APPROVED BY THE DECISION OF THE GOVERNOR
OF THE CENTRAL BANK OF ARMENIA NO 1/520-A
FROM JUNE 4, 2010

ANNEX

Typology 10

Money Laundering through Commercial Transactions Related to Cross-Border Conveyance of Goods

Chapter 1: Scope of Application

1. The scheme of transactions presented by this typology may be relevant for the following types of reporting entities:
   a. Banks;
   b. Attorneys, independent lawyers and firms providing legal services;
   c. Independents accountants and accounting firms;
   d. Independents auditors and auditing firms.

Chapter 2: General Provisions

2. The purpose of this typology is to uncover motives of economic entities to forge documents on commercial transactions related to the conveyance of goods trough the customs border of the Republic of Armenia (hereinafter: RA), and to identify money laundering schemes deriving from such motives. This, in turn, aims to assist the reporting entities designated by the RA Law on Combating Money Laundering and Terrorism Financing (hereinafter: the Law) in due performance of their obligation to recognize suspicious transactions or business relationships and to file suspicious transaction reports to the Authorized Body.
3. The description of possible money laundering schemes and the examples of their use, as presented by this typology, is not exhaustive; it just outlines a standard framework of typical money laundering risks in commercial transactions, so as to provide a general understanding to reporting entities and to guide their internal compliance function in the prevention of identical and similar risks.
4. Reporting entities should pay special attention to the prevention of money laundering risks related to the cross-border conveyance of goods in fulfillment of their obligation to conduct on-going customer due diligence as defined by Article 16 of the Law. This obligation entails monitoring of the transactions with customers to assure veracity of the information on customers, their business and risk profile and, where necessary, the source of their income. In view of this, in the course of monitoring the customers involved in import or export activities, reporting entities should take into consideration the specific risks pertinent to such transactions, understand the nature

of the transactions – by means of requesting from the customers and examining the necessary information or documents, and assess their veracity, conducting enhanced due diligence as appropriate and filing to the Authorized Body reports on suspicious transactions or business relationships as necessary.

Chapter 3: Basic Terms and References

5. This document uses the following terms as defined by the RA Customs Code and by other laws:
   1) ***Customs territory of the RA*** comprises land, water, and air space of the RA. The territory of the RA may comprise customs warehouses and free trade zones not included into the RA customs territory.
   2) ***Customs value*** is the price of the transaction, that is the amount actually paid or subject to payment or to be paid for the purchase of goods and for their transportation to the customs border of the RA. Customs value of goods conveyed through the RA customs border is determined by the declarant, except for the cases stipulated by the RA Customs Code, when it is determined by customs authorities.
   3) ***Customs payments*** are payments defined by law and collected by customs authorities for the conveyance of goods and vehicles through the RA customs border, including:
      a. Customs duties;
      b. Customs fees;
      c. Taxes, duties, and other mandatory payments defined by law and collected by customs authorities.
   4) ***Customs duties*** are mandatory collections to the State Budget pursuant to the procedure and in the amounts stipulated by the RA Customs Code for the conveyance of goods through the customs border of the RA. Customs duties and their rates are determined by the RA Customs Code. Depending on the nature of operations, the following customs duties are applied in the RA:
      a. Export duties – for goods exported out of the customs territory of the RA;
      b. Import duties – for goods imported into the customs territory of the RA;
      c. Seasonal duties – for exporting specific goods out or importing thereof into the customs territory of the RA within certain periods of the year.

      The rate of customs duties may be zero or 10 percent[1] as per the list defined by Article 102 of the RA Customs Code.
   5) ***Customs fees*** are mandatory collections to the State Budget pursuant to the procedure and in the amounts stipulated by the RA Customs Code, used for the promoting customs affairs, providing the material/ technical basis of customs authorities, and social protection of customs officials.

[1] At that, the agreement on Armenia's joining the World Trade Organization in 2003 envisages that the country may establish and apply other rates, as well. The RA Government so far has not made such a decision (which, in essence, would establish a predicate for determining a rate other than zero or 10 percent); however, this does not mean that a higher (up to 15 percent) rate may not be applied in future for protecting domestic producers.

The rates of customs fees is defined 3.500 drams for customs formalities, 10.000 drams for customs escort (for each 100 kilometers), and 1.000 drams for each document produced.

6) ***Taxes, duties, and other mandatory payments*** defined by law and collected by customs authorities include value added tax (VAT), excise tax, environmental payments, road payments etc. For the purposes of this typology, consideration is given only to value added tax – an indirect tax paid at all phases of importing goods into the country, of their production and sales within the country, as well as at all phases of the provision of services.

6. According to Item 4, Article 6 of the RA Law on Value Added Tax, import of goods under the *"import for free turnover"* customs regime is a VAT taxable operation, which implies calculation and collection of taxes by customs authorities on the RA customs border. According to Article 16 of the same law, export of goods under the *"export for free turnover"* customs regime is taxable by a zero percent rate of VAT applied to the taxable turnover of exported goods.
7. Application of VAT on the RA customs border in the case of imports has certain peculiarities and exceptions, as follows:
   1) No VAT is calculated and collected on the border in respect of the goods, for which:
      a. The RA Customs Code determines a zero percent rate of import customs duties and an exemption from excise tax; the list of such goods is defined by a separate law[2];
      b. Supply is exempt of VAT in accordance with Item 28, Article 15 of the RA Law on Value Added Tax (supply of goods under humanitarian or charitable programs by intergovernmental, religious, and non-governmental organizations, including charitable organizations).
   2) Article 6[1] of the RA Law on Value Added Tax defines that in the case of importing certain types of goods (the article also specifies unique identification codes of those goods) payment of VAT is deferred: a) by one year from the date of declaration – for goods below 70 million drams of customs value; b) by two years from the date of declaration – for goods above 70 million drams of customs value; and c) by three years from the date of declaration – for goods above 300 million drams of customs value. The same article establishes that in the case of importing goods other than those specified by the said article and imported under investment projects above 300 million drams by entities and individual entrepreneurs determined by the RA Government decisions, payment of VAT may be deferred by three years.
8. Application of VAT on the RA customs border in the case of exports has certain peculiarities, as follows:

[2] Law on Approving the List of Goods Imported by Organizations and Private Entrepreneurs, Subject to a Zero Percent Rate of Customs Duties and Exempt from Excise Tax, For Which Customs Authorities Do Not Calculate and Collect Value Added Tax" (adopted on June 29, 2001, HO-195).

1) According to Article 16 of the RA Law on Value Added Tax, VAT is not calculated and collected in respect of export transactions; in other words, a zero percent rate of VAT is applied[3].
2) According to the same article, the amount of VAT credited to tax accounts of VAT taxpayers in respect of purchased goods and received services related to transactions taxable by a zero percent rate of VAT are subject to refund (set-off).

9. In respect of transactions, which are not taxable by a zero percent rate of VAT, the first paragraph of Article 25 of the same law defines that if the amount of VAT subject to set-off in the reporting period exceeds the amount of VAT calculated for the taxable turnover of that period, the exceeding portion of VAT is set-off with the amount of VAT payable to the State Budget in the future periods. This does not apply to transactions taxable by a zero percent rate of VAT[4], for which, based on the written application of the taxpayer, the amount of VAT credited to tax accounts and separated in import customs declarations of the suppliers may:
   1) Be set-off with other tax liabilities of the taxpayer; and (or)
   2) In the absence of tax liabilities payable to the State Budget, be refunded or set-off with other tax liabilities of the taxpayer, should the taxpayer have a positive balance of VAT receivable. In such cases, the part of the positive balance of VAT receivable (excluding overpayments and amounts of taxes not subject to set-off) in an amount not exceeding 20 percent of the taxable turnover of zero percent rated VAT taxable transactions may be set-off with other tax liabilities of the taxpayer, and (or) be refunded.
10. Article 22 of the RA Customs Code defines the following **customs regimes** for the conveyance of goods through the RA customs border:
   1) *Import for free turnover;*
   2) Re-import;
   3) Transit shipment;
   4) Import to customs warehouse;
   5) Import to duty free shop;
   6) *Temporary import for processing;*
   7) Temporary import;
   8) Temporary export;
   9) Import to free customs warehouse;
   10) *Temporary export for processing;*
   11) *Export for free turnover;*
   12) Re-export;
   13) Renunciation of the ownership right for the benefit of the State;
   14) Destruction;
   15) Import to free trade zone.

[3] At that, the RA Customs Code also establishes a zero percent rate of customs duties in respect of exported goods.
[4] Except for transactions related to the export of black and color scrap metals.

Chapter 4: Description of Potential Money Laundering Schemes

11. In order to recognize operations potentially aimed at money laundering by means of commercial transactions related to conveyance of goods through the RA customs border, it should be considered from the viewpoint of importers and exporters separately.

12. **Identification of Money Laundering Risks in Import Operations**

    1) The description of perhaps the most widely-used regime – "import for free turnover" – of conveyance of goods through the RA customs border is the following:

       Let us assume that a RA resident entity imports goods with unit purchasing price of USD 85 and unit cost of transportation to the RA customs border (including insurance, freight etc) of USD 15[5]. For the purposes of this example, it is assumed that a certain rate (10 percent) of import customs duties defined by the RA Customs Code is applicable to the imported goods. For the customs clearance of the goods, apart from the calculation and collection of customs fees, the following computations are made:

       a. Customs value is equal to the sum total of all expenses related to transportation of goods to the RA customs border – in this example equal to USD 100;
       b. Customs duties, as per the list defined by Article 102 of the RA Customs Code, are equal to 10 percent of the customs value – in this example equal to USD 10;
       c. The amount of applicable VAT is equal to 20 percent of the sum total of customs value and customs duties (100+10=110) – in this example equal to USD 22.

    2) For maximal exactness, the expenses related to transportation of goods to the importer's warehouses – in this example equal to USD 5 – are also taken into account. Thus, the unit cost of imported goods in this example is equal to USD 115 (100+10+5), and the VAT receivable from the State Budget is equal to USD 22.

    3) Let us also assume that the importer intends to make at least a 30 percent profit on the sales of imported goods. This means that unit sales price of the goods should be at least USD 150 ([150-115]/115 = 30%). Hence, the retail unit sales price is set at USD 180, of which 16.67 percent – or USD 30 - is to be credited to the importer's tax accounts as the amount of VAT generated after the import of goods, due to their sales in the RA territory. Taking into account that, in terms of VAT, the importer has already accrued and made a payment of USD 22, the amount to be paid to the State Budget after the sales of the goods is USD 8 per sold unit.

[5] In the Republic of Armenia, accounts are kept in Armenian drams; however, for the sake of simplicity, cost and other calculations in this example are presented in US dollars.

4) In the sequence of actions described in sub-clauses 1 to 3 of this clause, for the purpose of maximizing profit through artificial reduction of the amount of customs duties and taxes payable to the State Budget, economic entities may have motives to **artificially reduce** the customs value of imported goods by means of forging import-related documents. The following circumstances have an influence on the formation of such motives in import operations:
   a. The rate of customs duties, which may be equal to zero or 10 percent depending on the type of the goods (as per the list defined by Article 102 of the RA Customs Code);
   b. Applicability of VAT, since the imported goods may be taxable or non-taxable in terms of VAT depending on whether they match the exception criteria defined by Item 4, Article 6 of the RA Law on Value Added Tax.
5) For instance, an economic entity importing goods subject to a 10 percent rate of customs duties and (or) taxable by VAT, may involve in abusive practices by artificially reducing customs value of the imported goods (particularly, by presenting forged documents on their purchase price), thus reducing customs payments to be made for those goods.
6) In similar circumstances, importers may have motives for **artificially raising** customs value of the imported goods. For instance, an economic entity importing goods subject to a zero percent rate of customs duties and (or) non-taxable by VAT, may artificially raise customs value of the imported goods, thus reducing sales profit and, consequently, paying less profit tax (in the case of private entrepreneurs – less income tax) to the State Budget.
7) At that, one should take into consideration specific details pertinent to the given situation: for instance, an importer enjoying a tax recess, or operating as a flat taxpayer, or having large accrued tax losses deferrable for 5 years forward, may not demonstrate the conduct of a "standard" profit taxpayer, since it is not concerned with the high profitability of its import operations.
8) Likewise, one should take into account that in addition to the transaction price method defined by Article 87 of the RA Customs Code (when the purchasing price documents presented by importers are taken as basis for determining customs value), customs authorities are authorized to use any of the other five methods defined by Articles 88-93 of the same Code[6]. As a result, the situation may be that, if the transaction value method is not used, a direct influence on profit tax under the given transaction perhaps is not relevant, since according to the RA Law on Profit Tax the original accounting documents are taken into account instead of the customs value determined and applied for customs clearance of the goods.
9) Moreover, forging the customs value in import operations may be conditioned not by or not only by the attempt to artificially reduce customs duties or taxes payable – so as to maximize profit, but also to create documentary substantiation for certain financial flows out of Armenia. For example, an importer wishing to

[6] These methods for determining customs value are: 1) transaction price of identical goods; 2) transaction price of similar goods; 3) unit sales price in the domestic market; 4) computed value; and 5) residual method.

legally move certain funds out of the country may "sacrifice" some money by paying more taxes (duties) due to declaring a higher purchasing price, which will enable making to its foreign counterparts/ suppliers transfers above the real cost of the purchased goods, thereafter making use of the extra-transferred funds by means of certain schemes (the possibility of using this option is higher when the counterparts/ suppliers are registered/ operating in offshore countries or territories).

10) Another wide-spread scheme involves the import of equipment, whose price structure may or may not comprise the cost of installation works and (or) intellectual property or accommodation rights. Since works, services, or intellectual property rights are not separate goods conveyable through the border, there is a possibility that economic entities attempt to change customs value of imported goods by means of these constituents. Typical examples of this are the import – through modern means of communication – of the software necessary for the startup of the imported equipment; acquisition of installation works or consultancy or data processing services at unrealistically high prices or under conditions not typical for the business practice.

13. **Identification of Money Laundering Risks in Export Operations**

1) The description of perhaps the most widely-used regime – "export for free turnover" – of conveyance of goods through the RA customs border is the following:

   Let us assume that a RA resident entity is involved in the production and export of certain goods. At that, the structure of the unit export price comprises material expenses equal to 60.000 drams, wages and social contributions equal to 15.000 drams, and an expected profit equal to 25.000 drams; that is the unit sales price totals 100.000 drams. According to Article 25 of the RA Law on Value Added Tax, exporters are authorized to claim refund of VAT in respect of material expenses included in the export price, while the amount of such refund can not exceed 20 percent of the export price. In accordance with Article 9 of the same law, the amount of refund is determined at a rate of 16.67 percent, which means that in this example the maximum amount of refund would be around 16.670 drams, whereas the concrete amount to be refunded (which usually is approved through examination by tax authorities) is equal to 60.000 * 20% = 12.000 drams.

2) In the sequence of these actions, for the purpose of maximizing the refund of VAT from the State Budget, economic entities may have motives to **artificially raise** the export price of goods by means of forging export-related documents. The following circumstances have an influence on the formation of such motives in export operations:

   a. The specific type of goods, which may be VAT exempt as per the list defined by Article 15 of the RA Law on Value Added Tax[7];

[7] For example, sales of newspapers and magazines, prosthetic/ orthopedic devises, precious and semi-precious stones as specified by the RA Government's list are exempt of VAT.

b. The specific taxation regime, which the exporter may use;
c. Presence of a free trade agreement, which might be signed between Armenia and the country of import.

3) For instance, an economic entity enjoying a profit tax privilege (according to Chapter 6 of the RA Law on Profit Tax) and exporting goods taxable by a 20 percent VAT, may involve in abusive practices by artificially raising customs value of the imported goods (particularly, by presenting forged documents on price formation), thus increasing the claimed VAT refund from the State Budget for the export of those goods. The same logic is applicable in the case of transfer pricing operations.
4) In this case, as well, one should take into consideration specific details pertinent to the given situation: for instance, an exporter enjoying a tax recess, or having large accrued tax losses deferrable for 5 years forward may not demonstrate the conduct of a "standard" profit taxpayer, since it is not concerned with the high profitability of its export operations.
5) Moreover, just like in the case of import operations, forging the export price may be conditioned not by or not only by the attempt to artificially raise that price – so as to maximize the amount of VAT refund, but also to create documentary substantiation for certain financial flows into Armenia. For example, an exporter wishing to legally move certain criminal funds into the country may "sacrifice" some money by paying more taxes (duties) due to declaring a higher export price, which will enable receiving from its foreign counterparts/ suppliers transfers above the real cost of the exported goods, thereafter making use of the extra-received funds by means of certain schemes (the possibility of using this option is higher when the counterparts/ buyers are registered/ operating in offshore countries or territories).
6) A particular case of the schemes described in clauses 1 to 5 above are the **commodity-void transactions** (the so called VAT "carousel" schemes), when economic entities involved in abusive practices attempt to get VAT refund for the export of non-existent goods or services on basis of forged documents[8].
7) Economic entities involved in export operations may also have motives to **artificially reduce** the export price of goods by means of forging export-related documents in cases, when the country of import has a more favorable taxation regime; that is, the exporter is interested in exporting goods and, respectively, importing them into the destination country at a lower price, since the profit generated thereon would be taxed at a lower rate as compared with the taxation in the RA – should the real export price be declared.
8) Hence, both in the case of import and export operations, disclosure of potential money laundering schemes requires that the specific characteristics of the transaction are considered so as to uncover the concrete motives of the importer/ exporter to demonstrate abusive conduct.

[8] In general, money laundering schemes through commodity-void transactions may be used under the veil of both import and export operations; that is, when flows of funds out or into the country are substantiated by agreements on provision of non-existent goods or services.

14. **Peculiarities of Transaction Related to Temporary Import for Processing and Temporary Export for Processing**

1) Motives for forging price-formation documents in import or export-related economic activities may be separately or in combination be present also in operations involving temporary import or export of goods for processing. Here one should take into consideration that: 1) under the "re-export" customs regime, when exporting goods once imported under the "temporary import for processing" regime, and 2) under the "re-import" customs regime, when importing goods once exported under the "temporary export for processing" regime, the following differences are calculated and collected on the RA customs border (in both cases excluding customs fees, which are non-deductible):
   a. In the first case – the positive difference between the customs payments envisaged for the export of processed goods under the "export for free turnover" customs regime and those for the import of to-be-processed goods under the "export for free turnover" customs regime;
   b. In the second case – the difference between the customs payments envisaged for the import of processed goods under the "import for free turnover" customs regime and those for the export of to-be-processed goods under the "import for free turnover" customs regime.
2) The peculiarity of operations specified in sub-clause 1 of this clause is that, for instance, the purpose of price forgery in the import of goods under the "import for free turnover" customs regime may be attained by means of one step (for example, through reducing the amount of calculated and collected customs duties and taxes on the RA customs border by means of presenting forged documents), and the movement of goods/ services and the underlying price-formation documents takes place in one direction (in this example, to Armenia), whereas in the case of temporary import/ export operations attainment of such purpose usually requires more than one step and a series of actions with constituents, which individually do not necessarily comprise irregular or illegal activities. Nevertheless, the totality such actions has a final objective of legalizing proceeds of a predicate offence, that is laundering money.

   For example, a company involved in imports of semi-processed goods, their further processing in Armenia (adding value), and exporting the final product may be interested in **artificially raising** the value of imported semi-processed goods and declaring the real cost of exported final product, thus minimizing the value added in the territory of the RA and, therefore, the taxes accruable and payable in the country. In this case, the motives for artificially raising the value of imports is not the same as those in the case of importing goods under the "import for free turnover" customs regime or of exporting goods under the "export for free

turnover" customs regime, since the economic entity involved in abusive practices attains the ultimate purpose of its illegal actions at the moment of exporting the final product – by means of minimizing the value added in the RA.

Chapter 5: Conclusions

15. In order to arrive at a conclusion on the existence of potential money laundering schemes, reporting entities should pay attention to the circumstances, which are essential in terms of uncovering such schemes, such as:
    1) Integrity of contents of the documents substantiating economical or logical relevance of the transaction (i.e. contracts, agreements etc); their conformity with the business practice of the given type of activity;
    2) Trustworthiness of other transaction-related documents (invoices, documents verifying conveyance through borders, transportation expenses etc);
    3) Conformity of the basic characteristics (price, deadlines, supply terms etc) of the transaction with the market terms and reasonable conduct;
    4) Conformity of the transactions with the customer's business profile, its declared and factually realized business objectives;
    5) Conformity of the amounts, directions, and frequency of financial flaws and other characteristics of the customer's transactions with the circumstances and facts set forth in the documents substantiating economical or logical relevance of the transactions;
    6) Involvement of offshore and other high-risk companies in the customer's transactions.