



Ivane Javakhishvili Tbilisi State University
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Illicit Income Legalization – Analysis of Judicial Practice of Georgia

Legalization of illicit income is a type of transnational crime, with many questions relating to the doctrine as well as a court practice remaining unaddressed.

For example, there is still no common opinion on whether to consider the subject of a previous (predicative) crime as its perpetrator; If it is to be considered, whether it refers to any action envisaged under the objective aspect of Article 194 of the Criminal Code of Georgia (hereinafter: CC).

As for the judicial practice, it is still unclear how the legalization of illicit income differs from the crimes against the property, which constitutes group of the most common previous (predicative) crimes of acquisition of "dirty" money; or whether spending of funds possessed as a result of a previous crime (e.g. the fraud) by the offender for his/her personal intent, can be qualified as legalization of illicit income (Article 194 of CCG) and etc.

The objective of the present article is to answer the questions raised in the judicial practice, within the format of the article.

The article answers, shows, how to separate, differentiate money laundering from crimes, that are committed against property (Property Crimes). Also, who is the subject of this (Money Laundering) crime.

Key words: *Illicit income, legalization, predicative crime, organized crime.*

1. Introduction

Legalization of illicit income belongs to a category of crimes, where purely criminal issues are not given a due attention not only in Georgian but also in foreign literature.

The researchers are more engaged in research of the practical manifestation of this crime (ways of legalization of illicit income) and pay less attention to the challenges faced by the judicial practice in terms of proper qualification of the action.

My study of the judicial practice in Georgia related to the legalization of illicit income aimed to identify problematic issues faced in terms of both the qualification of the action and the imposition of a sentence.

The analysis of practice revealed that in many cases, both the investigation body and the court misunderstand the legal essence of legalization of illicit income and, therefore, the wrongful qualification of the action takes place. In particular, an action is qualified as a combination of crimes, when in essence there is one crime actually committed. In addition, the action is qualified as legalization of illicit income, when in fact another crime is in place.

Deficiencies are also observed in terms of sentencing.

* Doctoral Student at the Faculty of Law, Ivane Javakhishvili Tbilisi State University.

Present article will focus on some of the shortcomings that were identified during the qualification of the action under the Article 194 of the CC.

2. A Shortcoming Revealed in Practice, when the Action is Qualified by a Combination of Offenses

The study of practice has revealed a case where a single offense (e.g., an offense against the property) takes place; however, the action is qualified under a combination of offenses (including legalization of illicit income along with the offense under discussion).

It is interesting, whether the case is understood correctly, when a person commits a crime (e.g., fraud or appropriation) misusing his/her official position and then withdraws the funds, unlawfully (e.g., fraudulently or other illegal way) transferred to the organisation's account, from the organization's account to use it for personal needs?

The example from the judicial practice of Georgia:

On August 8, 2014, the Judicial Panel of Criminal Cases of the Tbilisi City Court considered that the criminal case (without essential consideration) with the participation of the accused K., satisfied the motion of prosecutor and brought in a verdict of guilty **in fraud** for K., considering commitment of crime using the official position and in large quantities ("a" and "b" sub-paragraph, part 3, Article 180 of CC), **in legalization of illicit income**, which considers commitment jointly by more than one person, and accompanied by receipt of large income (sub-paragraph "a", part 2, Article 194 of CC, sub-paragraph "c", part 3 of the same Article) and **in illegal participation in entrepreneurial activities by an official** (Article 337 of CC).¹

How the fraud and legalization of illicit income committed by K. is justified?

The essence of the case was as follows: On January 8, 2007, K. was appointed to the position of the Deputy Governor of Old Tbilisi District of Tbilisi. On February 15, 2009 he was dismissed from this position. Thus, from January 8, 2007 to February 15, 2009, he was a public servant. Accordingly, he was prohibited the entrepreneurial activities and the right to hold a managerial position in an entrepreneurial institution.

According to the accusation, despite the prohibition, K. and the governor of Old Tbilisi intended to use their official position to obtain additional illicit income and subsequently legalize it. In particular, they made the relatives to establish the LTD with a 25-25% shareholding on May 1, 2007. On November 16, 2010, with the change made in the Entrepreneurial Registry, they became partners of the company and K. was appointed to the position of Director of this company (who had already been dismissed from the position of the Deputy Governor).

The mentioned LTD was systematically executing the state projects. During 2007-2012 it participated in number of tenders announced by the Administration of Old Tbilisi District, Tbilisi City Hall and other state bodies, and regularly won such tenders. Whereas, in most cases, the mentioned procurements were announced by K. and the Governor of Old Tbilisi, they were ex officio responsible

¹ See, 2014 Archive of Tbilisi City Court for criminal cases (since the case materials were provided in encrypted form, the case number cannot be specified).

for determining the terms and conditions of the state procurements, leadership and membership of the tender commission, as well as concluding contracts and controlling the execution of works. Due to the felonious intent, they performed this duty unscrupulously and supplied goods to the Old Tbilisi Administration at much higher price than to other parties, hence generating illicit income.

This section of accusation relates to K.'s fraud and unlawful participation in entrepreneurial activities, committed by using an official position.

The committed act can be divided into two stages:

The first stage covers the period from 2007 to 2009, when K., as a public servant, was responsible for announcing the tenders, definition of terms and conditions of public procurements, leading and membership of the tender commission, concluding a contract and controlling the execution of the work.

During this period, he was using the official position and systematically declaring the LLC, established on behalf of his relatives, as winner in the announced tender, and the LLC, in turn, was supplying the goods to the Old Tbilisi Administration at a much higher price, with the prior agreement with them. Thus, misappropriation of someone else's property (state property) took place fraudulently, and an official position (namely, of a public servant) was used. Thus, the fraud, using official position, is present.

The second stage covers the period from 2009 to 2012, when K. was no longer a public servant, but was the official Director of the LLC. At that time, he as the executive of a private organization, using his official position, knowingly was supplying the goods to the Administration of Old Tbilisi at a much higher price. That is, he was using the method of deception to embezzle money - he lied to the Administration.

As we can observe, there is illicit income obtained through fraud, which is transferred to the account of the LLC (the Director of which is the accused K.).

How the legalization of illicit income by K. is justified? According to the judgment, it is substantiated as follows:

"In order to give a legal form to this illicit income and to cover its illegal origin, they did not distribute net profit generated by the LLC and, allegedly, for the purpose of reinvestment, invested illicit profit into the enterprise operational turnover. To disguise the unlawful action, later, they, under the name of fictitious founder of the enterprise, prepared the false minutes for the partners' meeting on profit reinvestment...

For the purpose of final legalization of a particularly large amount of income received as a result of the use of the dividend accrued from the net profit of LLC and illegal participation in the management of the entrepreneurial activity, on February 10, 2011, November 1 of the same year and January 25, 2012, K. and his old partner withdrew GEL 1 927 237 in three stages, thus creating a legal basis for the use of the mentioned illicit income for personal purposes".

Let's follow these two sections of the judgment in stages.

As we can see, according to the judgment, the first stage of legalization of illicit (received fraudulently) income was manifested in the fact that K. did not distribute the net profit generated by

the LLC, but included this illegal profit in the turnover of the enterprise ostensibly for its reinvestment, for which he later drawn up a false protocol of the partners' meeting.

If we do not consider disputable that the illicit income received by the LLC was indeed fictitiously included in the turnover of the enterprise, several issues come up:

A) In particular, what kind of practical manifestation of the objective part (giving a legal form to illicit income) is the act incriminated to the convicted person, envisaged under the Article 194 of CC (use of property, purchase of property, possession, conversion, transfer or other action is present)?

It must be noted that this issue is not addressed, even superficially, in the judgment. It simply states that there is providing legal form to illegal income present in the case and judgement describes the action committed by K. Accordingly, the subsumption of action is not in place, and this must be considered as a drawback of this judgment;²

B) In general, to what extent can the action in question be considered as a method of legalization of illicit income?

Indeed, what could be a purpose of fictitious inclusion of illicit income obtained through fraud in the turnover of the enterprise – to disguise the fact of fraud or to legalize the illicit income?

In other words, how will the fraudulent income get the legal form through its fictitious involvement in turnover (through illusory reinvestment)?

Illegal income cannot get the lawful form through this action, as reinvestment of an organization's revenue generates an obligation for that organization for its subsequent inclusion in the turnover. Consequently, if the mentioned LLC does not use (even fictitiously) this amount for further turnover, but, on the contrary, withdraws it for private persons (even the heads of the LLC) to use for personal purposes, this action in itself raises legitimate doubt and additional question – whether the fact of reinvestment was fictitious? If it was not like that, then how can it be explained that the money invested for reinvestment purposes was not used purposefully and was withdrawn from the account of the LLC by the private persons for personal use?

Therefore, a fictitious transfer of illegal income transferred by the perpetrator of a previous crime (in this case fraud) to the account of his/her organization to the reinvestment fund of the same organization **does not serve** as the method for legalization of this income. On the contrary, it is more likely to raise additional questions and may be used as evidence to expose a crime (fraud).

It is rightly mentioned in the legal literature: in order to the transactions/transfers be chaotic, vague, the money launderers primarily use a wide range of ways, methods to disguise the dirty money, conceal illegal origins, in order to further convert them, transfer them to assets in other form - to other types of assets and, finally, to integrate them into the legal economy.³

² When qualifying the action as an offense, on the issue of subsumption, see *Mtschedlishvili-Hedrich, K.*, Special case solving methods in criminal law, Tbilisi, 2010, 11-22 (in Georgian); *Turava M.*, Criminal Law, General Part Review, Tbilisi, 2013, 379-383 (in Georgian); *Gvenetadze N., Turava M.*, Methodology of Decision-Making in Criminal Cases, Tbilisi, 2005, 108-109 (in Georgian); *Dvalidze I., Tumanishvili G., Gvenetadze N.*, Special case solving methods in criminal law, with attached special case samples, Tbilisi, 2015, 61-75 (in Georgian).

³ Transnational Organized Crime Analyses of a Global Challenge to Democracy, *Schönenberg R., (ed.)*, Germany, 2013, 17.

It is recognized that the main areas, where the legislation and regulations related to money laundering need to be effective, are: 1) organized crime; 2) drug trafficking; 3) terrorism financing.⁴

According to the FATF, the legalization of illicit income is described as "the processing of criminal income to disguise its illicit origin" in order to "legitimize"⁵ the illegally obtained income.

Therefore, the action in question **can only serve as a way** to legalize illicit income, if the actual turnover of that income is formally recorded in the productive process; in other words, if another fictitious document is drawn up, thus confirming the turnover of this income in the productive process. Such a fictitious document facilitates the "confusion" and formally "removes the dirt" from the money obtained through fraud, "legitimizing" it.

However, in this case the partners of the LLC (or its Director) did not take such an action (did not draw up a new fictitious document on the further turnover of the income in productive activities).

As for **the second and final stage of legalization** of illicit income, according to the judgment, it was manifested in the fact that K. and his partner withdrew the income, obtained as a result of their unlawful participation in entrepreneurial activities, from the account of the LLC in three stages, thus creating the legal basis for personal use of the illicit income.

Several questions arise in relation to the action taken:

a) In general, in what extent can one consider withdrawal of illegal income recorded on the organization's balance from this organization, as the way of legalization of illicit income? What is a likelihood of "washing away" the "dirt" from the money with such an action?

b) If withdrawal of illicit income from an organization's account can generally be considered as means of money laundering, then why could not these individuals withdraw that income from the organization's account before it was fictitiously transferred to the operational turnover as if for reinvestment? Why did the partners need to ostensibly reinvest this income? This money has already been transferred to the legal account of the LLC and it was possible to withdraw it

The above question should be answered as follows: The partners at their discretion can withdraw the income (of course, legal as well) from the account of the LLC at any time; moreover, they even can make decision on liquidation of this LLC. No matter when the partners of the LLC withdrew illicit income – immediately after its transfer on the account or following further fictitious reinvestment, thus **they would not be able** to create **a legal basis** for its use as needed. This creates **only a factual basis** for its use. Indeed, the **fact of withdrawal** of funds from the account (especially from its reinvestment fund) of the LLC cannot be fully substantiated to prove that the money was obtained legally ("it is clean"); this fact cannot disguise its illegal origin. In other words, a person is not released from the obligation to substantiate the origin of the said amount in respect of the amount withdrawn from the account of the LLC (when the time for its further use comes) - there is no regulation that removes the obligation to substantiate the legal origin of the amount taken from the organization's account. **As for the money transferred for reinvestment in the organization**, its withdrawal for personal purposes is unlawful, because it should serve a specific purpose (further

⁴ Cox D., Handbook of Anti-Money Laundering, West Sussex, United Kingdom, 2014, 8.

⁵ Yikona S., Slot B., Geller M., Hansen B., El Kadiri F., Ill-Gotten Money and the Economy: Experiences from Malawi and Namibia, World Bank Study, Washington, DC, United States 2011, 2.

turnover) and not someone's personal purpose. Accordingly, in the present case, withdrawal of money from the reinvestment fund could not serve the legalization of this income, could not create a **legal basis** for its use for personal purposes. **On the contrary, it would have made it clear** that this money had not been used for reinvestment purposes. Consequently, such an action **creates a legal basis only** for the disclosure of these persons.

Therefore, the illicit income obtained through fraud cannot be "laundered" either by withdrawing it after the transfer to the account of the LLC, and **moreover, or** by transferring it to the reinvestment fund and then withdrawing it from there. There is no doubt that withdrawing of money from reinvestment fund for personal purposes raises legitimate suspicion and forms the basis for initiating an investigation.

It is fairly mentioned in the legal literature that throughout the history people have developed various tactics to ensure the peaceful use of their criminally obtained property, and on top of that, not leading to initiation of criminal prosecution against them and confiscation of that property.⁶

The question is: whether the action under consideration gives us **any indication** of the objective composition of the crime under Article 194 of the CC? In other words, it is true that the judgment does not focus on this issue, but the action actually taken by the convicted person could really include sign of the objective composition of Article 194 of the CC? In particular, could we have in place assigning the lawful form to illegal property **by owning** this property?

This question arises naturally, as K., withdrawing illegally transferred amount from the reinvestment fund of the LLC, actually exercised **its possession**, which, according to the first part of Article 194 of the CC, is one of the ways of assigning legal form to illegal property.

As it is fairly recognized in the legal literature, possession of property is one of the ways of giving legal form to an illegal property, if it is implemented not by perpetrator or accomplice of a previous (predicate) crime, but by a third party, who was not related to the previous crime (in this example, fraud). He/she later became involved in a criminal scheme - money laundering process. The legal definition of money laundering is very broad from an economic point of view. If even the possession of money obtained from an illegal source is called "money laundering", then money laundering is no longer an action, but simply a label for money that is of illegal origin.⁷

This means that possession of money obtained from an illegal source can only be considered as "money laundering" if it is owned **not by** the person who had committed previous act (received the money through illegal action), **but by a completely different person**.

For example, in agreement with the bank manager, the perpetrator of the previous crime transferred illegally obtained money to this bank in order to launder funds through various further banking transactions. From the moment of transferring money to the bank (before performing other actions), possession of illegal property is evident in the actions of the bank manager.

⁶ Transnational Organized Crime Analyses of a Global Challenge to Democracy, *Schönenberg R. (ed.)*, Germany, 2013, 18.

⁷ *Yikona S., Slot B., Geller M., Hansen B., El Kadiri F.*, Ill-Gotten Money and the Economy: Experiences from Malawi and Namibia, World Bank Study, Washington, DC, United States, 2011, 3.

As for the example under consideration, K. is a person who has committed the previous crime (fraud, using official position). Thus, he is not a third person. **This fact in itself precludes** the possibility of qualification of K.'s action under property possession, since the final stage of fraud naturally implies the acquisition (or possession) of a movable item.

As mentioned above, the action taken by K. (withdrawal of money from the reinvestment fund) also cannot be considered as "other action" envisaged under the first part of Article 194 of the CC, as one of the ways of giving legal form to illegal property.

The first part of Article 194 of the CC provides for other methods of assigning legal form to illegal property (use of property, purchase of property, conversion, transfer), but it is indisputable that none of them is present in the case under consideration. Thus, we will not focus on the above.

Finally, in connection to this case, it must be noted that K. has been over-charged under the Article 194 of the CC - legalization of illegal income; there are no signs of this crime in his actions.

3. Shortcoming of Judicial Practice in Case of Qualification of Action under the Article 194 of CC

The study of the practice also revealed a case, when person's action includes signs of another crime, but it is erroneously qualified under the Article 194 of the CC (legalization of illicit income).

Example: On November 12, 2013, according to the judgment of Tbilisi City Court, citizen K.K. was found guilty of legalization of illicit income in a group, which was accompanied by receiving a large amount of income (four episodes) and preparation of false settlement documentation for selling and its use (four episodes) – according to subparagraph "a", part 2, Article 194 of the CC, subparagraph "b", part 3 of the same Article and the first part of Article 210 of the CC.⁸

The essence of the case was as follows: On February 2, 2007, K., under prior agreement with citizen B., established LLC; K. K. was appointed on the position of company Director; however, the actual owner and manager of the company was B.

In the same year, the mentioned LLC has signed two agreements with Tbilisi City Hall, the total value of which (including VAT) amounted to GEL 5 405 577, fully reimbursed by the City Hall. K.K., in agreement with citizen B., misappropriated approximately GEL 1 800 000 from the mentioned amount. In particular:

According to the accusation, in order to assign legal form to misappropriated funds or to disguise the source of origin and to hide the ownership right, they have drawn up fictitious cash withdrawal orders, according to which the false pay-rolls were issued in 2007-2008, where the salaries actually paid to individual employees were artificially increased, after which said pay-rolls were registered in the LLC accounting system;

According to the accusation, K.K., in agreement with B., has drawn up fictitious cash withdrawal orders in his own name, as the Director of the organization, according to which GEL 981 900 was allocated to him in the form of a fictitious loan;

⁸ See, Tbilisi City Court Archive of 2013 on Criminal Cases. The case number could not be specified as the case materials were provided in encrypted form.

According to the accusation, K.K., also under prior agreement with B., in 2007-2008, in order to give a legal form to the illicit income, prepared false invoices, cash withdrawal orders and fictitious purchase orders, according to which they allegedly purchased goods of different denominations from various individuals and legal entities. They were preparing invoices, as if to buy goods from different persons, the above purchases not really taking place. False documents confirming the purchases were registered in the company's accounting system.

These actions were assessed by both the investigation and the city court as legalization of illicit income.⁹

How correct is the legal assessment of the committed act?

Can the artificial increase (inflation) of salaries paid to the employees of the organization be considered as a way of giving a legal form (its legalization) to illicit income?

As it is not clearly stated in the judgment under consideration, whether the total amount (GEL 5 407 577) was transferred to the account of the LLC before the commencement of works, the question **should be answered in two ways** with the stipulation that in both cases the Director of the LLC, K. K. was definitely preparing fictitious document indicated above:

1. The City Hall transferred the entire amount to the above-mentioned LLC from the very beginning (immediately after concluding two contracts in November 2007);
2. The City Hall was transferring the amount specified in the contracts to the account of the LLC in tranches, after submitting the relevant documentation to the City Hall about the work performed.

In the first case, i.e. when the amount stipulated by the agreement of the parties was transferred by the City Hall to the account of the LLC from the very beginning, the mentioned amount was already transferred to the lawful management of the Director of the LLC (as the person responsible for its activities). This means that K. K. was officially obligated to ensure its targeted spending.

Accordingly, the first option shows the money legally transferred to the account of the LLC.¹⁰

This means that there is "clean" money, which does not need to be "laundered". In addition, these funds are under lawful management of K.K., however, of course, not in his possession.

K. K. decided to acquire it unlawfully, to transfer it to his illegal possession.¹¹

As for money laundering, its implementation is caused by the requirement, according to which a false legal origin shall be created for funds/means that have been affected by their illicit origins or other individual ways. Representatives of all types of underground world feel the fear that the illegal path that helps them to receive illegal income may be revealed, leading to the detection of a crime and seizure/confiscation of funds received.¹²

⁹ See descriptive-motivational part of the judgment.

¹⁰ The question of how to qualify an action when the organization executive appropriates the amount transferred to the account of this organization on the basis of the submission of inflated expenses prepared by him/her in advance will be discussed below.

¹¹ See *Lekveishvili M., Todua N.*, in the book: Criminal Law, private section. Book I., Tbilisi, 2019, 534 (in Georgian).

¹² Transnational Organized Crime Analyses of a Global Challenge to Democracy, *Schönenberg R. (ed.)*, Germany, 2013, 17.

Thus, K.K. **faces the task** to acquire these funds by using his official positions and **not with the task of money laundering**, and at the same time he must perform the task in such a way as to disguise this action well and formally make everything look legal. In other words, K. K. **is faced with the task:**

A) to appropriate a certain part of the funds transferred to the account of the LLC;

B) to disguise the appropriation committed.

One task (and relatively easy) is to appropriate the property in your legitimate management (or in possession), but it is quite another task (and more complicated) to do this in a way to formally provide legitimacy to the action.

Indeed, the perpetrator of any deliberate crime (especially when the deliberate intent is present) makes every effort to commit crime and not leave any evidence. All the more, no surprise that a person who uses his/her official position to commit a crime and has the legal instrument to make everything look legal, uses such instrument.

This is exactly the case we are dealing with, where the appropriation takes place committed through the use of official position (subparagraph “c”, part 2, Article 182 of the CC).

As one can see, money laundering is carried out not to acquire the property that is in the lawful possession of a person, but to prevent a person from being exposed for a crime already committed and, at the same time, not to be seized of illegally acquired property, thus making it impossible to integrate it into the economy by the offender.

It is acknowledged that “illegally obtained money” includes income generated as a result of crime, fraud, corruption and evasion of the tax - regardless of whether these actions are criminalized in a given jurisdiction. A crime includes all actions that are determined by law as a “crime”.¹³

In addition, Article 182 of the CC is a special delict. Its perpetrator is not any subject of criminal law, but only a person who legally owns or administers someone else's property.

In particular, the subject of appropriation and embezzlement provided for **in the first part of this Article** is a person, who has lawful **physical access** to another's item (seller of a commercial object, distributor, etc.).

As for subparagraph “c”, **part 2, Article 182** of the CC, its perpetrator has **not only** physical (physical access is not decisive) but also **legal access** to this item, which is not characteristic of the perpetrator of the first part of Article 182 of the CC.¹⁴ This means that a person has the right to make decisions on various legal issues related to someone else's item. For example, to determine the price of an item, to regulate it, to dispose the item, to announce a tender or auction, to invest property to achieve a legitimate purpose, etc. He/she can be a civil servant, a person equated to it, or a state-political official, but also a person in a responsible position in the private sector (executive of a private

¹³ *Yikona S., Slot B., Geller M., Hansen B., El Kadiri F.*, Ill-Gotten Money and the Economy: Experiences from Malawi and Namibia, World Bank Study, Washington, DC, United States, 2011, 3.

¹⁴ See *Lekveishvili M., Todua N.*, in the book: Criminal Law, private section. Book I, Tbilisi, 2019, 522 (in Georgian).

organization, a person with representative or special powers).¹⁵ Director of LLC is exactly one of the above.

Unlike the subject of appropriation/embezzlement, the subject of legalization of illicit income is illegal or unjustified property. Thus, a necessary precondition for the realization of its objective side is that the **special subject of the crime must already be present** - Illegal or unjustified property, and only then implementation of actions (use of property, purchase, ownership, etc.), aimed at its legalization, begins for any purpose provided for in Article 194.¹⁶

It is recognized in the literature that money laundering is manifested in three types of active action (*actus reus*). Article 6 of the Strasbourg Convention¹⁷ calls on the States to incriminate three types of actions of illicit income legalization:

(i) the conversion or transfer of property, **realizing** that such property is originated/received by offence or offences set forth in sub-paragraph “a” of this paragraph, or establishes an action by a party to such offense or offenses, for the **purpose** to conceal or disguise the illegal origin of ownership/property, or to assist any person involved in the committing of such offense or offenses in order to avoid the legal responsibility for the act committed;

(ii) Disguising or concealing the true nature, source, location, placing, movement, rights directly related to the ownership/property, or ownership of the property, **realizing, knowing** that the property is originated/obtained through an offense or offenses, established in sub-paragraph “a” of this paragraph, or through participation in such offense or offenses.

(iii) acquisition, possession or use of property upon receipt and **realizing** that such property is acquired/received through an offense or offenses established in accordance with sub-paragraph “a” of this paragraph, or through participation in such offense or offenses.¹⁸

As we can see, in order to qualify an action as legalization of illicit income, **it is not sufficient** to have illegal or unjustified property, but it is **also necessary** to be aware of this fact in advance.

This initial precondition **is not in place** in the case under consideration, as the executive of the LLC had legally transferred the money from the City Hall to the account of this LLC. Thus, this property was neither illegal nor unjustified. Consequently, the question of its “laundering” should not have arisen.¹⁹

Let us consider the stages of the actions taken that, according to the accusation, were implemented for the purpose of legalization of illicit income.

As mentioned, actions include drawing up of fictitious cash withdrawal orders, according to which false pay-rolls were issued in 2007-2008, where the salaries actually paid to individual

¹⁵ About these persons see *Mamulashvili G.*, in the book: Criminal Law, private section. Book I. Tbilisi, 2019, 660.

¹⁶ See *Todua N.*, in the book: Trends of Liberalization of Criminal Legislation in Georgia, *Todua N. (ed.)*, Tbilisi, 2016, 397 (in Georgian).

¹⁷ See Convention on Money Laundering, searching, seizure and confiscation of incomes obtained as a result of criminal activities, Strasbourg, 8.XI.1990.

¹⁸ *Guy S.*, Money Laundering, A New International Law Enforcement Model, Cambridge, 2000, 113.

¹⁹ See *Todua N.*, in the book: Trends of Liberalization of Criminal Legislation in Georgia, *Todua N. (ed.)*, Tbilisi, 2016, 397 (in Georgian).

employees, were artificially increased, after which the mentioned pay-rolls were included in the accounting system of LLC.

The question arises: what legal assessment should be given to the actions of the Director of LLC when he artificially inflated the salaries actually paid to employees to create the impression that the amount in his legitimate administration (namely, the part of the amount transferred by the City Hall that was shown in the pay-roll) was ostensibly used for a legitimate purpose (employee salaries), but in fact the difference between the amounts was appropriated by him?

When the executive of this or that organization consciously inflates the amount of remuneration to be paid to employees, in order to appropriate the difference between the funds (and even manages to do that), appropriation of property (salary fund), being under legal management of a person, takes place, committed using the official position, but not the legalization of illicit income. It is acknowledged and not arguable that one of the means of appropriation by using the official position is the deliberate inflating (so-called "non-commodity operations") of real costs (including the wage costs), which gives the offender a factual opportunity to appropriate (or misappropriate) the part of property under his/her management (though not ownership).²⁰

It is rightly mentioned in the legal literature that the legalization of illicit income is gradually expanding and gaining a foothold in more sectors. In this process, the criminals and their intermediaries invent and create an innumerable number of money laundering schemes. What all these schemes have in common is that they try to conceal the "dirty" origin of existing funds and create a false legitimate presentation through a series of deals/transactions.²¹

As we can see, concealing of "muddy" ("dirty") origins of money, as well as creation of a false legitimate presentation through a number of deals or transactions, are recognized as purposes of money "laundering".

Thus, creation of false pay-rolls by the Director of the LLC, artificially inflating the amounts paid to employees, **served not** providing legal form to the misappropriated money, disguising its source of origin and concealing the ownership over it (as indicated in the descriptive-motivational part of this judgment),²² but to appropriate the property (money) under its legal management. This appropriation had to be performed in a way to ensure its perception as legal.

Indeed, if the fictitious data entry did not take place in the official document (in this case - the pay-roll), how would the LLC Director have appropriated part of the amount transferred from the City Hall to the LLC account? He did not have physical access to these funds (he did not own it physically) and had only legal access to the funds.

Consequently, it is indisputable that the director of the LLC would not have been able to do so in the given case without drawing up a fictitious document.

²⁰ See *Lekveishvili M., Todua N.*, in the book: *Criminal Law, private section. Book I*, Tbilisi, 2019, 526-527 (in Georgian).

²¹ *Transnational Organized Crime Analyses of a Global Challenge to Democracy*, *Schönenberg R. (ed.)*, Germany, 2013, 21.

²² See Archive of 2013 of Tbilisi City Court on criminal cases. 3. Since the case materials were provided in encrypted form, we were not able to specify the case number.

It should be noted here: The above should not be understood in such a way that in other cases of appropriation, when appropriation is possible even without drawing up a fictitious document, the fact of entering false data in the document should be assessed as legalization of illicit income.

It is true that entering false information in a document often serves not the appropriation of property (in many cases, appropriation using official position is possible even without such a document), but concealing the appropriation; **however, this does not mean** that the action directed to cover the fact of appropriation is legalization of illicit income;²³

Nevertheless, why is it not legalization of illicit income? Namely, is this an action to hide or disguise the source of the origin of illegal property, which is one of the signs of the objective side of Article 194 of the CC?

To find out why this question should be answered negatively, we need to distinguish between:

- a) appropriation committed using official position, when a fictitious document is drawn up to disguise the fact of appropriation (and not to carry out appropriation);
- b) legalization of illicit income carried out by hiding or disguising the source of origin of illegal property.

In the first case, the person in a responsible position has not yet acquired the illegal income, however, we have in place someone else's property, which is under his/her legitimate management (i.e., "clean" money is in place). He/she intends to acquire this property and at the same time, to acquire it in a way to be perceived as legitimate. In other words, to acquire in a way that the fact of illegal and gratuitous acquiring is not recorded in the documents. **The purpose of this action is** to increase the proprietary funds of the offender at the expense of someone else's property.²⁴

As for the subsequent use of the appropriated funds, it may not even be connected to the legalization of illicit income, i.e. the laundering of this appropriated money. In other words, the perpetrator may further spend funds gradually in a way that the question of substantiating the lawful origin of this amount does not even arise. However, whether the above issue is raised in the future, is not relevant for qualification of action as appropriation.

In the second case (in the case of legalization of illicit income), the person does not face a problem of acquiring someone else's property (he already owns the illegal income), but **a person faces completely different problem that serves a completely different purpose**. Namely, there is a problem of how to "wash away the dirt" from this property that has already been transferred to its illegal ownership. The purpose of this action is not to increase the own property at the expense of others, but to seamlessly **integrate it into the country's economy**.

²³ For detailed information on this issue, see *Mamulashvili G.*, Legalization of illicit income, in the book: Problems of criminalization and conviction of modern manifestations of organized crime in Georgian Criminal Law, Tbilisi, 2014, 147-163 (in Georgian); *Todua N.*, in the book: Trends of Liberalization of Criminal Legislation in Georgia, *Todua N. (ed.)*, Tbilisi, 2016, 396-402 (in Georgian); *Todua N.*, Money laundering and separate crimes against the property, in the book: Europeanization of Georgian Economic Criminal Law, Conference materials, Tbilisi, 2017, 43-56 (in Georgian).

²⁴ On the signs of criminal appropriation against the property, see detailed information: *Todua N.*, in the book: Criminal Law, Private Section, Book I., Tbilisi, 2019, 458-469 (in Georgian).

For example, to start an entrepreneurial activity using this property, or to buy a property of a value, for the purchase of which proving of origin of funds is necessary etc. Appropriation is not characterized by the above-mentioned purpose, even if it is committed using fictitious documents drawn up to disguise the appropriation.

It is recognized that using the financial system for achieving the criminal purposes, such as money laundering, **undermines** the functioning and integrity²⁵ (and not right of ownership) of the financial system.

The doctrine rightly states that since the "offenders" have a fear of exposing their crimes and thus face a risk of confiscation of the property, they resort to legalization of illicit income. The wider the scope of criminalization and the stronger the law enforcement authorities, the more difficult it becomes for criminals and they try harder to provide their assets with a legal form (legalization of income).²⁶

It is also rightly pointed out that one of the negative consequences of legalization of illicit income for the economy is outflow of capital (Capital Flight).²⁷

Capital outflow/flight is the indistinct and active movement of large sums of money outside the country. The Overseas Development Institute (ODI) of Great Britain determines the capital outflows as "resident/local capital outflows, motivated by economic and political uncertainty-instability."

What is the main cause of capital outflow?

There are several possible reasons for this issue, namely lack of investor confidence - these factors also include:

- 1) political unrest/unrest, which may lead to public demonstrations/risk of civil conflict;
- 2) fear that the government is planning to take the property/assets under the state control;
- 3) exchange rate volatility, e.g., expectations related to the possible devaluation;
- 4) fears concerning the stability of the country's banking system.²⁸

Moreover, as Baker (2005) argues, the outflow of "dirty money" from developing countries to the economies of advanced countries is 10 times greater than the amount of foreign aid.²⁹

As we can see, it is emphasized that money laundering damages country's economy as capital outflows may exceed capital inflows. Consequently, the above also reflects the social threats for the country's economy related to this action.

This is why the financial institutions need to pay special attention to business relationships and personal transactions, involving companies and financial institutions from the countries not applying

²⁵ Combating Money laundering and the Financing of Terrorism: A Comprehensive Training Guide, The international Bank for Reconstruction and development/The World Bank, Washington DC, 2009, 20.

²⁶ Transnational Organized Crime Analyses of a Global Challenge to Democracy, *Schönenberg R. (ed.)*, Germany, 2013, 20.

²⁷ *Yikona S., Slot B., Geller M., Bjarne Hansen, El Kadiri F.*, Ill-Gotten Money and the Economy: Experiences from Malawi and Namibia, World Bank Study, Washington, DC, United States, 2011, 12-15.

²⁸ <<https://www.tutor2u.net/economics/reference/what-is-capital-flight>> [16.03.2020].

²⁹ Stuart Yikona, Brigitte Slot, Michael Geller, Bjarne Hansen, Fatima el Kadiri, Ill-Gotten Money and the Economy: Experiences from Malawi and Namibia, World Bank Study, Washington, DC, United States, 2011, 13.

or implementing insufficiently the *FATF* recommendations; in addition, when these transactions have no apparent economic or visible legal purpose, their origin and purpose should be re-examined as thoroughly as possible.³⁰

Therefore, it is undeniable that the intent of the offender in money laundering is not to find ways of spending illegal or unjustified property, but to "wash away the dirt" from it, in order to integrate it into the economy.

Approaching the issue differently, we get the following picture:

The action of a thief, who bought various items (say, a car, clothes or jewellery) for himself, his wife or another family member with stolen money, should be qualified under the Article 177 of the CC (theft) along with Article 194 of the CC.

In addition to the above, along with the murder committed for mercenary purposes (Article 109 of the CC), Article 194 of the CC should qualify the action of the grandson, who killed his grandfather in order to come into fortune, and after receiving the fortune the same person bought the apartment (or, for example, a car) with the money received.

Accordingly, after appropriation of another person's property, further disposal of the object of offense by the offender at his/her own discretion must in all cases be qualified under Article 194 of the CC.

Moreover, according to this logic, the act of committer of theft (or receiving a bribe) presenting a stolen item (or subject of bribe) to a relative or paying off a debt using such funds, should be qualified as legalization of illicit income.

Such an approach to the issue would contradict not only the essence of Article 194 of the CC, but also the Convention,³¹ on the basis of ratification of which this Article has been included in our Criminal Code, as well as the general principles of Criminal Code.

Namely, according to the Criminal Code of Georgia, **the purpose** of introducing the liability for legalization of illicit income **is not** to qualify all cases (including spending) of further use of illegally obtained property under Article 194 of the CC. **The purpose** of introducing this norm is **quite different** and it is easy to determine, taking into account the systemic position of this Article.

Legalization of illicit income is positioned in the chapter of the Criminal Code, where the entrepreneurial or other economic activities are the specific objects³² of criminal protection against these offenses.

³⁰ Combating Money laundering and the Financing of Terrorism: A Comprehensive Training Guide, The international Bank for Reconstruction and development/The World Bank, Washington DC, 2009, 63.

³¹ See Convention of Council of Europe on Money Laundering, searching, seizure and confiscation of revenues obtained as a result of criminal activities and the financing of terrorism, Warsaw, May 16, 2005, 1st and 3rd sections of Article 6.

³² On the object of criminal protection and its types, see Criminal Law, General section, *Nachkebia G. (eds.)*, Tbilisi, 2007, 110-114 (in Georgian); *Turava M.*, Review of general section of criminal law, Tbilisi, 2013, 83-84 (in Georgian); Criminal Law, General Section, Manual, *Nachkebia G., Todua N. (eds.)*, Tbilisi, 2019, 125-126 (in Georgian).

Thus, this chapter contains Articles, some of which infringe, and some threaten³³ the entrepreneurial or other economic activities of the country. Inflow of "dirty" money into the country's economy takes place, which hinders healthy entrepreneurial or other economic activities.

The fact that money laundering is not reflected in the spending of illegally obtained property is evidenced by the opinion expressed in the literature about the dangers of various banking services.

It is considered that specific banking services are means that carry a high risk of money laundering and simplify the money laundering process. Such services may include, for example: electronic payment services, electronic banking, mobile banking and others.³⁴

In fact, these services simplify the process of legalization of illicit income, as by using this service an individual is provided with an opportunity to make bank transfers not only within the country, but also abroad, so as not to use the direct services of the bank, which could hinder suspicious transfer. Therefore, it can be said that such action is more covered up for the monitoring service. It is also faster and simpler and has a somewhat disguised nature.

Finally, we should answer the following question: Is it appropriate to consider the appropriation using official position as the means of providing legal form to illegal income? Can the property appropriated through fictitious documents look as legally obtained?

Let's discuss this issue in the context of the given case.

The Director of the LLC appropriated the part of the money legally transferred from the City Hall by entering the inflated data in the pay-rolls. In particular, he appropriated the difference between the salaries to be actually paid and the salaries actually registered. Thus, he already acquired illegal income - appropriated money.

It is interesting to understand, if the money appropriated through fictitious documents could look like ostensibly legally earned income? Namely, if the Director of an LLC is faced with the issue of investing this appropriated money in legal circulation, how would he substantiate its legal origin? Would the documents (pay-roll) registering salaries in the accounting system be useful for this purpose?

Of course - not. He cannot use this document to justify the legality of the money in his illegal possession. On the contrary, if the Director of LLC submits the employee pay-rolls to the appropriate authority in order to justify the legality of the money in his possession, he will be "self-incriminated" as the legitimate question arises: how did he get the part of the money to be issued to other persons?

Consequently, it is indisputable that the entry of fictitious data in the official document (pay-rolls) **was aimed not** at giving legal form to the illicit income, **but** at embezzlement and, at the same time, in such a way that the fact of embezzlement was to be covered (and not to "wash away the dirt" from the appropriated property).

³³ On the delict of infringement and danger, see *Tsereteli T.*, Criminal Problems, Volume 4, Tbilisi, 2010, 175-225 (in Georgian); *Tskitishvili T.*, Delict endangering human life and health, Tbilisi, 2013, 22-110 (in Georgian); *Mchedlishvili-Hedrikhi K.*, in the book: Criminal Law, General Section, *Nachkebia G., Todua N. (ed.)*, Tbilisi, 2019, 367-371 (in Georgian).

³⁴ *Chatain P. L., McDowell J., Mousset C., Schott P. A., Willebois E. V. D. D. D.*, Preventing Money Laundering and Terrorist Financing, A Practical Guide for Bank Supervisors, The World Bank, Washington DC, 2009, 223-225.

The second action, which according to the judgment is also assessed as legalization of illicit income, is that K.K., in agreement with M.B., drawn up the fictitious cash withdrawal orders in his name, as the Director of the organization, according to which GEL 981 900 was disbursed to his name in the form of a fictitious loan.

What legal assessment should be given to this fact? Can the fictitious loan be used as a way of legalization of illicit income?

To clarify this issue, the following question must be answered: was the amount, part of which has been transferred to the LLC Director in the form of a fictitious loan, an illegal income (or this was "dirty" money), or whether it was the amount legally owned by the LLC?

Undoubtedly, the amount was transferred to the account of the LLC on the basis of a proper agreement concluded with the City Hall in line with a legitimate objective. Thus, it was legally transferred to the account of the LLC. I will repeat once again that the **Director** of the LLC **was not faced with** the issue of "laundering" this amount. **He was faced with** the issue of appropriation of its part and in such a way that the appropriation would have a legitimate appearance.

Only after this action (i.e. when the Director of LLC could appropriate it), it already turned into illicit income. Consequently, in the future it may become the subject of legalization of illicit income, although, committing such an action by the Director thereafter cannot be observed in case materials.

It is recognized that the idea of money laundering is quite simple. A person who is in a possession of purchase of illegal origin, aspires, attempts to use these funds in a way that the public is not able to identify the improper origin of the funds.³⁵

As we can see, when evaluating money laundering activities, the emphasis **is not on the purpose** of offender, how to appropriate someone else's property, but on the purpose to use the already illegally possessed property so that no one can learn about its illegal origin.

Third action: According to the accusation, K. K., again under prior agreement of B., in 2007-2008, in order to give a legal form to illicit income, prepared false invoices, cash withdrawal orders and fictitious purchase orders, according to which they allegedly bought goods of different denominations from various individuals and legal entities. They were preparing invoices, as if to buy different goods from different individuals, however such purchases never took place. False documents confirming the purchase were registered in the company's accounting system.

It shall be determined, what legal assessment should be given to the fact of executive of any organization (e.g., LLC) making fictitious purchases to appropriate a part of the property (e.g., the money) under his/her legitimate management?

In this case the person, using his/her official position, appropriates part of the property that is under his/her legal control or management. Accordingly, this property is not illicit income. It becomes illicit income only after its appropriation for the purpose of misappropriation, i.e. when it is appropriated.

One of the recognized ways of carrying out appropriation by a manager is so-called "non-commodity operation".³⁶

³⁵ Cox D., Handbook of Anti-Money Laundering, West Sussex, United Kingdom, 2014, 6-7.

Unlike the legalization of illicit income, when a person buys the property with "dirty" money, or also imitates its purchase with "dirty" money (i.e. the fictitious purchase of goods takes place), in case of appropriation the fictitious purchase is made with "clean" money that is in the rightful possession or management of that person. Accordingly, the issue is not its "laundering", but its appropriation, which is carried out by the manager of the organization.

We have to also consider the second option for this case - the City Hall was transferring the amount specified in the contract to the account of the LLC not in full, but in tranches, following submitting the relevant documentation to the City Hall about the works performed by the LLC.

The director of the LLC (in agreement with the other person) was implementing the various illegal operations discussed above. In this way he was inflating the amount of money required and submitting the relevant documents to the City Hall, thus misleading it. Accordingly, the City Hall was transferring to the LLC's account the larger amount than actually required to perform the agreed work. The difference between the above amounts was appropriated by the Director of the LLC (as well as another person).

How is this version different from the first option discussed above? Namely, is appropriate to qualify the committed act as legalization of illicit income in the second version of events?

The point is that the question is more relevant for the second version, because, unlike the first version, the amount transferred to the LLC's account is not in its (LLC's) rightful possession or administration, on the basis of fictitious documents (i.e. on the basis of fraud).

Therefore, it can be said that, unlike the first version, in this version illegally received money - "dirty" money is in place.

Nevertheless, the legalization of illicit income is not present in this version either. The point is that in all cases when the illicit income takes place, the unlawful act committed does not substantiate the composition of Article 194 of the CC.³⁷

In the case under consideration, the fraud committed using official position (of course, also in large quantities and by prior agreement in groups) is in place.

Namely, the Director of LLC (along with his accomplice) uses the method of deception. Fraud precedes the transfer of money to the account of the LLC and conditions the amount of money transferred. This means that there is a causal link³⁸ between the fraud and the transfer of the inflated amount of money to the account of the LLC. In addition, when committing a fraud, the official position is used - a person holds an official position, which gives him the right to compile and sign the document to confirm its authenticity, document further submitted to the relevant body (sub-paragraph "a", part 3, Article 180 of the CC).

³⁶ On the essence of so-called "non-commodity operations" see *Lekveishvili M., Todua N.*, in the book: Criminal Law, Private section, *Mamulashvili G., Todua N. (eds.)*, Tbilisi, 2019, 527-528 (in Georgian).

³⁷ See *Todua N.*, in the book: Trends of Liberalization of Criminal Legislation in Georgia, *Todua N. (ed.)*, Tbilisi, 2016, 402-407 (in Georgian).

³⁸ See *Lekveishvili M., Todua N.*, in the book: Criminal Law, Private section, Book I. *Mamulashvili G., Todua N. (eds.)*, Tbilisi, 2019, 506 (in Georgian).

By submitting these documents to the City Hall, the Director of the LLC deceived the relevant service of the City Hall contracting the company. Proceeding from these false data presented as real, the City Hall was transferring accordingly increased amount to the LLC. The difference between the amounts was appropriated by the director of the LLC.³⁹

Thus, the use of method of deception is indisputable, because if the director of the LLC had reflected the correct data in the relevant documents, then the City Hall would have transferred much smaller amount (the amount spent for the works performed).⁴⁰

And yet, why the legalization of illicit income does not take place in this case?

As already mentioned, the point is that by drawing up and using fictitious document, by which the fact of money transfer to other persons (and not to that person) is formally lawfully proved, the Director of LLC cannot create the legal basis necessary for substantiation of legality of illegally obtained income. **These documents cannot serve to prove** that this amount fell into the hands of the Director of the LLC in a lawful manner. **This document may be used only to prove** that the money was lawfully moved to other persons (e.g. the employees). Thus, on the contrary, such a document will most likely create a legal basis for the disclosure of the Director of LLC.

Accordingly, creation and use of a fictitious document only serves the transfer of property to the LLC's account via fraud and gives the impression that the LLC (and not its Director) allegedly received the money on a lawful basis and also spent it for lawful purposes.

Thus, the fraud committed using official position takes place.

4. Conclusion

The following conclusions are made in the article regarding the legalization of illicit income:

1. Withdrawal of money illegally transferred to an organization's account as a result of an offense committed using the official position (e.g., fraud or appropriation) for the purpose of personal use, cannot be assessed as legalization of illicit income;

2. A fictitious reinvestment of funds credited to organization's account into a productive turnover, as a result of a crime committed using official position (e.g. fraud), **can only be considered** as legalization of illicit income if second stage is carried out before the offender withdraws funds from the account of the organization – other fictitious document is prepared confirming turnover of this income in the productive process;

3. Possession of property can only be considered as one of the ways of giving a legal form to illegal property, if it is committed not by a perpetrator or accomplice of a previous (predicative) crime, but by a third party, who was not related to the previous crime and, thus, became involved in a criminal scheme - in the process of money laundering;

4. Unlike the subject of appropriation/embezzlement, the subject of legalization of illicit income is illegal or unjustified property. Thus, a necessary precondition for the implementation of its objective

³⁹ Comp. *Todua N.*, in the book: Trends of Liberalization of Criminal Law in Georgia, Tbilisi, 2016, 401 (in Georgian).

⁴⁰ Comp. *Ibid*, 401-402.

side is that **a special subject of the crime is in place** - illegal or unjustified property, and **only after that** the implementation of actions aimed at its legalization (use of property, purchase, possession, etc.) begins, for any purpose provided for in Article 194 of the CC;

5. If the executive of any organization deliberately inflates the amount of remuneration to be paid to employees in order to appropriate (and even manage to do so) the difference between the amounts, the appropriation of property (salary fund) being under lawful administration of a person **takes place**, committed by using the official position **and we do not** have legalization of illicit income in place;

6. When legalizing the illicit income, a person is faced not with the problem of acquiring someone else's property (he/she already took a possession of illegal income), but with the problem to somehow "wash away the dirt" over property that has already been transferred to his/her illegal ownership, but is not yet possible (or risky) to integrate it into the economy. **Accordingly, the purpose of the action is not** to increase his/her property at the expense of another and without the will of the rightful owner, **but** to integrate the already owned property into the economy of the country without hindrance; for example, to start an entrepreneurial activity using unjustified or illegal income, or to acquire property of a value for the purchase of which it is necessary to justify the origin of money, etc.;

7. When a fictitious loan is registered using the amount transferred to the organization's account (for the purpose to appropriate this amount) for a legitimate purpose, appropriation and not legalization of illicit income takes place, because this money is not "dirty" and does not need "laundering";

8. Implementation of fictitious purchases (so-called non-commodity operations) with the money in the rightful possession of the organization for the purpose of appropriation of the money also does not represent the legalization of illicit income, as it does not serve money "laundering" (it is not "dirty") but appropriation of property under lawful possession;

9. For qualification of action under the legalization of illicit income, it is not sufficient just to have illegal or unjustified property, but it is also necessary for a person to be aware of this fact in advance.

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