

Analysis

On Risk Assessment of Funds Received from Agricultural Exports in the Context of Money Laundering

Introduction

Considering the suspicious transaction reports received during 2015-2016 regarding funds received by individuals from abroad as payment for agricultural exports, as well as the significant volumes of funds involved, the Financial Monitoring Center (FMC) has conducted an analysis to assess the potential money laundering risk¹ associated with these transactions and to issue appropriate notifications to reporting entities.

The analysis was conducted primarily to evaluate whether these transactions complied with Armenia's tax legislation, or, alternatively, to explore the hypothesis of potential tax evasion, given the lower probability of other hypotheses. Specifically, the study examined how individuals involved in the production, sale, purchase or resale of agricultural products, including exports to other countries, might incur tax liabilities and whether they might be inclined to obscure or structure financial flows in a non-transparent manner to avoid these obligations.

Definition and Scope

According to Articles 8 and 36 of the Republic of Armenia Law on Income Tax and the Republic of Armenia Law on Corporate Profit Tax, agricultural goods are defined as goods obtained for final or intermediate consumption through the biological transformation of animals or plants, including:

1. Cereal and leguminous grain crops;
2. Industrial crops;
3. Root crops, vegetables, and greenhouse products;
4. Forage crops cultivated in open fields;
5. Other products of feed production;
6. Products of orchards, vineyards, perennial nurseries, and floriculture;
7. Seeds of trees and shrubs, as well as seeds contained in fruits;
8. Saplings of trees and shrubs;
9. Seedlings of trees and shrubs;
10. Livestock products;

¹ The risk of terrorist financing associated with this type of activity has been assessed as very low, based on the 2014 National Assessment of Money Laundering and Terrorist Financing Risk. This assessment takes into account the absence of any prior alerts related to this matter from both domestic and international partners.

11. Pig farming products;
12. Sheep and goat farming products;
13. Poultry farming products;
14. Horse, donkey, and mule breeding products;
15. Deer and camel breeding products;
16. Rabbit farming, fur farming, and hunting industry products;
17. Fish farming, beekeeping, silkworm breeding, and artificial insemination products.

Notably, although crayfish farming is not explicitly included in these articles, according to official clarification by the Chairman of the State Revenue Committee under the Government of the Republic of Armenia No. 3 of 23 February 2013, live fish and other aquatic animals are classified as fish farming products.

Furthermore, crayfish farming has repeatedly come under the FMC's scrutiny, despite not being explicitly classified in the legislation. Another recurring area of concern in cases monitored by the FMC has been the export of products from orchards, vineyards, perennial nurseries, and floriculture.

Production and Sale

The following tax regulations apply to revenue generated from the sale of agricultural products produced by individuals. According to Article 8 of the Republic of Armenia Law on Income Tax: "When determining the taxable object², the gross income of a taxpayer engaged in agricultural production is adjusted to exclude income from the sale of agricultural products, as stipulated by this article." This means that individuals engaged in agricultural production (including farmers and sole proprietors) are not subject to income tax on income derived from the sale of their own agricultural products.

Legal entities are also exempt from profit tax on income derived from selling their own agricultural products. According to Article 36 of the Republic of Armenia Law on Corporate Profit Tax: "Taxpayers engaged in agricultural production are exempt from paying profit tax on income derived from the sale of their own agricultural products."

Purchase, Sale, or Resale

If individuals exporting agricultural products (excluding sole proprietors) are not the actual producers of those products but are instead engaged in the purchase and resale of agricultural goods produced in the Republic of Armenia, this activity may be considered illegal entrepreneurship. This is because, according to Article 2 of the Republic of Armenia

² The taxable object is the taxable income, as defined by Article 4 of the Republic of Armenia Law on Income Tax.

Civil Code: “Entrepreneurial activity is considered an independent activity carried out at one’s own risk, with the primary purpose of generating profit from the use of property, the sale of goods, the performance of work, or the provision of services.”

At the same time, Article 26 of the Republic of Armenia Law on Taxes defines the penalties for illegal entrepreneurship and clarifies what does not constitute entrepreneurial activity from a tax law perspective (e.g., the sale of personal property, leasing out property, etc.). Additionally, it states: “This article does not apply to ... (b) individuals directly engaged in agricultural production, in the scope of that activity.”

Therefore, individuals who are not directly engaged in agricultural production (excluding sole proprietors) but engage in the purchase and resale of agricultural products will be considered to be conducting illegal entrepreneurial activity.

Sale through Export

From the perspective of regulating agricultural exports, it is important to note that, according to Part 3 of Article 89 of the Republic of Armenia Law on Customs Regulation: “The customs duty rate for goods exported from the Republic of Armenia is set at zero percent (...).” As a result, no customs duties are charged on the export of agricultural products from the Republic of Armenia to any country, regardless of whether the exporter is an individual, a sole proprietor, or a legal entity.

According to Article 203³ of the Republic of Armenia Customs Code, penalties apply for failing to declare goods transported across the customs border. The amount of the penalty depends on whether the failure to declare results in an underpayment of customs duties or a violation of non-tariff regulations. Therefore, even though the customs duty rate is zero, agricultural exports must still be declared.

Regarding tax obligations arising from exports, although the relevant provisions of the Republic of Armenia Law on Income Tax and the Republic of Armenia Law on Corporate Profit Tax (discussed in the previous section) do not explicitly mention exports, the term “sale” applies to transactions both within and outside Republic of Armenia. Consequently, income received by individuals and legal entities from sales made through exports is not subject to taxation.

However, a key regulatory distinction is that the sale must be conducted by the producer. This means that if a legal entity or a sole proprietor exporting agricultural products is engaged in the purchase and resale of those products rather than their production, they must pay corporate profit tax, income tax, and/or turnover tax, as applicable.

³ Failure to declare goods and vehicles or declaring them under a false name.

Money Laundering Risk

The money laundering risk associated with the activities of individuals who are not sole proprietors but engage in the intermediary export of agricultural products (i.e., purchasing agricultural products in the Republic of Armenia and exporting them abroad) can be considered low. This assessment is based on the fact that such individuals are subject to customs controls requirements when conducting exports, and the volumes of the funds involved – at least in cases monitored by the FMC – are not significant.

However, it is important to note that individuals who are not sole proprietors may conduct agricultural product purchase and export transactions through an affiliated legal entity or sole proprietor engaged in the same activity. By doing so, they could conceal the actual turnover of the legal entity or sole proprietor.

Additionally, agricultural exports may be formally carried out by a legal entity or a sole proprietor, while the corresponding financial flows are managed through the accounts of individuals who are not sole proprietors. This approach could also be used to evade taxes.

Conclusion

In conclusion, when individuals engaged in agricultural production (including sole proprietors and legal entities) export agricultural products, they are not subject to customs duties, or direct or indirect taxes⁴. Consequently, in such cases, there is no money laundering risk. For individuals who are not sole proprietors and are not engaged in agricultural production, the money laundering risk associated with agricultural exports is considered low, provided that:

- These individuals are not affiliated with legal entities or sole proprietors engaged in the same activity; and
- The funds received from exports do not exceed a specified annual threshold⁵.

However, it cannot be ruled out that certain individuals may engage in high-risk transactions⁶ under the guise of agricultural exports and sales for the purpose of money laundering.

⁴ With the exception of legal entities classified as turnover tax payers (if their turnover does not exceed 115 million AMD). In accordance with Article 3 (“Suspension of Tax Privileges”) of the Republic of Armenia Law on Turnover Tax, tax privileges established under tax legislation for VAT and profit tax are suspended for matters regulated by this law concerning turnover tax payers. Therefore, if a legal entity engaged in agricultural production qualifies as a turnover tax payer, it must pay turnover tax at a rate of 3.5% on income derived from production activities.

⁵ Which corresponds to the 115 million AMD turnover threshold established for determining turnover tax payer status.

⁶ For example, regular incoming transfers from high-risk countries.

In preventing such cases, financial institutions – alongside customs authorities – can play a key role by requiring additional due diligence measures, including requesting relevant documentation and conducting further analysis, including:

- Determining whether the individual is engaged in the production and sale of agricultural products or is exclusively involved in buying and reselling, including through export.
- Requesting customs and other relevant documents related to the exported agricultural products.
- Establishing the individual's connection to companies and sole proprietors engaged in agricultural exports.
- Assessing the volume of funds received by affiliated persons/related parties for exported agricultural products and comparing it to an established threshold.