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Tax Evasion and Incomplete Tax Transparency

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Abstract: This article discusses the impact of incomplete tax transparency on tax evasion. While FATCA and CRS address some forms of tax evasion, tax evaders may still use other tax evasion opportunities. Anti-tax evasion measures might not be effective or cost-efficient if tax evaders can continue evading taxes through alternative tax evasion channels. Automatic exchange of information (AEOI) might also exacerbate the social harm from tax evasion if tax evaders take costly actions to avoid reporting. This article explores policy responses that could better address the problems created by incomplete tax transparency.

Keywords: tax evasion; tax transparency; AEOI; CRS; FATCA; beneficial ownership register; cryptocurrencies

1. Introduction

The U.S. Foreign Account Tax Compliance Act (FATCA) and the international Common Reporting Standard (CRS) were enacted to combat tax evasion. These automatic exchange of information (AEOI) regimes put a spotlight on one form of tax evasion: holding reportable financial assets in compliant financial institutions (FIs) in jurisdictions that implement FATCA and CRS. For example, a Canadian tax resident who holds a bank account in Switzerland will be reported to the Canadian tax authority. Many tax evaders, especially those who were not aware of FATCA and CRS when they became effective, were caught in the AEOI headlights. Some tax evaders voluntarily disclosed their previously undeclared offshore funds. However, it is possible that other tax evaders have not been deterred or caught by AEOI because they shifted their undeclared offshore financial assets to other tax evasion channels that are not subject to AEOI (De Simone et al. 2018).

What are the main tax evasion channels in the era of AEOI? First, tax evaders may invest in offshore non-financial assets. The direct ownership of non-financial assets, such as real property, precious metals, artwork, and collectibles, is not reported to foreign tax authorities under FATCA and CRS. Cryptocurrencies are also not subject to AEOI where they are not held by FIs and where they are not classified as financial assets. It is possible that some tax evaders emptied their offshore financial accounts before the start of AEOI by buying real estate or other non-financial assets. Second, tax evaders may still hold unreported offshore financial assets by using noncompliance opportunities and loopholes that undermine the effectiveness of FATCA and CRS. Third, onshore assets are not subject to AEOI. In some countries, tax authorities may know more about their taxpayers' offshore financial assets than they know about their taxpayers' onshore assets. This increases the incentive for tax evaders to engage in onshore tax evasion. The result of these tax evasion opportunities is that the tax transparency created by AEOI is limited and easy to circumvent.

The experience with AEOI teaches important lessons about limited tax transparency. Blocking some tax evasion opportunities but not others may result in a limited effect on the overall tax evasion as many tax evaders could take advantage of the tax evasion opportunities still available (De Simone et al. 2018). The benefit of reporting regimes and other measures that do not lead to

complete tax transparency might not justify the cost of such measures. When policymakers assess the potential benefits and costs of any particular anti-tax evasion measure, they should take into account the behavioral response of tax evaders that may avoid detection by shifting assets into other tax evasion channels.

Tax evaders may undertake costly actions in order to avoid AEOI reporting. For example, assume that a tax evader uses unreported offshore funds to buy offshore real estate to avoid AEOI reporting. This investment might be suboptimal because it is driven by tax evasion considerations. Also, the tax evader may decide to keep the property unused, instead of renting it out, because of the concern that if the rental income is accumulated in a financial account, it would be reported. These costs increase the harm to society from tax evasion (see generally [Slemrod 2017](#)).

To better fight tax evasion, policymakers should consider how to address the limited effectiveness of the current measures against tax evasion. This article discusses various measures that would enhance tax transparency, including the following: adopting AEOI-like reporting regimes for real estate, precious metals, and artwork; making changes in beneficial ownership registers to make the information more useful for tax authorities; amending FATCA and CRS to eliminate loopholes and noncompliance opportunities; and improving measures to detect onshore tax evasion. Complete or near-complete tax transparency would curb tax evasion more effectively, but the cost of complete tax transparency would be very high. The compliance costs for AEOI are already very large ([Byrnes 2017](#)), and achieving complete tax transparency would entail even higher compliance costs. Complete tax transparency would heighten serious concerns that have been raised about privacy ([Hatfield 2018a, 2018b](#)). The expected benefits of complete tax transparency should be compared to the costs.

This article is organized as follows: Section 2 provides an overview of the FATCA and CRS reporting regimes. Section 3 reviews the main tax evasion opportunities in the era of AEOI. Section 4 explores ways to address these tax evasion opportunities. Section 5 considers the potential benefits and costs of such measures. Section 6 offers a conclusion.

2. FATCA and CRS

This section reviews what information is reported under FATCA and CRS. The FATCA rules summarized here are from the U.S. Internal Revenue Code, regulations, and intergovernmental agreements for the implementation of FATCA.¹ The CRS rules summarized here are from the CRS ([OECD 2017](#)) and the OECD's guidance materials (available on the OECD website) including the CRS Implementation Handbook, Commentaries on the CRS ([OECD 2017](#)), and CRS-related Frequently Asked Questions.

FATCA and CRS reporting is generally required by FIs in participating jurisdictions if such FIs maintain the financial accounts of reportable persons. Under FATCA, reportable persons are U.S. persons, which include U.S. citizens, permanent residents, and other U.S. tax residents. Under CRS, subject to limited exceptions, reportable persons are tax residents of reportable jurisdictions. Each jurisdiction that implements CRS enters into AEOI relationships with other jurisdictions through bilateral competent authority agreements or the CRS Multilateral Competent Authority Agreement (MCAA). When two jurisdictions have entered into an AEOI relationship, FIs from one jurisdiction should identify the tax residents of the other jurisdiction as reportable persons. Under the FATCA legislation and regulations, all FIs outside the United States are required to report the information of their U.S. account holders to the Internal Revenue Service (IRS). Otherwise, noncompliant FIs would be subject to FATCA withholding tax on certain payments. The United States has entered into intergovernmental agreements (IGAs) with over 100 countries for the implementation of FATCA by the FIs in these countries. Even if a country has not entered into an IGA, its FIs are nevertheless subject

¹ I.R.C. §§ 1471-4; Treas. Reg. §§ 1.1471-1.1474; Rev. Proc. 2014-47.

to FATCA withholding if they do not comply with the regime. Many countries have enacted legislation incorporating FATCA and CRS into their domestic laws.

There are four categories of FIs: custodial institutions, depository institutions, investment entities, and specified insurance companies.² Custodial institutions are entities that maintain a substantial portion of their business financial assets for other persons or entities. Depository institutions (e.g., banks) are entities that accept deposits from customers. Investment entities (e.g., funds) are entities that primarily conduct certain financial activities for their customers. These activities include trading in financial assets, portfolio management, and “otherwise investing, administering, or managing Financial Assets or money on behalf of other persons.”³ An entity that is managed by an FI, and whose gross income is primarily attributable to investing financial assets, is also classified as an FI under the investment entity category. This category includes many private-wealth holding structures such as trusts and private investment holding companies. Lastly, specified insurance companies are insurance companies that issue cash value insurance contracts or annuity contracts.

FIs must implement certain due diligence procedures to identify account holders that are reportable persons (i.e., U.S. persons or tax residents of reportable jurisdictions).⁴ If an account is held by a passive non-financial entity (Passive NFE), the controlling persons of such entity must be identified, and the information regarding their tax residency should be obtained to determine whether they are reportable persons. The implementation with respect to preexisting accounts is generally based on the information the FIs have in their records on their existing clients (preexisting accounts for FATCA purposes are accounts that existed on 30 June 2014; for CRS purposes, the relevant dates are generally 31 December 2015 for jurisdictions that were early adopters of CRS, and 31 December 2016 for other jurisdictions). For new accounts, FIs must obtain self-certification forms from the account holders prior to opening the account. The FIs must assess the reasonableness of the self-certification based on the information they have on the account holders, including the information obtained pursuant to anti-money laundering (AML) and “know your customer” (KYC) procedures. If any of the employees of the FI knows or has reason to know that the information provided by an account holder is incorrect, or if a change in circumstances is identified, the FI must act on this knowledge and reject information that is incorrect or unreliable.⁵

Reporting is required where an FI identifies that one or more of the account holders (or controlling persons of Passive NFE account holders) is a reportable person. The following information must be reported under FATCA and CRS:⁶

- (a) The reportable account holder/controlling person’s name, address, jurisdiction of residence, and, subject to exceptions, tax identification number (TIN) and date of birth.
- (b) Account number.
- (c) The FI’s name and identifying number.
- (d) The account value or balance at the end of the relevant calendar year, and:
 - i. where the account is a custodial account, dividends, and proceeds from the sale or redemption of financial assets paid to the account during the relevant calendar year;
 - ii. where the account is a depository account, the gross amount of interest paid to the account during the relevant calendar year; and
 - iii. where the account is a cash value insurance contract, annuity contract, or debt or equity interest in an investment entity FI, the gross amount paid or credited to the account holder during the relevant calendar year.

² I.R.C. § 1471(d)(5); Treas. Reg. § 1.1471(e); CRS § VIII.A.

³ CRS § VIII.A.6.b.

⁴ Treas. Reg. § 1.1471-4(c); CRS § II-VII.

⁵ Treas. Reg. § 1.1471-4(c)(2)(ii)(A); OECD 2017 at 203-4.

⁶ I.R.C. § 1471(c)(1); Treas. Reg. § 1.1471-4(d); CRS § I.

Where the account was closed during the year, the fact of closure should be reported under CRS. Under the FATCA IGAs, the account balance immediately before the closure should be reported. Under the FATCA regulations (which apply in the absence of an IGA), the value or amount withdrawn from the account in connection with the closure should be reported.

3. Tax Evasion Opportunities in the Era of AEOI

FATCA and CRS try to curb tax evasion, which should increase tax collection from previously untaxed income. As CRS is in its early stages of implementation, it is too early to tell whether CRS reporting will increase tax collection. The experience with FATCA, however, raises questions about the effectiveness of this reporting regime. According to [Byrnes \(2017\)](#), “except for the extraordinary penalties assessed, little additional tax has been collected. In comparison to the annual on budget spending by the U.S. government, the actual amount of tax collected by FATCA is statistically insignificant.” If FATCA has not increased tax collection, one possible explanation is that the tax gap was not as large as it had been previously estimated. Another possible explanation is that FATCA has not been effective in catching and deterring tax evaders.

[De Simone et al. \(2018\)](#) show evidence consistent with U.S. taxpayers reducing their cross-border investments from tax havens in response to FATCA. Some tax evaders voluntarily disclosed their previously undeclared funds. This reaction is consistent with the results in [Johannesen et al. \(2018\)](#) that document increased tax compliance in the United States following enforcement measures that targeted offshore tax evasion prior to FATCA (see [Oei 2018](#) and [Noked 2018a](#) for further discussion regarding the voluntary disclosure policies in the United States). While some tax evaders voluntarily became compliant or were detected by tax authorities through AEOI, it is possible that other tax evaders continue to evade taxes by shifting undeclared funds into tax evasion channels that are not subject to AEOI ([De Simone et al. 2018](#)). This section discusses how tax evaders may escape reporting in the era of AEOI (for further discussion on tax evasion opportunities, including the ones reviewed in this article, see [Knobel and Meinzer 2014](#); [Morris 2017](#)).

3.1. Offshore Non-Financial Assets

AEOI only applies to financial accounts maintained by FIs. The FATCA definition of “financial assets” includes partnership interest, commodity, notional principal contract, insurance contract or annuity contract, or any interest (including a futures or forward contract or option) in a financial asset mentioned above. The CRS definition is similar, and it adds that “the term ‘Financial Asset’ does not include a non-debt, direct interest in real property; or a commodity that is a physical good, such as wheat” ([OECD 2017](#)). The direct ownership of the following assets is not subject to AEOI:

Real property. Tax evaders may avoid reporting under FATCA and CRS by investing undeclared funds into real estate. [De Simone et al. \(2018\)](#) document an increase in residential real estate investment since 2012 in countries without foreign buyer restrictions, which may be explained by tax evaders’ investments of undeclared funds into real estate, although there may be other factors that explain this increase. It is unknown as to how much undeclared money has been invested in real estate in order to avoid reporting, although media reports indicate that this form of tax evasion might be quite common (see, e.g., [South China Morning Post 2017](#); [The Straits Times 2016](#)). Where a tax evader rents out such property, the rental payments are typically made to a bank account in the country where the property is located. The account balance at the end of the calendar year will be reported if the tax evader is a tax resident of a reportable jurisdiction. Tax evaders that are concerned about this reporting may decide to avoid renting the property out. Alternatively, as further discussed below, tax evaders could empty the account before the end of the calendar year. There will be a reporting of the existence of the account, but the reporting of accounts with low or no balance might not attract the attention of the tax authorities. The cash from the account can be used to buy other unreported assets, as discussed below.

Gold and other precious metals. Precious metals, owned directly, are not considered “financial assets.” Therefore, holding such assets should not trigger reporting, even if they are kept in safety deposit boxes in banks or custodial institutions. Tax evaders may also store such assets in the facilities of non-financial companies that are not subject to any reporting requirements.

Artwork and collectibles. Such assets are not considered financial assets, and there is no reporting regime that applies to them. Tax evaders will likely avoid purchasing artwork in venues that require the disclosure of the purchasers’ information. They will also likely avoid high-profile purchases that may attract media attention. De Simone et al. (2018) show evidence that suggests that tax evaders may be shifting undeclared funds into artwork. It is unknown how common this form of tax evasion is, although media reports (see, e.g., Rubinfeld 2017; Bowley and Rashbaum 2017) suggest that the use of art sales for money laundering (which includes purchasing assets with the proceeds of tax evasion) is on the rise.

Cryptocurrencies. There are a few reasons why AEOI is ineffective with respect to the reporting of the purchasing, holding, and selling of cryptocurrencies. First, many virtual tokens may not be classified as financial assets. Regulators from around the world are still considering whether to classify different cryptocurrencies as securities, currencies, or other types of property. In June 2018, the director of corporate finance for the U.S. Securities and Exchange Commission (SEC) stated publicly that the SEC does not consider Bitcoin and Ethereum as securities. However, other tokens may be considered as securities. Second, FATCA and CRS do not provide guidance on the classification and the required reporting of cryptocurrencies. Third, although some exchanges are registered as FIs on the IRS FFI List (e.g., Coinbase UK, Ltd.), reporting is only required where the exchange maintains financial accounts for its customers. Where the exchange only provides exchange services, without accepting deposits or holding financial assets for or on behalf of customers, no reporting is required even if cryptocurrencies are considered as financial assets. Fourth, AEOI is irrelevant where the tokens are held by the owner directly, and not by any intermediary that may be classified as an FI. Any regulation that requires reporting by financial intermediaries cannot be effective with respect to transactions made solely in cryptocurrencies between their parties who use a blockchain platform to transact without intermediaries (Marian 2013; Viswanathan 2018). Finally, anonymous cryptocurrencies (e.g., Monero) pose greater challenges for tax authorities. It is very hard for tax authorities to catch tax evaders if they receive income in anonymous cryptocurrencies, hold them directly, and use them to purchase assets, goods, and services directly from the seller.

Governments can demand that domestic exchanges provide information on their customers, as done by the IRS recently.⁷ However, it is unclear whether a tax authority would be able to obtain a large amount of information regarding transactions from offshore exchanges where the reporting of such information is not required under AEOI. Countries with a comprehensive double tax agreement (CDTA) or a tax information exchange agreement (TIEA) can file a request for information, although requests for a large amount of information about many transactions with no nexus to an investigation might be too broad (i.e., a “fishing expedition”). Moreover, exchanges do not have information about direct transactions between the owners of tokens and other parties.

Tax evaders may want to sell the investments in the abovementioned assets sometime in the future, and use the funds for consumption, other investments, or gifts. If the assets are sold in exchange for cash that is paid into an account maintained by an FI in a participating jurisdiction, then the balance of the account at the end of the calendar year should generally be reported to the account holder’s jurisdiction of tax residence. However, the tax evader may avoid AEOI reporting by using one of the strategies discussed in the next section.

⁷ United States v. Coinbase Inc., No. 3:17-cv-01431 (N.D. Cal. 2017).

3.2. Offshore Financial Assets

There are multiple loopholes and noncompliance opportunities that enable tax evaders to continue holding offshore financial assets without reporting. This section reviews some of the main loopholes and noncompliance opportunities (for further discussion on these loopholes and noncompliance opportunities, see [Knobel and Meinzer 2014](#); [Morris 2017](#)).

Holding unreported assets in the United States and other non-participating jurisdictions. The United States is the only OECD member and the only large economy in the world that has not adopted the CRS. The United States previously stated that instead of joining the CRS, it will fulfill its information reporting obligations under the FATCA IGAs. Some of the IGAs are reciprocal, and under these reciprocal IGAs the United States should report some information to the IGA jurisdictions. Nonetheless, the required reporting under the reciprocal IGAs is far less comprehensive than the required reporting under CRS. Tax evaders who reside in a jurisdiction that has a reciprocal FATCA IGA with the United States can avoid reporting by holding financial accounts through an entity resident in a non-reciprocal IGA jurisdiction, as the beneficial owners of entities are not subject to reporting even if the entities are owned and controlled by tax residents of a reciprocal IGA jurisdiction ([Cotorceanu 2015](#)). Tax evaders who are not resident in a reciprocal IGA jurisdiction are not subject to any reporting. According to the Tax Justice Network's financial secrecy index, the United States' financial system is the second least transparent system in the world ([Tax Justice Network 2018](#)). The Tax Justice Network, other analysts, and media outlets have pointed out that the United States' policies try to defend the U.S. tax base against tax havens while serving as a tax haven for foreigners hiding undeclared funds in the United States. For example, a Bloomberg editorial noted that "[w]hile the rest of the world provides the transparency that the U.S. demanded, the U.S. is rapidly becoming the new Switzerland . . ." ([Bloomberg 2017](#)). In addition to the United States, there are a few other non-participating jurisdictions that may attract tax evaders. Thailand, the Philippines, and other developing countries, mostly in Africa and Latin America, have not joined the CRS. However, foreign tax evaders might prefer parking their unreported funds in other countries because of various factors, including currency exchange control regulation in some of these countries, the underdeveloped financial industry, and the risk of information leakage.

Holding unreported assets under closely held private investment entities that classify as FIs. Tax evaders can hold offshore financial assets through closely held, unregulated, private investment entities that classify as FIs for FATCA and CRS purposes ([Noked 2018b](#); see also [Morris 2017](#) for a discussion on a loophole involving investment entities that are managed in the same jurisdiction as the account holders). Under the FATCA and CRS entity classification rules, and as mentioned earlier, many private trusts and private investment companies are classified as FIs. These entities are required to identify and report their "account holders" if those people are residents of reportable jurisdictions. However, where these entities are owned and managed by tax evaders, it is unlikely that this reporting will ever take place ([Noked 2018b](#)). At the same time, the banks and other FIs that maintain the financial assets of such private investment entities are not required to make any reporting of accounts held by other FIs. Imposing reporting obligations on such private, closely held investment entities is similar to requiring *self-reporting* by the owners of these entities. If such private investment entities were classified as Passive NFEs, then the FIs that maintain the financial assets of the private investment entities would be required to report the private entities' controlling persons. This would be *third-party reporting*, which increases the likelihood of detection of noncompliance significantly ([Kleven et al. 2016](#)). Tax evaders' ability to avoid AEOI reporting by holding financial assets through private, closely held investment entities poses a serious threat to the effectiveness of FATCA and CRS.

Holding unreported assets under Active NFEs. The controlling persons of an entity classified as an Active NFE are not subject to AEOI reporting. There are a few types of Active NFEs, including publicly listed NFEs, NFEs that conduct an active business (i.e., more than 50 percent of the entity's gross income is active income and more than 50 percent of the entity's assets produce or are held for the production of active income), NFEs that serve as holding companies or treasury centers of

non-financial businesses, non-profit NFEs, and government entities. Tax evaders might avoid reporting by holding undeclared assets in an Active NFE they own (Morris 2017). There will be a reporting of the Active NFE if it is a resident in a reportable jurisdiction, and the Active NFE itself may be required to include its assets and income in its tax reporting, but there will not be AEOI reporting of the beneficial owners of the Active NFE. For example, assume that a French person holds an active business that classifies as an Active NFE in the United Kingdom and an investment portfolio, also in the United Kingdom. If the investment is registered under that person's name, AEOI reporting will take place and the French tax authority will receive the information about the portfolio investment account in the United Kingdom. However, if the investment is registered under the Active NFE's name, no reporting will take place. The result is that tax evaders can hold unreported financial assets through the active businesses they hold. This also creates an incentive to invest undeclared funds into active businesses.

Holding unreported assets under exempt FIs. Tax evaders may hold offshore assets in entities that classify as non-reporting (i.e., exempt) FIs, which include government entities, certain retirement funds, and exempt collective investment vehicles. CRS also states that governments can classify other entities as non-reporting FIs if they have substantially similar characteristics to government entities or exempt retirement funds. There is a concern that such exempt FIs may be used by tax evaders to avoid AEOI reporting. For example, Hong Kong classified registered Occupational Retirement Schemes (commonly referred to as "ORSO schemes") as non-reporting FIs. There have been media reports noting that such schemes were marketed to high-net-worth individuals as a way to avoid CRS reporting (The Economist 2017). The Hong Kong government recently indicated that it intends to repeal the non-reporting status of these schemes, so this loophole will likely be eliminated. However, it is possible that tax evaders will exploit other types of exempt FIs in other jurisdictions to avoid AEOI reporting.

Residence/citizenship by investment schemes. Various jurisdictions offer "citizenship by investment" (CBI) or "residence by investment" (RBI) schemes to foreigners (OECD 2018a; Morris 2017; Goulder 2018; Knobel and Heitmüller 2018). Some of these schemes impose limited or no requirements to be physically present in the relevant jurisdictions. Some of these jurisdictions impose low or no taxes on foreign source income or exempt income earned by the participants in these schemes. People who obtained residency or citizenship through these jurisdictions may be tax residents of other jurisdictions. For example, a French tax resident may obtain a passport of Saint Kitts and Nevis through that country's CBI scheme. An abuse of CBI/RBI schemes occurs where account holders falsely claim that they are tax residents only of the CBI/RBI jurisdictions in the self-certification forms and other information they provide to FIs, without disclosing that they are tax residents of other jurisdictions. The OECD stated that the correct implementation of the existing due diligence procedures can often prevent this problem (OECD 2018a). Under CRS, FIs cannot rely on documentary evidence or a self-certification where they know or have reason to know that the information provided is unreliable, incomplete, or incorrect. In addition, the account holder must provide a permanent physical residence address, and not an in-care-of address or a PO box. However, even fully compliant FIs may not be able to detect abuse of CBI/RBI schemes aimed at circumventing CRS where a physical residence address is provided, and the FI does not know or have reason to know that the account holder is a tax resident of another jurisdiction. The OECD is currently in the process of addressing this problem. The OECD actions include issuing the Mandatory Disclosure Rules (OECD 2018b), working with certain jurisdictions to reduce the risk of abuse of their schemes, and preparing a list of schemes that involve a high risk of being used by tax evaders to circumvent CRS (OECD 2018c).

Payments out of depository and custodial accounts. Under FATCA and CRS, payments out of depository and custodial accounts are not subject to reporting. Tax evaders may use reportable offshore financial accounts during the year and empty the accounts before the year-end in order to avoid the reporting of a high balance. Under CRS, if an account holder withdraws the full balance of her bank account before 31 December, then the existence of the account will be reported (or the fact of closure if the account was closed during the year), but the reported balance will be zero. As mentioned

earlier, under the FATCA IGAs, if the account was closed during the year, there will be a reporting of the balance or value immediately before closure. Tax evaders may avoid this reporting by not closing the account or by emptying the account some time before the closure, so that the balance or value immediately before closure would be low or zero. If the jurisdiction of the FI and the account holder's jurisdiction of tax residence are CDTA or TIEA partners, the latter jurisdiction can file a request for the transactions in the account during the calendar year. However, where a tax authority only knows of an account with a low or no balance, or that an account was closed, the likelihood that it would file an information request appears to be low in light of the resources needed to prepare such requests.

3.3. Onshore Assets

Prior to AEOI, unreported offshore holdings were harder to detect (Oei 2018). This created an incentive for tax evaders to engage in offshore tax evasion. As discussed above, in the era of AEOI, tax evaders may still avoid the reporting of offshore assets if they invest in certain assets that are not within the scope of AEOI or if they use loopholes and noncompliance opportunities to avoid AEOI reporting. However, such options may be more expensive than before, and it is possible that governments will eliminate these loopholes and noncompliance opportunities in the future. As holding undeclared funds offshore becomes costlier and riskier, tax evaders may prefer engaging in *onshore* tax evasion.

Even before AEOI, it appears that the majority of tax evasion was through onshore tax evasion. Byrnes (2017) notes that "FATCA was passed on the unsubstantiated basis that 'each year, the United States loses an estimated \$100 billion in tax revenue due to offshore tax abuses.'" According to an IRS report from 2016, the estimated average annual tax gap in the tax years 2008–2010 was \$458 billion, of which an estimated amount of \$52 billion was collected, so the estimated net tax gap was \$406 billion (IRS 2016). If we accept the estimate of \$100 billion for the annual offshore tax gap, this amount represents less than a quarter of the overall tax gap. This means that tax evaders have ways to evade tax onshore.

Different taxpayers may have different tax evasion opportunities and preferences. There is evidence showing that wealthier taxpayers are more likely to engage in offshore tax evasion (Alstadsæter et al. 2017). Self-employed people and small businesses are more likely to evade taxes because of the absence of third-party reporting (Kleven et al. 2016). It is unclear whether tax evaders that use offshore tax evasion opportunities can substitute them with onshore tax evasion. Where onshore tax evasion opportunities can substitute offshore ones, tax evaders may use the former ones if the latter ones become costlier and riskier.

The extent of domestic information reporting of domestic tax residents to the local tax authority varies across jurisdictions. In some countries, the tax authority knows more about its tax residents' offshore accounts (as this information is received through AEOI) than it knows about their onshore accounts. For example, the Israeli tax authority can only access domestic bank account information of Israeli tax residents if it obtains a court warrant. Tax evaders' preference for onshore over offshore tax evasion is likely to be stronger in countries where the government's access to the onshore information is limited.

4. Potential Policy Responses

The incomplete tax transparency created by AEOI is problematic for two reasons. First, as discussed in the previous section, AEOI might not effectively curb tax evasion because tax evaders may avoid AEOI reporting by using a variety of offshore and onshore noncompliance opportunities and loopholes (De Simone et al. 2018). The costs of FATCA and CRS are high because FIs and compliant parties incur large compliance costs for the implementation of FATCA and CRS (Byrnes 2017). From the experience with FATCA, there is a good reason to believe that AEOI might not be cost-effective when comparing the benefits of curbing tax evasion and the implementation costs.

Second, to avoid AEOI reporting, tax evaders may take costly actions that increase the social waste from tax evasion. For example, as discussed above, some tax evaders may buy real estate and keep it empty to avoid the reporting of the rental income that may be reported if it were kept in an FI. Tax evaders may be deterred from tax evasion if the costs of avoiding AEOI reporting are high enough. However, tax evaders would prefer incurring these additional costs while continuing evading taxes if these costs (together with other tax evasion costs and risks) are lower than the costs of becoming compliant. These efficiency costs aggravate the harm to society from tax evasion (see generally [Slemrod 2017](#)).

A possible response that governments should consider is moving towards complete tax transparency: putting in place AEOI not only for offshore financial assets maintained by FIs in participating jurisdictions but a system that reports information (or makes such information public) regarding *all* assets that might be used for tax evasion. The sections below discuss possible reporting regimes and changes to the current AEOI rules that would enhance tax transparency. This is a high-level discussion of the general features of such possible measures. Many of these measures were proposed by the Tax Justice Network ([Knobel and Meinzer 2014](#)) and other analysts (e.g., [Morris 2017](#)).

4.1. AEOI-Like Regime for Real Estate Ownership

Governments can adopt an AEOI-like regime for the identification and the reporting of the owners of real estate properties ([OECD 2012](#); [Knobel and Meinzer 2014](#); [Morris 2017](#)). The European Union adopted such a regime: the EU Member States are required to automatically exchange information regarding residents of other Member States with respect to five categories of income and capital including ownership of and income from immovable property where this information is available to the tax authorities.⁸ However, European tax evaders can avoid this reporting by holding real estate in countries that are not members of the European Union. An AEOI-like regime for real estate ownership must be adopted widely in order for it to be effective.

To fight tax evasion effectively, the information collected by governments should include the owners' jurisdiction of tax residence, TIN, and other information required under AEOI. Similar to FATCA and CRS, the owners can provide this information in self-certification forms to the governmental real property registry. However, there is a key difference between real property registries and FIs: FIs are required to assess the reasonableness of the self-certification using the information they have on the account holders, including information they obtained pursuant to the applicable AML/KYC procedures. In addition, FIs are better positioned to identify changes in circumstances where an account holder becomes a reportable person. FIs frequently handle high-net-worth clients by assigning relationship managers to those clients. Many relationship managers keep in regular contact with these clients, and when they identify that a client has become a reportable person, the FI must report that client. Land registries do not conduct similar due diligence procedures, and their employees do not have any knowledge regarding the tax residency of the owners. If land registries record the information as provided by the owners, this would be self-reporting with no verification by a third party, and tax evaders who lie about their tax residency in the information they provide to land registries might not be caught (for the lack of verification problem in the context of beneficial ownership registers, see [Open Ownership 2017](#)). To address this problem, the land registry itself can conduct due diligence procedures to assess the reasonableness of the self-certification, similar to FIs under FATCA and CRS. Alternatively, it is possible to require third-party verification of the self-certification, which may include a confirmation from an accountant stating that the accountant reviewed the information and found it to be correct.

⁸ Council Directive 2011/16/EU on administrative cooperation in the field of taxation (DAC1) Art. 8.

As an alternative to an AEOI-like regime for real estate ownership, governments can consider making the ownership information public so that foreign tax authorities can identify their tax residents' ownership of real estate properties. Adopting an AEOI-like regime for real estate ownership appears to have a few advantages over providing information on a public register with no information exchange between tax authorities. First, public disclosure of certain information regarding the owners, such as the owners' TIN information, would raise serious privacy concerns. Second, information regarding the sales of properties can be reported as part of an AEOI-like regime for real estate. If governments only have access to a public land ownership register, information regarding the sale of properties by foreign tax residents would not be readily available. Tax authorities can try to identify instances where assets that were previously held by their tax residents are no longer held by them, which means that the assets were sold or otherwise disposed of, and the tax authorities can also try to find the purchase price of the property by its current owner, but it appears to be simpler and more efficient to report such information in an AEOI-like manner.

4.2. AEOI-Like Regime for Precious Metals, Artwork, and Other Valuable Assets

Precious metals and artwork are typically not registered by any government. It is possible to develop an AEOI-like regime that would apply to platforms and service providers that facilitate transactions in precious metals and artwork (Knobel and Meinzer 2014; Morris 2017). For example, art dealers, galleries, and auction houses can be subject to regulation that includes obligations similar to those imposed on FIs: they would be required to conduct due diligence and report buyers and sellers that are tax residents of reportable jurisdictions. Tax evaders might be able to purchase and sell precious metals and artwork without using platforms and professionals that are subject to reporting requirements. However, these platforms and professionals provide valuable services for the buyers and sellers because they verify the authenticity and the quality of the assets. If tax evaders buy these assets without using services provided by such intermediaries to avoid reporting, they run the risk of overpaying for fraudulent or low-quality assets. Potential buyers would likely demand a substantial discount for assets that are not sold through standard channels and without intermediaries that can verify the authenticity and the quality of the assets.

An AEOI-like regime may also apply to another group of businesses: storage and safe deposit box service providers (Knobel and Meinzer 2014). Where assets such as artwork, precious metals, or other valuable properties are kept in storage or safe deposit boxes, the service provider may be subject to obligations similar to those that apply to FIs. Although it might not be practical to estimate the value of the assets, reporting may include the purchase price, type, and quantity of the relevant assets. Tax evaders may avoid such service providers if they are subject to reporting obligations. Instead, tax evaders may keep their gold and valuable artwork in a safe at home. However, this might entail a higher risk of theft, so this form of tax evasion might become more expensive and riskier.

4.3. Cryptocurrencies

FATCA and CRS could be amended to address some of the challenges posed by cryptocurrencies. First, FATCA and CRS could provide guidance on whether cryptocurrencies are financial assets for AEOI purposes. Second, they could define what financial accounts of cryptocurrencies are and who should be required to report them. The rules could clarify when intermediaries are required to implement FATCA and CRS due diligence and reporting requirements with respect to cryptocurrencies. However, these rules would only address the reporting by intermediaries classified as FIs.

As noted above, AEOI-like solutions are irrelevant where the tokens are held by the owner directly, and not by any intermediary that may be classified as an FI. Any regulation that requires reporting by intermediaries cannot be effective with respect to transactions made solely in cryptocurrencies between their owners and other parties who use a blockchain platform to transact without intermediaries (Marian 2013). Anonymous cryptocurrencies pose challenges for tax authorities. It would be very hard for tax authorities to catch tax evaders that receive income in anonymous cryptocurrencies, hold them

directly, and purchase assets, goods, and services in exchange for such cryptocurrencies. This problem should be addressed as part of a broader policy concerning cryptocurrencies. One potential solution would be to prohibit the use of any cryptocurrency that does not have features that enable tax authorities to observe the identity of its owners. Another solution would be to prohibit the use of cryptocurrencies as a payment method for the purchase of assets, goods, and services unless the tokens have been transferred through an intermediary that implements the AEOI due diligence and reporting requirements with respect to the virtual tokens. Other solutions, such as imposing a tax on anonymous transactions (Marian 2015) and regulating the entry and exit points from the blockchain economy (Viswanathan 2018), should also be considered.

4.4. Beneficial Ownership Registers

It is important to consider whether beneficial ownership registers for entities can be used by governments to fight tax evasion effectively. Following the G20 summit in November 2014, which adopted a statement on “High-Level Principles on Beneficial Ownership and Transparency,” many countries have set up or are in the process of setting up beneficial ownership registers for entities. While some countries, including the United Kingdom, have public beneficial ownership registers, many countries allow restricted access to the registers. A beneficial ownership register does not help detect tax evasion if tax authorities of other countries cannot identify beneficial owners that are tax residents of such other countries in the register. Where foreign governments do not have free access to the register, such governments may be able to file a request for information with respect to specific entities (which are already under investigation), but they would not be able to use the register to detect tax evaders that they do not have any information on.

Even where foreign countries have free access to the full information on the registers, this information may not be very useful for detecting tax evasion due to the lack of third-party verification and certain tax-related information (jurisdiction of tax residence and TIN). In addition, beneficial ownership registers do not record the value of the relevant entities. Therefore, beneficial ownership registers may offer tax authorities limited help in their fight against tax evasion.

Beneficial ownership registers may be more helpful for tax authorities if they record the beneficial owners’ tax residence and TIN information (Knobel et al. 2017), and require third-party verification of the entity’s self-reporting. It is also possible to require a periodical valuation of the entity. This valuation can be within a range (e.g., below US \$1 million, above \$1 million and below \$10 million, or above \$10 million). However, as noted above, privacy concerns and taxpayer confidentiality protections might prevent publishing certain beneficial owner information, such as TIN information. Such information could be exchanged with the relevant tax authorities on an automatic basis without disclosing it to the public.

4.5. Closing FATCA and CRS Loopholes and Noncompliance Opportunities

The OECD is acting against CRS loopholes and noncompliance opportunities. The OECD website allows members of the public to share information “on potential schemes, products and/or structures that may be used for circumventing reporting . . . ” The information can be provided on an anonymous basis. This is one source through which the OECD secretariat can learn about noncompliance opportunities and loopholes. In March 2018, the OECD published the Model Mandatory Disclosure Rules (OECD 2018b), which impose reporting requirements with respect to certain arrangements that circumvent CRS reporting (CRS Avoidance Arrangements) and structures that avoid the reporting of beneficial owners of offshore passive entities (Opaque Offshore Structures). These disclosure requirements generally apply to intermediaries, which are defined as the persons responsible for the design or marketing of such arrangements/structures, and those persons that provide assistance or advice with respect to the design, marketing, implementation, or organization of such arrangements/structures where such persons could reasonably be expected to know that the arrangements/structures are CRS Avoidance Arrangements or Opaque Offshore Structures. Although

countries are not obligated to adopt the Mandatory Disclosure Rules, it is likely that many countries will adopt them over time, making them part of the international norms.

The Model Mandatory Disclosure Rules and other actions taken by the OECD can address some problems in the current AEOI rules, but these measures do not address some of the most problematic noncompliance opportunities mentioned in Section 3.2. FATCA and CRS should be amended and dozens of countries should enact legislative amendments to address certain flaws in the AEOI rules, such as the problem of tax evaders holding assets through closely held private investment entities that classify as FIs (for further discussion on possible amendments, see [Knobel and Meinzer 2014](#); [Morris 2017](#)). Also, it is unclear if and when the United States would join CRS or amend its IGAs to include reporting similar to the reporting under CRS.

As noted in Section 3.2, there is no reporting of the amount paid out of a depository or custodial account during the calendar year. This means that a tax evader can sell unreported assets in exchange for the cash deposited in her account, and pay out the money from the account by the end of the calendar year. That money can be reinvested into another asset that is not subject to reporting, used for consumption, or given to another person as a gift. It is possible to amend FATCA and CRS to require the reporting of the aggregate payments out of the depository or custodial account during the calendar year. If such a reporting requirement is imposed without also implementing the reporting of other assets (e.g., real estate), this will increase the lock-in effect: tax evaders will not sell unreported assets that they currently hold because it would result in reporting where the sale proceeds are paid into a reportable account. Such tax evaders may still avoid reporting if they hold such assets until they die, give them as gifts, or sell them only after they cease to be tax residents of the country where they evaded tax.

4.6. Improving Onshore Reporting

As the pressure on offshore tax evasion has been rising, tax evaders have a stronger incentive to commit onshore tax evasion. Tax authorities should respond to this by identifying schemes that might be used for onshore tax evasion and adopt measures to counter such schemes. Countries in which tax authorities have more information about tax residents' offshore assets than information about their onshore assets may consider imposing broader domestic reporting requirements or adopt other measures, such as withholding taxes, to ensure domestic tax compliance.

5. Complete Tax Transparency—At What Price?

Before taking more steps in the direction of complete tax transparency, a cost-benefit analysis should be conducted to compare the benefits and the costs of such measures. The main benefits of tax transparency are higher tax collection and better deterrence of tax evasion. As discussed above, the benefit from measures that block some tax evasion opportunities but leave others open might be limited. The benefit is likely to be larger where complete tax transparency is achieved. Therefore, the marginal benefit from each measure taken separately might not be significant, but the benefit might be large if multiple measures are adopted against all tax evasion opportunities and tax evaders can no longer hide. As this potential benefit depends on the actual tax gap, it is important to use an accurate estimate for the magnitude of the tax gap for the cost-benefit analysis.

Complete tax transparency is likely to be very expensive. The compliance costs of FATCA significantly exceeded the increase in tax collection that resulted from FATCA ([Byrnes 2017](#)). It is yet to be seen whether CRS is a cost-effective measure. The cost-effectiveness of the AEOI-like proposals discussed above is also uncertain. Future research on FATCA and CRS may provide more information about the compliance costs and the revenue effects of these reporting regimes. Before adopting new measures, policymakers should conduct a detailed analysis of the expected compliance costs.

In addition to the implementation costs, privacy concerns that have been expressed with respect to tax transparency initiatives thus far would be even greater with respect to complete tax transparency, which would entail a higher risk to taxpayers' privacy because more information is collected and

exchanged between more tax authorities (see generally Hatfield 2018a, 2018b). This information collection and sharing would increase the risk of leaks, hacking, and other privacy-related risks for many compliant taxpayers. Privacy concerns and the risk of information leakage should be taken into account when considering additional steps in the direction of complete tax transparency (see generally Oei 2018; Noked 2018c). A high risk for privacy may support collecting less taxpayer information (Hatfield 2018a). Transparency measures may also affect corporate governance (Donald 2011) and other aspects that are not directly related to taxes. These effects should also be considered.

Even without reaching complete tax transparency, policymakers should consider improving the existing reporting regimes—FATCA and CRS—as the required changes would have minimal additional compliance costs. Making beneficial ownership registers more helpful for tax authorities may also be cost-efficient. It is important that any regulation of the evolving blockchain economy will address the problem of tax evasion. Countries should also identify and address onshore tax evasion risks.

6. Conclusion

Anti-tax evasion measures, such as FATCA and CRS, may not be effective and cost-efficient if tax evaders continue evading tax by using alternative tax evasion channels. Moreover, such measures might increase the social waste from tax evasion if tax evaders take costly actions to avoid AEOI reporting. This article discusses the main tax evasion opportunities in the era of AEOI, and it explores various measures that can address these problems by increasing tax transparency. Nonetheless, although limited tax transparency is problematic, complete tax transparency might not be optimal because of the high implementation cost and the risk to taxpayers' privacy. While further research is required to determine whether complete tax transparency is optimal, the current limited tax transparency is likely to be suboptimal. Policymakers should consider taking steps to increase the effectiveness of AEOI, beneficial ownership registers, regulation of cryptocurrencies, and other anti-tax evasion measures.

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