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Tackling offshore tax evasion and avoidance: progress has been made, but this is not enough[1]

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Offshore tax non-compliance and lost revenues on hidden assets overseas, are long-standing issues. Tax competition and economic unfairness, as well as the opacity that offshore tax non-compliance leads to, can undermine effective markets. On top of this, bank secrecy can enable money laundering and increase income and wealth inequality. However, this is not only a problem for one country, but rather an international one that requires strong international commitment and coordination – unilateral actions are not enough by themselves to curb tax evasion and avoidance.

For this reason, there is a set of information exchange frameworks negotiated at the OECD and delivered through its member countries. The landmark framework that enables the automatic exchange of information to the tax authorities is the Common Reporting Standard (CRS), or the Directive on Administrative Cooperation (DAC) in the EU. With 167 members participating in the Global Forum on Transparency and Exchange of Information for Tax Purposes, around EUR 114 billion in additional revenue has been generated through voluntary disclosure programmes. However, this number is just a bit more than 1 % of the EUR 10 trillion of assets that are held offshore.

The progress made has been substantial, but much remains to be done. Implementation should be enforced, not only with the automatic exchange of information, but also in the context of beneficial ownership registries. Information exchange frameworks should be adapted to the current realities (i.e. crypto-assets) and there should be an expansion of the assets under their scope (e.g. real estate, art, gold). Tax authorities need to be equipped with all the necessary tools (e.g. artificial intelligence) and rules that will allow them to identify tax compliance risks and process the collected data. International cooperation and communication between jurisdictions and different standard setters should be strengthened, as well as within-country communication between the relevant authorities.

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[1] This Policy Brief builds on the discussions held during a half-day conference organised by ECMI-CEPS in cooperation with the UK Mission to the European Union on 'Tackling offshore tax evasion and avoidance', on 21 March 2023.

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We have come a long way

Fifteen years ago there was very limited exchange of tax information, and it was very easy for a taxpayer to hide information from their relevant authority by simply opening a bank account in a jurisdiction with banking secrecy. However, since then many things have changed and several initiatives have been launched in the field of international exchange of tax information, thanks to the consensus of the international community and strong political will.

One of the first steps in this direction was the Multilateral Convention on Mutual Administrative Assistance in Tax Matters ('the Convention'), which was developed jointly by the OECD and the Council of Europe in 1998 and amended by Protocol in 2010. The Convention – one of the most comprehensive multilateral instruments for tax cooperation – enabled cooperation and information exchange relationships to be established between 147 jurisdictions without having to enter into bilateral agreements.

A few years later, an initiative to combat tax evasion at the global level was taken. In the wake of the global financial crisis in 2009, the G20 under the UK presidency took action to end the era of bank secrecy by compelling tax havens to sign bilateral treaties providing for the exchange of bank information. Although the exchange of information upon request (EOIR) was a major step forward, there was still a major limitation – a request could only be initiated if there was already an indication of non-compliance. Thus, very quickly, the discussion shifted towards the automatic exchange of information (AEOI), meaning a systematic exchange without being triggered by a request from another jurisdiction.

These discussions were sparked by the US Foreign Account Tax Compliance Act (FATCA), a unilateral law enacted in 2010 requiring financial institutions all over the world to report US account holders to the Internal Revenue Service (IRS). But FATCA put EU financial institutions in a dilemma. They had to either choose to comply with FATCA – in which case they would breach EU data protection rules[2]. Or they had to choose to comply with the EU data protection rules – in which case they would suffer a 30 % withholding tax on all income received from the US[3].

This resulted in discussions between the US and G5 countries to implement FATCA on the basis of the international exchange of information. Instead of EU financial institutions reporting directly to the US, they would report to their own country's authorities which would then exchange that information on their behalf with the US. This has been the actual template for AEOI.

In 2013, the G8 – again under a UK presidency – asked the OECD to come up with a plan on how FATCA intergovernmental agreements can be utilised as a basis for a multilateral framework for AEOI. In 2014, the standard for AEOI was developed, also known as the Common Reporting Standard (CRS). CRS calls on jurisdictions to obtain information from their financial institutions and automatically exchange it with other jurisdictions on an annual basis. In the EU, the legal basis for administrative cooperation in the field of direct taxation between Member States was established with the Directive on

[2] FATCA requires non US financial institutions to report the identities of their US customers and any assets they hold to the US government, via 'intergovernmental agreements' signed with the countries in which foreign financial institutions are located. However, the exchange of personal information between public authorities under existing international agreements need to comply with the General Data Protection Regulation (GDPR). This means that EU Member States must breach their own laws in order to comply with US law.

[3] Under US domestic tax laws, a foreign person is subject to 30% US tax on the gross amount of certain US-source income.

Administrative Cooperation (DAC). Since 2011 and the adoption of DAC1, the Directive has been amended several times.

The UK was one of the first countries that signed up for mandatory disclosure rules and one of the first to implement CRS. It was also one of the four countries (alongside Australia, Canada and the US) that initiated the Joint International Taskforce on Shared Intelligence and Collaboration (JITSIC). This is a platform under the auspices of the OECD's Forum on Tax Administration (FTA) that brings together 42 national tax administrations to collaborate and share expertise in tackling tax evasion and avoidance. Furthermore, the UK is member of the Joint Chiefs of Global Tax Enforcement ('J5'), a set of countries (Australia, Canada, the Netherlands and the US) committed to combating transnational tax crime through increased enforcement collaboration.

What can we learn from data?

CRS is a real game changer for many reasons. First, it has a much broader scope than any of the exchange frameworks developed thus far in terms of products, financial institutions, and account holders covered. Second, it is a broadly adopted standard with more than 110 CRS-committed jurisdictions. Third, it has generated around EUR 114 billion of additional income[4]. Fourth, it has helped to identify about 111 million financial accounts held offshore covering more than EUR 10 trillion of assets.

Regarding taxpayers and their reaction to CRS, BIS data on banks' cross-border deposit liabilities reveal that there is a gradual decrease of cross-border deposits held in tax havens, of about USD 45 billion. Although this number may seem small, it is worth remembering that it based only on those tax havens that participate at exchanging tax information. Or, to put it into perspective, it is bigger than Estonia's and Latvia's GDP combined.

However, a more granular examination shows significant differences on the implementation of a global standard like CRS at national level. In particular, the reduction is greater when the tax authority of the receiving country uses highly digitalised means to analyse the collected data. Or when the tax authority of the sending country has a higher level of enforcement. Thus, it is not only about having the law in place, but more importantly, about implementing it.

Equally important effective communication about CRS by tax authorities to taxpayers. When tax transparency laws are in place or have been recently implemented, the literature finds that there is an increase in the reporting of previously undeclared income and wealth. Although, the increased reporting is mainly due to small amounts held by taxpayers in non-tax havens, it highlights that cross-border tax evasion is definitely not over and there are still areas where improvements are necessary.

One country for example that does not participate into CRS is the US. It has been shown that after the introduction of CRS, there was a reallocation of USD 55 billion to the US. Another form of cross-border tax evasion is the relocation to non-reportable assets (e.g. real estate, artwork). For example, an increase in the purchase of real estate in the UK by companies or individuals located in tax havens has been observed. This is more evident when there is a shock to the economy, and investors decide to move their assets outside the country.

[4] This figure may represent a minimum estimate, given that jurisdictions have reduced their level of secrecy which acts as a deterrent.

Furthermore, there are also cases of exploitation of citizenship and residence by investment programmes (in the context of CRS but also in relation to other mandatory disclosure rules like the DAC6). This exploitation has resulted in an increase of cross-border deposits held by residents of countries that offer citizenship if a significant financial investment is made. Finally, and despite the fact that third-party reporting significantly increases the likelihood of compliance and detecting noncompliance in comparison to self-reporting, evidence shows taxpayers avoid reporting by converting third-party reporting to self-reporting. FATCA and CRS's decision to impose reporting obligations on private investment entities provides tax evaders with a simple – yet effective – way to avoid reporting their offshore financial assets.

Beneficial ownership registries

Beneficial ownership can be broadly interpreted. It does not only include persons who hold a significant economic stake in a legal entity, but also those who can exercise a degree of control over a legal entity (regardless of their economic stake). Thus, there are different understandings of beneficial ownership across different countries, with some of them relying on legal ownership, while others on economic ownership. All these different interpretations offer an opportunity to avoid disclosure.

By definition, a country cannot exchange information on beneficial ownership if there is not a registry in that country. For example, this is the case for Switzerland. Although it is part of the AEOI framework (exchanging about 2-3 million datasets per year) and the principles of FATCA have been transposed into local law, this is on a non-reciprocal basis. This means that the country is only able to send information on US citizens' accounts in Switzerland but cannot receive information on Swiss citizens' accounts in the US. To put that into perspective, Swiss authorities send about 22 000 datasets per year and receive only about 200 back[5].

Thus, the first step is establishing a beneficial ownership registry in every country. In fact, such obligation already exists at the international level, while the Global Forum monitors and peer reviews implementation across countries on a regular basis. Moreover, technical and legal assistance is also provided. However, if a country does not subscribe or align to international standards and meet certain criteria, then defensive measures or sanctions may kick in, and result to the offending country being listed as a non-cooperative jurisdiction.

Although it is important to introduce legal changes on paper, it is more important to make sure that they are implemented in practice, enforced, and deliver the expected outcomes. Regarding beneficial ownership registries, there are countries in which a registry exists but implementation is ineffective, verification elements are missing, or regulatory arbitrages are present. Thus, priority should be on properly implementing the rules and ensuring that beneficial ownership registries are as efficient and effective as possible.

Europe has achieved a lot, but...

To ensure that all actors have the appropriate tools and use them in an effective way, the European Commission has recently established a peer review system to identify best practices within the EU. For example, this also entails artificial intelligence (AI) and how it can be a helpful tool in the hands of

[5] However this is also related to the constitutional structure of the country. Switzerland is highly federalist and structured on three levels: the Confederation, the 26 cantons, and the more than 2 000 municipalities. This means that each canton needs to request information separately.

Member States to tackle tax evasion and avoidance. There are currently Member States that don't use AI, so although they receive billions of data points, they cannot use them. In short, just receiving the data is not enough.

Regarding beneficial ownership registers, there is the need to make better and bigger use of them. In the EU, since 2018 the Fifth Anti-Money Laundering (AML5) Directive requires Member States to ensure that national registers of beneficial ownership of legal persons – established by AML4 in 2015 – are publicly available. However, there are several aspects that still need to be solved. Perhaps the most important is the Court of Justice of the European Union's recent decision in November 2022, which declared invalid the provision requiring EU countries to provide public access to beneficial ownership registers[6]. Although this is a major setback, an alternative way forward may be to make public access under a different legal basis (e.g. under the Company Law Directive). Moreover, discussions are ongoing on how to reform the criteria used by the EU Council's Code of Conduct Group for establishing the blacklist of uncooperative tax jurisdictions.

On tax intermediaries, the European Commission is planning to introduce new rules that will target intermediaries and prevent them from helping taxpayers to create structures in third countries leading to tax evasion or aggressive tax planning. The legislative proposal, that is expected later this year, will also include a definition of aggressive tax planning.

As for the Commission's draft directive on the misuse of shell entities fort tax purposes (known as the Anti-Tax Avoidance Directive, ATAD3 or Unshell Directive), which was approved by the European Parliament in mid-January 2023, it is expected to have a substantial impact on European holding structures. ATAD3 will not only allow the automatic exchange of certain information between Member States, but also give them the right to request other Member States to audit specific entities. As a next step, the EU Council will have the final say on its adoption and subsequent implementation into domestic legislation by Member States. However, there are efforts to water it down, as Member States are concerned about the consequences of the directive on bilateral tax agreements that pertain to shell companies.

The European Commission's efforts to close all potential tax-related loopholes and be up-to-date with international developments and with technological advancements are laudable. However, over a 12-year period, there have been six amendments to the DAC, and it is currently discussing a seventh one. On top of that, there is the Unshell Directive, Pillar Two, and several other proposals. Constant changes do not allow the legislation to sink in and they increase the compliance burden on tax authorities, taxpayers, and tax advisors. There are also different interpretations of the legal framework across Member States that are not consistent. This creates a sense of compliance fatigue that may run counterintuitive to the goal of tackling tax evasion and avoidance.

A lot remains to be done

Although a lot have been achieved in the fight against tax evasion and avoidance, this is not enough and there are still several areas where further work is needed. The first is implementation. Despite the

[6] Another example is the European Court of Human Rights' decision on the case of L.B. versus Hungry. The Grand Chamber's decision was in favour of the taxpayer and against Hungary, which has been publishing the names and addresses of tax defaulters. Although both cases concluded in favour of privacy against transparency, they also illustrate that there is no clear legal framework or legal certainty with regards to the outcome. Each case is assessed individually based on its particularities.

110 jurisdictions that have implemented CRS, there are still others that need to do so. But even those that have implemented CRS are not finished with implementing it. In November 2022, the Global Forum published the results of the peer review of the automatic exchange of financial account information. These show that there is still work to be done, both from a sending country's perspective – to ensure that financial institutions comply with the framework and collect all the necessary data – and a receiving country's perspective – to ensure that all information is used effectively.

CRS is subject to some limitations that are related to assets that do not have compatible framework in place, for example real estate, art and gold, as well as delays with exchanging information under CRS, a year after the income was generated. This means that the nature of the information does not lend itself to compliance by design. Moreover, there are challenges related to the sharing of CRS information with law enforcement agencies that need access to this information. Thus, that process seems to be difficult and subject to a number of conditions.

From a design perspective, CRS must be adapted to fit with current realities. The OECD has done a comprehensive review of the standards over the past few years and since the publication of CRS, but the financial landscape has evolved, particularly since the rapid emergence of crypto-assets. Based on this, in October 2022, the OECD published the final rules and commentary of the Crypto-asset Reporting Framework (CARF), as well as enhancements to CRS. CARF aims to capture all transactions involving crypto-assets by requiring reporting at transaction level (rather than reporting held assets as done under the CRS). As for CRS's enhancements, these are related to due diligence procedures, additional fields of reporting, and changes to definitions (e.g. 'financial account', 'investment entity') to allow a broader scope of reporting while avoiding duplicate reporting with the CARF.

As economies develop and new financial products and services become available to citizens, taxpayers, and businesses, so do the opportunities for those want to avoid or evade tax. From a tax authority's perspective, identifying tax compliance risks and being able to tackle them, requires special rules that would provide them with the necessary data. Furthermore, it's absolutely key that tax administrators, tax authorities, and governments have the right tools at hand to use and analyse the collected data in the most effective and efficient ways[7].

International cooperation and communication are vital. After more than 10 years of standard setting within the OECD, there is the need to avoid having multiple standard setters and different requirements across jurisdictions. Mutually agreed international standards should be respected and applied consistently, and not be supplemented by governments, local tax authorities or other standard setting bodies.

On top of international cooperation, it is equally important to foster and strengthen cooperation between authorities within countries. For example, while anti-money laundering is more of a due diligence issue for the financial supervisory institution in the country, CRS is the responsibility of the tax authority. Therefore, and given that the same type of information is relevant to multiple authorities, there is a need for more cooperation and the exchange of information and data across different

[7] In addition, and as technology rapidly evolves, so does the demand for IT transformation. UK tax authorities, for example, to ensure that taxpayers understand their tax obligations and complete their income returns correctly, are using digital prompts. These are specifically tailored real-time messages, aimed at helping taxpayers avoid errors and omissions. Moreover, by reviewing thousands of offshore disclosures to find the most common errors preventing taxpayers from getting their offshore tax declarations correct, authorities use these insights to develop education awareness products, including YouTube tutorials, on foreign income and double taxation.

administrations within countries. Having interconnected registers, linked in a searchable and intelligent way with reciprocity and access rights, would largely benefit taxpayers and authorities.

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