Good practices

Customer tax integrity risk management

DeNederlandscheBank

EUROSYSTEEM

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1 Introduction

1.1 Rationale behind this guidance document

The Panama Papers, Paradise Papers and other data leaks have exposed in a very public manner that all over the world individuals and companies use financial constructions to conceal their visibility from state bodies, such as the Tax Department. Financial institutions want to avoid becoming involved in tax evasion through the provision of their services. This means that they have to actively assess whether this risk might occur with their customers and that they must take adequate measures where needed. Moreover, tax avoidance is raising more and more questions these days. Social tolerance for tax avoidance is decreasing and international developments have led to the introduction of stricter regulations to curb such practices. Governments, companies and supervisory authorities are called upon to implement these regulations as efficiently as possible.
As gatekeepers of the Dutch financial system, financial institutions, including banks, take up an important role in combating tax evasion[1] and tax avoidance[2]. Banks have a statutory obligation to take measures to ensure controlled and sound business operations and to prevent involvement in financial and economic crime, including money laundering related to tax evasion. Ensuing from this obligation, the bank will have to investigate the various tax-driven and other motives of their customers with respect to the banking services they wish to use in order to ascertain whether the bank faces potential tax-evasion-related risks. If a bank fails to assess these factors sufficiently, it may unwittingly facilitate tax evasion and consequently also money laundering.
Financial institutions seek to uphold their reputation and confidence in the Dutch financial sector in providing services to their customers. As a result of this, banks also seek to gain insight into potential risks of tax avoidance among their customers. While tax avoidance is not illegal, its harmful effects could certainly damage a bank's reputation as well as the confidence in the Dutch financial sector.
In the context of risks of tax avoidance, it is also important for banks to determine an individual risk appetite that corresponds to the interests of all of their stakeholders. Banks also have an interest in ascertaining whether their customers may be engaging in tax avoidance or tax evasion. For this reason, too, banks should be alert to the risk of tax avoidance.

De Nederlandsche Bank (DNB) has prepared this guidance document to provide you with practical tools for implementing risk management as it relates to tax avoidance and tax evasion in order to safeguard controlled and sound business operations. Tax avoidance and tax evasion are hereinafter jointly referred to as tax integrity risks.
This guidance document provides good practices that will show you how you as a bank can structure your internal processes and measures, including the

1 Section 3:10(1), under b, of the Financial Supervision Act
2 Section 3:10(1), under c, of the Financial Supervision Act

Systematic Integrity Risk Analysis (SIRA), in such a manner as to enable you to identify and manage customer-related tax integrity risks. The focus areas and examples in this document are supplemental to the legislation and regulations in force and to previously published guidelines on this subject, such as:

- DNB's Guidelines on the Anti-Money Laundering and Anti-Terrorist Financing Act (*Wet ter voorkoming van witwassen en financieren van terrorisme - Wwft*) and Sanctions Act (*Sanctiewet 1977 - Sw*), version 3.0; April 2015[3]
- Post-event transaction monitoring process for banks[4]
- Integrity risk analysis – More where necessary, less where possible[5]
- Q&A Assessment of Ongoing Due Diligence Process (*Wwft* and *Sw*) of December 2013[6], and
- Good Practice, Integrity Risk Appetite[7]

These good practices are specifically aimed at tax integrity risks with banking customers. Possible tax integrity risks vis-à-vis the bank's own operations fall outside the scope of these good practices. Anti-money laundering legislation has been in force for more than a decade.
Investigations into risks of tax evasion among customers as a manifestation of money laundering is therefore not a new or additional legislative obligation. The obligation to assess the risk of tax evasion is principle-based, as is supervision of compliance with this obligation. This means that the practical implementation has not been prescribed in detail by the supervisory authority or in legislation and regulations. As a bank, you have the freedom to choose how you implement this obligation.
The supervisory authority assesses the outcome.

1.2 Reader's guide

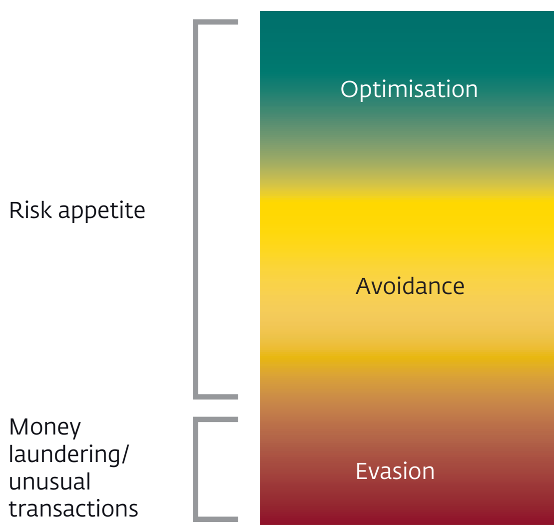
In preparing this guidance document, DNB has utilised the main findings of the thematic examination into "Aggressive tax planning and customer anonymity", conducted in 2017. The good practices describe how problems can be handled in actual practice, potential solutions that can be devised and how working methods can be improved even further. The good practices thus provide examples of how you can identify tax integrity risks in your customer portfolio and how this is related to your integrity risk appetite. The good practices also show the consequences of these results for assessments of individual customers with an increased risk profile and their transactions.

3 www.toezicht.dnb.nl/en/binaries/51-212353.pdf
4 www.toezicht.dnb.nl/en/binaries/51-236846.pdf
5 https://www.toezicht.dnb.nl/en/binaries/51-234068.pdf
6 www.toezicht.dnb.nl/en/3/51-229616.jsp
7 https://www.toezicht.dnb.nl/en/binaries/51-236451.pdf

2 Legal context and scope

2.1 Scope of tax integrity risks

Figure 1 Diagram of tax-driven motives and the associated integrity risks



The diagram above shows that customers can have various tax-driven motives with various potential associated tax integrity risks. A bank will have to assess a customer's tax-driven motives first of all to avoid the bank's involvement in tax evasion. The bank will also have to assess whether or not customer's tax integrity risks are acceptable if motives of tax avoidance are indeed present. If the bank has ascertained that no tax evasion or tax avoidance has taken place, but the assessment has revealed a tax optimisation strategy, the risks will generally be limited. Such an assessment of tax-driven and other motives does not necessarily mean that the bank has to fully understand every tax aspect of each and every customer's financial dealings. It suffices for the bank to make sure that the customer's tax integrity risks, and the associated transactions, are clear and acceptable.

2.2 How do these good practices fit within international legislation and regulations?

Tax integrity risks specifically occur in cross-border transactions and among customers with a complex international company structure. This is why international organisations such as the G20, OECD and FATF have established that fighting tax evasion and tax avoidance effectively requires international measures and principles, with the aim of then also incorporating these measures and principles into national legislation and regulations. This has led to the development of the OECD's Common Reporting Standard (CRS) and the Base Erosion and Profit Shifting (BEPS)[8] action points, as well as the FATF's recommendations on tax integrity risks.[9] The EU has also converted these international regulations into relevant European legislation and regulations in this area.

8 http://www.oecd.org/tax/beps/
9 http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/

The European legislation and regulations are first and foremost relevant to banks, as they explicitly refer to tax integrity risks as a form of money laundering. The Fourth Anti-Money Laundering Directive states among other things: "It is important expressly to highlight that 'tax crimes' relating to direct and indirect taxes are included in the broad definition of 'criminal activity' in this Directive, in line with the revised FATF Recommendations."[10] The FATF Recommendations 2012 have defined that tax evasion is a basic offence for money-laundering.[11]

The European legislation and regulations pertaining to combating tax avoidance are also relevant to banks if their customers use such structures. Based on the revised EU Directive on Administration Cooperation[12] (DAC 6), which was definitively adopted in 2018 and will enter into force as of 2020, banks in their role as intermediaries are expected to report cross-border tax structures of customers that meet the essential features established in the Directive to the relevant tax authorities.[13 14]

2.3 Dutch legal framework

Banks have a statutory obligation to take measures to ensure ethical operational management and to prevent involvement in money laundering. These measures should also be geared towards addressing tax integrity risks. The statutory obligations are enshrined in the Financial Supervision Act (*Wet op het financieel toezicht - Wft*), the Decree on Prudential Rules for Financial Undertakings (*Besluit prudentiële regels Wft – Bpr*) and the Anti-Money Laundering and Anti-Terrorist Financing Act (*Wet ter voorkoming van witwassen en financieren van terrorisme - Wwft*).

Section 3:10 of the *Wft* states with regard to ethical operational management that:

b) it prevents a financial institution or its employees from committing criminal offences or other violations of the law which may damage confidence in the financial institution or the financial markets;
c) it prevents confidence in the financial institution or the financial markets from being damaged on account of the activities of its customers;
d) it prevents other activities by the financial institution or its employees that conflict with the

10 Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32015L0849&from=EN

11 FATF Recommendations 2012, p.114: http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf

12 https://ec.europa.eu/taxation customs/business/tax-cooperation-control/administrative-cooperation/enhanced-administrative-cooperation-field-direct-taxation_en

13, 14 Directive (EU) 2011/16 on administrative cooperation in the field of taxation: http://eur-lex.europa.eu/ legal-content/EN/TXT/HTML/?uri=CELEX:32011L0016&from=en

generally accepted precepts of unwritten law to such an extent that confidence in the financial institution or financial markets can be seriously damaged.

Considering the fact that the *Wft* and *Bpr* (ethical operational management) and the *Wwft* have a similar objective, the measures taken by a bank under the *Wft* and *Wwft* can to a large degree be integrated and your bank can implement the requirements of the *Wft* and *Wwft* in the same manner. In this regard, DNB refers to its Guidelines on the *Wwft* and *Sw*.[15] It is important that a bank knows who it is doing business with and the purpose of the business relationship. In case of insufficient transparency as regards structures, financial flows and/or tax-driven motives of a prospective customer, a bank is not allowed to accept the customer.[16] This would entail an unacceptable risk that the bank could become involved in facilitating tax evasion by the customer. In order to gain an adequate insight into the type of integrity risks that may occur with banking customers, as a bank you first of all have carry out a SIRA under Section 10 of the Bpr and Section 2(b) of the *Wwft*.[17] Integrity risks are defined in that context as "the danger of harming the reputation of a financial institution, or an existing or future threat to the assets or result of a financial institution as a result of insufficient compliance with that which is prescribed under or pursuant to any legal provision." This also includes tax integrity risks. If a bank identifies tax integrity risks upon conducting the analysis, it must formulate policy, establish procedures and take adequate measures. Based on the statutory requirements regarding safeguarding ethical and sound operational management, banks are also expected to state, on the basis of their SIRA, whether or not they deem certain structures as acceptable or will continue to deem them as acceptable. The bank checks the outcome of the SIRA against its own integrity risk appetite.[18] Specifically regarding the risks of involvement in money laundering, the *Wwft* requires that a bank takes measures to establish and assess its risks of money laundering and the financing of terrorism, with the measures being proportional to the nature and size of the institution.[19] The *Wwft* also determines that, upon acceptance, a bank must assess its customers and afterwards conduct regular checks of its customers and their transactions. Customer due diligence assessments enable the bank to gain insight into the tax-driven motives of its customers, thus exposing potential tax integrity risks. The bank must also identify the purpose and intended nature of the business relationship, take adequate measures to gain insight into the customer's ownership and control structure, and

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15 DNB's Guidelines on the Anti-Money Laundering and Anti-Terrorist Financing Act and Sanctions Act, version 3.0, April 2015: www.toezicht.dnb.nl/en/binaries/51-212353.pdf

16 Section 5(1) of the *Wwft*

17 www.toezicht.dnb.nl/en/binaries/51-234068.pdf

18 www.toezicht.dnb.nl/en/binaries/51-236706.pdf

19 Section 2b(1) and (2) of the *Wwft*

furthermore must also conduct regular checks.[20] This allows banks to ensure that the customer's transactions correspond with the knowledge the bank has on the tax structure of the customer as well as his risk profile and, if needed, conduct an assessment into the source of the means used in the business relationship or the transaction. Banks are also expected to conduct adequate assessments when customers amend their tax or other structure due to newly introduced legislation and regulations.

The *Wft* and *WWft* prescribe a risk-based approach. In this context, a risk-based approach means that a bank intensifies its assessments as the risks identified increase. A bank must also be able to substantiate this at any time based on the SIRA. A bank is expected to receive sufficient transparency from its customer as regards their structure, financial flows and tax-driven motives. Any tax integrity risks identified by the bank are to be investigated further, whereby the bank is to determine whether they fit within its risk appetite.

We are aware that due to the huge number of relationships in certain customer segments, such as banking services to private individuals or SMEs, assessments of tax-driven motives are bound to vary in scale, scope and intensity.

In order to carry out customer due diligence in a practical and risk-based manner, a bank may categorise its business relationships based on tax-risk profile. This involves defining its own indicators based on several customer features which may indicate increased tax integrity risks, for instance the complexity of the structure, the customer's activities, the countries involved, type of transactions, et cetera.
A bank can carry out a screening of its customer portfolio on the basis of these indicators.
In order to safeguard its procedures and measures, the bank must ensure that its employees, in so far as relevant to the performance of their duties, are sufficiently able to identity tax integrity risks, determine what this means for customer due diligence and receive regular training.
This should enable them to conduct a proper and full customer due diligence assessment, identify tax integrity risks in the course of such an assessment and pinpoint and report any related unusual transactions.

2.4 Scope of the guidance document

This guidance document pertains to:
- Banks established in the Netherlands, as defined in Section 1(1) of the *Wwft*
- Branch offices of foreign banks established in the Netherlands, as defined in Section 1(1) of the *Wwft*
- Internationally operating banks, within the meaning of Section 2(1) of the *Wwft*. This means that if banks do not have branch offices or subsidiaries in a non-EU/EEA member state, the branch office or subsidiary concerned must set

20 Section 3(2), under b, c and d, of the *Wwft*

up its customer due diligence in such a way as to ensure *Wwft* compliance.

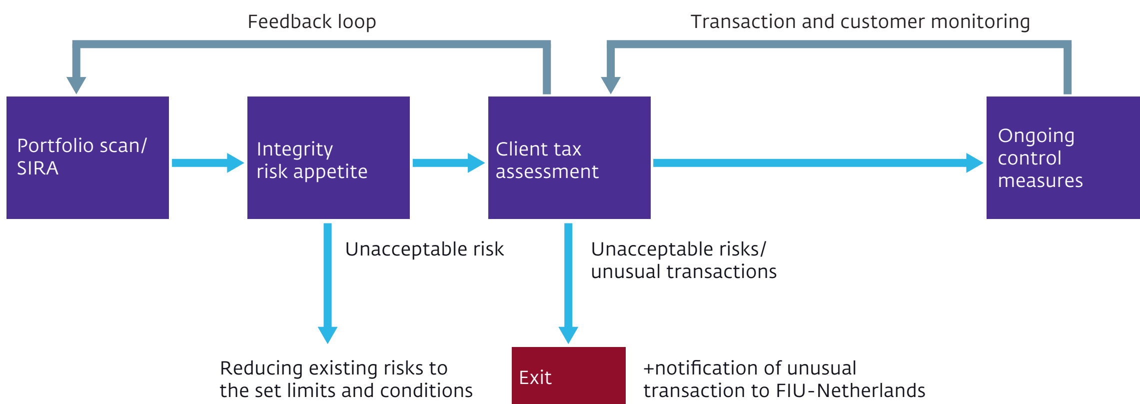
- Internationally operating banks, within the meaning of Section 2(1) of the *Wwft*. In other words, these banks apply codes of conduct and procedures at the group level, which are then effectively implemented by branch offices or subsidiaries in a Member State.[21]

2.5 Process of investigating tax integrity risks

Below, we present a flowchart of the process banks follow in the continuous assessment of tax integrity risks of their customers.

In the following chapters we describe several good practices on how banks could incorporate these process steps in their operational management. For each example, we provide a short explanation of why DNB finds the example a good practice.

Figure 2 Process of assessing tax integrity risks



21 Also see Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012

3 Customer portfolio scan

3.1 Risk-based approach to existing customer portfolio

In this chapter, we present good practices of banks which, as part of their SIRA process, have conducted a scan of the inherent tax integrity risks in their customer portfolio.

The banks have used the outcome of these scans to conduct impact analyses of the tax integrity risks in the various components of their customer portfolio. This impact analysis makes it clear to the banks which customers and transactions need further assessment, and which do not.

Good practice: Scan the customer portfolio for tax integrity risks

A bank conducts a regular scan of its entire customer portfolio to assess the customer groups who present inherent increased tax integrity risks. For this scan, the bank has defined a series of tax risk indicators based on customer characteristics, such as the complexity of the structure, the customer's activities, the countries involved, the banks involved, the supply channels and the transactions.

- Complexity of the structure

The bank has defined the following risk indicators for the structure of the customer:

- multiple layers in the customer's ownership structure
- ownership structure contains entities in offshore jurisdictions
- presence of an object company
- presence of special purpose vehicles (SPVs)
- presence of a trust
- foreign legal entities, including foundations, trusts, LLPs
- presence of a trust office foundation
- presence of a limited partnership
- presence of investment and fund structures
- amendments to the customer's ownership structure, recent or otherwise

The bank has also defined indicators which point to unacceptable risks for a customer or group of customers. With regard to the structure indicators, these are:

- the presence of nominee shareholders in the structure
- the presence of bearer shares in the structure

The bank has developed similar risk indicators for customer activities, the countries involved, supply channels, banks involved and customers' transactions. The bank applies the principle that when a combination of risk indicators applies to a customer or group of customers, a higher risk assessment generally results.

- Type of activities of the customer and group

The bank has also developed risk indicators based on certain sectors which possibly come with increased tax and other integrity risks, such as trade, commodities, oil and gas, transport, pharmaceuticals, sports, real estate, intellectual property and consultancy services. These risk indicators apply to the customer's activities and to the group to which the customer belongs.

- Countries involved

The bank has defined risk indicators based on the countries and jurisdictions involved. These are the jurisdictions where the customer is established, the customer's place of business for tax purposes, the countries where the group is operational and the jurisdictions where the companies or holding companies are established. This also includes the countries where the ultimate beneficial owners (UBOs) are established.
The bank also makes a selection based on the countries where the companies are established with which a customer conducts transactions on a regular basis. An important element is the principle that financial transactions with low tax and/or low transparency countries can be tax-driven, such as is often the case with offshore jurisdictions. Activities in offshore jurisdictions and/or in combination with UBOs from high-risk countries generally point to increased tax integrity risks.

- Supply channels

The bank determines risk indicators based on customers' supply channels. The bank has drawn up a list of trust offices and certain tax consultants who have introduced customers to the bank or who have represented them as a service provider or feeder and who pose an increased risk. International publications on money laundering show that unethical consultants often set up a similar structure and/or transaction for different customers. By screening the entire customer portfolio for involvement of these consultants, the bank will gain insight into the tax integrity risks that might be more widespread in the customer portfolio.

- Banks involved

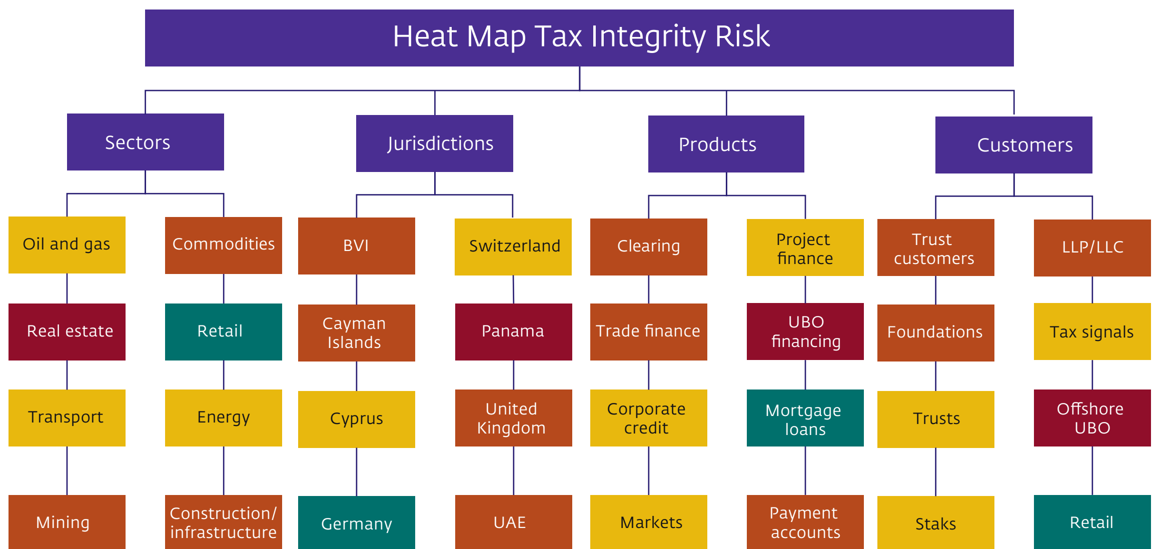
The bank also establishes risk indicators, which are based on the banks involved. The banks involved have been selected on the basis of the customer's foreign or domestic bank accounts or the bank accounts of the key counterparties to the transactions. The banks involved that are established in countries that currently have or used to have banking secrecy, such as Monaco, Liechtenstein and Switzerland, are an indicator of increased risks. The bank has also identified foreign branch offices of banks in countries with increased AML risks, including countries in the Middle East or the former Soviet Union, as risk indicators.

- Consulting public sources and internal signs

The bank furthermore makes use of the information available in the customer file, which includes an open source intelligence investigation. Thanks to the automated process, the bank can verify whether or not a customer has been linked to tax avoidance and/or tax evasion practices. This also involves the screening results of other customer data, such as the name of the company, business address, UBOs, representatives, etc. in public databases, such as the Panama Papers and the Paradise Papers databases. Additional indicators which the bank may also include internally available, relevant information on the customer in the form of signals received, incidents, questions from other banks and questions from the Tax Department or investigative authorities.

This is a good practice in the eyes of DNB, as the scan is based on knowledge of the sectors, customer characteristics and the presence of tax risk indicators. As a result, the bank gains a substantiated risk assessment of the tax integrity risks in its customer portfolio.

Figure 3 Heat map



(The values presented in this example are fictitious, only serving to provide structure to the heat map)

Good practice: Impact analysis

A bank has transformed the results of the scan into an impact analysis, which indicates in which sectors, products and customer groups the tax integrity risks are highest for the bank. The bank has verified the results of the scan on the basis of the knowledge that account managers and the compliance department have about a certain sector. In order to make the impact analysis accessible and comprehensible, the bank has created a heat map of its various business lines and the sectors in which it operates. This heat map gives the bank an insight into the likelihood of tax integrity risks arising in a sector or customer group and to how many customers this risk applies.

The bank has identified its most relevant risk areas on the basis of its risk indicators and the outcome of the impact analysis. The gross risk assessment per sector, jurisdiction, product, etc. likely differs per bank, depending on the customer population in a particular segment or sector. For example: A bank with a real estate portfolio which predominantly consists of customers involved in real estate development with complex offshore financing constructions will generally yield a higher gross risk. However, a bank with primarily customers involved in leasing existing or future Dutch real estate, which may or may not involve financing exclusively by a Dutch private limited company, will present a relatively lower tax risk assessment.

We view this as a good practice, as in addition to gathering and analysing the relevant data, the bank has visualised the outcome of the impact analysis in the form of a heat map. The heat map provides insight into the customer groups where there is a concentration of increased tax integrity risks to the bank. It is up to the management board to determine whether or not these risks are in line with the established integrity risk appetite. The board can then provide guidance in ascertaining for which sectors and customers further risk-mitigating measures are required.

4 Integrity risk appetite

In this chapter, we present good practices on how banks establish an integrity risk appetite aimed at tax integrity risks. These good practices are in line with the Good Practice, Integrity Risk Appetite document we published in 2017. This document contains a methodology and general principles you can use to implement an integrity risk appetite. While the scan and impact analysis provide insight into the tax integrity risks in your customer portfolio, the integrity risk appetite indicates the limits to the risks you as a bank are willing to accept.

Good practice: Tax integrity risk appetite: Responsibility of the management board

In a bank, the management board holds final responsibility for the bank's risk profile and therefore also for the banks integrity risk appetite. It is the management board that makes a balanced choice to accept, reject, avoid or manage certain risks. In actual practice, the management board has the following responsibilities[22]:

- Ensuring congruence between the integrity risk appetite and the bank's strategic goals in the short term, mid-term and long term.
- Ensuring a sound implementation of the integrity risk appetite within the entire organisation and clear internal and external communication on the integrity risk appetite.
- The management board reports on the effectiveness of the integrity risk appetite to the supervisory board and stakeholders. This provides insight into how the identified risks relate to the risk limits, in how many cases within a predefined period actions fell outside the risk appetite and how the situations falling outside the risk appetite were handled.

The bank may choose to publish (on its website for instance) the tax integrity risk appetite to inform all relevant stakeholders. This is how the management board provides transparency on its strategy and risk appetite.

This is a good practice in the eyes of DNB, as the bank's management board considers the integrity risk appetite as its responsibility. By doing this, the management board ensures that the integrity aspects are embedded in the formulation of the bank's vision and strategy.

Good practice: Tax integrity risk appetite methodology

A bank has established a tax integrity risk appetite according to the methodology it also uses for credit risk, for instance:

- The bank has a policy and procedures in place for drawing up and recording the tax integrity risk appetite.

22 See also Financial Stability Board - Thematic Review on Corporate Governance, 28 April 2017, p. 26.

- The bank conducts a regular review on the integrity risk appetite as regards the bank's actual risk profile, including independent verification.
- The bank ensures that it tests and monitors the effectiveness of control measures and effectuates any measures when operating outside the integrity risk appetite.
- The bank makes a proper distinction between different risk appetite levels, for instance bank-wide, per business line, per sector and per country.
- The bank sets objective limits per subsector or per country where the bank operates.
- The bank makes a distinction between limits that apply during regular times and in times of stress. The bank temporarily tightens limits in times of certain major incidents, such as the Panama Papers.
- The bank monitors the risk limits and the application of the conditions at the various sublevels.

This is a good practice in the eyes of DNB, as the bank has stipulated in the integrity risk appetite which risks are relevant and what the appropriate risk appetite is per activity, business unit and product. The bank has used its SIRA to identify different scenarios of structures per customer group that indicate increased tax integrity risks. With the integrity risk appetite as an assessment framework and based on defined key risk indicators (KRIs) and risk limits, the bank determines to what extent the identified tax integrity risks are acceptable and under which conditions. A good practice of a bank that has elaborated these key risk indicators and risk limits is given below.

Good practice: Key risk indicators and risk limits

A bank has made the integrity risk appetite practicable by translating the established risk appetite regarding customers' tax integrity risks into key risk indicators (KRIs) and risk limits. The KRIs and risk limits are a combination of quantitative and qualitative elements, with which the bank can continuously check whether operational management is still operating within the confines of the integrity risk appetite. If this is not the case, the outcome also enables the management board to take targeted and effective measures to reduce the risks.
It does so by applying the following quantitative risk limit: the bank has set a maximum percentage per sector of the number of customers with increased tax integrity risks (i.e. one or more risk indicators are present) that the bank wishes to have in its customer portfolio.
The bank has also formulated several qualitative KRIs, including identifying KRIs of customers who are not acceptable to the bank in accordance with its risk appetite: for instance, offshore customers in high-risk sectors or structures with bearer shares, or nominee shareholders or back-to-back loans.

This is a good practice in the eyes of DNB, as the bank has made its integrity risk appetite measurable and practicable. The management board is able to clarify which risks it is willing to accept and mitigate the risks, if and when necessary. The bank and its management board can give their employees clarity regarding the acceptable range of risk.

The table below shows how a bank may structure its integrity risk appetite by applying KRIs and tailor-made conditions per customer group.[23]

4.1 The need for an integrity risk appetite

A key element of your risk management is that you continuously make well-considered choices on tax and other integrity risks: which risks are you as a bank willing to accept and which risks should be avoided or reduced by taking control measures? These choices are

Figure 4 Example of tax integrity risk appetite

Customer group/sector	Risk appetite	Risk limits and conditions	KRIs unacceptable risk
Real estate	Medium	Max. X% of customers with increased tax integrity risks and only acceptable if: no offshore companies are involved and an external tax opinion is present.	Offshore customers, bearer shares or nominee shareholders or back-to-back loans.
Transport	Low	Max. X% of customers with increased tax integrity risks and only acceptable if: no offshore companies are involved and an external tax opinion is present.	ditto
Oil and gas	Low	Max. X% of customers with increased tax integrity risks and only acceptable if: there is an external tax opinion present and the financial flows run via countries where the company actually carries out operational activities.	ditto
Commodities	Medium	Max. X% customers with increased tax integrity risks and only acceptable if the bank also provides trade finance transactions and documentation, and if there is insight into the company's main financial flows.	ditto

23 The values and conditions presented in this model/example are fictitious and in support of the integrity risk appetite's structure.

best taken after you have formulated a suitable integrity risk appetite.

By checking the outcome of the SIRA against your integrity risk appetite, you can determine on a rolling basis whether or not you are willing to accept, limit or avoid the risks you have identified, in compliance with legal obligations as the minimum requirements.

DNB is well aware that in actual practice you will encounter various forms of tax integrity risks in your customer portfolio. This may vary from risks of tax avoidance to tax evasion. Depending on the risks, various measures may be necessary.
You can explicitly state in your integrity risk appetite in advance which types of customers and structures are unacceptable to you as a bank. You may do this because you do not want to become involved in the tax integrity risks that are inherently associated with these customers and structures. Another possibility is that you do not have the tax expertise to adequately assess such risks, or you may not be prepared to bear the high costs required for effective risk control. In such cases you can adjust your integrity risk appetite accordingly.

In actual practice, there will be an evolvingprocess: for example, due to developments in relationships with customers, amendments to tax law or expectations of external stakeholders and/or society. Based on this, you can regularly update the integrity risk appetite, and the SIRA if applicable. The assessment of tax integrity risks of customers and their transactions also gives your bank improved insight into which structures are vulnerable to abuse. You may use this knowledge to tighten the risk appetite and update it where needed (feedback loop).

Your integrity risk appetite also applies to identified risks, which may not necessarily indicate tax evasion but rather tax avoidance. You can lay down in your risk appetite under which conditions and within which limits your bank is willing to accept these risks. The basic premise here is that a high risk appetite will require a high level of control and acceptance of the associated costs by your bank. Your integrity risk appetite for tax integrity risks can also be included in the Supervisory Review and Evaluation Process (SREP). DNB maps out all risks, including the reputation risk[24] of a bank in the SREP. This is used as the basis for setting a bank's capital and liquidity requirements.

A high risk appetite for tax integrity risks may therefore also lead to additional prudential requirements for your bank, such as extra capital buffers.

24 See also Section 6.4.3. of the EBA Guidelines on common procedures and methodologies for the Supervisory Review and Evaluation Process (SREP)

5 Assessment of individual customers

Based on the scan of the portfolio and the impact analysis, the bank has determined which customer groups present increased risks. The integrity risk appetite then indicates whether or not the extent of the risk is acceptable or if measures should be taken to reduce the risks. Individual customers with increased risks require further assessment to determine whether or not the estimated risks will actually materialise. This also gives the bank direct feedback on whether its risk indicators are performing properly or if they need to be recalibrated.

This section presents good practices for an assessment of tax integrity risks in individual customers. Such an assessment may be conducted as part of the customer acceptance or review process, or specifically in response to the SIRA outcome.

Good practice: Tax risk profile

When assessing an existing or a new client, the default procedure of a bank is to establish a tax risk profile or adjust the existing profile. Part of the procedure is for the bank to add various customer details taken from computer systems to this tax risk profile.

The account manager fills in the rest of the form with information from the customer file and knowledge of the customer. No fields on the form may be left empty. The risk profile focuses on a set of relevant tax risk indicators: customer activities, structure, transactions, countries involved, banks involved, supply channels and the tax opinion.

If the risk profile shows the bank that there are one or more tax risk indicators, the customer is automatically escalated to Compliance and the tax experts for a more in-depth analysis of the tax integrity risks. Based on the outcome, the bank determines whether the risk is acceptable.

This is a good practice in the eyes of DNB, as this bank has chosen to apply a risk-based approach to control tax integrity risks. This means that the bank takes a structured approach to applying the legally required measures in accordance with the risks of its customers, products and services or countries. The framework of the *Wft* and *Wwft* assumes that institutions divide customers into risk categories according to the nature and extent of the risk. In order to establish a customer's tax risk profile, a bank may make use of a set of relevant tax risk indicators of its own choosing against which it checks the customer. Some components of these tax risk indicators may be equal to the criteria the bank uses when scanning its customer portfolio.

5.1 Further investigation into tax integrity risks

Good practice: Step-by-step plan for assessment of tax integrity risks

A bank has established a simple five-step plan for assessing the tax integrity risks of individual customers.

Step 1: Gain insight into all relevant elements of the structure
The bank expects to receive an updated structure chart of all relevant companies of the customer, including an explanation by the customer regarding the role of these companies. The bank records this information by including the structure chart with the customer's current ownership and control structure in the customer file, including the associated explanation. The bank substantiates this structure chart with a schematic overview of the relevant financial flows between the companies involved, the flow of funds diagram, which is included in the file.

Step 2: Substantiate the structure with a tax opinion
The bank requests an updated tax opinion from the customer to substantiate the entire structure as chosen. In many cases, internationally operating companies have tax advisers who consult with them on their company structure. These customers are then able to submit their adviser's tax opinion to the bank. The bank assesses whether the tax opinion covers the entire structure or that it substantiates only the tax motives for part of the structure and/or financial flows. In the latter case, the bank may request additional opinions from the customer.

Step 3: Check the transactions against the structure
The bank subsequently checks whether the customer's transactions dovetail with the knowledge acquired regarding the structure. The bank makes this assessment based on the structure diagram, the flow of funds diagram, the transaction profile - current or anticipated - and the tax opinion. The bank subsequently includes relevant internal and other documents, according to the nature of the customer's tax integrity risks and the bank's relationship with the customer. Depending on the severity and extent of the risk, the bank assesses the following documentation: credit information, trade financing documentation, annual accounts (audited or not), audit reports, alert files and transaction documents, rulings from tax authorities, CRS/FATCA information, transfer pricing analyses, country-by-country reports, overview of effective tax burden of the group/UBOs.

Step 4: Assessment of open source information
In addition to the information the bank receives from the customer, it also utilises information from open sources. The bank screens UBOs, business relationships, companies and counterparties in public sources to find information on potentially unethical tax-related conduct (open source intelligence). This also concerns the screening results of customer data, such as the name of the company, business address, UBOs, representatives, etc. in public databases, such as the Panama Papers and the Paradise Papers databases. In addition, the bank includes internally available relevant information in its assessment. This includes signals received, incidents, questions from other banks, questions from the Tax Department or investigative authorities. The bank then records how it has weighted this information in its risk assessment.

Step 5: Benchmark: compare to similar cases
When assessing a customer, the bank compares the customer with previous cases similar structures in order to identify risks more swiftly. This benchmark serves as a further substantiation of its analysis and may also provide quicker insight into the relevant risk. If in the course of its assessment the bank has

identified a customer with unacceptable tax integrity risks, then the bank will also apply this knowledge in a reassessment of similar customers in the portfolio.

Finally, the bank may decide that in certain, clearly defined cases it will be necessary to gain more insight into the extent of the actual taxes a customer pays. In those cases, the bank will request the tax return of the individual customer or of the entire group with which the customer is affiliated for further substantiation. The bank's risk analysis is dependent to a great degree on the customer's (or group's) cooperation and transparency.

The bank records the outcome of the five-step process in a fully substantiated customer tax assessment.

This is a good practice in the eyes of DNB, as the bank has detailed the more in-depth assessment of individual customers in a comprehensible step-by-step plan. Depending on the identified risks, the implementation of these various steps might differ per customer, but the bank gives its employees a clear process indicating the actions the bank requires from the employee when conducting an assessment.

Below, we present several good practices of a bank that has identified high-risk factors to be assessed more thoroughly. These high-risk factors concern: a) the structure and the countries involved, b) the operational and other activities of the customer and c) the transactions.

5.1.1 Company structure and countries involved

Good practice: Determine the high-tax risk jurisdictions

To determine the tax integrity risks, a bank has drawn up a risk-based list of countries with jurisdictions with increased tax integrity risks. The bank's basic assumption is that a country with a low tax rate and/or extensive exemptions and/or low transparency or cooperation with international authorities is a high-risk country. The bank has supplemented this with published lists of countries, such as the IMF OFC list[25], the OECD list[26], the EU Black and Grey list of tax havens and the Financial Secrecy Index[27], the Low-taxing states and non-cooperative jurisdictions for tax purposes scheme[28], to assemble its own list of countries. The bank regularly reviews this list of countries. Not only is the bank interested in the country of establishment or tax domicile of the customer, the group and the UBOs, but it also checks countries which are the source or destination of substantial and regular financial flows. Again, transactions from and to countries with a low tax rate and low transparency or cooperation indicate increased risks.

This is a good practice in the eyes of DNB, as the bank also includes the jurisdictions where activities and/or financial flows take place in its assessment besides the legal forms of the structure. However, there is no internationally accepted definition of tax havens or offshore jurisdictions. Moreover, lists of countries published by international organisations change constantly due to various factors, including changing trends in frequently used tax routes and tax legislation. It is a good practice that the bank has drafted a list of countries based on risk and substantiated with international publications.

Good practice: Focus on high-risk structures

When it comes to assessing structures, the bank has identified which company structures are characteristic of increased tax integrity risks. The bank sees shielded properties or split-off or hybrid structures as criteria for raising a customer's tax integrity risk.

Shielding of property
This is the case if one or more of the following indicators is present:

- nominee shareholders are present
- bearer shares are present
- the presence of any other structure that hampers transparency of the ownership and/or actual control structure.

Split-off structures
Splitting off certain business units into separate sister companies may indicate tax risks. In such cases the bank will endeavour to attain transparency on the tax motives and the possible tax integrity risks, especially if such a sister structure contains offshore companies and/or if there is limited insight into and supervision of a customer's financial records. Such controlled

25 Background Paper: Offshore Financial Centers, IMF, (2000)
26 Brief on the State of Play on the international tax transparency standards, OECD, September 2017
27 Financial Secrecy Index, Tax Justice Network (2018)
28 https://zoek.officielebekendmakingen.nl/stcrt-2018-72064.html

foreign company (CFC) structures indicate increased tax integrity risks.

Hybrid structures
The use of hybrid entities or financial or other instruments may also be an indication of tax-driven motives. Structures that have been set up with a view to tax avoidance are referred to as hybrid mismatches. In a hybrid mismatch, the tax qualification differs from an entity or funding in the various countries involved due to differences between national tax laws. This possibly creates a situation of double non-taxation. The bank wishes to know if its customers have such mismatches and how the tax consequences fit in with the bank's risk appetite.

This is a good practice in the eyes of DNB, as the bank has identified characteristic elements in the customer's structure which may indicate increased tax integrity risks. In actual practice, this also means that the bank not only maps out the formal control structure, but also focuses attention on other intra-group or other entities with which the customer conducts transactions and the associated tax integrity risks.

5.1.2 Customer activities

Good practice: focus on customer and group activities

In its risk-based acceptance and review process, a bank has laid down that the activities of current and new customers, and the group to which they belong, must be clearly mapped out. Furthermore, the customer file must clearly indicate the customer's economic position within the group. The bank substantiates this assessment with relevant documents, such as the annual accounts, the profit and loss statement and business reports. The bank substantiates any tax-driven motives underlying the customer's activities. It states not only the group's general operational and other activities, but also indicates for what purpose the customer uses the bank's services.

DNB views this as a good practice, as the bank first gains insight into the customer's activities and the activities of the group to which the customer belongs. A bank can only proceed with assessing the customer's tax and other integrity risks once this aspect has been sufficiently investigated.

Good practice: Example of unacceptable risks involving the customer's operational activities

A bank provides services to a customer, who indicates to be operationally active in a sector with increased tax and other integrity risks, such as commerce, commodities, energy, transport, pharmaceuticals, real estate and consultancy services. The bank has also specified the inherently increased tax risks in these sectors in its SIRA. As a result, the bank investigated whether or not the customer actually carried out the operational activities as stated. Based on the information requested from the customer, it turned out that the customer had provided insufficient substantiation for its operational activities. It appeared that the customer was only used by the group for offshore re-invoicing. The consequence was that the bank was not sufficiently able to assess the tax integrity risks of the customer's transactions.
In the end, the bank terminated its relationship with the customer, as it no longer fit in with its integrity risk appetite. The bank also reported the unusual transactions to FIU-Netherlands, as the bank suspected the customer of tax evasion due to the illegitimate shifting of profits and costs.

This is a good practice in the eyes of DNB, as the bank conducted a more in-depth investigation of the tax integrity risks in a specific group of customers based on the SIRA. On the basis of the outcome of the assessment, the bank was able to substantiate why the risks of tax evasion were unacceptable. With respect to operational companies, the customer's activities are also assessed in conjunction with other risk indicators, for instance if the operational company is also established in an offshore jurisdiction.

5.1.3 Transactions

In addition to insight into the formal ownership structure, it is important that the bank gains transparency into where revenue is generated in the structure, what the role of the customer is or will be in these financial flows and where the profits flow to. The actual ownership structure and flow of funds that are thus uncovered may deviate from the ownership structure, and this may provide insight into the risks of split-off structures, for example.

Good practice: Transaction profile

At the beginning of the customer relationship, the bank draws up a suitable transaction profile for the customer. This transaction profile, in combination with a flow of funds diagram, gives the bank insight into the expected financial flows and the customer's counterparties. The bank also clearly indicates whether the transactions involve third parties or whether they are intra-group transactions. Transactions that deviate from the customer's transaction profile prompt the bank to request further information from the customer about the objective and nature of the transactions.[29]

29 See the guidance on Post-event transaction monitoring process for banks, section 5.1.1 'Risk profile: expected transaction pattern

DNB views this as a good practice, as a transaction profile gives the bank insight into the current and anticipated financial flows of the customer and of the group to which the customer belongs. Deviating transactions are detected and investigated at an earlier stage and result in more effective transaction monitoring by the bank.

Good practice: Insight into relevant financial flows

When assessing a new prospect, a bank discovered that the customer formed part of a group. The customer had its key current accounts with a foreign, non-EEA bank. The group to which the customer belonged also used the services of this foreign bank. This prompted the bank to inform the customer that they could only do business if the bank received more information about the customer's and the group's financial flows.

DNB views this as a good practice, as the bank sets insight into the customer's and group's financial flows as a condition for acceptance as a new customer. For this bank, the limited transparency and/or insight into the group and its financial flows formed a tax risk indicator. As a result, the bank formulated conditions to mitigate this risk.

Good practice: focus on intangible assets transactions

Customers who conduct or receive transactions based on intangible assets pose an elevated risk to the bank. The bank has determined that this concerns property rights, patents and licences, among other things. The associated royalty payments might be tax-driven, and various characteristics could indicate illicit activities. The bank demands insight into the economic rationale behind these transactions and a substantiation that they are in line with market conditions and rates before accepting the customer.

This is a good practice in the eyes of DNB, as the bank has designated transactions involving intangible assets as an inherently increased risk, and because the bank has set clear conditions regarding the desired substantiation and transparency prior to accepting the customer.

Good practice: Intra-group transactions and external financing

Intra-group transactions
A customer states the intention to mainly conduct intra-group transactions, including financing. The bank requests documents from the customer with the aim of answering the following questions:
- how do these transactions fit in the group structure?
- have market rates and conditions been applied?
- are there tax-driven motives?

The regular payments are established in the customer acceptance phase. Thereafter, the bank can use the answers to the questions to identify transactions that deviate from the standard.

Intra-group transactions are usually not isolated transactions, but rather a series of connected transactions. The bank assesses these transactions in coherence, with a focus on significant value jumps in the transfer of shares, option rights or assets, for example.

External financing
A bank focuses closely on the financial flows when a customer receives external financing. As a result, the bank expects the customer to indicate how this external financing fits in the company profile and whether tax-driven motives are involved. This applies to interest relief as regards loan capital. The bank also carries out a more in-depth assessment of back-to-back loans or guarantees issued to the customer by third parties that do not form part of the customer's structure.

DNB views this as a good practice, as the bank sets insight into the customer's and group's financial flows as a condition for acceptance of a new customer.

5.2 Assessment of identified risks

As a result of the bank's more in-depth investigation into individual customers, it can determine whether there are legitimate tax-driven motives or if there are risks of tax evasion and its facilitation.
The investigation also gives the bank insight into structures with possibly legal consequences (tax avoidance) that may yet be undesirable for the bank. The bank can determine whether or not these structures fall within the scope of its risk appetite.

This is a good practice in the eyes of DNB, as the bank uses a clearly defined process to determine which actions are in line with the identified risks. The bank takes customer transparency as a key starting point to arrive at an adequate assessment. The bank maintains an internal list of signals that may point to a lack of transparency, including:

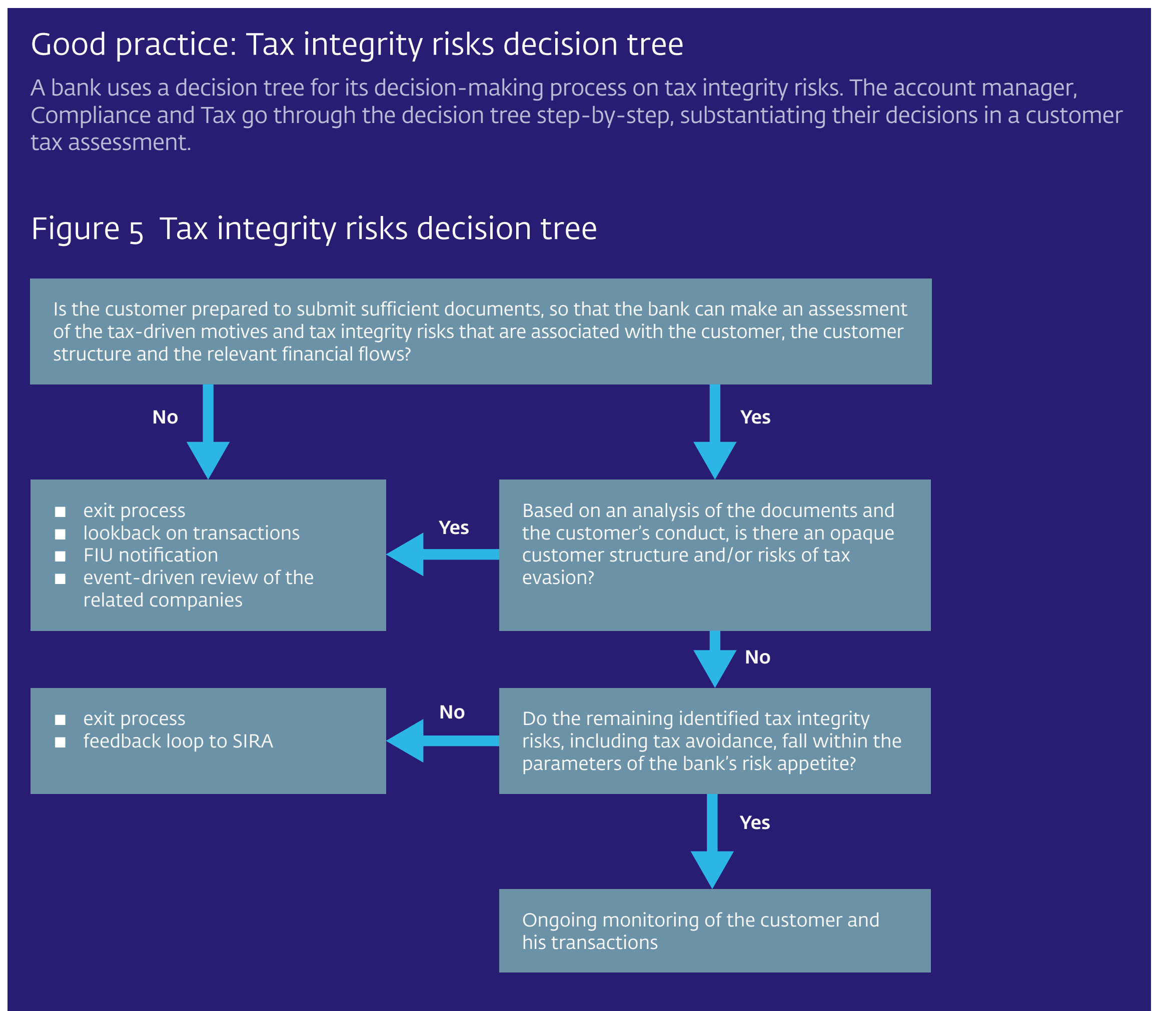
- the customer refuses to give relevant tax and other information to the bank
- the customer provides contradictory statements
- the customer fails to provide sufficient substantiation of its tax-driven motives

The manner in which your bank structures the assessment of the tax integrity risks of an individual customer or customer group depends on the structure of your organisation and the relevant risks of the customers concerned. In certain cases, you may not have the internal tax expertise required to be able to adequately assess the risks. In such cases, you may choose to seek external expertise. Another option may be to no longer do business with this type of customer if your current organisation is unable to sufficiently assess and control the risks.

Good practice: Tax integrity risks decision tree

A bank uses a decision tree for its decision-making process on tax integrity risks. The account manager, Compliance and Tax go through the decision tree step-by-step, substantiating their decisions in a customer tax assessment.

Figure 5 Tax integrity risks decision tree



6 Transaction monitoring and training

The previous chapters describe good practices for the portfolio scan, the integrity risk appetite and customer due diligence assessments. Your bank undoubtedly has specific, related procedures and measures which you would like to use for mitigating tax integrity risks. This could include transaction monitoring, training and awareness among personnel. In this chapter, we give two good practices in the area of transaction monitoring, training and awareness.

Good practice: Transaction monitoring in tax integrity risks

A bank's internal audit department has established that the existing money laundering scenarios and business rules are insufficiently applicable to the detection of tax integrity risks. As a result, the bank has developed specific scenarios and business rules as regards tax integrity risks for detecting unusual transactions in the transaction monitoring system.
The bank has established these scenarios of tax evasion and tax avoidance on the basis of its existing customer portfolio and backtesting of previously assessed files. The bank made use of cases that resulted in FIU notifications due to the risks of tax evasion. The characteristics of these unusual transactions were important input for establishing the scenarios.
For instance, the bank has developed the following scenarios for offshore and other companies that result in an alert:

Transactions involving offshore companies
- The customer is an offshore company and effects transactions
- The customer is an offshore company and effects transactions related to operational costs/activities, for instance via re-invoicing
- The customer receives funds from an offshore company, such as in the form of a loan, capital contribution, share premium, current account etc.
- The customer pays funds to an offshore company

Transactions from and to bank accounts in high-risk countries
The customer pays funds to or receives funds from companies with bank accounts at banks established in high-risk countries
The customer pays funds to or receives funds from their own bank accounts at banks established in high-risk countries

Transactions with vague descriptions or an obscure counterparty
- The customer pays funds to or receives funds from what appear to be third parties, stating in the description 'intra-group loan' or 'dividend pay-out'.
- The customer pays funds to or receives funds from what appear to be third parties, which are not stated in the transaction profile.

The bank has drawn up clear procedures and instructions for the further assessment of alerts generated by personnel in order to determine which actions are necessary. This includes a description of situations which require the sourcing of additional tax expertise in order to adequately investigate such alerts.

DNB views this as a good practice, as the bank was able to detect independently that the existing scenarios and business rules were not suitable for detecting unusual transactions associated with tax integrity risks. As a result of this analysis, the bank has adjusted its transaction monitoring accordingly.

Good practice: Education and training

A bank is aware that not every employee at the bank has specialist knowledge of national and international tax law and regulations. However, the bank considers it imperative that the customer relationship managers and other relevant employees receive sufficient education and training so that they are able to identify signs of tax integrity risks in customers.

For Compliance personnel, who conduct a more in-depth assessment of individual customers, the bank has adopted a specialist training programme so that they can gain more profound knowledge of international tax evasion cases, misuse of offshore companies and international developments in the area of tax avoidance. The bank also engages its tax department to give its personnel additional tax-related training. In cases where specific expertise is not available in-house, the bank engages external parties. The bank may also use external expertise to make a well-considered decision about certain high-risk customers and customer groups.

In its education and training programmes, the bank emphasises tax evasion and tax avoidance techniques, the misuse of offshore companies, the international context and standards and new developments in this area. The bank also uses investigation files from its own practice to interpret tax integrity risks. In order to stay updated on the latest developments and to promote awareness in a more sustainable manner, the bank regularly provides its personnel with tailor-made training programmes that are in line with their position and duties.

DNB views this as a good practice, as the effectiveness of the procedures and measures geared towards tax integrity risks strongly depend on the knowledge and expertise of personnel. The bank acknowledges this by offering its personnel adequate training. The education and training of personnel are important ways for the bank to safeguard its expertise in the area of tax integrity risk and to continually refine its own integrity risk appetite.

DISCLAIMER

De Nederlandsche Bank N.V. (DNB) has prepared this guidance document to present our findings regarding the good practices we have identified or expect in supervisory practice, which in our opinion constitute a sound application of the legal framework regarding tax integrity risks management. This document also contains case examples.

It must always be read in conjunction with the regulations and DNB's Guidelines on the Anti-Money Laundering and Anti-Terrorist Financing Act and Sanctions Act, April 2015 edition. You can incorporate the good practices from this brochure in managing your customers' tax integrity risks, taking account of your own circumstances. Some cases may require a stricter application of the underlying rules.

This is not a legally binding document nor a DNB policy rule within the meaning of Section 3(4) Book 1 of the General Administrative Law Act, and it has no legal effect.

This document does not replace legislation and regulations, or policy or supervisory regulations in this area. The examples in this document are not exhaustive and cannot be automatically deemed as sufficient in all cases. They are a guideline to the explanation and application of legal obligations.

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