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Regulatory Arbitrage and Non-Judicial Debt Collection in Central and Eastern Europe – Tax Sheltering and Potential Money Laundering

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Abstract: Non-judicial recovery of debts is now rampant in Central and Eastern Europe (CEE). The reason is two-fold. On the one hand, the significant number of defaults in the poorer areas of Europe makes the CEE region a very attractive market for debt-collection. On the other hand, the activity is almost entirely unregulated, especially regarding abusive debt collection practices. The CEE region still lacks mature, strong, and experienced supervisory agencies that could tackle borderline activities. This enables companies involved in debt collection to comply easily with the minimal legal provisions and to circumvent the actual purpose of the law, including through tax sheltering and money laundering. The main argument developed in the paper is that the debt collection system it is designed to maximize profits, minimize tax base and, potentially, can serve as money laundering mechanism. The system functions in a triadic relationship: the debt-seller (a credit institution), the debt-buyer (usually an investment company), and the debt-administrator (a debt-collection agency, either fully owned by, or under the control of the debt-buyer), where debt portfolios are purchased at huge discounts (varying between 90 and 95% of face value). By revealing the mechanism used by debt-collectors, the paper calls for legislative intervention to seal the gap and ensure adequate taxation of debt-collection activities. The nature of regulatory arbitrage involved relates both to tax law as well as to regulatory standards, such as licensing requirements. Debt buyers benefit from the EU passport rule, make high returns on their 'investments' and optimize their taxes on profits obtained. Debt administrators perform their activity at almost no liability and no tax payable to the state. This mechanism creates favorable premises for money laundering and financing of illegal activities, as

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the web of offshore companies behind the debt-buyer renders the verification of the origin of their investment money extremely difficult. Using Romania as a case study, the paper addresses not only the aforementioned practices and risks, but also the potential reasons behind the state's inability either to adopt adequate legislation, or to enforce it. In doing so, the paper employs empirical evidence regarding the activity of ten Romanian debt collection agencies and relevant case law thereof. The paper concludes with the authors' proposal for a potential solution, which can be extended beyond Romania.

Keywords: collection agencies, debt collection, regulatory arbitrage, tax sheltering
JEL Classification: H26, D18

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1 Introduction

Regulatory arbitrage is 'the manipulation of the structure of a deal to take advantage of a gap between the economic substance of a transaction and its regulatory treatment'.[1] It is used 'to avoid taxes, accounting rules, security disclosure, and other regulatory costs'[2] by exploiting the 'limited ability of a legal system to attach formal labels that track the economics of legal transactions with sufficient precision'.[3] This definition proposed by Fleischer in 2010 still stands valid.[4] However, while regulatory arbitrage is not illegal, it carries significant potential to undermine the rule of law by fostering lack of transparency or accountability. The non-judicial debt-collection industry in Central and Eastern Europe (CEE) in general and the Romanian case in particular, offer good examples and new insights into the phenomenon.

There are multiple causes for the wide spread of regulatory arbitrage in CEE region. Generally, it was noticed that: 'the complexity of the modern administrative state provides more opportunities for regulatory arbitrage'.[5] More specifically, most of European Union (EU)'s CEE countries – Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Slovakia, and Slovenia – were communist states until 1989 and had to undergo a painful and long transition to market economy. Many lacked (and the majority still do) the expertise and the institutions to tackle new legal phenomenon, such as non-judicial debt collection, cross-border operations, tax sheltering, and money laundering. Affected by poverty and various levels of corruption, the CEE countries provide a perfect setting for rapacious businesses engaging in regulatory and fiscal arbitrage.

One should not forget that companies aim to generate and maximize profit. Thus, they will structure their activities so that profits are accumulated where taxes

1 Victor Fleischer, *Regulatory Arbitrage*, 89 Texas Law Review (2010), 230.
2 Id. at 229.
3 Id. at 229.
4 Other definitions reveal similar traits of regulatory arbitrage. Rosario J. Girasa, Shadow banking, the rise, risks, and rewards of non-bank financial services (Palgrave Macmillan.Cham, Switzerland 2016), 50.
5 Fleischer, Texas Law Review, (2010), 237.

are minimal or non-existent, while expenses are recorded where subsidies and deductions are maximized,[6] *via* controlled special purpose vehicle entities (SPVs).[7]

Palan and Wigan state that the assumptions on which taxation laws were designed are challenged by two changes in economic activity. On the one hand, the services sector development means that more economic exchanges are based on incorporeal property, which makes locational, ownership, and valuation issues more fungible and mobile. On the other hand, in the area of finance and commerce, ownership, location, and the forms of capital can be unbundled, rearranged and relocated to ensure either that profit is registered where the levy is minimal or non-existent, or that the transaction is structured in a manner that tax authorities do not easily recognize it and, thus, it escapes their radar.[8] All these are exacerbated in the EU, where the creation of a fully integrated market, based on freedom of movement of capital and services, opened numerous possibilities for regulatory arbitrage.

As our case study reveals, the debt-collection industry in Romania is actively engaging in regulatory arbitrage and tax sheltering, by resorting to a very simple, yet very effective triadic contractual relationship: debt sellers, debt buyers and debt-collectors. At the same time, the cases selected for analysis allow us to highlight the risks of money laundering posed by securitization[9] in the wake of 'shadow banking', [10] due to a number of circumstances, the most important of which was to avoid significant governmental regulation.[11]

1.1 Article's Aim

The article serves multiple purposes. Firstly, it advances the research in the field of regulatory arbitrage, revealing the schemes employed by financial services providers and debt collectors. To the best of the authors' knowledge, to date this is the

6 Ronen Palan & Duncan Wigan, *The economy of deferral and displacement: finance, shadow banking and fiscal arbitrage* in Anastasia Nesvetailova, Shadow banking: Scope, Origins and Theories (Taylor and Francis, 2017), 204.

7 Id. at 209 and 211.

8 Id. at 204–205.

9 Andrew Haynes, *Securitisation, Money Laundering and Fraud*, 1 Journal of Money Laundering Control (1997), 148–153.

10 According to IMF, securitization is shadow banking, whether it is conducted directly on balance sheet by a bank or indirectly through a SPV. International Monetary Fund. Monetary and Capital Markets Department, Global Financial Stability Report, October 2014: Risk Taking, Liquidity, and Shadow Banking: Curbing Excess while Promoting Growth, https://www.imf.org/en/Publications/GFSR/Issues/2016/12/31/Global-Financial-Stability-Report-October-2014-Risk-Taking-Liquidity-and-Shadow-Banking-41631, accessed 12.08.2019.

11 Girasa, 2016, 2.

first article tackling the issue of regulatory arbitrage in connection with debt collection, from where it derives its novelty and relevance.

Secondly, it postulates that a legitimate business – debt collection – is being used for the purpose of regulatory and fiscal arbitrage, which also raises significant red flags concerning the potential for criminal activities, such as tax evasion or money laundering.

Thirdly, it conducts a case study to test the above statement by using empirical evidence. Ultimately, the article's aim is to highlight an existing phenomenon, raise the awareness of legislators in relation to the associated risks and propose solutions to tackle them.

1.2 Structure, Research Question, and Methodology

The article explores the potential for regulatory and fiscal arbitrage stemming from debt collection activities. Given the exploratory nature of this research, no specific hypothesis is formulated. Instead, the article postulates the following general propositions:

P1. *The debt-collection industry takes advantage of the lack of/low level of regulation in the CEE region of EU in order to maximize returns via regulatory and fiscal arbitrag*e,

P2. *The cross-border structure of the debt-collection industry is exploited for fiscal arbitrage,*

P3. *The contractual relationship on which the debt-collection activities are structured is used for both regulatory and fiscal arbitrage,*

P4. *The structure of debt-collection activities bares a significant risk of criminal activities, such as tax evasion and money laundering.*

In terms of methodology, the article conducts an empirical research for which it resorts to both primary and secondary sources. While the former is gathered from Romanian public databases (Trade Registry, the Ministry of Finance, National Authority for Fiscal Administration, the Consumer Protection Agency's Registrar of Debt Collectors, the authors' own practice and case files), the latter consists in legal literature for the purpose of creating the theoretical background.

The article uses a case study to test the validity of the propositions made. The authors chose their national jurisdiction, Romania, for several reasons: the access to public available data needed; their practical and theoretical expertise in Romanian law; the representativeness of the country for the CEE region; and the extent of the debt collection market, which provides a significant number of potential subjects for the empirical research. At the time of drafting the article, 77 debt-collection entities were registered with the National Agency for Consumer Protection (NACP) in Romania.[12] Out of these, 10 were chosen as samples for the case study.

The article is structured in several sections. The Section 2 addresses non-judicial debt collection in the CEE region. It introduces the general framework governing financial services in the EU, the legal framework governing non-judicial debt collection in the EU, the characteristics of non-judicial debt collection in the CEE regions and provides an overview of debt-collection in Romania. The Section 3 contains the case study, where we use empirical data to test the validity of the working propositions made in the introduction. The Section 4 analyses the scheme employed for regulatory and fiscal arbitrage in non-judicial debt collection as it transpires from the case study and details on its concomitant risks, focusing on tax sheltering and money laundering. Lastly, Section 5 contains the article's findings and the authors' proposals.

2 Non-Judicial Debt Collection System in Central and Eastern Europe

The CEE region referred to in the paper consists of a number of EU Member States (MS): Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia.[13] It is a geographical, cultural, and political space, which shares a long common history, characterized by both national strife and its struggle with its recent communist past and transition to capitalism. Their current EU membership status brings all these jurisdictions under the umbrella of EU law. Thus, although occasional discrepancies may be found, these countries now share many legal communalities.

2.1 General Framework for Financial Services in the EU

The primary sources of EU law are the founding treaties: Treaty on the European Union (TEU) and Treaty on the Functioning of the European Union (TFEU). Secondary sources are the legal instruments based on the mentioned treaties, such as regulations, directives and decisions, as well as conventions and agreements signed between EU countries or institutions.[14] These are supplemented by the case law of the Court of Justice of the EU (CJEU), who has exclusive competence in interpreting EU law.[15]

12 The full list is at: http://www.anpc.gov.ro/articol/863/registru-1-1-1-1, accessed 10.05.2019.

13 The Czech Republic, Hungary, Poland, Slovakia and Slovenia joined the EU in 2004, Romania and Bulgaria in 2007, while Croatia was admitted in 2014.

14 Sources of the European Union law, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM%3Al14534, accessed on 16.05.2019.

15 Art 19 TEU.

From the primary sources, of relevance are the fundamental freedoms, specifically the free movement of capital,[16] of establishment[17] and services,[18] as well as the 'single passport' rule in financial services. The former mean that all restrictions on capital movements between MS are removed, with certain justified restrictions.[19] The latter means that companies established in any of the MS have access to the single market for financial services and can establish branches in other EU MS or provide financial services across the EU, without the need for further authorization.[20]

Relevant are also the 'justified restrictions to the free movement of capital', which include: 'measures to prevent infringements of national law, namely for taxation and prudential supervision of financial services and measures justified on the ground of public policy or public security.'[21] These enable national agencies to tackle companies that engage in regulatory or fiscal arbitrage and abuse EU law norms meant to establish a functional internal market. However, as our evidence shows, that is not the case yet.

Issues stem from the fact that taxation still lies in the hands of the MS, while the EU has only limited competences, focused on ensuring a smooth running of the single market and harmonizing indirect taxation (which could hinder the single market).[22] Combating tax evasion and avoidance by re-establishing, for instance, the link between taxation and geographical location of economic activity have only recently become priority for EU policies,[23] with little notable results.[24]

16 Art 63–66 TFEU.

17 Art 49–55 TFEU.

18 Art 56–61 TFEU.

19 Art 65 TFEU.

20 European Parliament's Briefing of February 2017 on Understanding Equivalence and the Single Passport in Financial Services. Third-country Access to the Single Market, https://www.europarl.europa.eu/RegData/etudes/BRIE/2017/599267/EPRS_BRI(2017)599267_EN.pdf, accessed 16.05.2019.

21 Art 65 (b) TFEU.

22 European Parliament's Factsheet on General Tax Policy, https://www.europarl.europa.eu/ftu/pdf/en/FTU_2.6.9.pdf, accessed on 17.05.2019.

23 EU Commission's Communication: A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action, published on 17.06.2015, objective no. 1, 6, https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/company_tax/fairer_corporate_taxation/com_2015_302_en.pdf, accessed 17.05.2019.

24 An EU Parliament Committee on Financial Crimes, Tax Evasion and Tax Avoidance was only set up as of 1st March 2018. https://www.europarl.europa.eu/committees/en/tax3/home.html, accessed 17.05.2019. Similar conclusions and modest results have been reached by the OECD, according to Tim Butler & Matthias Thiemann, *Breaking Regime Stability? The Politicization of Expertise in the OECD/G20 Process on BEPS and the Potential Transformation of International Taxation*, 7 Accounting, Economics and Law: A Convivium (2017), 5.

2.2 Legal Framework for Non-Judicial Debt Collection in the EU

The EU does not have sector-specific legislation dedicated to non-judicial debt collection.[25] According to the updated EU Guidance to Directive 2005/29/EC (UCPD),[26] debt collection falls under the scope of this directive, since it qualifies as an 'after-sale service',[27] which means consumer-debtors should still benefit from consumer protection rules at EU level. The Guidance does not distinguish between assignment and collection of performing or non-performing credit agreements. Thus, from the perspective of EU law, such distinction is irrelevant for the purposes of UCPD and removing the collection process from the original agreement, by outsourcing it to a third party, should not render consumer protection rules inapplicable.

According to the document, several national authorities stated that 'irrespective of whether a trader has assigned a claim to a third party, debt collection activities should be regarded as after-sales commercial practices, because the debt collection is directly connected with the sale or supply of products.'[28] Furthermore, the said authorities found that 'there are no objective reasons to differentiate that assessment based on whether a trader outsources it through specialized agencies or not.'[29]

This approach was reinforced by the CJEU in its Gelvora decision (C-357/16), where it held that the UCPD 'must be interpreted as meaning that the legal relationship between a debt collection agency and the debtor, who has defaulted under a consumer credit agreement and whose debt has been assigned to that agency, falls within the material scope of the directive.'[30] In the view of the court, it was irrelevant that the bank provided the original service (credit), and the debt-collection was outsourced to a third party. It reasoned that such limitation of application of the UCPD 'could call into question the effectiveness of the protection afforded to consumers by that directive, since professionals could be tempted to separate the recovery phase, in order not to be subject to the protective provisions of that directive.'[31]

25 Catalin-Gabriel Stanescu, Self-Help, Private Debt Collection and the Concomitant Risks. a Comparative Law Analysis (Springer.Switzerland 2015), 211–217.

26 Guidance on the Implementation/Application of Directive 2005/29/EC on Unfair Commercial Practices, Brussels, 25.05.2016, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016SC0163&from=EN, accessed 16.05.2019.

27 Id at 7.

28 Id at 6.

29 Id at 6–7.

30 Case C-357/16, „Gelvora' UAB v Valstybinė vartotojų teisių apsaugos tarnyba, http://curia.europa.eu/juris/document/document.jsf?text=&docid=193031&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=3825935, accessed 16.05.2019.

31 Id at Para 28.

Both the Guidance and the court decision confirm that non-judicial debt collection is a phenomenon that requires legal coverage and adequate consumer protection, thus revealing the regulatory uncertainty that surrounded non-judicial debt collection in the EU until 2017. At the same time, while they do set a minimum standard of consumer protection to be evaluated by the courts, they do not remove the potential for regulatory arbitrage and fiscal optimization of the debt-collection scheme.

2.3 General Characteristics of Non-Judicial Debt Collection in CEE Region

Non-judicial debt-collection is a widely known phenomenon in CEE region, with striking similarities. The most significant is that non-judicial debt-collection is largely unregulated at national level. Bulgaria, Croatia, Czech Republic, Hungary,[32] Poland, Slovakia, and Slovenia[33] have no sector specific legislation in this regard, while Romania has only managed to implement sector specific legislation in 2016.[34]

Another similarity is the lack of adequate responses from national consumer protection agencies, which might stem from a number of reasons such as the lack of regulatory framework, regulatory capture, or the lack of experience and understanding of the phenomenon.[35] The recent developments from Romania in Bancpost and OTP Bank Romania cases discussed below provide two telling examples of how these reasons intertwine.

Lastly, the empirical data we collected reveals that many of the actors involved in debt-collection in CEE either originate or function in several countries from the region. Thus, it is safe to infer that in the absence of a regulatory framework, in a setting with significant lack of experience and exposure to regulatory capture, the

32 Although Hungary does not have sector specific legislation (hard law), there is a Guideline concerning fair debt collection practices issued by the Financial Supervisory Authority (soft law). Tibor Tajti, *A holistic approach to extra-judicial enforcement and private debt collection: A comparative account of trends, empirical evidences, and the connected regulatory challenges*, 10 PRAVNI ZAPISI : ČASOPIS PRAVNOG FAKULTETA UNIVERZITETA UNION U BEOGRADU (2019), 316–318.

33 According to an EU wide survey conducted by one of the authors in 2019, 18 out of the 27 EU MS do not have sector specific legislation addressing non-judicial debt collection.

34 Government Emergency Ordinance (GEO) no 52/2016 concerning credit contracts offered to consumers for immovable assets, and for amending Government Emergency ordinance no 50/2010 concerning consumer credit (GEO 52/2016), published in Official Gazette of Romania, Part I, no 727/20.09.2016.

35 In the United States, the Fair Debt Collection Practices Act (FDCPA) was implemented, at federal level, in 1977 and is enforced by the Federal Trade Commission (FTC), a supervisory agency dealing with promotion of consumer protection and anti-trust law, whose history and experience goes back to 1914. The experience of the United States and its supervisory bodies in tackling abusive debt collection spreads over 40 years, which cannot be easily matched by any newly adopted rules in CEE region.

practices and schemes employed are very much the same in all jurisdictions covered. This enables us to extrapolate on the findings regarding Romania.

2.4 Overview of Debt Collection in Romania

The non-judicial debt collection market in Romania is one of the most profitable and dynamic, with substantial incomes registered from year to year.[36] According to a study conducted by the Association of Commercial Debt Management, which collected data from only 13 debt collection agencies in Romania, the total value of their referred consumer debts in 2017 was approximately 2 billion Euro, with recoveries reaching 348 million Euro.[37] As the debt collection market in Romania grew, it attracted more and more entities involved in the debt recovery process.[38] In parallel, given the absence of state supervision of any kind, these entities engaged also in unlawful and abusive practices, which emphasized the need for an appropriate regulatory framework.[39]

This need became stronger after 2008–2010, when the financial crisis generated a dramatic increase in consumer indebtedness and default. Evidence is five legislative drafts submitted between 2010 and 2016, which attempted to regulate the activity of the collectors of receivables and to prohibit the use of abusive practices in relation to the consumer-debtor.[40] However, the implementation process was sinuous and lasting, affected by the lack of political will and the financial sector's lobby.[41]

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36 The value of claims managed by Romanian companies on the domestic market recorded a 45% increase in 2016, compared to 2015: https://www.profit.ro/povesti-cu-profit/financiar/piata-de-colectare-a-creantelor-a-inregistrat-o-crestere-de-45-in-2016-fata-de-anul-precedent-16998922, accessed 15.02.2019. The upward trend continued in 2017, when the debt collection market increased by 14% compared to 2016, reaching a value of over 440 million lei. Anelis Buciu – EOS: The debt collection market increased by 15% last year to RON 400 million, October 11, 2017, https://www.zf.ro/banci-si-asigurari/eos-piata-de-colectare-de-creante-a-crescut-cu-15-anul-trecut-la-400-milioane-de-lei-16763436, accessed 15.02.2019.

37 Study on Debt Collection for 2017, 13, http://amcc.ro/wp-content/uploads/2018/08/AMCC-MARKET-Survey-2017_EN_10082018.pdf, accessed 17.05.2019.

38 *Supra* n 14.

39 The World Bank, Romania. Diagnostic Review of Consumer Protection and Financial Literacy. Vol II Comparison against Good Practices (2009), 7.

40 Catalin Stanescu – *Recuperatorii, banii și românii. O evaluare a încercărilor României de a legifera colectarea abuzivă de creanțe* in Revista Romana de Drept al Afacerilor, Wolters Kluwer, Vol 1, July 2019.

41 On several occasions the Government has committed itself to international creditors to refrain from promoting any legislative initiative that could undermine 'credit discipline' and to 'maintain payment discipline.' Government Opinion on Insolvency Law of Individuals, 2, n 1 and 2, http://www.cdep.ro/proiecte/2014/500/70/9/pvg823.pdf, accessed 15.02.2019.

Ultimately, the first normative act containing concrete measures in this regard came into being in 2016.[42] Among the reasons for the introduction of the provisions relating to the assignment of consumer debts, the preamble states: 'In view of the increasingly frequent use by creditors of the assignment of credit agreements and claims, in particular to debt recovery entities, it is necessary to regulate the rights and obligations of the parties in such situations.'[43]

The legislators introduced obligations for debt collectors and banned certain practices deemed abusive. Other measures concerned the registration and authorization of debt collection companies. According to the Explanatory Memorandum, 'since the activity of debt recovery entities has been growing more and more lately, with no overview of their number and their work',[44] the activities in question can only be carried out by the registered entities.

The most problematic aspect of GEO no 52/2016 is its lack of immediate effect. According to its provisions, all consumer-debtor protection measures against unfair debt collection practices are applicable only to future contracts.[45] This creates an unjustifiable difference in legal status and protection between consumer-debtors with ongoing contracts (even if not necessarily already undergoing recovery) and those who enter into credit agreements after the entry into force of the law. The reasons why the former will not be protected from abusive practices that take place after the law enters into force remain unclear.

3 Case Study: The Debt Collection Scheme in Romania

Romania is one of the 'pioneers' in the CEE region regarding regulation of non-judicial debt collection. GEO no. 52/2016 introduced a (relatively simplistic) registration and authorization procedure for debt collection entities.[46] It provides for a list of banned abusive practices[47] and, contains supervisory and administrative implementation measures.[48] Nevertheless, although the assignment of debts is dedicated an entire chapter in the law, there are no distinctions regarding

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42 *Supra* n 36.

43 http://www.cdep.ro/proiecte/2016/500/10/1/conc749.pdf, accessed 31.03.2019.

44 Explanatory Memorandum, http://www.cdep.ro/proiecte/2016/500/10/1/em749.pdf, accessed 31.01.2019.

45 Art 135 GEO 52/2016.

46 Art 128 corroborated with Art 95^1 GEO 52/2016.

47 Art 71^2 GEO 50/2010.

48 Art 85–89^1 GEO 50/2010.

assignment to national or foreign entities, and no specific tax rules, to address tax shielding or the potential for money laundering.

Given the lack of *lex specialis* provisions to tackle the issue of assignment of debts in Romania, one needs to turn to the general rules applicable. We identified two categories. On the one hand, the provisions of the Civil Code[49] governing cessation of debts, and, on the other hand, the sector-specific laws governing the requirements for credit institutions and consumer credit.[50] As our research reveals, although the legislation regulating credit institutions provides for more stringent rights and obligations that its subjects need to observe, credit institutions sell and purchase debts on the basis of the provisions of the Civil Code, which are more lax, taking advantage of the blind eye turned by the supervisory authorities, the Romanian National Bank (RBN)[51] and the National Authority for Fiscal Administration (NAFA).[52]

3.1 Data Collection

The collected data stems from two main sources. On the one hand, an online service for monitoring companies, centralizing information from three verified and trustworthy public authorities: the Trade Registrar, the Ministry of Finance, and NAFA.[53] This provided us with access to public data reported by the assessed companies, including the elements in our focus: annual turnover, reported debts, circulating assets, own funds, net profit declared for taxation and number of employees. Our postulate is that if the debt collection scheme is set up for regulatory and fiscal arbitrage, then the data will reveal significant discrepancies between the debt-collectors' annual turnover, profitability rate (calculated as profit

49 The New Civil Code of Romania was republished in the Official Gazette of Romania, Part I, no 505/15.07.2011.

50 GEO no 99/2006 concerning credit institutions and capital adequacy (GEO 99/2006), published in the Official Gazette of Romania, Part I, no 1027/27.12.2006, The Romanian National Bank's Regulation no 5/2013 concerning prudential requirements for credit institutions, published in the Official Gazette of Romania, Part I, no 841/30.12.2013, Law 190/1999 concerning mortgaged credit for immovable investment, published in the Official Gazette of Romania no 611/14.12.1999, and Law no 289/2004 concerning the legal framework applicable to consumer credit contracts, published in the Official Gazette of Romania, Part I no 319/23.04.2008, currently abrogated by GEO 50/2010.

51 Romanian National Bank's Answer no XX/1/2969/20.04.2018 to NACP, 3–4, https://i0.1616.ro/media/2/2621/33206/18335063/5/anexa-18-raspuns-bnr-2018-04.PDF, accessed 17.05.2019.

52 NAFA's Minute of 06.12.2016.

53 https://www.listafirme.ro/stare-firme.asp, accessed 16.05.2019.

per annual turnover) and their net taxable income. The data collected was available for the past 10 years, however, we chose to limit it to the last five, as emphasized in Table 1, below.

On the other hand, there are a series of documents disclosed to the press by an officer of the NACP, about the practices of two Romanian branches of foreign banks, Bancpost SA[54] and OTP Bank Romania SA.[55] Both cases involve assignment of debt-portfolios (both performing and non-performing) to entities located in an EU tax haven (the Netherlands), who in their turn hired collection agencies in Romania to collect the debts.

According to NACP, this practice resulted not only in losses of hundreds of millions of Euro to the detriment of Romanian consumer-debtors (arising from abusive charge of interest and commissions),[56] but also raised suspicion of activities qualifying as tax evasion and money laundering,[57] thus supporting our initial hypotheses. The disclosed documents contain among others the assignment and administration contracts signed between debt-sellers, debt–buyers and debt administrators, as well as the correspondence and official positions expressed by state authorities, such as the NACP, the NAFA, or the RNB. The documents enabled us to trace the contractual nexus of the debt-collection system as designed by these corporate entities and to observe the reaction and response of the supervising authorities to the unveiling of the scheme.

Additional sources came from publicly available case law, the personal experience of the authors as legal practitioners, the media, consumer blogs, and the website of the NACP – all of which are referenced throughout the article. These allowed us to

54 Documents concerning Bancpost SA case, https://www.profit.ro/stiri/exclusiv-document-cjpc-constanta-sanctionat-bancpost-cesiunea-creditelor-olanda-dispune-restituirea-dobanzilor-platite-consumatori-functionar-avertizeaza-daunele-suferite-consumatori-depasesc-300-18335063, accessed on 17.05.2019.

55 Documents concerning OTP Bank SA case, https://www.profit.ro/povesti-cu-profit/financiar/banci/exclusiv-documente-dupa-bancpost-banca-lovita-protectia-consumatorilor-cjpc-constanta-sanctionat-otp-bank-cesiunea-creditelor-olanda-dispune-restituirea-dobanzilor-platite-consumatori-18679061, accessed 17.05.2019.

56 According to NACP Address no 1224/09.05.2018, point 16, the damage caused to consumers by Bancpost was estimated at over 300 million Euro, notwithstanding the damage caused by penalizing interest and recovery procedures. At the same time, the estimated damage caused by OTP Bank Romania SA was over 200 million Euro, https://i0.1616.ro/media/2/2621/33206/18335063/24/anexa-19-informare-anpc-finalizare-cercetare-bancpost-2018-05.PDF, accessed 16.05.2019.

57 NACP notified the National Agency for Fiscal Administration (NAFA), the Service of Investigation of Economic Crime, the National Office for Prevention and Combating Money Laundering and the Romanian National Bank, http://www.anpc.gov.ro/articol/1097/anpc-sanctioneaza-bancpost-sa-pentru-practici-comerciale-incorecte-, accessed 16.05.2019.

gain access to public data such as the complete list of registered-debt collectors,[58] private cases of aggrieved consumer debtors,[59] journalistic investigations on the topic,[60] interviews with whistleblowers and confidential sources.[61]

3.2 An Overview of the Bancpost SA and OTP Bank Romania SA Cases

In 2018, two cases revealing the underlying scheme of debt-collection in Romania were brought to public attention by a local office of NACP. Both cases reveal a similar system designed and used for more than a decade to expatriate debt-portfolios for both performing and non-performing loans. In NACP's view, this resulted in the unlawful payment of banking fees and commissions by Romanian consumers, tax planning and tax avoidance, and raised red flags for tax evasion and money laundering operations. Moreover, the public disclosure of relevant documents pertaining to the investigation, revealed also an institutional conflict between various supervisory authorities in the country.

Both cases share a common origin. The consumer credit industry in Romania reached its peak in the wake of the financial crisis. Romanian subsidiaries, financed by their mother banks, have extended their market share of foreign currency credits to consumers, a trend which the RNB tried to stop. In order to do so, it raised the level of mandatory minimum reserves (MMR) to 40%.[62] Thus, for each 100 euro placed in credit operations, banks had to deposit 40 euro with their RNB accounts. Some transferred the additional cost to customers, others, like Bancpost and OTP Bank Romania chose to expatriate their credit portfolios and reduce their turnover. As their size shrank, so did the costs – mainly capital requirements and MMRs.

In the first case, starting from 2008, Bancpost SA had assigned debt portfolios of performing consumer loans to EFG New Europe Funding II BV (currently ERB New Europe Funding II BV), held by EFG New Europe Holding BV (currently ERB New Europe Holding BV). The holding company was owned by EFG Eurobank Ergasis, who also owned at the time the majority pack of shares in Bancpost SA. Thus, the sale of debt-portfolios was an intra-group operation, which enabled the parent company to decrease the taxation base of its Romanian subsidiary, and at

58 *Supra* n 14.
59 *Infra* n 79.
60 *Infra* fn 72 and 74.
61 *Supra* fn 65 and *infra* fn 74.
62 Decision no 3/14.02.2006 of RNB concerning the modification of the mandatory minimum reserve rate for financial assets in foreign currency published in the Official Gazette of Romania, Part I, no 175/23.02.2006.

the same time it provided the latter with a non-competitive advantage on the market, because it allowed it to reduce its risky assets ratio and MMRs deposits.

After the transfer, the buyer company signed an 'administration contract' with Bancpost SA. As a result, the company located in the Dutch tax haven was cashing the principal, the interest and the commissions, while the bank in Romania was managing the customer relations and handled the actual collection of payments. In other words, *via* a nexus of intra-group contracts, a non-employee mail-box company from the Netherlands became the sole beneficiary of almost 60% of all consumer credits granted by the Romanian subsidiary, despite the fact that according to Romanian law it did not qualify as a credit institution. This scheme continued until 2010, without consumers' knowledge, for the group members failed to inform them of the assignment. Since the bank was still handling the customer relations and debt-collection, the appearances masked the real situation.

From the fact that the Dutch company did not qualify as a credit institution under the Romanian law, stems another issue mentioned by NACP – the unlawful collection of interest, fees, commissions from its customers, estimated at around 300 million euro. This, in NACP's view should have triggered the intervention of the RNB. However, while admitting that the Dutch shell company is not authorized in any way to conduct credit services in Romania, the RNB deemed the debt-portfolio transfer to be legal under the provisions of the Civil Code, which imposed no limitations on such transfers.

In 2010, Romania implemented new consumer credit rules by GEO 50/2010. EFG concluded addendums in the assigned contracts, in which it undertook the role of creditor, although it did not qualify as one under the national legal definition. As consequence, the NACP considered that the Dutch shell misled consumers, which qualified as an unfair commercial practice under the transposing instrument of the UCPD. Only in 2018 were the remaining debt-portfolios transferred to Eurobank Ergasis (the parent company), which, due to the passport rule, is authorized to conduct credit activities in Romania.[63]

Following the investigation, Bancpost was sanctioned by NACP with a 150.000 RON (roughly 31.500 euro) fine and was obliged to return to its customers the 300 million euro resulted from unlawful interests, fees, and commissions. In addition, NACP publicly accused the RNB of failing to perform its task of prudential supervision and sent official notices to the NAFA, the National Office for

63 Mihai Banita – *Constanta a sanctionat Bancpost pentru cesiunea creditelor in Olanda si dispune restituirea dobanzilor platite de consumatori. Un functionar avertizeaza ca daunele suferite de consumatori depasesc 300 milioane de euro,* 8.08.2018, https://www.profit.ro/stiri/exclusiv-document-cjpc-constanta-sanctionat-bancpost-cesiunea-creditelor-olanda-dispune-restituirea-dobanzilor-platite-consumatori-functionar-avertizeaza-daunele-suferite-consumatori-depasesc-300-18335063, accessed 18.05.2019.

Prevention and Combating Money Laundering and the criminal investigation bodies for suspicion of tax evasion and money laundering operations.[64]

The second case concerns OTP Bank Romania SA, a Romanian subsidiary of OTP Bank Plc (Hungary). The system used is a mirror image of the one utilized in the Bancpost case. During 2007–2009, the Romanian subsidiary (original seller) has transferred debt-portfolios of performing consumer loans to its mother company (initial buyer), who, in its turn, has transferred them further to a controlled entity in the Netherlands, OTP Financing Solutions BV (the subsequent buyer). The Dutch company has transferred debt-portfolios containing non-performing loans to OTP Faktoring Zrt, a debt collection company set up by OTP Bank Plc and part of the same group, and gave the debt-portfolios consisting of performing loans to the original seller for administration and collection.[65]

Although slightly more complex due to the number of entities involved, the system observed in the OTP Bank case uses the same mechanism from Bancpost: externalization of debts, base erosion of taxable activities and assets in Romania, aggressive tax planning and optimization, causing exorbitant losses for Romanian consumers (estimated at 200 million euro) and for the Romanian state budget.

As a result of the investigation, NACP has sanctioned OTP with a fine of 160.000 RON (roughly 34.000 euro), and accused once again the RNB of failure to perform its prudential supervision duties.[66] The national bank, however, maintains its position that the mechanism of rerouting debt-portfolios on the basis of the Civil Code provisions was lawful, this time backed also by inspectors of NAFA. The battle has moved to courts and is currently pending.

64 NACP Press Release of 8.08.2018, http://www.anpc.gov.ro/articol/1097/anpc-sanctioneaza-bancpost-sa-pentru-practici-comerciale-incorecte-, accessed 18.05.2019. Bancpost challenged NACP's decision in court. In 2019, the first instance court of the Second District of Bucharest found in favor of the bank and removed all sanctions. The decision is now under appeal. At the same time, criminal authorities have dismissed the criminal complaint, considering that the administrative fine applied by the NACP sufficed. See: https://financialintelligence.ro/decizie-pe-fond-instanta-da-castig-de-cauza-bancii-transilvania-bancpost-in-procesul-cu-anpc/, and https://evz.ro/bancpost-ionut-rotaru-amenda-anpc.html, both accessed 18.05.2019.

65 Mihai Banita – *Dupa Bancpost, o noua banca este lovita de Protectia Consumatorilor: CJPC Constanta a sanctionat OTP Bank pentru cesiunea creditelor in Olanda si dispune restituirea dobanzilor platite de consumatori*, 28.11.2018, https://www.profit.ro/povesti-cu-profit/financiar/banci/exclusiv-documente-dupa-bancpost-banca-lovita-protectia-consumatorilor-cjpc-constanta-sanctionat-otp-bank-cesiunea-creditelor-olanda-dispune-restituirea-dobanzilor-platite-consumatori-18679061, accessed 18.05.2019. See also the NACP Memoranda in OTP case https://i0.1616.ro/media/2/2621/33211/18679061/77/avertizare-publica-nota-fundamentare.pdf, accessed 18.05.2019.

66 https://www.bancherul.ro/stire.php?id_stire=18597&titlu=otp-bank,-amendata-de-anpc-pentru-cesionarea-creditelor-in-franci-elvetieni-(chf), accessed 18.05.2019.

The two cases briefly described above brought to the public attention hard evidence concerning the triadic contractual relationship between original debt sellers, debt buyers and debt collectors. In Section 3.3, we present the *modus operandi*, as it transpires from the leaked documents.

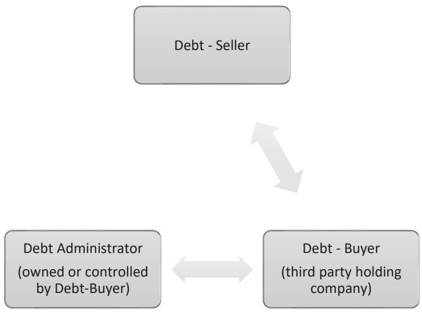
3.3 The Contractual Nexus: Debt Seller-Debt Buyer-Debt Collector/Administrator

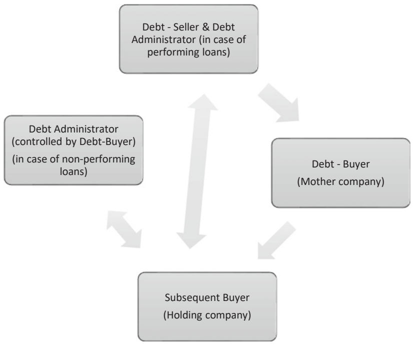
Our article postulates that the intra-EU cross-border debt collection system is designed to maximize profits, minimize tax basis and can potentially serve as money laundering mechanism. Evidence suggests that it mainly functions on the basis of a tri-/multi-partite contractual relationship involving the following parties: *the (original) debt-seller* (usually, a credit institution), *the debt-buyer* (usually, an investment or holding company, or the parent company of the credit institution), and *the debt-administrator* (the original seller, or a debt-collection agency, fully owned by, or under the control of the debt-buyer), where debt portfolios are purchased at significant discounts (varying between 90 and 95% of face value). The documents made public revealed that the debt portfolios contained both performing and non-performing loans, hence, the nature of the debt is irrelevant for the usage of the scheme.

The evidence also allowed us to identify two types of debt-collection schemes. The first involves a unique contract by which a credit institution sells debt-portfolios to an off-shore company, which then passes the non performing loans to a collection agency for 'administration' and recovery. Generally, in this scenario the credit institution is not related to the debt-buyer, however, the latter owns or controls the debt-collection agency.

The second involves an intra-group nexus of contracts by which a host state based credit institution sells the debt-portfolios to a holding company located in a tax-haven, who then passes the debt-portfolios back to the original seller (in case of performing loans) or to a collection agency (in case of non-performing loans) for administration and recovery.[67] In the second case, the debts are purchased and repurchased, at significant discounts, with money usually loaned by the mother company, which enables the members of the group to structure their corporate debt in order to maximize profits and minimize tax liabilities. Notwithstanding the differences between the two types, the mechanism and its outcomes are the same.

67 According to a set of documents released by the NCPA in Romania, there are variations form the second type. For instance, the debt portfolio could be first sold to the mother company abroad, who then sells it to a holding company located offshore, who then either passes the portfolio back to the original seller or sells it back to the original seller. *Supra* n 66.





The tri-partite structure of a contractual relationship in debt-collection.[68] The structure of an intra-group contractual nexus used in debt collection.[69]

The functioning of the scheme and its outcome are facilitated by its cross-border aspect. While the debt-seller and the debt-administrator are registered and function under the laws of the host-state where debt collection takes place, the debt-buyer is usually registered abroad, in a tax haven such as Cyprus, Malta, or the Netherlands, taking advantage of the fact that, so far, the EU has turned a blind eye on the ill-behavior of its own members.[70]

68 The scheme is based on a Framework Agreement concerning the Sale-Purchase of Non-Performing Debts disclosed in Case no 29264/299/2016 of Bucharest First Instance Court.
69 The scheme is based on a series of Agreements within OTP Group, concluded between 2008 and 2015 between OTP Bank Romania SA (seller and debt administrator), OTP Bank Nyrt (Debt Buyer), OTP Financing Solutions BV (Debt Buyer/Subsequent Buyer), disclosed by the NCPA in 2018 and made available by the media.
70 Out of the four mentioned examples, solely the Isle of Man was placed on a watch list by the EU in 2017, according to a Briefing of the European Parliament: Listing of tax havens by the EU, Annex – EU non-cooperative tax jurisdictions: https://www.europarl.europa.eu/cmsdata/147412/7%20-%2001%20EPRS-Briefing-621872-Listing-tax-havens-by-the-EU-FINAL.PDF, accessed 18.05.2019. The other countries mentioned are EU MS and thus, deemed compliant, although various reports consider that they should also feature on the EU's blacklist according to EU's own criteria. For instance, a 2017 Oxfam Briefing Note: Blacklist or Whitewash. What a real EU blacklist of tax havens should look like, 3, nominates Ireland, Luxembourg, Malta and Netherlands as EU tax havens, https://www.oxfam.org/sites/www.oxfam.org/files/file_attachments/bn-blacklist-whitewash-tax-havens-eu-281117-en_0.pdf, accessed 18.05.2019. In March 2019, the committee of the European Parliament found that seven of the EU MS behave like tax havens. The nominated seven were Belgium, Cyprus, Hungary, Ireland, Luxemburg, Malta and the Netherlands, https://www.europarl.europa.eu/news/en/press-room/20190225IPR28727/tax-crimes-special-committee-calls-for-a-european-financial-police-force, accessed 12.11.2019.

Tax havens provide taxpayers with opportunities for tax avoidance,[71] while their secrecy and opacity serves to hide the origin of the proceeds of potentially illegal or criminal activities. What they all have in common is making it possible to escape taxation in the state where the activities take place and income is generated, while their distinctive characteristics include low or zero taxation, fictitious residences (with no bearing on reality) and tax secrecy. The last two enable ultimate beneficial owners to keep aggressive tax-planning schemes under the radar and purport a significant risk of money laundering carried out in support for criminal activities, including tax evasion and fraud.[72] These aspects increase the likelihood and occurrence of regulatory and fiscal arbitrage because in the intra-EU debt collection scheme, both the debt-seller and the debt-buyer (together with its SPV) use and abuse the regulation gaps in place for their own benefit, as we show in detail in Section 4.

3.4 Financial Data Analysis

As indicated in Section 3.2, we have collected and compiled data regarding 10 collection agencies active on the Romanian market, in order to see whether their reported figures – their annual turnover, their debts, their circulating assets, their own funds, net profit and number of employees – confirm our hypotheses that these companies engage in fiscal arbitrage, which would result in minimizing tax liabilities in Romania. Confirmation should be apparent from any significant discrepancies between their turnover, profitability rate and net profit. We have also looked at their ownership structure (for instance involvement of holding companies) and/or group associations with companies located in tax haven jurisdictions, in order to verify: a) the extent of the cross-border aspect of the scheme, b) its spread across the EU, and c) the use of tax havens.

The 10 companies surveyed were:

EOS KSI Romania SRL, member of EOS Group, owned by EOS International Beteiligungs Verwaltungsgeselschaft MBH (Germany) and EOS Holding GMBH (Germany). According to its reports, the company registered a net profit of 5586 RON (approximately 1300 euro) in 2017, 27 million RON in debt and 4.3 million

71 The under-valuation of intangibles, the over-capitalization of low-taxed entities and the contractual transfer risks to low-tax affiliates have been recognized by the OECD as the biggest issues in regard to transfer pricing, according to OECD's Action plan on base erosion and profit shifting, 19–20, cited by Butler & Thiemann, ACCOUNTING, ECONOMICS and LAW: A CONVIVIUM, (2017), 14.

72 *Supra* n 72.

RON in circulating assets. The difference is staggering, given that the annual turnover for 2017 was 52 million RON.

INTRUM Romania SA, member of INTRUM group, is owned by INTRUM Justitia AB (Sweden) and INTRUM Justitia BV (*Netherlands*). The company reported no data for 2017. Yet, according to its 2016 reports, the company registered a loss of 107.000 RON, 5 million RON in debt and 5.5 million RON in circulating assets. The difference is once again staggering, given that the annual turnover for 2016 was 22.4 million RON.

KRUK Romania SRL is part of KRUK group, and it is owned by KRUK SA (Poland). In 2017, Kruk reported a net profit of 9 million RON, with 131.1 million RON in debt and 140.6 million RON circulating assets. Its annual turnover for 2017 was 112.4 million RON.

CREDITEXPRESS FINANCIAL SERVICES SRL is owned by Credit Express Group B.V. (*Netherlands*). In 2017 it reported a net profit of 1.5 million RON, 3.9 million RON in debt and 5.3 million RON in circulating assets. Its annual turnover was 9.8 million RON.

OTP Factoring SRL is owned by OTP Faktoring ZRT (*Hungary*) and OTP Bank Romania SA (Romania). Since its inception, in 2009, OTP Factoring SRL operated solely at a loss. In 2017, it reported a loss of 3.3 million RON, 108.2 million RON in debt and 53.1 million RON in circulating assets. Its annual turnover, however, remained fairly constant at 6 million RON.

CYCLE European SRL is owned by Challenor Enterprises Ltd, Savio Holdings LTD and Adairena LTD, all located in *Cyprus*. Out of 14 years of existence, in eight years it operated on a loss. In 2017, the company registered a loss of 36.000 RON, debts in value of 2.8 million RON and 4.9 million RON in circulating assets. Its annual turnover was 6.5 million RON.

APS Consumer Finance IFN SA is owned by APS Capital Group SRO (Czech Republic) and Asset Portfolio Servicing Romania SRL. Based on its reports, in 2017 it generated a net profit of 545.000 RON and registered 12.000 RON in debt. However, its reported annual turnover is zero, and so is the value of its circulating assets.

KREDYT INKASO Investments Ro SA is owned by Kredyt Inkaso SA (Poland) and Kredyt Inkaso Portfolio Investments Luxembourg SA (*Luxembourg*). In 2015 it reported a net loss of 1 million RON, 27.8 million RON in debt and 30.9 million RON in circulating assets. Its annual turnover was 3.8 million RON.

COFACE ROMANIA CREDIT MANAGEMENT SERVICES SRL is owned by COFACE CENTRAL EUROPE HOLDING AG (Austria) and COFACE ROMANIA INSURANCE SERVICE SRL (Romania). In 2017, it reported a net profit of 2.2 million RON, 3.7 million RON in debt and 7.4 million RON in circulating assets. Its annual turnover was 20.4 million RON.

COLECTARE RECUPERARE CREANTE CRC SRL is owned by Fiba Capital Investments BV and Clean Sweep Holding BV, both located in the *Netherlands*. In 2017 its registered net profit was 229.000 RON, its debts amounted to 2.1 million RON, and its circulating assets were in the value of 5.6 million RON. The annual turnover was 5.6 million RON.

As the data reveals, at least six of the 10 of the surveyed companies are owned by or connected with companies located in EU tax havens. The preferred one appears to be the Netherlands, followed by Cyprus, Hungary, and Luxembourg.[73] All companies surveyed have a foreign ownership, in six of them a holding company being involved. Seven companies are part of international groups, underlining the cross-border aspect of their activities and tax schemes as well as the spread of the mechanism employed by the debt collection industry in the EU.

In regard to their financial figures (Table 1),[74] one must notice that in the majority of the cases big discrepancies are visible between the companies' annual turnover and their taxable net profit. Generally, debt-collection agencies declare a profit between 0 and 10% of their annual turnover to the fiscal authorities. Of these, given the fixed profit tax applicable in Romania (16%), that would indicate a paid tax situated between 0 and 1.6% of the companies' turnover. If in some cases these figures could be explained as a business attempt to grab market share quickly (such as the case of KRUK), in certain cases this cannot constitute a valid explanation (OTP and Cycle European). In addition, several players (Cycle European, Intrum Romania, Kredit Inkasso, or Kruk) had very low profitability margins for years, yet this did not prevent them from increasing the number of employees, at the risk of further losses (See Figure 1).

Detailed analysis of the declared financial data, number of employees and profitability rates for the period 2013–2017 also reveals a number of anomalies. For instance, OTP Factoring Romania SRL has reported for all five years only negative profits. In fact, for its entire existence on the Romanian market, OTP Factoring

73 All four countries are mentioned among the seven EU MS that behave as tax havens by a European Parliament special committee on Financial Crimes, Tax Evasion and Tax Avoidance according to a press release https://www.europarl.europa.eu/news/en/press-room/20190225IPR28727/tax-crimes-special-committee-calls-for-a-european-financial-police-force, accessed 12.11.2019. In 2018, Cyprus, Hungary, Luxembourg and Netherlands have also been criticized by the European Commission for their aggressive tax policies in its biannual report on economic and fiscal policy coordination, https://www.oxfam.org/en/press-releases/eu-tackles-tax-competition-inside-eu-and-increases-pressure-tax-havens, accessed 12.11.2019. According to the same source, Luxembourg and the Netherlands fail also to meet the EU's own blacklist criteria for tax havens.

74 All amounts are expressed in RON, as per the official figures obtained. Currently, 1 RON is roughly 0.21 euro.

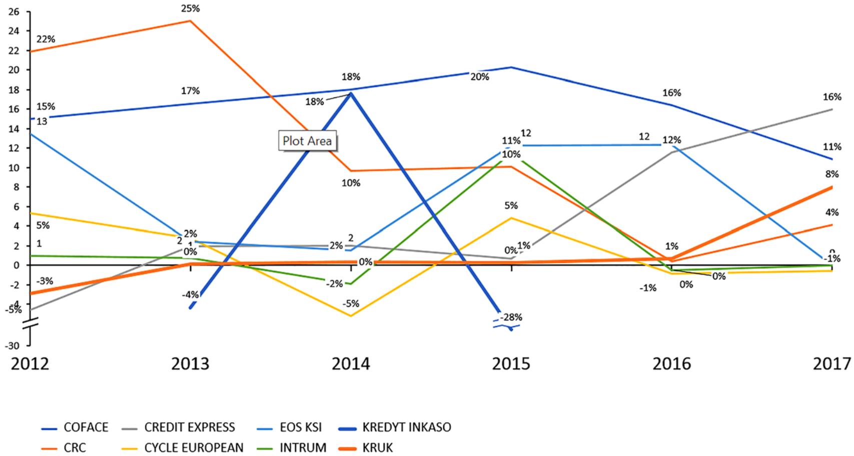


Figure 1: Overall Profitability Rate for Eight of the Surveyed Companies, for the Past Six Years.

Romania SRL has operated on a loss. Moreover, the company did not increase its revenues either, which would have suggested a potential attempt to grab a bigger market share. The suspicion stems from the fact that a company with low or negative profitability cannot stay in the negative territory for so many years in a row (Figure 2).

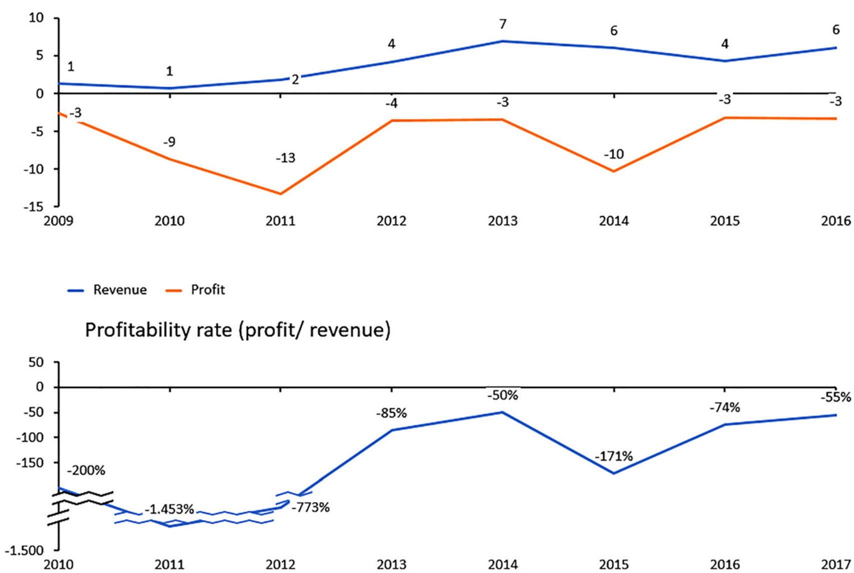


Figure 2: OTP Factoring Romania SRL's Profitability Rate.

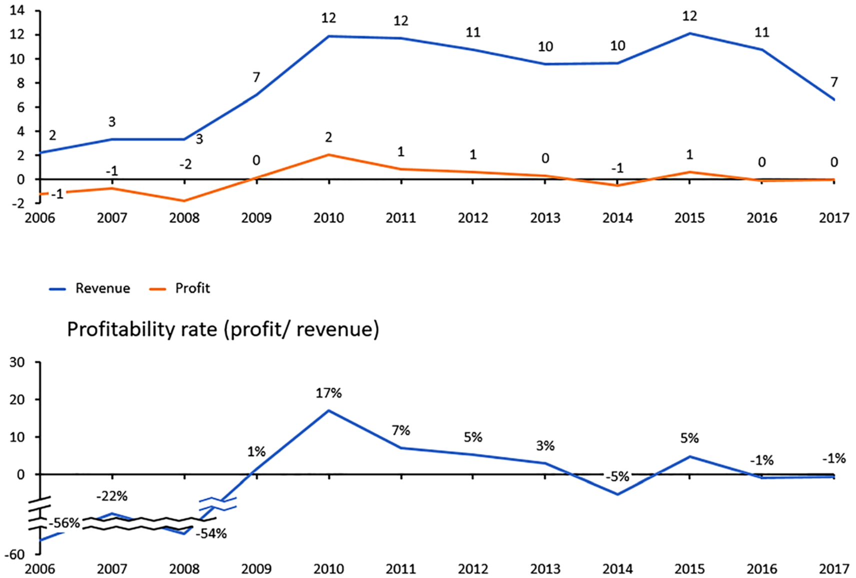


Figure 3: Cycle European's Profitability Rate.

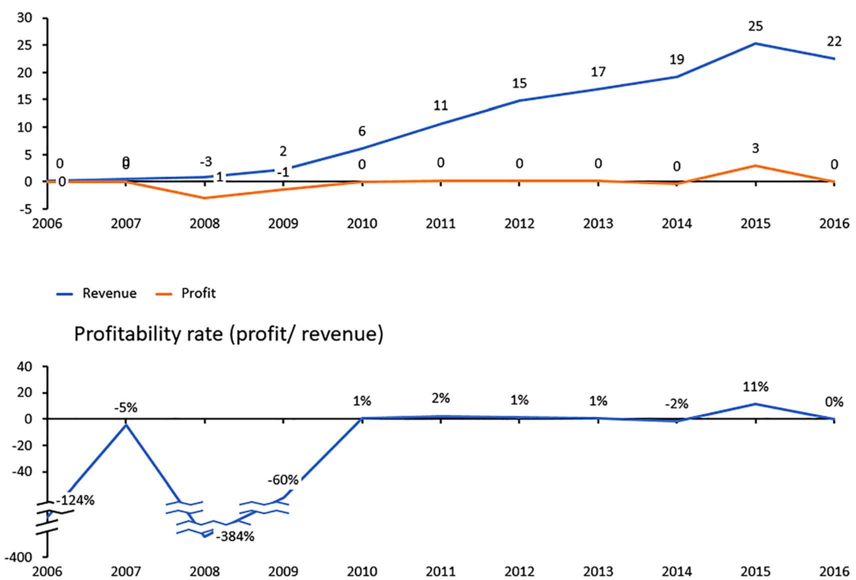


Figure 4: Intrum Romania's Profitability Rate.

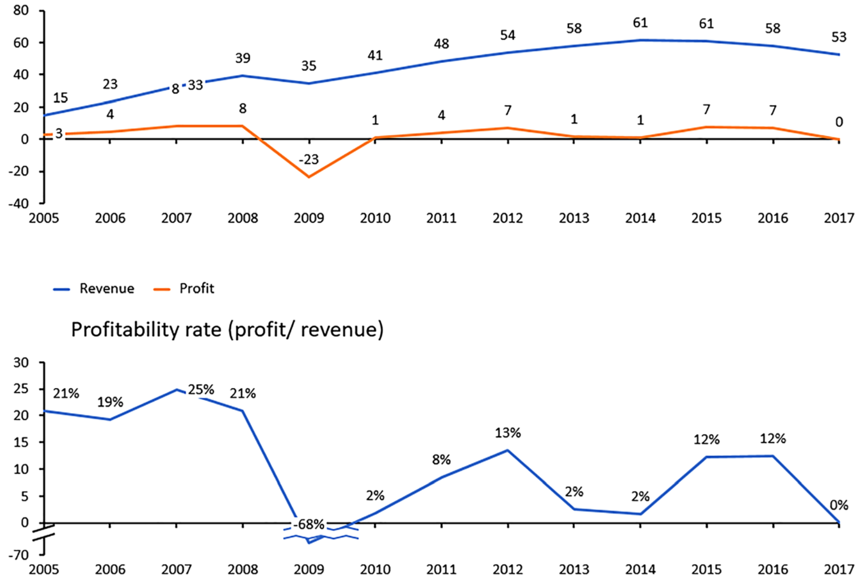


Figure 5: EOS KSI Romania SRL's Profitability rate.

A similar situation occurs in the case of Cycle European SRL and Intrum Romania, which have reported losses during three, respectively two of the surveyed five years, despite investing less in the team and having a rather stable revenue level (in case of Intrum Romania, the revenue had continuously grown) (Figures 3 and 4).

Kredyt Inkasso Investments Ro SA has also reported two years of losses, however, this company has not reported any financial data for 2016 and 2017, so the number of years affected by negative net profits could be higher. Another anomaly concerns APS Consumer Finance IFN SA. The company reported 545.142 RON in net profits for 2017 and 47 million RON in 2016, this being the largest net income reported by any of the surveyed companies throughout the covered time-period. This is anomalous due not only to the staggering amount of profit declared, but also because it does not actually match the trend of the company who has declared net losses for 2013 and to 2014 and zero net profits for 2015. It is hard to explain such changes, given that the company has never reported any annual turnover or circulating assets.

Finally, we noticed anomalies also in regard to companies that declare very low net profits, compared to the size of their annual turnover. For instance, EOS KSI

Table 1: Financial Data of Surveyed Companies for the Period 2013–2017 (Past Reported Five Years).

Year	Annual turnover	Net profit	Debts	Circulating assets	Own capital	Employees (average)	Profitability rate
APS CONSUMER FINANCE IFN SA							
2017	-	545,142	12,457	-	-	-	-
2016	-	47,077,805	17,528,113	-	-	1	-
2015	-	-	25,763,547	-	-	-	-
2014	-	(3,400,802)	26,861,039	-	-	2	-
2013	-	(3,480,203)	28,232,521	-	-	-	-
COFACE ROMANIA CREDIT MANAGEMENT SERVICES SRL							
2017	20,487,366	2,229,724	3766250	7492685	4,255,445	53	11%
2016	20,989,920	3,446,289	4276874	9207933	5,311,788	58	16%
2015	24,433,533	4,947,922	4000053	10961175	7,481,660	71	20%
2014	25,062,078	4,521,227	4355834	10845193	6,468,076	77	18%
2013	23,627,051	3,916,386	7120988	12138828	5,357,576	77	17%
COLECTARE RECUPERARE CREANTEC RC SRL							
2017	5,616,075	229,759	2,128,125	5,670,313	3,342,280	49	4%
2016	6,259,400	24,692	1,143,329	4,749,561	3,164,096	0	0%
2015	6,484,953	652,851	563,003	4,120,630	3,139,404	0	10%
2014	5,503,993	533,265	3,694,124	6,682,174	2,459,890	0	10%
2013	3,919,137	980,182	3,203,438	5,104,462	1,926,625	0	25%
CREDIT EXPRESS FINANCIAL SERVICES SRL							
2017	9,865,006	1,577,991	3,942,190	5,351,108	1,812,305	79	16%
2016	9,981,788	1,154,808	4,009,744	4,006,033	234,314	83	12%

Table 1: (continued)

Year	Annual turnover	Net profit	Debts	Circulating assets	Own capital	Employees (average)	Profitability rate
2015	10,866,965	72,524	4,872,442	3,657,471	(935,493)	126	1%
2014	9,311,661	188,149	4,848,097	3,647,456	(1,008,018)	103	2%
2013	7,609,217	147,896	5,720,329	4,460,505	(1,196,167)	93	2%
CYCLE EUROPEAN SRL							
2017	6,553,077	−36279	2842379	4958956	2155503	166	−1%
2016	10,746,310	−94415	1187536	3122980	2191782	265	−1%
2015	12,053,632	579543	1099251	3402111	2286197	266	5%
2014	9,617,065	−500481	1463747	2725274	1706654	241	−5%
2013	9,521,015	267642	1600060	3283888	2233153	232	3%
EOS KSI ROMANIA SRL							
2017	52,618,785	5,586	-	-	-	53	0%
2016	58,068,617	7,175,488	-	-	-	495	12%
2015	60,788,079	7,472,267	-	-	-	561	12%
2014	61,196,741	954,679	-	-	-	590	2%
2013	57,843,199	1,431,517	-	-	-	638	2%
INTRUM ROMANIA SA							
2016	22,476,836	(107,078)	-	-	-	230	0%
2015	25,218,706	2,894,742	-	-	-	263	11%
2014	19,147,760	(367,102)	-	-	-	259	−2%
2013	16,940,532	123,867	-	-	-	211	1%
KREDYT INKASO INVESTMENTS RO SA							

Table 1: (continued)

Year	Annual turnover	Net profit	Debts	Circulating assets	Own capital	Employees (average)	Profitability rate
2015	3,847,489	(1,092,028)				65	−28%
2014	4,306,696	757,015				40	18%
2013	16,475,011	(714,730)				15	−4%
KRUK ROMANIA SRL							
2017	112,415,548	9,006,155	-	-	-	565	8%
2016	86,399,932	570,944	-	-	-	572	1%
2015	42,835,318	111,522	-	-	-	540	0%
2014	34,889,197	107,612	-	-	-	485	0%
2013	28,303,527	32,526	-	-	-	336	0%
OTP FACTORING SRL							
2017	6,068,411	(3,332,746)	-	-	-	34	−55%
2016	4,243,407	(3,157,704)	-	-	-	39	−74%
2015	6,050,398	(10,362,361)	-	-	-	38	−171%
2014	6,865,358	(3,424,587)	-	-	-	31	−50%
2013	4,193,705	(3,562,692)	-	-	-	25	−85%

Romania SRL had in 2017 an annual turnover of 5.2 million RON, yet the net profit was only 5.500 RON (0.1% of the annual turnover). A similarly low rate was identifiable in 2016 in the case of Colectare Recuperare Creante CRC SRL, who reported a net profit of approximately 24.000 RON although its annual turnover was 6.2 million (Figure 5).

In our opinion, the data centralized in Table 1 clearly evidences huge discrepancies between the annual turnover and circulating assets of debt-collection agencies covered, their taxable net profit, as well as the large levels of company debt and low profitability levels that stretch for years. These discrepancies can be explained by the fact that the debt-collection system, on which these companies operate, allows them to engage in tax avoidance by base reduction. At the same time, the fact that some of these companies are active for a long period of time, some of them maintaining a high number of employees, despite low profitability, raises red flags in regard to a) the reasons why the said companies are kept alive and b) the source of their financing. The numbers are, thus, a confirmation of our initial postulates that the design of the debt-collection activity can and is being used for regulatory and fiscal arbitrage, with implications regarding the potential for money laundering operations.

4 Regulatory and Fiscal Arbitrage in Non-Judicial Debt Collection

In Section 3 we addressed the tri-/multi-partite design of the contractual relationship between debt-sellers, debt-buyers, and debt-collectors, and we supported with figures the hypotheses that the debt-collection system is engaging in regulatory and fiscal arbitrage. In Section 4 we elaborate on the purposes of such design and the benefits obtained by each of the parties.

4.1 Purposes and Risks Associated with Regulatory and Fiscal Arbitrage

Before delving into the risks associated with regulatory and fiscal arbitrage in debt collection, we deem necessary to define what these risks are. We focus here on two specific ones: tax sheltering and money laundering

4.1.1 Tax Sheltering

Tax sheltering is defined as 'any financial arrangement made to lower a person's or a company's tax liabilities.'[75] Tax sheltering is questionable and lies at the fringes of legality as it can rapidly turn into an abusive type, usually sanctioned by the law. The best examples are the usage of offshore companies or of financing agreements that exploit tax benefits.

The issue arises from the fact that through such devices the transactions are not reported at fair market value, which lowers tax liabilities. Moreover, beside the avoidance of taxes in the jurisdictions where the operations take place, these transactions have no real economic value, given that debt-portfolios are sold by credit institutions for only a small fraction of their face value. In the United States (US), such undertakings would fall under the 'business purpose' and 'substance over form' doctrines, for as held in *Gregory v. Helvering*, 'though conducted according to the terms of the statute, [they are] in fact an elaborate and devious form of conveyance'[76] and holding otherwise 'would be to exalt artifice above reality.'[77]

However, such transactions go either unobserved, or unsanctioned by tax and bank authorities in the CEE region, as companies take advantage of the freedom of movement of capital and of the intra-EU conventions for avoiding double taxation. This enables companies engaged in debt-collection to transfer capital cross-border and to ensure that their profits are being taxed in EU tax-heaves such as Cyprus, Malta, or the Netherlands, assuming they are taxed at all.

In the EU, tax shielding is associated with tax avoidance, aggressive tax planning, base erosion and profit-shifting. Although the phenomenon is not new, it only came to light after the leaks of the Panama and Paradise papers, which revealed how public figures and major corporations were using various instruments to route funds *via* a number of countries with favorable taxation schemes and rates. It may be that if the said leaks would not have occurred and would not have involved prominent public figures (politicians, sportsmen), the phenomenon would have continued unnoticed, favored by the blind eye of the EU, which deems its MS automatically compliant with the principles of transparency and fairness in taxation.

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75 Jonathan Law & Gary MSc Owen, *A dictionary of accounting*, A DICTIONARY OF ACCOUNTING (2010).
76 Gregory v Helvering, 293 U.S. 465 (1935).
77 Ibid.

4.1.2 Money Laundering

The risk of money laundering *via* sales of debt portfolios by the Romanian banks is also to be understood against the background of applicable AML/CTF[78] legislation and the conditions under which the Romanian banks operated after 2008.

Pursuant to domestic existing regulation, credit and financial institutions had to perform customer due diligence, e.g., when establishing a business relationship with a customer or when there was a suspicion of money laundering, regardless of any derogation, exemption or threshold. According to Romanian law, suspicious transaction means 'an operation which has no apparent economic or legal purpose or which, by its nature and/or its unusual character in relation with the activities of the client raises suspicions of money laundering or terrorism financing.'[79] In addition, financial institutions were to conduct ongoing monitoring of the business relationship based on a risk-based approach with every existing customer, including scrutiny of transactions. The aim was to ensure that the transactions conducted were consistent with the institution's knowledge of the customer, the customer's business and risk profile, including, where necessary, the source of funds. The problem arising from the intra-group transactions described above is that no such scrutiny is conducted and, hence, no one can actually know what the source of the funds used to purchase debt portfolios is.

According to FATF standards[80] regarding the characteristics of transactions with a money laundering suspicion typical grounds for suspicion warranting reporting included, inter alia: a) 'cash payments to the client's account which will be used for purchasing securities or derivatives'; b) 'single unusually large [national or cross-border] payment not conforming to normal turnover and/or not sufficiently justified'; c) 'large payments and/or smaller periodic payments with the clients of the banks located in the territories with higher money laundering risks.' The lax attitude adopted by Romanian supervisory authorities makes it very difficult to establish the existence of money laundering, although the likelihood is very high. In fact, as already mentioned, the NACP has filed criminal charges

78 EU Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing ('Third AML Directive') has been implemented in Romanian Law by GEO no 53/2008 concerning the modification and completion of Law 656/2002 concerning prevention and sanctioning of money laundering as well as for instituting measures for prevention and combating the financing of terrorism (Law 656/2002), published in the Official Gazette of Romania, part I, no 333/30.04.2008.

79 Art 2, letter d) Law 656/2002.

80 FATF 2009 Report, *Money Laundering and Terrorist Financing in the Securities Sector*, https://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20in%20the%20Securities%20Sector.pdf, accessed 12.08.2019.

alleging money laundering operations in the sales of debt portfolios witnessed in Bancpost and OTP cases.[81]

An additional risk arising from the triadic relationship – seller – buyer – debt-collector – is that it makes very difficult to verify the origin of funds that are expatriated to tax heavens under the umbrella of collected receivables and internal transactions. Basically, dirty money could be sent to the holding company's accounts as legitimate collections, without anyone noticing.

In accordance with FATF standards, since the block trades of debt portfolios are being transacted at a pre-agreed price between two parties, a series of red flags of money laundering carried out through the securitization process can be identified. On the one hand, parties agree to the initial purchase of an illiquid security at an artificially low price with the same security being bought back some time later by the original seller or an associate at a significantly higher price. On the other hand, such transactions can and are used to transfer profits from high-tax to low-tax jurisdictions and for the purposes of avoiding exchange control regulations.'[82] Still, Romanian authorities refused to investigate any money laundering claims.

By juxtaposing the international incumbent obligations of all state actors to guarantee the integrity of the financial system with the facts of Bancpost or OTP investigations, the cases illustrate that the red-flags of money laundering were completely ignored by the Romanian authorities, who failed to detect, prevent, recognize and tackle[83] any of the risks associated with money laundering process in relation to the transfer of the debt-portfolios.

4.2 The Debt Seller-Debt Buyer Axis

Debt-portfolios are being traded at huge discounts. The evidence showed, for instance, prices situated at 3% of the face value of non-performing loans,[84]

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81 *Supra* n 64.

82 *Supra* n 82.

83 Obligations for a financial institution to detect AML failings with regard to Non-Resident Portfolio Due diligence measures could be: a) failing to identify and verify the customer (and (ultimate) beneficial owners where applicable) and obtain information on the purpose and nature of the business relationship; b) failing to monitoring the transactions; c) failing to screen the suspicious transactions; d) lacking identification of the source and origin of funds used in transactions; e) use of investment schemes and financial institutions.

84 Eliza Avram – Românii „vânduţi' de bănci scapă de cea mai mare parte a datoriei, Romania Libera, 13.03.2018, https://romanialibera.ro/economie/romanii-vanduti-de-banci-scapa-de-cea-mai-mare-parte-a-datoriei-715338, accessed 11.05.2019.

although other sources indicate an average of 10%.[85] Concerning performing loans, these are usually sold at a smaller discount, the evidence indicating a rate of 24–25%.[86] The question becomes why a credit institution would sell debt-portfolios for such small amounts.

4.2.1 The Advantages of the Debt Seller

One explanation is that collecting debts is a long, risky, and costly business. Recovery efforts require additional personnel, may be challenged in court, which in its turn will require payment of judicial and attorney fees. Judicial proceedings and enforcement also require time and are risky, because the outcome may be negative. In addition, the debtor may become insolvent, which may render all recovery efforts moot. This is why, in theory, a creditor with non-performing loans, would prefer to outsource the process of debt-collection.

Another explanation comes from the nature of credit operations and their concomitant obligations. Once a credit becomes non-performing, the bank must constitute a provision for the risk. As shown, in Romania that provision was very high (40% of the value of the loan). At the same time, its insolvability risk rate is increasing, as the bank is now exposed in regard to the debt. By selling off debts arising from non-performing or risky loans, the bank obtains an amount of cash, it improves its rating and removes all exposures in regard to the assigned debtor. Moreover, once the non-performing loan is removed from its portfolio, the bank 'frees' the provisions and its costs. Thus, by selling off its debts, not only does a bank avoid the risk of unsuccessful debt-collection, but it also improves its situation in the eyes of the supervisory authority and continues to expand its business by offering new loans.[87]

A third potential explanation, following the financial crisis, stems from the prudential requirements for credit institutions[88] and investment firms after Basel

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85 The Maltese Crow, published by Rise Project's #ParadisePapers, 08.11.2017, : https://www.riseproject.ro/articol/corbul-maltez/, accessed 15.08.2019.

86 According to NACP Memoranda in OTP case, *supra* n 67, p. 104, the average discount for debt-portfolios of performing loans was 24%.

87 'The timely recognition of provisions and timely write-off of unrecoverable loans is a key supervisory focus as it serves to strengthen the balance sheet of banks and *enables them to (re) focus on their core business,* most notably lending to the economy' (emphasis added) in European Central Bank. Banking Supervision – Guidance to banks on non-performing loans, March 2017, 81, https://f.datasrvr.com/fr1/117/34697/NPL_Guidance.pdf, accessed 11.11.2019.

88 C. PROCTOR, THE LAW AND PRACTICE OF INTERNATIONAL BANKING (Oxford University Press, 2015), pp. 138–139.

III rules[89] and Regulation 575/2013 – Capital Requirements Regulation[90]. It may be that the sale of non-performing loans bundled in portfolios may be a way to reduce the capital ratio exposure of the financial institution.[91] However, the practice of selling portfolios of non-performing loans existed long before the financial crisis, thus, the adoption of Basel III and Regulation 575/2013 can only constitute a further encouragement, not an explanation for its existence. These are the general reasons for the debt seller to sell its debts, assuming that the debt-portfolio was sold to a third party, unrelated to the credit institution.

There are additional fiscal benefits to be considered, in case the transaction involves a debt-buyer belonging to the same group as the debt-seller. For instance, according to most European tax laws, all income generated within the MS will be taxed in that particular MS, at its national tax rate. By selling of debt-portfolios to companies of the same group, located in a tax haven, the credit institution achieves two additional benefits on top of those already mentioned. On the one hand, it keeps all profits generated by the collection of the debts within the group. On the other hand, it avoids paying taxes in the country of its location, by removing it from the reach of the national tax authorities and submitting it to a tax law of its own choosing, with more favorable rates.

4.2.2 The Advantages of the Debt Buyer

The debt buyer also benefits from the deal. The first and most obvious advantage is the potential for profit generated by the discounted purchase of debt-portfolios, especially in the case of non-performing loans. Even if not all debts are collected, the debt-buyer will still make a 20–30% profit of the total face value in case of consumer debt, plus interest and other costs.[92]

The second advantage is its location abroad, in a tax haven. This enables it to elude payment of taxes in the country where the debt-collection takes place and pay the rate of the chosen jurisdiction. Moreover, if the debt buyer uses the services

89 Id. at 125 and 127.

90 *Supra* n 97.

91 'Institutions can increase their capital ratio in two ways […] reduce risk-weighted assets: [a]n institution can also […], *sell loan portfolios* […], thereby reducing its RWAs, which has the effect of […] increasing its capital ratio' (emphasis added) in European Commission Memo – Capital Requirements – CRDIV/CRR – Frequently Asked Questions, 15, : https://europa.eu/rapid/press-release_MEMO-13-690_en.htm, accessed 11.11.2019.

92 Gheorghe Piperea – Cesiunea creditelor catre firmele proprii de recuperatori este la limita legalitatii, 23.03.2010, : https://www.conso.ro/citeste-comentariu/146/cons/Cesiunea-creditelor-catre-firmele-proprii-de-recuperatori-este-la-limita-legalitatii.html, accessed 15.08.2019.

of a debt administrator under its control, it will also be able to control its contractual liabilities and thus minimize its taxable income even more.

4.2.3 An Arms' Length Transaction?

The matter of discounted sales brings to the forefront the issue of an apparent lack of direct economic interest on the side of the seller, which might indicate a more hidden, indirect one. As we have shown, on the seller-buyer axis, there are significant advantages in going through with the transaction. But is there a genuine economic interest on the side of the party who sold a debt-portfolio at maximum 10% of its face value?

The issue is specifically mentioned in a memorandum issued by the NAPC in Romania in regard to the debt-sales and re-sales of debt-portfolios in the OTP case. The agency found that 'the transactions were performed in violation of the principle of fair value or the principle of arms-length transactions, according to which a transaction must be perfected exactly under the same conditions as it would have been done with a third party, otherwise there is a suspicion of tax evasion.'[93]

4.3 The Debt Buyer-Debt Collector Axis

Beside the advantages of the debt buyer, there are others originating from its relationship with the debt-collector, especially in situations where they are part of the same group. That is because the sale and potential resale of debt-portfolios within the group enables the group to engage in tax optimization across several jurisdictions, by eroding the tax base where the tax rate is high. In addition, in cases where the debt-administrator is the former debt-seller, the debt buyer benefits from using the entire apparatus and expertise of the debt-seller's employees, at virtually no cost.[94]

4.3.1 The Advantages of the Debt Buyer

By outsourcing the debt, the debt-buyer receives regular payments.[95] Moreover, it not only avoids paying tax in the country where the debt-collection process takes

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93 NACP Memoranda in OTP case, *supra* n 67, 103.

94 Preamble (F) of the Administration Contract between OTP Bank Romania SA as Asset Administrator and OTP Financing Solutions BV as Beneficiary of 8th May 2009, : https://i0.1616.ro/media/2/2621/33211/18679061/42/anexa-11-contract-administare-2009-otp-financing-solutions-otp-bank-romania-ro.PDF, accessed 14.05.2019.

95 Id at Section 2.1.2 A.

place by making use of the Conventions for prevention of double-taxation,[96] but it also holds liable the debt-administrator for any potential tax or other liabilities that may arise in the process,[97] thus maximizing its gains.

Nevertheless, beside tax shielding, manipulation of prices, expatriation of profits, the greatest advantage is circumventing the banking regulations applicable and avoiding the supervision from the national central bank (or other competent bodies). As the Bancpost and OTP Bank Cases reveal, the ultimate debt-buyer is a limited liability company. Yet these companies continue to behave as credit institutions and collect interest as if the assignment never took place. They manage to do so by using the original debt-seller (a credit institution) as a cover and by abusing the fundamental freedoms of the EU regarding freedom of movement of capital and the passport rule.

Prima facie, this might appear complicated, yet the situation is quite straightforward, as revealed by the NACP in Romania. By law, the supervisory authority in Romania in regard to credit institutions is the RNB.[98] In order to undertake activities in Romania, each credit institution needs either to have an authorization,[99] or to be authorized and supervised by the competent authority from another MS, provided it sets up a subsidiary or it performs services directly, covered by the authorization of the MS of origin.[100] However, the Dutch limited liability companies used by Bancpost or OTP are not authorized in their origin country to conduct credit activities, hence, they should not have been permitted to conduct them in Romania either.[101] This means that the debt-buyer should be precluded from collecting interests and commissions on assigned debts, as these are prerogatives belonging exclusively to credit institutions.[102] However, due to regulatory arbitrage and a blind eye from the supervisory authority, limited liability companies located in EU tax havens enjoy the benefits of a credit company and elude its obligations.

4.3.2 The Advantages of the Debt Collector

The debt-collectors' advantages from the scheme are less prominent, but not absent. Debt collectors are companies operating under the laws of the host country, which means they cannot escape tax liabilities. Hence, the regulatory arbitrage

96 Id at Section 2.1.2 B.
97 Id at Section 2.8.(vii) and Section 2.11.
98 Art 4 GEO 99/2006.
99 Art 10 GEO 99/2006.
100 Art 45 GEO 99/2006.
101 *Supra* n 95.
102 Art 5 GEO 99/2006.

mechanism designed by debt collection schemes enables them to avoid tax on collected debts (since they are not their property, and hence not part of their taxable income), but also to accumulate costs and debts, to reduce the tax liability on taxable income (as debt-collectors will be paid for services rendered, usually in the form of a commission[103]). The empirical data we collected on ten Romanian debt-collection agencies revealed that despite significant turnovers and circulating assets, these companies declare very low taxable incomes, if any, in the country where they undertake their activity and generate their income.

The debt collectors do not operate on their own money. Operations are conducted based either on commissions received, or *via* a loan provided by the parent companies (the debt-buyers). The debt-collectors operate on debt, and thus, their net income tax will be low or even negative despite a high business turnover. This aspect is verifiable. Since the debt collectors operate under the laws of the host state, their public reports are available and constituted the main source for testing our hypotheses. That the debt collection scheme is designed to maximize returns, while minimizing tax liabilities in the host country, is visible in the public reports of the surveyed debt-collection companies where, in most cases, the level of debts is higher or close in value to the annual turnover.

A distinction must be made between the situation where the debt-collectors are a third party under the control of the debt buyers, but not from the same group as the debt-sellers (Situation A) and where all parties involved belong to the same group (and the debt collector is the same person as the debt-seller) (Situation B).

In Situation A, the debt-collectors provide solely recovery services, and their main purpose is to minimize tax in the host country, while removing the net profits generated by the difference between the discounted price paid by the debt buyer and the actual value of recovered debts from the reach of the host state's tax authorities.

In Situation B, where all parties are members of the same group and where the debt-seller is the same as the debt collector, the combination of banking services and non-banking services enables the debt-seller/debt-collector to shift costs and liabilities and minimize tax liabilities in the host country for a wider range of operations. Moreover, both the debt-buyer and the debt-seller/debt collector, benefit from the confusion in relation to consumer-debtors and supervisory authorities. As it is a credit institution conducting debt-collection operations, through its internal apparatus, the appearance of legality is maintained.

103 *Supra* n 96, Section 2.6.

4.4 The Debt Collector-Consumer Debtor Axis

As already shown, the CEE region does not regulate non-judicial debt collection. This means that in most CEE countries debt-collectors operate in a legal void. In Romania, until 2017, they have not been even required to hold a license, which meant that any limited liability company could engage in debt collection operations, with no supervision, no control, and no requirements of professional diligence. Since most of these companies did not qualify as credit institutions, but as mere debt-collection agencies, they escaped supervision from the RNB.[104] In the absence of any sector specific legislation, the NACP was also largely unable to intervene.

In a completely unregulated area, debt-collection companies proliferated, especially after the financial crisis. The Romanian debt-collection market is on a continuous growing trend and generates more and more money each year. Yet, the net profits made by the debt-collectors, are not for themselves, but for their tax-haven based owners. This means that for one of the most lucrative businesses in the country, the host state is not receiving adequate tax.

The lack of regulation also means that consumer-debtors had been and continue to be exposed to a whole range of abusive practices, ranging from verbal abuse and harassment to violence and inflated debts.[105] The issue of abusive debt collection practices goes beyond the scope of this paper. However, we will mention here again that due to absent or inadequate regulation and by engaging in regulatory arbitrage, debt-collectors managed to collect interest and commissions for debt-buyers, although the latter did not qualify as credit institutions under the law. In the words of OTP Bank Romania its debt-buyer 'merely took advantage of an existing legal void.'[106]

5 Conclusions

At the beginning of our paper, we postulated that the intra-EU cross-border debt collection system is designed to maximize profits, minimize tax exposures and can potentially serve as money laundering mechanism. To test these hypotheses, we conducted a case study regarding the debt collection industry in Romania. On the one hand, we referred to two recent cases involving transfers of debt-portfolios to

104 *Supra* n 53 at point V, 5/6.
105 STANESCU, 2015, 209–263.
106 OTP Bank Romania's Answer to NACP, no 46650/21.11.2018, https://i0.1616.ro/media/2/2621/33211/18679061/12/anexa-32f-otp-bank-raspuns-2018-11.pdf, accessed 15.05.2019.

companies located in tax heavens and, on the other hand, we closely analyzed the financial data of ten debt collection agencies in Romania.

The case study revealed that the contractual nexus on which the collection industry functions is based on a tri-/multi-partite cross-border relationship (generally inside the same company group), under which debt portfolios are traded at huge discounts of the face value and then returned to the original seller/country for collection. The cross-border aspect bears important consequences, as it enables the group members to exploit the lack of harmonized tax rules and the freedoms of movement at EU level and, thus, engage in regulatory or fiscal arbitrage.

The financial figures concerning the selected debt-collection agencies revealed significant discrepancies between annual turnovers and taxable net profits and a number of anomalies which should have raised the attention of the fiscal authorities. In our opinion, the discrepancies can only be explained by the fact that the debt-collection system on which the surveilled companies operate allows them to engage in tax optimization/avoidance by base reduction, which ultimately confirms our working hypotheses. In addition, the abovementioned case studies illustrate the lack of capacity and expertise of supervisory authorities, which were unable to adequately address the said issues and to protect consumers.

Ultimately, our selected cases can serve as benchmark for deepening the awareness on the necessity to regulate non-judicial debt collection, along with tackling the risks associated with money laundering and tax avoidance arisen from regulatory arbitrage.

Based on our research, we conclude that a reconsideration of the manner in which fundamental freedoms and cross border transactions are being treated for tax purposes is needed at EU level. It is obvious that the said freedoms and rules were designed to foster trade and enable economic development, not to deprive states of taxable revenues and to subject consumers to unfair treatment. The perverse effects generated by regulatory and fiscal arbitrage – the debt collection industry is a mere example in this regard – must be tackled by coordinated and joint action of EU institutions and MS.

In regard to the risks of money laundering, we argue that it is imperative to implement mechanisms, which guarantee that 'follow the money' is the most appropriate strategy of crime-control, enable the tracing of the source of the loans, and the following of the money trail, together with confiscation, as illegal pecuniary advantage, of the proceeds of these aggressive avoidance techniques. Last, but not least, civil mechanisms of compensation should be made available to consumers.

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