzlement concerns a public or private official appropriating money or other assets that they have been entrusted with in their official capacity. Embezzlement is a kind of financial fraud, which often involves the falsification of documents and records over a long period of time, while small amounts are regularly secreted in a systematic manner.

Extortion

Extortion is the illegal use of a person's position to forcefully demand payment in return for granting an undue economic advantage. Like bribery, in extortion a payment is made to a person who is in a position of power or influence. However, in the case of extortion, the person in the position of power or influence demands the payment and does so using intimidation, threats or force.

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The role of the tax administration in combating bribery and corruption

Tax administrations have an important role to play in combating bribery and corruption. In the course of their activities tax examiners and auditors are in a very strong position to identify indicators of possible bribery or corruption, and the tax administration has a responsibility to exercise its duties and powers to assist other government agencies in fighting these crimes. The tax administration assists the fight against bribery and corruption in two main ways.

Firstly, a tax administration is responsible for ensuring compliance with domestic tax law. In most countries, bribes and other payments associated with corruption are not tax deductible. Tax examiners and auditors should take steps to identify these payments and ensure that deductions are not allowed for tax purposes and, where applicable, apply the appropriate penalties in accordance with domestic tax law. Bribes received and other proceeds of corruption may also be taxed under domestic tax legislation, and this should be enforced. In spite of denying a deduction for bribes paid or taxing the income or gains of bribes received and applying penalties accordingly, tax administrations may never totally put an end to corrupt behaviour but do what is in their power to limit it. Some individuals and companies will continue to accept the risks as a cost of doing business. However, by enforcing these laws strictly, tax administrations will reduce the benefits of corruption, thus sending a clear message that bribery and corruption are not acceptable business practices.

Secondly, where in the course of their work a tax examiner or tax auditor uncovers information that leads them to suspect bribery or corruption may have occurred, the tax administration in most countries has an obligation to refer these suspicions to the appropriate law enforcement authority or public prosecutor. This can significantly increase the likelihood of a successful prosecution. It also means that, alongside a prosecution, steps can be taken by the appropriate authority to recover the proceeds of the corruption from the people or companies involved. This ensures that, to the extent possible, nobody obtains a financial benefit from the corrupt activity.

Where a tax examiner or auditor refers their suspicions of possible bribery or corruption to a law enforcement authority or public prosecutor, the tax administration should take all steps necessary to ensure this information remains strictly confidential and to ensure the safety of their employee. A clear policy that is put into practice to protect tax examiners and auditors enables them to do their jobs in safety and encourages others to refer similar suspicions. The content of such a policy may vary depending upon the particular profile of a

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country and its tax administration, and should be based on an assessment of the risks faced by tax examiners and auditors in that country.

Links to money laundering

Bribery and corruption are predicate offences for money laundering purposes, and so where a tax examiner or auditor identifies indicators of possible bribery or corruption, they should also consider whether any indicators of possible money laundering are also present. If this is the case, the tax examiner or auditor may also be under an obligation to report this to the national Financial Intelligence Unit (FIU). This means that information uncovered by a tax examiner or auditor may also result in a money laundering investigation.

The OECD *Money Laundering Awareness Handbook for Tax Examiners and Tax Auditors* is a practical guide to raise awareness of issues surrounding money laundering, and the indicators of possible money laundering that tax examiners and auditors may come across in the course of their work.

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The role of tax examiners and tax auditors

Raising awareness

Tax examiners and auditors around the world are highly trained and skilled specialists, who in the course of their normal activities routinely examine the financial affairs, transactions and records of millions of individuals, companies and other taxpayers. However, they may be unaware of what the typical indicators of possible bribery or corruption are, as well as their own role in referring their suspicions to the appropriate law enforcement authority or public prosecutor where they have identified possible bribery or corruption. Furthermore, tax examiners and auditors should be reminded that bribes and other payments linked to corruption are not tax deductible and the proceeds of corruption are often taxable income or gains under domestic law. While the aim of this Handbook is to raise awareness among tax examiners and auditors of issues surrounding bribery and corruption, it is not meant to replace domestic laws, policies and procedures. Tax examiners and auditors must, at all times, carry out their duties in accordance with the laws, policies and procedures which apply in their country. Therefore, in ensuring that their country's domestic tax law is properly applied, tax examiners and auditors should be aware of their role in detecting bribery and corruption and thus alert to indicators of possible bribery or corruption.

In order to conceal evidence of bribery and corruption, taxpayers will often use the same techniques that they also use to conceal income when evading taxes or laundering the proceeds of crime. As in the case of recognising indicators of possible tax evasion or money laundering, tax examiners and auditors should therefore also be alert to indicators of possible bribery or corruption.

Throughout this Handbook, references are made to the fact that tax examiners and auditors should be aware of indicators of possible bribery or corruption. However, any actions that a tax examiner or auditor takes in the course of their enquiries must always be for the purpose of determining a taxpayer's civil tax liability. In the course of these enquiries a tax examiner or auditor should pay attention to indicators that may lead them to suspect bribery or corruption may have taken place, but it is not their role to determine whether an offence has been committed. Conducting investigations into possible criminal activity is the responsibility of the appropriate law enforcement authority or public prosecutor, and not the tax examiner or auditor.

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Detecting bribery and corruption

Corruption transactions, including the payment of bribes, may be "on the books" (in other words, they are found in an individual's or business's financial records and accounts) or "off the books". Tax examiners and auditors are most likely to detect indicators of possible corruption that are "on the books", as they review the taxpayer's financial records. Generally, this should not create additional work for the tax examiner or auditor, as a review of financial books and records will be undertaken as part of their normal activities to verify the sources of taxpayer income and identify untaxed income or gains and non-deductible expenses. In order to identify indicators of possible bribery or corruption, tax examiners and auditors should use the same analytical and audit skills and training, together with their judgement, that lead them to detect possible tax evasion. However, it is vital that tax examiners and auditors are aware of what the possible indicators of bribery and corruption look like, in order that they will recognise them.

While indicators of possible bribery or corruption are discussed later in this Handbook, it is important to note that these fall into two broad groups, as follows.

- "Affirmative indications" indicate that acts *may* have been committed for the purposes of deception, concealment, or to disguise the facts. Affirmative indications are not in themselves sufficient to establish that bribery or corruption has taken place. Examples of affirmative indications include management or employees with a lifestyle which is not supported by known income; a business undertaking transactions with unusually high or low gross profit margins; and an unusually close relationship between a taxpayer and external consultants.
- "Affirmative acts" establish that a particular action, or series of actions, was deliberately committed for the purposes of deception, concealment, or to disguise the facts. Affirmative acts must be present in order to establish that bribery or corruption has taken place. Examples of affirmative acts include the omission of items from financial records where other similar items are included; the concealment of bank accounts; the failure to deposit money receipts into business accounts; and concealing the source or destination of payments.

In order to support tax examiners and auditors in identifying possible corruption, many tax administrations are adopting a risk based approach, based on three pillars: *(i)* intelligence, *(ii)* awareness and *(iii)* training. It is intended that this Handbook can be used to support each of these three pillars. By focusing on the areas of highest risk and discussing general and specific indicators of possible bribery or corruption, this Handbook can supplement other sources of intelligence in assisting tax examiners and auditors to plan their work to ensure resource is allocated where risk is greatest. As previously noted, the purpose of this Handbook is to raise awareness among tax examiners and auditors of the indicators of possible bribery or corruption. Furthermore, this Handbook stresses the importance of detecting and disallowing bribes for tax purposes and taxing the proceeds of corruption, as well as the importance of making referrals to the appropriate law enforcement authority or public prosecutor when evidence of possible bribery or corruption is identified. Therefore, this Handbook is structured so that it can be used both as a training tool and as a reference guide for tax examiners and auditors.

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Examination plan and compliance checks

During the planning phase, when conducting a review of tax returns, tax examiners and auditors, and their supervisors, should be alert to situations that lend themselves to the creation of illegal or improper payments, such as bribes. Valuable sources of information during this phase (and throughout an examination or audit) include internal audit reports, media reports, the internet, and (anonymous) tip-offs. Databases containing information on fair market prices can also be useful when comparing a taxpayer's position with business norms. When deemed appropriate and necessary, an examination plan should include consideration of the following compliance checks:

- an examination of internal audit reports and related working papers to determine if any reference is made to the creation of any secret or hidden corporate fund;
- a review of the taxpayer's copies of reports filed with other governmental regulatory agencies;
- consideration of the use of foreign entities and operations, the terms of contractual or pricing arrangements, details of fund transfers, and use of tax haven locations; and
- a review of the internet and other open sources.

Information available from other government agencies

In planning and conducting their work, tax examiners and auditors should consider what information, if any, could be requested from other government agencies. Details of mechanisms for sharing information and other co-operation between domestic government agencies, together with descriptions of successful practices, are contained in the report *Effective Inter-Agency Co-operation in Fighting Tax Crimes and Other Financial Crimes* ("the Rome Report"), launched by the OECD in 2012.

Information available from other countries

In planning and conducting their work, tax examiners and auditors should take steps to ensure they are aware of any information that may already have been received by their tax administration from abroad. Where a tax examiner or auditor requires further information for use in their enquiries, and they have exhausted options for obtaining this information in their own country, they should consider whether this information could be obtained from another country.

Various legal mechanisms provide for exchange of information between countries for tax purposes. These include bilateral instruments, such as Double Tax Conventions which contain an exchange of information article based on Article 26 of the OECD Model Tax Convention and Tax Information Exchange Agreements, and multilateral instruments, such as the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. These instruments may also provide for other forms of international co-operation, such as the use of simultaneous tax examinations by tax administrations in more than one country. The terms and use of a wide range of instruments for international co-operation are described

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in the publication *International Co-operation against Tax Crimes and Other Financial Crimes: A Catalogue of the Main Instruments*, published by the OECD in 2012.

Exchange of information between tax administrations in different countries is handled by officials known as "competent authorities", which are nominated by the countries' respective governments. Direct contact between tax officials in different jurisdictions is not generally allowed. Where a tax examiner or auditor receives information from another country which indicates that a non-tax criminal offence may have taken place, they should seek advice from specialists within their tax administration as sharing the information with law enforcement authorities may be prohibited without the consent of the country which provided the information.

Where a tax examiner or auditor obtains information that is foreseeably relevant to the administration or enforcement of another country's tax laws, they should consider whether they are able to exchange this information with that country's tax administration through bilateral or multilateral conventions. This will include, for example, where the tax examiner or auditor suspects that bribes have been paid by a taxpayer in another country, which should be disallowed for tax purposes in that country. Again, any contact with the tax administration in another country should be conducted through each country's competent authorities.

Steps following the discovery of indicators of possible bribery or corruption

Where a tax examiner or auditor identifies one or more of the indicators referred to in this Handbook they should, subject to their domestic laws, where it is necessary and does not compromise a possible criminal case, conduct further enquiries to determine whether these are sufficient to suspect that bribery or corruption may be present. Where this is the case, they must take steps to ensure compliance with domestic rules to deny deductions for bribes and other payments connected with corrupt practices, and to tax the proceeds of bribery and corruption. The tax auditor is reminded that although he or she may form suspicions of possible bribery or corruption, the purpose of their actions must always be the determination of a civil tax liability, and not the determination of criminality. However, where during the course of an audit, and based on the findings of that audit, the tax auditor suspects that bribery or corruption may be present, he or she is encouraged to make a referral to the appropriate law enforcement authority or public prosecutor.

Where required by domestic law, the tax administration should also refer these suspicions to the appropriate law enforcement authority or public prosecutor. This referral must be in accordance with their country's rules and procedures, which may include a standard format. An outline of the types of information that should be included in a referral is included in Annex B. Following a referral of suspected criminal activity, a tax examination or tax audit may generally continue, but all questions and enquiries concerning the suspected bribery or corruption must cease. This is both to protect the rights of possible suspects and to avoid jeopardising any criminal investigation. Nevertheless, a decision on the deductibility of payments may be made at the same time as making a referral to the appropriate law enforcement authority or public prosecutor.

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Indicators of possible bribery or corruption

Tax examiners and auditors need to be aware of the indicators of possible bribery or corruption to ensure they can be taken into account when planning an examination, and can be recognised when they are present. This chapter categorises the main indicators of possible bribery or corruption that may arise during the compliance risk analysis process for selecting the cases, during the examination of a tax return, the planning of a tax audit and during the audit itself.

Indicators of possible bribery or corruption can be discovered in a wide range of places. The most obvious of these include tax returns, bank records and financial accounts, including income statements, balance sheets and cash flow statements. However, tax examiners and auditors may also look for indicators in publicly available information including news articles, websites about relevant industries or geographic regions, and databases on fair market prices (to compare the terms of contracts with market norms). Internal audit reports, court reports and anonymous tip-offs may also prove useful sources of information, though any information provided anonymously should be thoroughly verified with independent evidence.

Bribery and corruption can take place in many different situations and at all levels of public and private sector organisations. Tax examiners and auditors should be aware of the possibility of corruption in the public sector arising in transactions which involve a Politically Exposed Person (PEP), due to their high level of influence. A PEP is a person who has been entrusted with a prominent public function, such as a senior political figure, as well as the close relatives and business associates of such a person. Because of the increased money laundering risk posed by PEPs, financial institutions and certain other bodies are required to keep records of transactions and accounts involving PEPs. To assist institutions in identifying PEPs, a number of public and private organisations maintain lists of PEPs, and it may be possible for tax examiners and auditors to access these lists in the course of their enquiries.

For the purposes of this Handbook the indicators of possible bribery or corruption have been categorised into five broad groups, which are discussed in the following chapters. In practice, most indicators that a tax examiner or auditor are likely to come across will relate to taxpayers who are making bribes or other payments related to corruption, and these are covered in the next four chapters. Many of the indicators included in these four chapters are also relevant when considering the position of someone who may have received the proceeds of bribery or corruption. However, the fifth chapter in this Handbook looks at indicators of possible bribery or corruption that are particularly relevant to these recipients. These next five chapters are:

- Indicators concerning the taxpayer's external and internal risk environment.

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- Indicators concerning the taxpayer's transactions.
- Indicators concerning payments and money flows.
- Indicators concerning the outcomes of the taxpayer's transactions.
- Indicators specifically concerning recipients of the proceeds of possible bribery or corruption.

Even a single indicator of possible bribery or corruption should be taken seriously, and may mean that a tax examiner or auditor should pay increased attention to try and identify other indicators or possible evidence before reaching a decision to refer a possible offence. Where bribery or corruption is present, indicators rarely exist in isolation. This is shown in each of the next five chapters, which include examples taken from real world cases where tax examiners or auditors identified key information that resulted in, or contributed to, a corruption investigation.

Wherever a tax examiner or auditor suspects they are dealing with a taxpayer or official who may be involved in bribery or corruption, they should consider for the purpose of determining the civil tax liability of the parties involved, extending their enquiries to look for indicators on the other side of the bribery or corrupt transaction. This may include contacting the tax administration in another country, if the suspected bribery or corruption is taking place across national borders.

A complete list of all the indicators referred to in these chapters is included in Annex C.

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Indicators concerning the taxpayer's external and internal risk environment

Introduction

Tax examiners and auditors should be aware that detecting possible corruption begins as early as at the assignment of the file and before field work begins. Both tax examiners and auditors should, as with any other file, familiarise themselves with the particulars of the taxpayer's business and its industry.

Once in the field, before a tax auditor can decide whether corruption may be present, he or she should perform a thorough review of the taxpayer's business environment, a tour of the business premises and an in depth review of the taxpayer's records. Only by doing so, will the tax auditor be able to obtain a clear picture of the taxpayer's transactions and how stakeholders might be involved in corruption. In terms of the business environment, the tax auditor needs to determine the strengths of the taxpayer's internal controls and assess if possibilities exist for the owners or management to pay bribes without detection.

The tax auditor can use the tour of premises and time spent on site to note the presence of any indicators of possible bribery or corruption. By asking questions relevant to their tax enquiries with respect to who negotiates and signs contracts and authorises payments, the tax auditor may be able to identify weaknesses in controls and opportunities for corruption. By connecting the dots, for example from a review of expense accounts typically used in bribery transactions, identifying the key players in the transactions and any relationships between them, questioning the use of an intermediary such as a consultant, reviewing contracts and the value of goods transferred, reviewing correspondence, banking records, travel logs, other key documents and by perhaps using information external to the taxpayer's records, the tax auditor can be comfortable that payments should be disallowed, subject to their domestic tax laws.

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Indicators

Indicators concerning the taxpayer's external risk environment

- Operates in, or is related to companies operating in, a high risk country.[1]
- Operates in a high risk industry,[2] such as:
  - Public works and construction
  - Utilities
  - Real estate, property, legal and business services
  - Oil and Gas
  - Mining
  - Power generation and transmission
  - Pharmaceutical and healthcare
- Operates in a highly regulated sector, or one which requires government authorisations and licenses.

Indicators concerning the taxpayer's internal risk environment

Indicators concerning the taxpayer's legal structure and connections

- Complex or international legal structure with no apparent commercial, legal or tax benefits.
- Owns or controls a legal entity with little or no commercial purpose, particularly one located offshore.
- Employs, or has business connections with, close relatives of the owner or senior management.
- Employs, or has business connections with, Politically Exposed Persons (PEPs) or relatives of PEPs.

Indicators concerning the taxpayer's internal controls

- Management has a lax or non-existent anti-corruption philosophy and regime.
- Few or no internal controls in place, such as an independent internal audit function, to detect and deter corruption.
- Weak controls over the hiring and use of consultants.

Indicators concerning the taxpayer's background and history

- Previously faced suspicions or litigation concerning any kind of financial crime.

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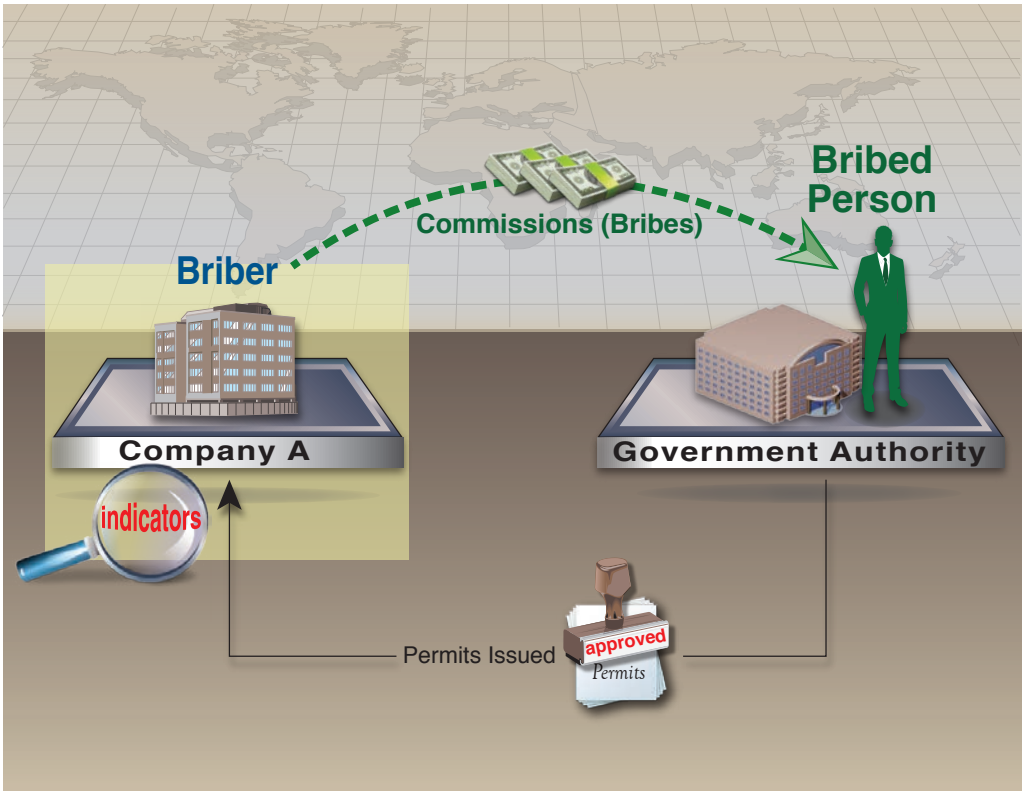
Indicators concerning attempts to impact the tax examination or audit

- Attempts to influence the tax examiner or auditor, including by offering a bribe.
- Attempts to hinder the tax examination or audit, for example by refusing to answer questions or withholding financial information or correspondence.

Examples

Operations in a high risk country



Company A (Briber) was a construction company building a large scale industrial facility in Country X, which has a very low score on the Transparency International Corruption Perceptions Index. During a tax audit, the tax auditor discovered cash payments described as "commissions" totalling USD 400 000. However, the management of Company A were unable to give a convincing explanation of these large cash payments, and the tax auditor further found that there were no underlying invoices for the payments (the company had used 'self-prepared vouchers' to raise the payments). This led to the tax auditor conducting further

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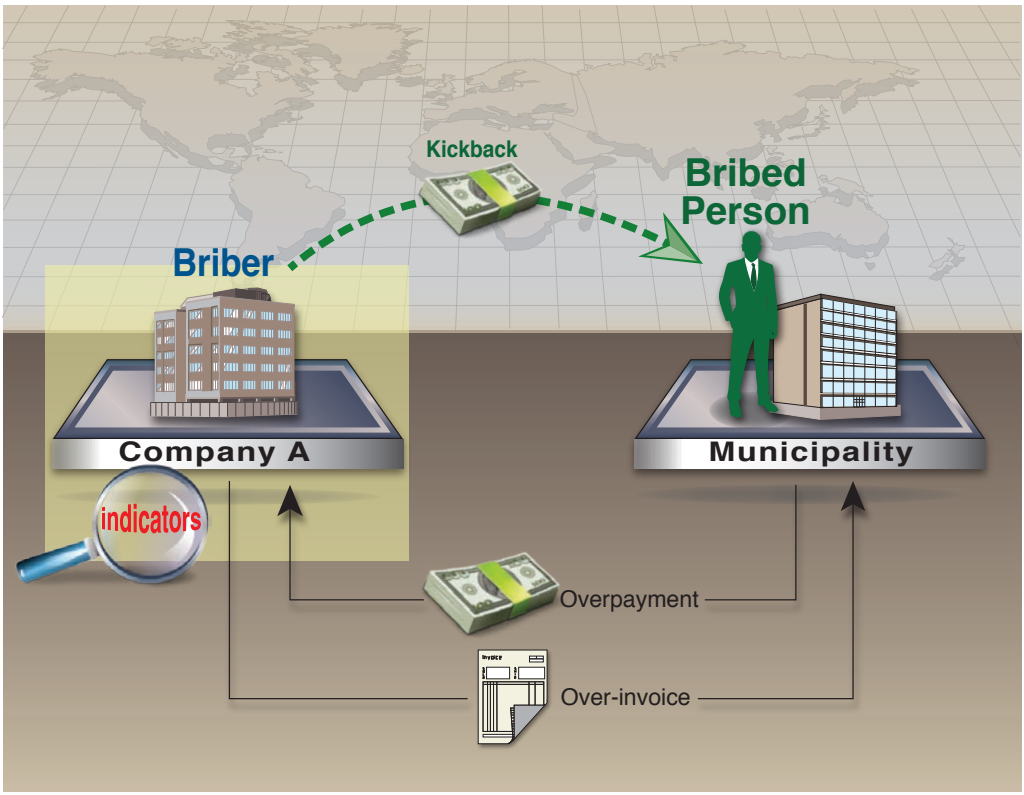
enquiries which revealed that, during the course of construction, Company A had needed specialised industrial machinery to be shipped to the work site. This required a delivery permit to be obtained, which Company A knew could take a long time and might be refused. Company A therefore approached officials in the Government Authority (Bribed Person) and offered to pay cash bribes in return for them issuing the permit promptly.

In this case, the key indicator that caused the tax auditor to suspect possible corruption was that Company A was undertaking a large project in a high risk country. Other indicators included the fact that Company A was operating in a sector which required government licences, large payments were being made in cash, and these payments were made on the basis of self-prepared vouchers.

Business connections with a close relative



A Municipality is one of the largest customers of a small painting company, Company A (Briber). During a tax audit of Company A, the auditor discovered evidence that the amount of paint being used by the company on its work for the Municipality was much lower than the contracts would suggest, and its gross profit was significantly higher than would be expected within the industry, indicating that the company may be over-invoicing for this work.

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As a result, the tax auditor decided to perform a third party check at the Municipality, which revealed that the painting contracts were being granted by an employee (Bribed Person) who was also a close relative of the owner of Company A. The tax auditor referred these suspicions to the appropriate law enforcement authority, which initiated a criminal investigation. This investigation revealed that the Municipality had no effective controls in place to ensure independence in the awarding of contracts and the same employee had also granted other contracts to friends and relatives. The criminal investigation uncovered that some of the money paid by the Municipality to Company A was being paid back to the municipal employee as kickbacks. Based on the results of the criminal investigation, a prosecution was brought for corruption and organised crimes, which resulted in a number of convictions.

In this case, the key indicator that caused the tax auditor to suspect possible corruption was the fact that municipal contracts were being granted to Company A by a close relative of the company's owner. Other indicators included Company A's very high gross profit margin on contracts with one particular customer, these contracts were approved by a single individual, and the lack of public tenders for the contracts.

Notes

1. High risk countries include those which do not engage in effective exchange of information, have a low score on the Transparency International Corruption Perceptions Index or Bribe Payers Index, or have a high score on the Tax Justice Network Financial Secrecy Index.

2. High risk industries include those with a low score on the Transparency International Bribe Payers Index. The list of industries included above achieved low scores in the 2011 index.

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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.

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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).

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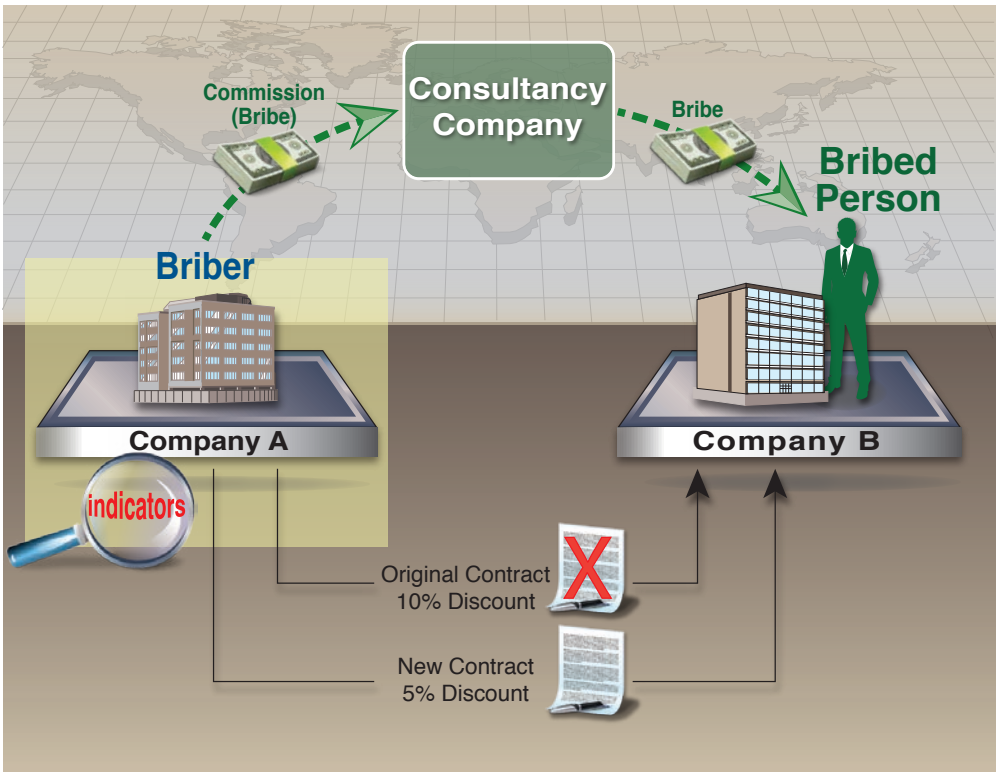
- Contract provides for payments which are contingent on the outcome of agreements with other parties.
- Normal procurement procedures are not followed (for example, it has not obtained multiple quotes that would usually be required).
- Under-qualified people in senior positions or fictitious employees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

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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.

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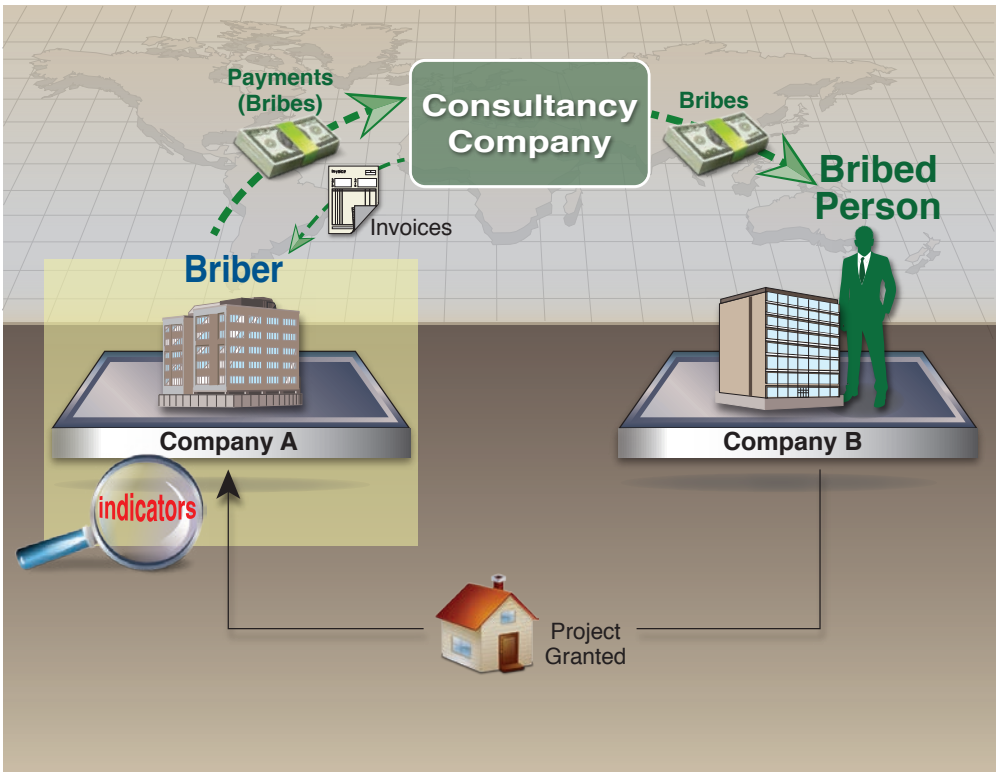
Transaction does not fit taxpayer's profile



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.

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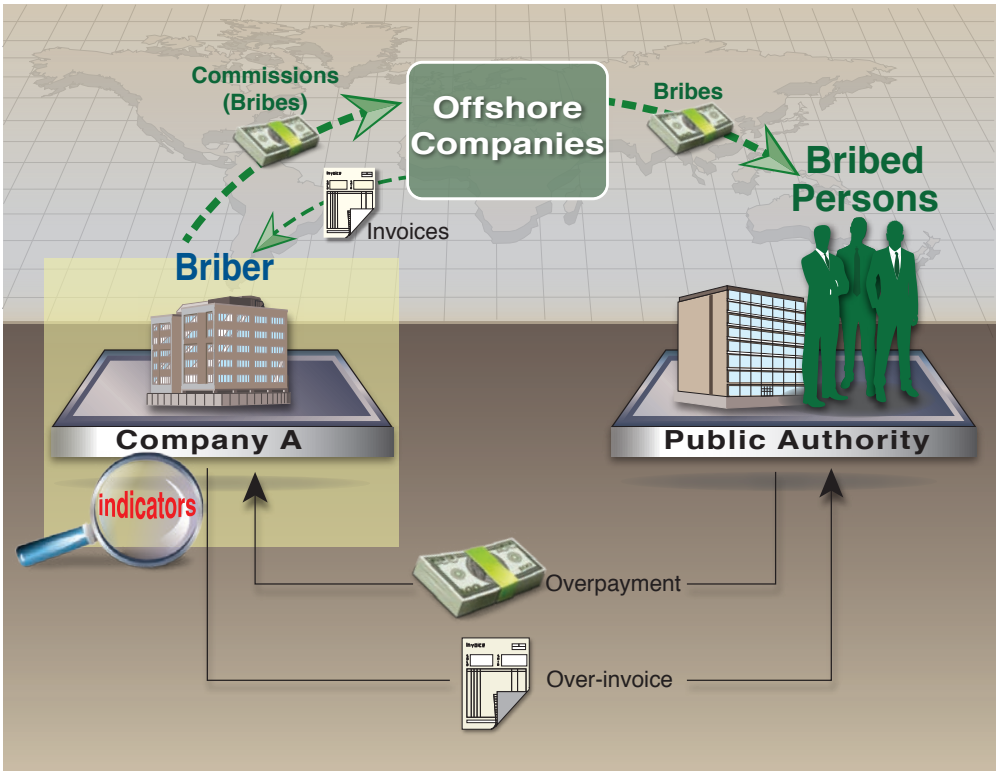
The tax auditor conducted further enquiries and discovered that Mr J (Bribed Person) in fact worked for Company B, a company which was involved in a large commercial development. Company B had recently granted Company A a number of contracts to design and build properties. This led the tax auditor to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

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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.

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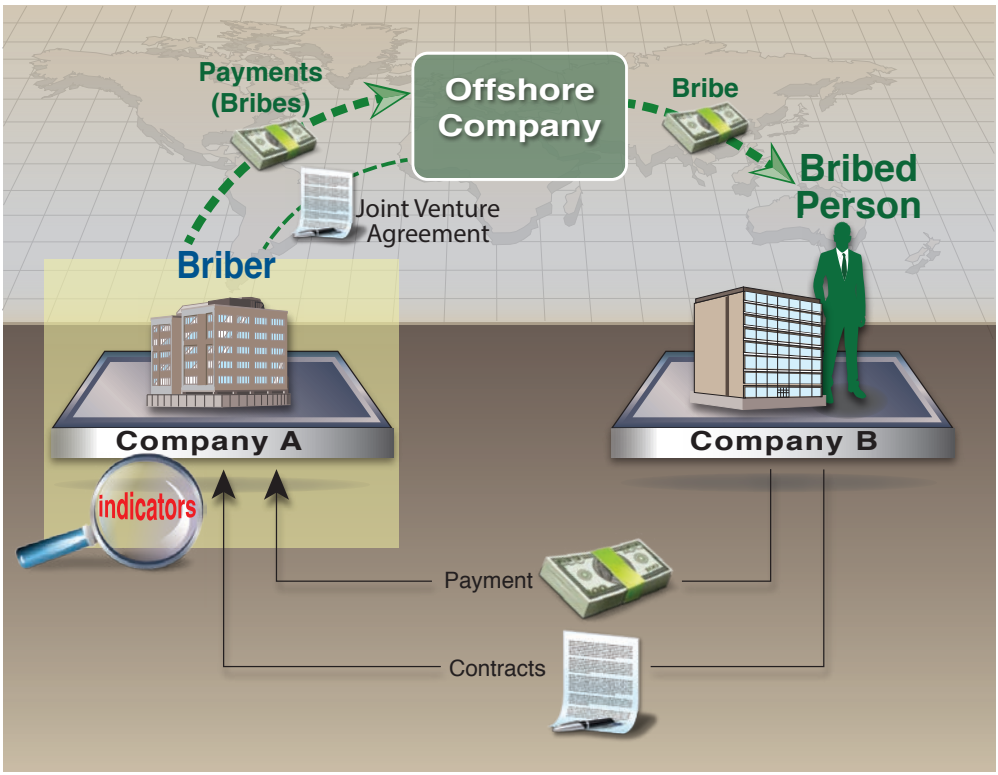
Joint venture with no commercial substance



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.

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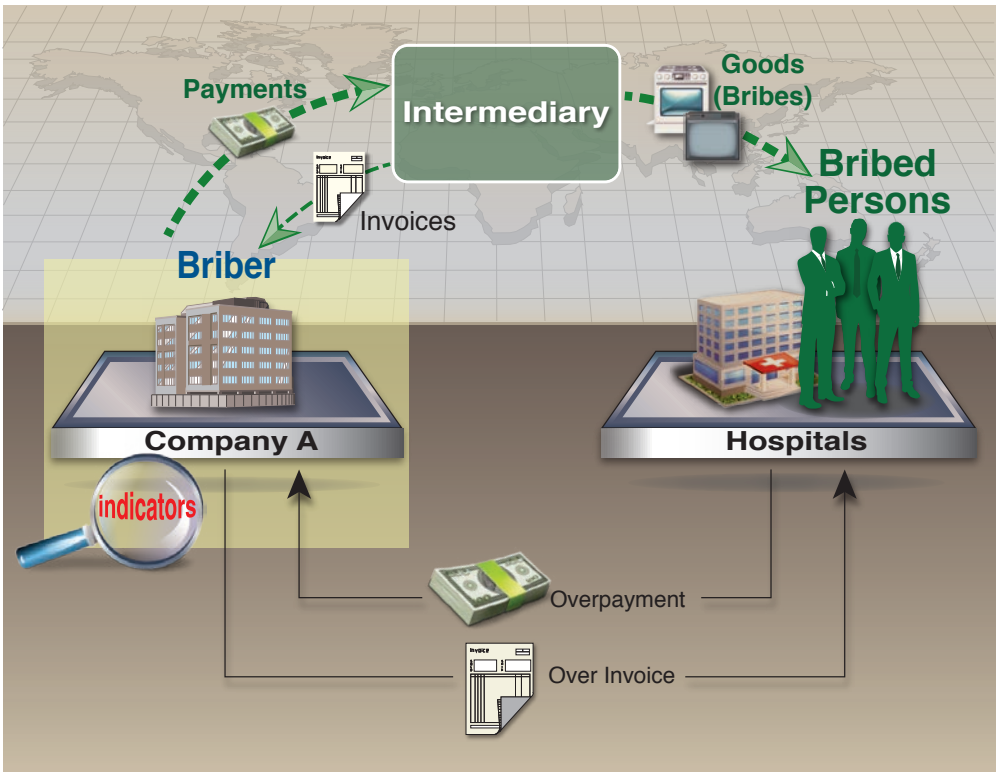
Contract terms do not reflect reality



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.

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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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Indicators concerning payments and money flows

Introduction

Much bribery and corruption consists of the illicit transfer of assets, which the parties to a transaction will try to disguise as legitimate business payments. However, because many taxpayers will still seek to claim a tax deduction with respect to bribes and other payments made for the purposes of corruption, a paper trail is likely to be left behind which can be uncovered by tax examiners and auditors.

Tax examiners and auditors may come across a wide range of indicators in the course of their normal activities, which relate to payments and money flows between the parties to bribery or a corrupt transaction. These include anything which makes a payment or money flow appear unusual, which might concern the amount or frequency of payments, where payments are made to or received from, or arrangements for approving the payment that differ from normal.

Indicators

Indicators concerning where payments are being made to or received from

- Payments to or from persons in high risk countries, who cannot be identified, or are companies whose beneficial owners cannot be identified.
- Payments made or received through intermediaries in third countries.
- High payments for handling services in high risk countries.
- Payments to foreign accounts of individuals or companies with which there is no business relationship.
- Payments made for travel and lodging of PEPs.
- Commission payments split into parts, paid into different offshore bank accounts.
- Payments made to countries with bank secrecy rules, which do not exchange bank information.

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- Payments to bank accounts in countries other than those where the recipient is located.
- Payments to personal bank accounts rather than to business accounts.
- Payments to entities that did not take part in projects or transactions.

Indicators concerning the terms of payments

- Large or frequent, rounded payments or receipts.
- Deviation from normal procedures in approving payments.
- Payments made or received where no written contract exists, or where written contracts are unclear or unavailable.
- Invoices paid which are not required under contracts.
- Payments made under invoices that do not fit the taxpayer's usual profile (for example, in terms of amount, timing, location of recipient etc.).
- Payments made under self-prepared vouchers rather than third party invoices.
- High commission payments made around certain dates (for example, when contracts are concluded).
- Payments made immediately upon (or before) receipt of an invoice or signing a contract.
- Third party makes payments directly to creditors on behalf of the taxpayer, or to entities controlled by the taxpayer.
- Favourable treatment shown to certain creditors (e.g. paying one supplier faster than others for no clear reason).
- Amounts received appear excessive for the goods or services provided.
- Amounts paid to intermediaries or consultants appear excessive.

Other indicators concerning payments and money flows

- Significant, unexplained cash withdrawals.
- Notary's or lawyer's third party account used where there is no apparent need.
- Origin of funds for a transaction is not clear.
- History of frequently opening and closing bank accounts.
- Significant unexplained payments into and out of the taxpayer's bank accounts.
- Evidence of payments that are not recorded in financial records.
- Certain payments cannot be satisfactorily explained.

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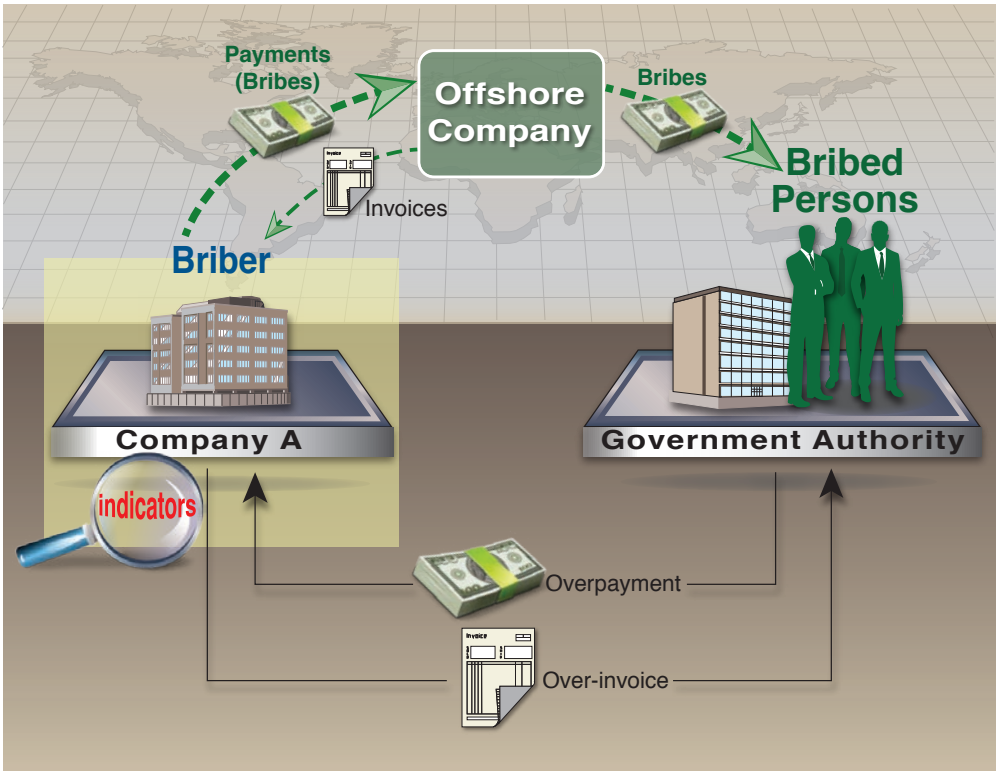
Examples

Commission payments to a high risk country



Company A (Briber) is a currency printing company. During a tax audit it was discovered that Company A had made payments of USD 20 million to an Offshore Company located in a country which does not share tax information. In Company A's records, these payments were shown as being in return for "business handling" services with respect to contracts with the government of Country X for printing bank notes. However, the tax auditor could not find any evidence of services provided by Offshore Company.

The tax auditor suspected that the payments were in fact bribes, and the money would somehow be paid to foreign public officials (Bribed Persons) in Country X in return for the contract being granted to Company A. The tax auditor also suspected that members of management at Company A would share in the money paid to Offshore Company. The tax auditor therefore wrote to Company A informing it that the payment to the tax haven company would not be deductible for tax purposes, as it was a suspected bribe. As a result, the supervisory board of Company A fired the management team involved in the transaction and reported the issue to the public prosecutor's office. The new management team has since stated that they will no longer conduct business in Country X.

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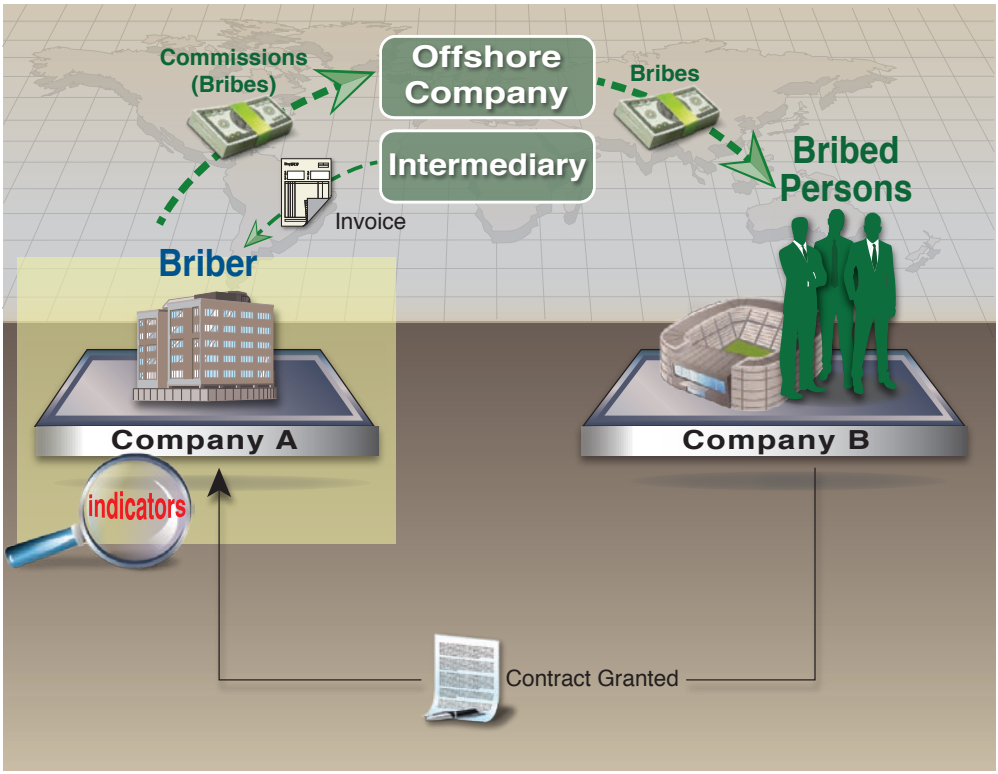
In this case, the key indicator that caused the tax auditor to suspect possible corruption was that large commission payments were being made to a company in a high risk country, where no services appeared to be received in return.

Payments sent via offshore companies



Company B, a State-owned Company in Country X, had authority to grant a contract to build a new sports stadium. To help it win this contract Company A (Briber), a construction business, entered into an agreement with an Intermediary. Under this agreement, Intermediary would broker contracts, assist in conducting site inspections and provide other support related to the completion of contracts. In return, Company A paid Intermediary a commission of USD 17.5 million, which was 5% of the total contract value.

During a routine audit, the tax auditor discovered that the invoice from Intermediary required Company A to pay its commission to an Offshore Company which was located in a country which did not exchange bank information. Further enquiries revealed that Intermediary and Offshore Company were owned by the same individuals (Bribed Persons). These individuals were also government employees in Country X, employed by Company B which was responsible for granting the contract to Company A. In substance, the 5% "commission" was in fact a bribe paid by Company A to the foreign public officials in order to secure a profitable contract.

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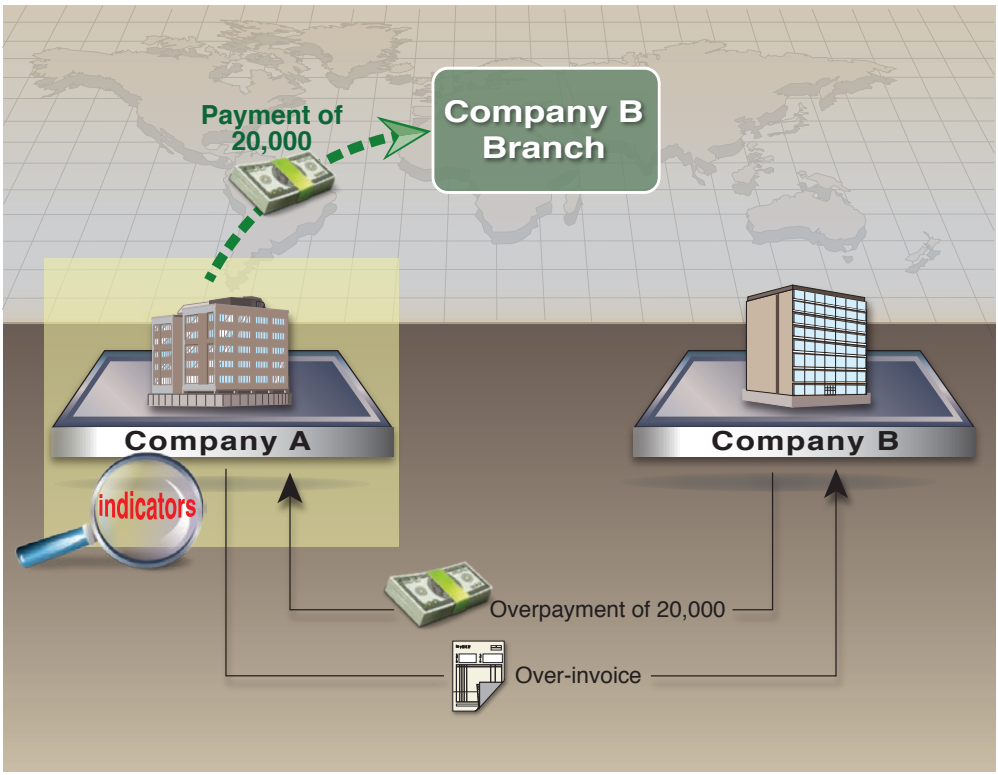
In this case, the key indicator that caused the tax auditor to suspect possible corruption was the fact that Company A was directed to pay the commission to Intermediary via an Offshore Company located in a high risk jurisdiction. Other indicators included the fact that Company A operated in a high risk industry, the fact that a valuable contract was awarded without a public tender, and the fact that both Intermediary and Offshore Company were owned by foreign public officials of Country X.

Over-invoicing of certain customers



Company A is a company engaged in international trade. During a tax audit, the tax auditor noticed that Company A repeatedly invoiced higher amounts to one of its customers, Company B, than it did to other customers for similar products. For example, where other customers were invoiced USD 100 000 for goods, Company B would be invoiced USD 120 000. Company B is located in Country X, which has strict currency exchange controls. Following payment of the invoices by Company B, Company A issued credit notes for the amount equal to the over-payment (in this example USD 20 000) to a branch of Company B located in a country which did not exchange tax or bank information. Company A then paid the USD 20 000 to a bank account of the Company B branch in this country.

When questioned by the tax auditor, management at Company A explained that this arrangement was entered into in order to facilitate business with Company B, by helping it

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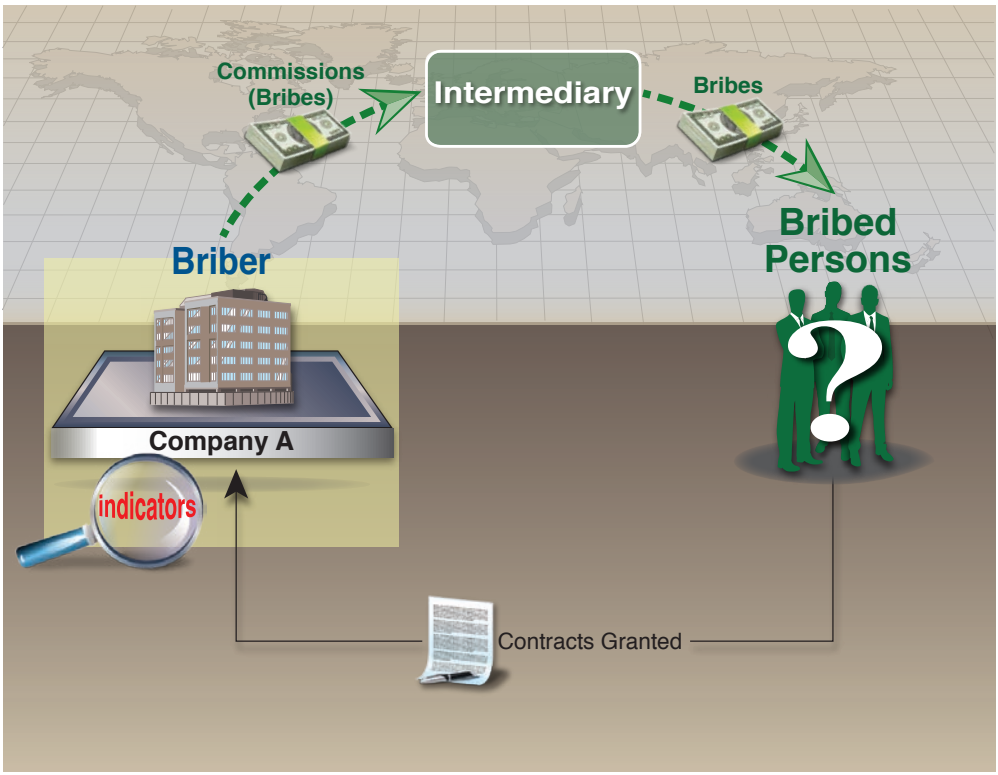
to avoid Country X's currency exchange controls. Based on the information available, it was not clear to the tax auditor whether this explanation was correct. However, the tax auditor had enough information to suspect that the company was engaged in, or facilitating, some form of corruption, tax evasion or other serious criminal activity. The tax auditor therefore referred her suspicions to the appropriate law enforcement authority.

In this case, the key indicator that caused the tax auditor to suspect possible corruption was that Company A was routinely over-invoicing a certain customer. Other indicators included the fact that Company A issued a large number of credit invoices; and large payments were being made to a high risk country.

Use of self-prepared vouchers



Company A (Briber) was a construction company that undertook large projects overseas. During a tax audit of the company, it was found that Company A often used a consultancy company, Intermediary, to deal with foreign governments when negotiating contracts. Intermediary received a commission of up to 5% of the contract value. However, no invoices were received from Intermediary, and all commission payments were made on the basis of self-prepared vouchers. Further enquiries revealed that payments to Intermediary were made in cash, while no detailed contracts existed to detail precisely what services Intermediary provided in return for its commission. This was sufficient for the tax auditor

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to suspect that the "commission payments" made to Intermediary were in fact bribes which would ultimately be paid to foreign public officials in the overseas countries. The tax auditor therefore referred these suspicions for criminal investigation. The foreign public officials were not identified.

In this case, the key indicator that caused the tax auditor to suspect possible corruption was the fact that commissions were being paid to Intermediary on the basis of self-prepared vouchers and not invoices. Other indicators included the fact that these payments were made in cash and contracts between Company A and Intermediary lacked detailed clauses concerning the services to be provided.

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Indicators concerning the outcomes of the taxpayer's transactions

Introduction

As discussed in previous chapters, tax examiners and auditors should be aware of anything in a taxpayer's risk environment, their transactions and their payments and money flows that indicate an increased risk of bribery or corruption. Tax examiners and auditors should also be aware of any indicators that bribery or corruption may have already taken place.

When considering possible indicators, tax examiners and auditors must think very broadly. Almost any significant feature of the taxpayer's business, financial records or personal finances (or those of close relatives) that appears unusual or unexpected and cannot be fully explained may be an indicator of possible bribery or corruption, and could be reason for the tax examiner or auditor to pay extra attention to other possible indicators that may be present, or even to refer their suspicions to the appropriate law enforcement authority, the public prosecutor or the FIU.

Indicators

Indicators concerning outcomes that impact the taxpayer's business

- Benefits from favourable treatment by government agencies, suppliers or customers.
- Unusually successful at obtaining and retaining contracts.
- Contracts or licences are granted by PEPs or their relatives.
- Contracts are granted without the need for public tender, negotiations, or documents which would normally be expected.
- Goods or services acquired under contracts were never in fact received.
- Company has recently fired senior staff members with no clear justification.
- Records include incriminating correspondence that suggests possible bribery or other corruption.

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Indicators concerning outcomes that impact the taxpayer's financial records

- Key financial ratios are out of line with similar businesses.
- Unusual or unexplained losses or profits on contracts.
- Records show no taxable gain when one would be expected.
- Records include expenses which are not linked to sales or profits.
- Balance sheet contains assets or rights acquired at higher or lower than market value, which have no real value, or may not even exist.
- Balance sheet assets or rights disposed of at a price higher or lower than their market value.
- Balance sheet contains an unexplained loan with an unrelated entity.
- Unexplained waiver of a loan with an unrelated entity.
- Balance sheet contains liabilities associated with assets which are unidentified, or where the value of the liability appears excessive.
- Business has seen a substantial and unexplained increase in capital.

Indicators concerning outcomes that impact the taxpayer's personal assets (or those of senior management)

- Company owns luxury assets unrelated to its business (private aircraft, yachts, expensive residential property etc.).
- The taxpayer, an employee or family member has a lifestyle or pattern of spending unsupported by their income.

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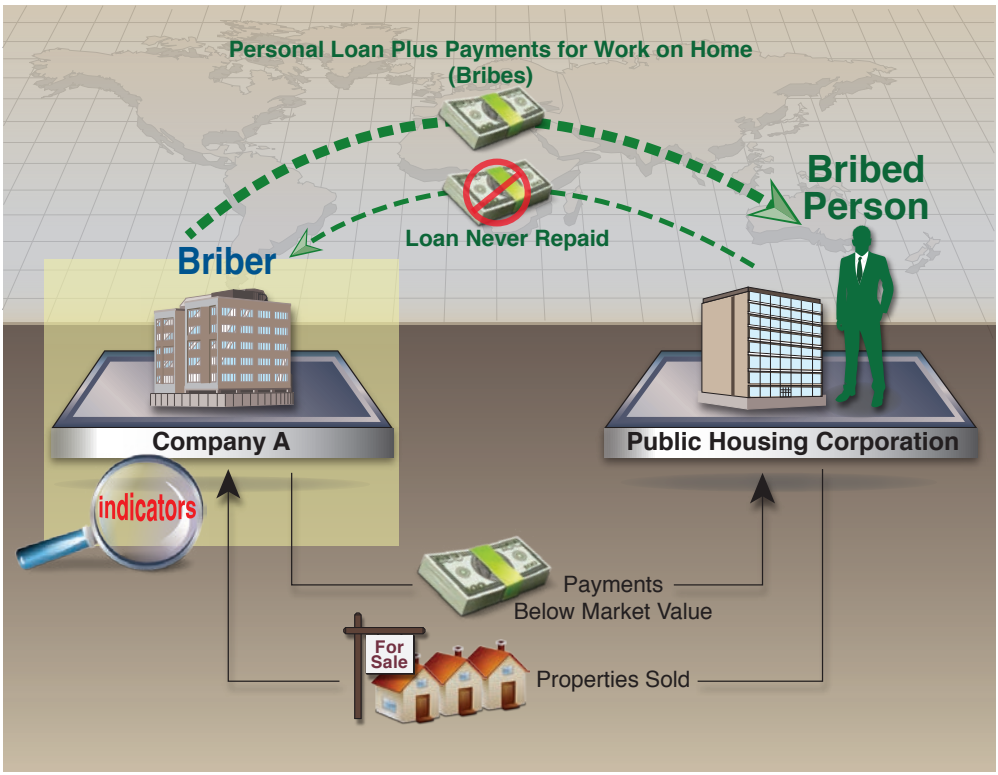
Examples

Favourable treatment from supplier



Company A (Briber) is a real estate company. During a tax audit, the tax auditor noted that Company A had a number of dealings with the same Public Housing Corporation, and decided to look more closely into this relationship. The audit uncovered that Company A had acquired a number of properties from the Public Housing Corporation at prices that appeared to be below the fair market value and on terms that were favourable to Company A. Company A did not appear to compensate the Public Housing Corporation for this. However, the tax auditor did discover that Company A had incurred significant costs on the renovation and re-decoration of a property that it did not own.

Further enquiries revealed that the property which had been renovated and re-decorated was owned by Mrs K (Bribed Person), the Chairman of the Public Housing Corporation. The tax auditor discovered that Company A had also made a "personal loan" to Mrs K that was not documented and that she was never required to repay. In total, Mrs K received benefits in excess of USD 750 000 which she did not declare to the Public Housing Corporation and did not include in her tax return. On the basis of this, the tax auditor suspected that Mrs K was in fact receiving bribes from Company A and referred these suspicions to the appropriate law enforcement authority, which commenced an investigation.

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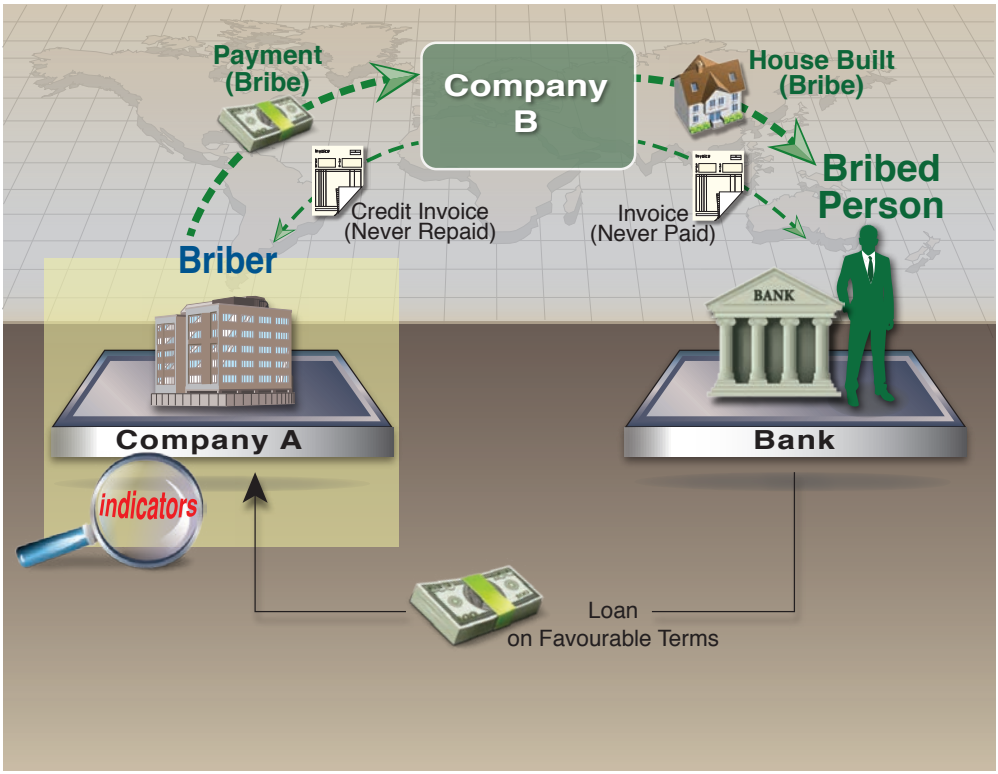
In this case, the key indicator that caused the tax auditor to suspect possible corruption was that Company A had entered into a number of contracts with the same Public Housing Corporation that seemed to be on favourable terms. Other indicators included the fact that Company A had incurred unexplained expenses on a property it did not own and had made an undocumented loan to Mrs K which she was not required to repay.

Unexplained expenses



Company A (Briber) was a project management company. During a tax audit, the tax auditor discovered that Company A was sent an invoice by Company B, a construction company, for building work on Company A's offices that had never taken place. Company A paid the invoice in full. Subsequently, Company B issued a credit invoice to Company A, but there was no evidence that Company A was ever actually repaid the price of the construction. At around the same time, Company A obtained a large loan from a local bank on what appeared to be favourable terms.

The tax auditor decided to conduct third party checks and discovered that Company B had in fact built a house for Mr L (Bribed Person), a senior staff member at a local bank. Company B had issued an invoice to Mr L with respect to the construction work, which was for the same amount as the invoice paid by Company A. The invoice issued to Mr L was never paid. In effect, Company A had paid Company B to build Mr L's house. The credit invoice

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issued to Company A and the invoice issued to Mr L appeared to have been generated to ensure Company B's books were in order, and were never intended to be honoured. The tax auditor therefore suspected that Company A had paid for the construction of Mr L's house as a bribe, in return for him exercising his authority at the bank and granting a loan to Company A on favourable terms. The tax auditor referred these suspicions to the appropriate law enforcement authority, which commenced an investigation.

In this case, the key indicator that caused the tax auditor to suspect possible corruption was that Company A had incurred unexplained expenses for work that had not taken place. Other indicators included the fact that Company A had received a credit invoice but no payment, and was not actively chasing payment; and Company A had around the same time received a large loan on favourable terms.

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Indicators specifically concerning the recipient of the proceeds of possible bribery or corruption

Introduction

Much of the focus in the previous chapters has been on the *payer* of bribes and other payments within corrupt transactions. However, tax examiners and auditors must remain aware of indicators concerning the *recipients* of bribes and other proceeds of corruption, and the tax consequences of the income or gains they receive. The recipients of possible bribes or other proceeds of corruption are individuals, whether government officials or decision makers in companies, which either seek to hide the payments they receive, or disguise them as another form of income. Wherever tax examiners or auditors uncover indicators of possible tax evasion or money laundering, they should also consider whether these may also suggest that the taxpayer is in receipt of bribes or other proceeds of corruption.

Many of the indicators discussed in the previous chapters are relevant in audits and tax return examinations of both the payers and the recipients of bribes and other corrupt payments, but there are a number of indicators that are particularly relevant to individuals who are the recipients of the proceeds of bribery and corruption and these are included below.

When considering the position of the recipient of the proceeds of possible bribery or corruption, tax examiners and auditors should keep in mind the need to pay particular attention to any unusual transactions, which could indicate increased risk. As set out in a previous chapter, 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 of the funds is unclear.

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Indicators

- Works for government agency in high risk country.
- Responsible for granting authorisations, licences or contracts to businesses.
- Ownership or control of entities not connected with recipient's main job.
- Receives commissions for consultancy work, but lacks relevant skills and experience.
- Receives additional employment or consultancy income when already fully employed.
- Sudden or unusual support given to particular companies or industries.
- Referred to in a Suspicious Transaction Report (STR) received by the FIU.
- Unexplained growth in net worth (including that of family members).
- Unexplained donations to political campaigns or parties.
- Unusual and unexplained spending, particularly in cash (including by family members).

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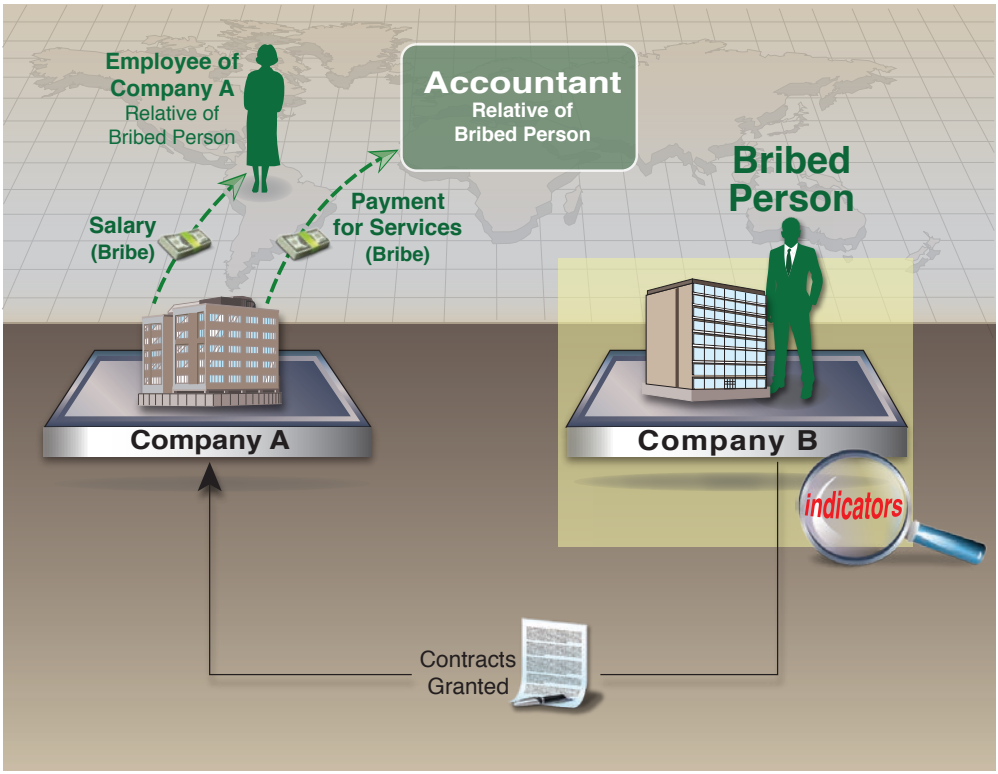
Example

Unusual and unexplained spending



Company B is a large mail order company. During a tax audit, the auditor became aware of a number of printing contracts which had been awarded without the usual approval process. Further enquiries revealed that the contracts had all been approved by Mr M, a senior manager responsible for production of the company's catalogue. Mr M was unable to provide a convincing explanation for how the contracts had been awarded. It also came to the attention of the auditor that Mr M had recently begun to enjoy a more lavish lifestyle, including a new car and expensive holidays, which it seemed unlikely could be supported by his salary.

The tax auditor conducted third party checks, and discovered that Mr M's wife, Mrs M, was employed by Company A, the printing company that had been awarded the largest contract to print the catalogue. However, although Mrs M was on Company A's payroll and received a salary, she did not seem to perform any work at the company. In addition it was found that Company A and a number of other printing companies that had been awarded contracts by Mr M, each made payments to the same accountancy firm, Accountant, without receiving any services in return. Further checks revealed that Accountant was owned by Mr M's daughter. The tax auditor suspected that Mrs M's salary and the payments to Accountant,

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were in fact bribes paid to Mr M and his family in return for the granting of the printing contracts with Company B. The suspicions were reported to the appropriate law enforcement authority, which commenced a criminal investigation. Company B also began its own internal investigation.

In this case, the key indicators that caused the tax auditor to suspect possible corruption were that contracts had been approved by Mr M that did not comply with the Company B's usual approval process, while at the same time Mr M was enjoying an unexplained increase in his personal expenditure. Other indicators included the fact that Mr M's wife was employed by Company A, which had been granted a large printing contract, while his daughter received payments for accountancy services from a number of printing companies which had contracts with Company B.

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Annex A

List of useful websites and resources

When looking for further information on bribery and corruption, tax examiners and auditors should look first to their own agency's guidance. The resources below may provide useful additional background information, but do not replace domestic legislation or regulation.

OECD resources

The OECD *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and Related Documents* contains information on instruments including the 1997 Convention and the 2009 *Recommendation on Tax Measures for Further Combating Bribery of Foreign Public Officials in International Business Transactions*, www.oecd.org/daf/anti-bribery/ConvCombatBribery_ENG.pdf.

The *2010 Recommendation to Facilitate Co-operation Between Tax and Other Law Enforcement Authorities to Combat Serious Crimes* introduces a requirement for countries to establish effective legal and administrative frameworks and provide guidance to facilitate reporting by tax authorities of suspicions of serious crimes arising out of performance of their duties to the appropriate domestic law enforcement authorities, http://acts.oecd.org/Instruments/ShowInstrumentView.aspx?InstrumentID=266.

The OECD *Money Laundering Awareness Handbook for Tax Examiners and Tax Auditors* provides guidance to tax officials on recognising possible money laundering, www.oecd.org/tax/crime/money-laundering-awareness-handbook.htm.

The report *Effective Inter-Agency Co-operation in Fighting Tax Crimes and Other Financial Crimes* contains an in-depth analysis of models for inter-agency co-operation in 48 countries, www.oecd.org/ctp/crime/effectiveinter-agencyco-operationinfightingtaxcrimesandotherfinancialcrimes.htm.

The OECD *Manual on Information Exchange* contains guidance on international co-operation, including exchange of information, simultaneous tax examinations and conducting tax examinations abroad, www.oecd.org/tax/exchange-of-tax-information/cfaapprovesnewmanualoninformationexchange.htm.

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International Co-operation Against Tax Crimes and Other Financial Crimes: A Catalogue of the Main Instruments is a useful guide to key instruments for international co-operation in fighting crime, www.oecd.org/ctp/crime/internationalco-operationagainsttaxcrimesandotherfinancialcrimesacatalogueofthemaininstruments.htm.

The OECD *CleanGovBiz* initiative contains information on a wide range of tools through which governments can reinforce their fight against corruption, www.oecd.org/cleangovbiz/.

Other international organisations

The United Nations Convention Against Corruption is the largest international legally-binding anti-corruption instrument, with 165 parties, www.unodc.org/unodc/en/treaties/CAC/.

The Financial Action Task Force (FATF) report *Laundering the Proceeds of Corruption* considers the links between corruption and money laundering, and issues surrounding recovery of the proceeds of corruption, www.fatf-gafi.org/topics/methodsandtrends/documents/launderingtheproceedsofcorruption.html.

The Transparency International Corruption Perceptions Index (www.transparency.org/research/cpi/overview) and Bribe Payers Index (www.transparency.org/research/bpi/overview), and the Tax Justice Network Financial Secrecy Index (www.financialsecrecyindex.com/) contain important information on high risk countries and industries.

The European Commission website contains information on anti-corruption instruments, policies and strategies within Europe, http://ec.europa.eu/dgs/home-affairs/what-we-do/policies/organized-crime-and-human-trafficking/corruption/index_en.htm.

The website of the Group of States Against Corruption (GRECO) contains documents concerning compliance by countries with European anti-corruption standards, www.coe.int/t/dghl/monitoring/greco/default_en.asp.

The United Nations Office on Drugs and Crime (UNODC) and PricewaterhouseCoopers (PwC) joint report *Anti-Corruption Policies and Measures of the Fortune Global 500* describes steps taken by companies to combat corruption, www.unodc.org/unodc/en/corruption/anti-corruption-policies-and-measures-of-the-fortune-global-500.html.

The International Chamber of Commerce is a global business organisation which advocates strong internal policies on corporate responsibility and anti-corruption, www.iccwbo.org/advocacy-codes-and-rules/areas-of-work/corporate-responsibility-and-anti-corruption/.

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Annex B

Information to be included in a referral of suspicions of possible bribery or corruption

Set out below is a summary of the types of information that should be included in a referral to the appropriate law enforcement authority or public prosecutor of a tax examiner's or auditor's suspicions of possible bribery or corruption. To facilitate the referring of suspicions, a country may wish to develop a standard form including space for this and other relevant information.

- Contact details of the tax official filing the referral.
- Name, address, tax identification number and other identifying information of the party to suspected bribery or other corrupt activity.
- Industry sector.
- Countries involved.
- Period in which the suspicious activity took place.
- Brief summary of the suspicious activity.
- Outline of factors which indicate possible bribery or corruption.
- Value of any possible bribes or other suspicious payments.
- Method of payment.
- Outline of work performed and enquiries undertaken, including requests for information from tax authorities in other countries.
- Attach detailed case notes containing full details of suspicions and relevant information.

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Annex C

Indicators of possible bribery or corruption

There are no absolute rules on what events or characteristics of a taxpayer or transaction should lead a tax examiner or auditor to suspect possible bribery or corruption. Every case must depend on its individual facts and circumstances, and be assessed in light of the tax examiner or auditor's experience. This annex contains a compilation of the indicators of possible bribery or corruption that are listed elsewhere in this Handbook. In some cases, a single indicator may be sufficient for a tax examiner or auditor to feel able to refer their suspicions to the appropriate law enforcement authority or public prosecutor. However, in most cases, the presence of a single indicator should encourage the tax examiner or auditor to also consider other indicators that may be present, to build a more complete picture, before deciding that a referral should be made.

INDICATORS CONCERNING THE TAXPAYER'S EXTERNAL OR INTERNAL RISK ENVIRONMENT

Indicators concerning the taxpayer's external risk environment

- Operates in, or is related to companies operating in, a high risk country.[1]
- Operates in a high risk industry,[2] such as:
  - public works and construction
  - utilities
  - real estate, property, legal and business services
  - oil and gas
  - mining
  - power generation and transmission
  - pharmaceutical and healthcare
- Operates in a highly regulated sector, or one which requires government authorisations and licenses.

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Indicators concerning the taxpayer's internal risk environment

Indicators concerning the taxpayer's legal structure and connections

- Complex or international legal structure with no apparent commercial, legal or tax benefits.
- Owns or controls a legal entity with little or no commercial purpose, particularly one located offshore.
- Employs, or has business connections with, close relatives of the owner or senior management.
- Employs, or has business connections with, Politically Exposed Persons (PEPs) or relatives of PEPs.

Indicators concerning the taxpayer's internal controls

- Management has a lax or non-existent anti-corruption philosophy and regime.
- Few or no internal controls in place, such as an independent internal audit function, to detect and deter corruption.
- Weak controls over the hiring and use of consultants.

Indicators concerning the taxpayer's background and history

- Previously faced suspicions or litigation concerning any kind of financial crime.

Indicators concerning attempts to impact the tax examination or audit

- Attempts to influence the tax examiner or auditor, including by offering a bribe.
- Attempts to hinder the tax examination or audit, for example by refusing to answer questions or withholding financial information or correspondence.

INDICATORS CONCERNING THE TAXPAYER'S TRANSACTIONS

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.

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- 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.

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INDICATORS CONCERNING PAYMENTS AND MONEY FLOWS

Indicators concerning where payments are being made to or received from

- Payments to or from persons in high risk countries, who cannot be identified, or are companies whose beneficial owners cannot be identified.
- Payments made or received through intermediaries in third countries.
- High payments for handling services in high risk countries.
- Payments to foreign accounts of individuals or companies with which there is no business relationship.
- Payments made for travel and lodging of PEPs.
- Commission payments split into parts, paid into different offshore bank accounts.
- Payments made to countries with bank secrecy rules, which do not exchange bank information.
- Payments to bank accounts in countries other than those where the recipient is located.
- Payments to personal bank accounts rather than to business accounts.
- Payments to entities that did not take part in projects or transactions.

Indicators concerning the terms of payments

- Large or frequent, rounded payments or receipts.
- Deviation from normal procedures in approving payments.
- Payments made or received where no written contract exists, or where written contracts are unclear or unavailable.
- Invoices paid which are not required under contracts.
- Payments made under invoices that do not fit the taxpayer's usual profile (for example, in terms of amount, timing, location of recipient etc.).
- Payments made under self-prepared vouchers rather than third party invoices.
- High commission payments made around certain dates (for example, when contracts are concluded).
- Payments made immediately upon (or before) receipt of an invoice or signing a contract.
- Third party makes payments directly to creditors on behalf of the taxpayer, or to entities controlled by the taxpayer.
- Favourable treatment shown to certain creditors (e.g. paying one supplier faster than others for no clear reason).
- Amounts received appear excessive for the goods or services provided.
- Amounts paid to intermediaries or consultants appear excessive.

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Other indicators concerning payments and money flows

- Significant, unexplained cash withdrawals.
- Notary's or lawyer's third party account used where there is no apparent need.
- Origin of funds for a transaction is not clear.
- History of frequently opening and closing bank accounts.
- Significant unexplained payments into and out of the taxpayer's bank accounts.
- Evidence of payments that are not recorded in financial records.
- Certain payments cannot be satisfactorily explained.

INDICATORS CONCERNING THE OUTCOMES OF THE TAXPAYER'S TRANSACTIONS

Indicators concerning outcomes that impact the taxpayer's business

- Benefits from favourable treatment by government agencies, suppliers or customers.
- Unusually successful at obtaining and retaining contracts.
- Contracts or licences are granted by PEPs or their relatives.
- Contracts are granted without the need for public tender, negotiations, or documents which would normally be expected.
- Goods or services acquired under contracts were never in fact received.
- Company has recently fired senior staff members with no clear justification.
- Records include incriminating correspondence that suggests possible bribery or other corruption.

Indicators concerning outcomes that impact the taxpayer's financial records

- Key financial ratios are out of line with similar businesses.
- Unusual or unexplained losses or profits on contracts.
- Records show no taxable gain when one would be expected.
- Records include expenses which are not linked to sales or profits.
- Balance sheet contains assets or rights acquired at higher or lower than market value, which have no real value, or may not even exist.
- Balance sheet assets or rights disposed of at a price higher or lower than their market value.
- Balance sheet contains an unexplained loan with an unrelated entity.
- Unexplained waiver of a loan with an unrelated entity.

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- Balance sheet contains liabilities associated with assets which are unidentified, or where the value of the liability appears excessive.
- Business has seen a substantial and unexplained increase in capital.

Indicators concerning outcomes that impact the taxpayer's personal assets (or those of senior management)

- Company owns luxury assets unrelated to its business (private aircraft, yachts, expensive residential property etc.).
- The taxpayer, an employee or family member has a lifestyle or pattern of spending unsupported by their income.

INDICATORS SPECIFICALLY CONCERNING THE RECIPIENT OF POSSIBLE PROCEEDS OF BRIBERY AND CORRUPTION

- Works for government agency in high risk country.
- Responsible for granting authorisations, licences or contracts to businesses.
- Ownership or control of entities not connected with the recipient's main job.
- Receives commissions for consultancy work, but lacks relevant skills and experience.
- Receives additional employment or consultancy income when already fully employed.
- Sudden or unusual support given to particular companies or industries.
- Referred to in a Suspicious Transaction Report (STR) received by the FIU.
- Unexplained growth in net worth (including that of family members).
- Unexplained donations to political campaigns or parties.
- Unusual and unexplained spending, particularly in cash (including by family members).

Notes

1. High risk countries include those which do not engage in effective exchange of information, have a low score on the Transparency International Corruption Perceptions Index or Bribe Payers Index, or have a high score on the Tax Justice Network Financial Secrecy Index.

2. High risk industries include those with a low score on the Transparency International Bribe Payers Index. The list of industries included above achieved low scores in the 2011 index.

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Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors

The purpose of this Handbook is to raise the awareness of tax examiners and auditors of issues concerning bribery and other forms of corruption. It provides guidance on how to recognise indicators of possible bribery or corruption in the course of regular tax examinations and audits.

Contents

What are bribery and corruption?

The role of the tax administration in combating bribery and corruption

The role of tax examiners and tax auditors

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Indicators concerning the taxpayer's external and internal risk environment

Indicators concerning the taxpayer's transactions

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