Summary Brief

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Linking Beneficial Ownership Transparency to Improved Tax Revenue Collection in Developing Countries

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Recent years have witnessed an accelerating push to expand access to information on the beneficial ownership of corporate entities, in an effort to bring greater transparency to multinational corporation (MNC) tax strategies, identify personal tax-evading wealth held overseas and combat global networks of criminality and corruption. This effort remains in its infancy, but has made important strides: the G20 has called for all countries to develop and share registers of beneficial ownership, and various jurisdictions have begun to do so.

Yet while this agenda has advanced quickly, the likely benefits of these efforts for low-income countries remain unclear. Significant thought has been given to the potential role of beneficial ownership information for anti-corruption efforts; substantially less detailed empirical attention appears to have been given to its likely role in facilitating tax collection, where the benefits may be more uncertain owing to problems related to data quality, access and the ability and willingness to use it effectively.

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This brief thus begins to explore a critical question for governments and civil society:

To what extent are current efforts to expand access to information on beneficial ownership likely, in practice, to enhance the ability of low-income countries to increase tax collection?

In the absence of significant empirical evidence there is a risk of answers being driven by a combination of gut instinct, professional association and ideology. This brief correspondingly seeks to identify the technical and political pre-requisites of improved outcomes, and to point toward the specific empirical questions that may guide conclusions and future action. Doing so is of significant consequence: it aims to inform the extent to which low-income countries – and their supporters – should (or should not) invest priority resources in supporting and advancing these efforts, and related initiatives around Automatic Exchange of Information (AEOI) and Base Erosion and Profit Shifting (BEPS). For some, asking this question may appear to risk undermining the impressive momentum of recent years around global reform. However, not to ask amounts to pouring scarce development resources into an uncertain enterprise for which we have strikingly limited existing evidence and, indeed, there is a mounting sense that low-income countries themselves are beginning to ask these questions.[1]

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In theory the links between expanded information on beneficial ownership and improved tax collection are straightforward, and compelling. Personal wealth held abroad is frequently disguised from tax authorities by hiding the beneficial owner(s) of that wealth behind shell corporations. Beneficial ownership transparency is explicitly designed to attack this secrecy, and is intertwined with AEOI: beneficial ownership information will only be useful to developing country tax authorities if it is shared by the countries hosting wealth held abroad, while AEOI can only function effectively if beneficial owners of wealth can be identified.

Meanwhile, corporate actors may exploit a lack of transparency around beneficial ownership in order to illicitly reduce their tax liabilities. These strategies turn on creating the appearance that a transaction is occurring between two unrelated parties, when they are, in fact, controlled by the same beneficial owner. “Round tripping”

[1] This was a central point of discussion at the side event titled “Base Erosion and Profit Shifting in Africa: Status Quo and Challenges” at the First Global Conference of the Platform for Collaboration on Tax, February 15, 2018, United Nations, New York

involves an investor seeking to take advantage of investment incentives reserved for foreign investors by making investments via a foreign shell corporation, for which beneficial ownership is obscured. In similar fashion, a local firm might be "sold" to a purportedly foreign investor in order to trigger new tax incentives. Alternatively, two firms owned by the same beneficial owner may wish to obscure their common ownership, in order to avoid the scrutiny of transactions between them for tax avoidance or evasion. In all cases, beneficial ownership information would reveal these transactions as fraudulent and allow more effective tax enforcement.

But while the potential role of beneficial ownership transparency in strengthening tax collection is clear, there is uncertainty about whether these gains are likely to be realised in practice by low-income countries. These countries may struggle both to access and deploy newly collected information, while the costs of participating, both financially and in terms of scarce human resources, may be substantial. This note suggests that, in charting a path forward, low-income countries and their supporters should ask three progressive questions:

1. Is beneficial ownership information effectively collected and shared?
2. Are tax administrations able and willing to use that information effectively?
3. And, if those 'links in the chain' do not hold, what are the alternatives?

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In each case the answers remain unclear. The goal is thus not simply to identify the relevant questions, but to begin to identify the empirical evidence needed to answer them more meaningfully.

Is Beneficial Ownership Information Effectively Collected and Shared?

In order for the push to improve collection of benefical ownership information to generate significant improvements in tax collection, that information needs to be relatively complete and of high quality, and needs to be available to the tax administrations of low-income countries. However, achievement of these requirements remains uncertain, despite progress.

The first risk is that the information contained in national registries of beneficial ownership will not be of sufficient quality. If the registry information is not entirely accurate and verified it may, for example, remain possible for the

true beneficial owners of corporate entities to remain disguised, despite the appearance of transparency. In theory, an imperfect registry could nonetheless deter significant secrecy and abuse, owing to the heightened risk and difficulty of setting up such arrangements. However, it is equally possible that an imperfect registry may achieve very little if those committed to avoiding it find it relatively easy to do so. This points toward two related empirical questions for ongoing research:

1. How complete and accurate are emerging registers of beneficial ownership?
2. Insofar as registries are imperfect, are they nonetheless effective enough to discourage the use of shell companies for tax purposes?

The second risk is that even if most countries develop high quality registers of beneficial ownership, a relatively small number of non-compliant jurisdictions could undermine any aggregate impact by offering an easy alternative for those seeking secrecy. A particularly prominent risk in this respect is that the U.S. State of Delaware may continue to offer a relatively easy setting in which to register anonymous corporations. Even if it were to pursue reform, other jurisdictions may take its place: the larger the number of jurisdictions that increase transparency, the larger the potential benefits to those that do not.[2] While funds appears less likely to flow through shell companies registered in less stable financial centers, it is nonetheless worth noting that many such developing countries may struggle to assemble accurate information on beneficial ownership even where they are committed to doing so. Given the incentives for some jurisdictions to resist calls for beneficial ownership transparency, existing efforts may need to be accompanied by special measures to deal with firms registered in non-compliant jurisdictions – or pressure to bring those non-compliant jurisdictions on board. Both, however, may prove challenging if the United States remains a prominent non-complier. This points toward three interconnected empirical questions:

1. Are all major jurisdictions participating in – and successful at implementing – the expanded collection and sharing of beneficial ownership information?
2. Insofar as there are non-participating jurisdictions (de jure or de facto), are there effective mechanisms in place to discourage their use for tax avoidance or evasion?
3. Insofar as there are non-participating jurisdictions, is there evidence of significant registration of shell companies in those jurisdictions for likely purposes of tax avoidance or evasion?

Finally, even if data collected is of a relatively high quality, and there is broad global participation, it will only be of significant value to lower-income countries if that data is shared freely, and in a timely manner.

[2] Elsayyad, May and Konrad, Kai. 2012. Fighting Multiple Tax Havens. *Journal of International Economics*. 86(2): 295-305

Whether this will be the case remains unclear, but there are certainly grounds for concern. There is mounting worry that many developing countries will not immediately be able to meet the minimum standards for participating in the OECD agreement on Automatic Exchange of Information – while wealthier countries have informally made clear that they would be reluctant to share significant information until better data security is in place. In turn, lower-income countries have raised concerns that putting in place the minimum conditions for participation – including, potentially, building effective beneficial ownership registries at home – could be very expensive financially, in human resources and in compliance costs, thus posing a significant barrier to participation. This could imply an extended period during which low-income countries are unable to access – and thus benefit from – newly available beneficial ownership information. And, indeed, at the time of writing, only five African countries had signed up for AEOI, let alone implemented it. This problem would not, of course, apply in the case of public registers of beneficial ownership information – but public registries have so far not been promoted by the OECD, and are being pursued by only a small number of countries. This raises two empirical questions:

1. Are low-income countries successfully able to access the full range of relevant beneficial ownership information from overseas either via public registries or participating in exchanges of information?

> “Of equal importance is whether tax administrations are likely to be able to use this data effectively, even if it is provided.”

2. Insofar as they are not participating, is there evidence from similar countries that participation is reasonably attainable, either by meeting minimum standards, or relaxing those standards – and at what cost?

Are Tax Administrations Able to Use Beneficial Ownership Information to Increase Tax Collection?

While there are significant challenges in collecting and sharing adequate beneficial ownership information for tax purposes, of equal importance is whether tax administrations are likely to be able to use this data effectively even if it is provided. To be clear, there is little doubt that there would be *some* benefit to accessing this data. But the magnitude of those benefits remains unclear, for both technical and political reasons.

From a technical perspective, the central challenge lies in the fact that access to beneficial ownership information is often designed to expose *potential* tax avoidance and evasion, but it nonetheless remains incumbent on national tax administrations to prove actual abuse. Doing so may be comparatively

straightforward in some cases as, for example, where broadly available beneficial ownership information reveals significant wealth held abroad – and untaxed – by domestic taxpayers. But even in those cases effective enforcement may require significant investigation of the finances of wealthy individuals, and significant international cooperation. Meanwhile, other cases may be more complex. For example, new data may reveal that transactions that appeared to be between unrelated parties were, in fact, conducted between firms with the same underlying ownership. This may, in turn, trigger audits to identify potential transfer mispricing and profit shifting. But the ultimate success of those efforts will be tied to the broader enforcement capacity of national tax agencies. While tax agencies are likely to reap at least some benefit, there are concerns that capacity to secure large-scale revenues from international tax audits may remain limited for the short or medium term. This implies the need for specific empirical data on tax administrative capacities:

1. Have tax administrations demonstrated the capacity to prosecute and raise revenue in cases of individual tax evasion through overseas tax structures or of aggressive international avoidance and evasion by corporations?

2. Insofar as they have not shown such capacity, is there empirical evidence – for example, from similar countries – of a reasonable likelihood of developing this capacity sustainably, at what cost and over what time horizon?

These technical concerns are, in turn, compounded by political concerns: even if tax administrations are technically able to use beneficial ownership information for tax enforcement purposes, will political authorities allow them to do so? The technically most straightforward use of beneficial ownership information, when combined with AEOI, will be in identifying wealth held abroad by wealthy individuals. However, there is now ample evidence that wealthy individuals are often shielded from more effective tax enforcement by powerful political supporters – or by virtue of being politically powerful themselves.[3] There are a variety of steps that low-income tax administrations could take immediately, domestically, to strengthen the taxation of wealthy individuals; if they are not already doing so, will access to beneficial ownership information change that? This political problem may be less acute in confronting the tax practices of large firms, but there is little doubt that some firms currently pay less taxes by virtue of their political connections, and beneficial ownership information may not substantially alter those political constraints. Even before implementing current agreements, current tax administration behavior may be illuminating. In particular:

[3] Kangave, Jalia, Suzan Nakato, Ronald Waiswa, and Patrick Lumala Zzimbe. 2016. "Boosting Revenue Collection Through Taxing High Net Worth Individuals: The Case of Uganda." *ICTD Working Paper* 45.

1. Are tax administrations in low-income countries currently making full use of available data from international sources in pursuing expanded enforcement efforts (e.g. international company registers, data from recent leaks)?

2. Insofar as tax administrations are not currently making use of already available data, is this a technical or political problem, and are there reasons to believe that this would change with greater access to beneficial ownership data?

The extent of these technical and political barriers to deploying beneficial ownership information is ultimately an empirical question, and the years to come should offer important insights into whether or not tax administrations in low-income countries are successfully deploying beneficial ownership data to strengthen tax enforcement. The monitoring of two questions will be critical, potentially beginning with the handful of low-income countries already registered to participate in AEOI:

1. With expanded access to data, have countries, in fact, been able to identify formerly disguised related party transactions, and has this resulted in additional tax payments?

2. Has secretive wealth held abroad been exposed, and has greater revenue been collected as a result – and have these efforts been broad-based, or targeted at political opponents?

That said, any such studies will need to be undertaken with care: insofar as tax administrations *are* able to use this data effectively, taxpayers may pre-emptively adjust their behavior and become more tax compliant. Studies that fail to account for this behavioral adjustment risk underestimating the benefits of access to beneficial ownership information. Researchers with detailed access to tax administration data may be able to assess such 'invisible effects' by looking for evidence of increased declarations by potentially affected parties immediately prior to the implementation of data sharing.

If Beneficial Ownership Transparency is not Achieving its Goals, What Are the Alternatives?

There are thus a range of reasons why expanded collection of beneficial ownership information on a global level may *not* make a significant contribution to increasing tax collection in lower-income countries. Data may be of poor quality, may be undermined by non-compliant jurisdictions or may not be shared with low-income countries, while low-income countries may struggle to use even high-quality data, for both technical and political reasons. To the degree that any of these constraints undermine the likely impact of existing initiatives, low-income countries (and their supporters) may need to consider possible responses.

The most straightforward potential set of alternatives is to clearly identify where the chain linking beneficial ownership to improved tax enforcement is breaking down for low-income countries, and to conduct targeted advocacy aimed at reforming that binding constraint on greater impact. Thus, for example, it might be that the data being collected is of adequate quality and completeness, and tax administrations would be able to use it effectively, but improved outcomes are prevented by a lack of effective data sharing toward low-income countries. Advocacy could target this binding constraint by pushing, for example, for stricter data sharing requirements and lower thresholds for low-income countries to qualify for access to data. Likewise, if the binding constraint on improved outcomes was the continued role of a subset of non-compliant jurisdictions, advocacy could target measures to incentivise compliance. If the key constraint is a lack of political will to use data effectively in low-income countries, then advocacy would necessarily focus on strategies to generate greater political pressure for enforcement. Of particular note is the potential role of *public* registries of beneficial ownership in overcoming several of the risks noted here: public registries eliminate problems related to inadequate data sharing across countries; could serve to generate political pressure (via civil society) for expanded enforcement where that data reveals potential abuses; and may, in some cases, help to overcome technical challenges by allowing external actors to scrutinise available data in search of evidence of lost revenues. Of course, public registries also present specific, and important, challenges that would demand careful attention.

> “Alternative strategies will be needed if the barriers to improved outcomes appear insurmountable in at least the short term, for either technical or political reasons.”

While advocacy to address barriers to improved outcomes may be an attractive option in some scenarios, alternative strategies will be needed if the barriers to improved outcomes appear insurmountable in at least the short term, for either technical or political reasons. Insomuch as most or all of the constraints detailed here apply, it may be unrealistic to expect changes in international rules to be adequate to generate significant gains for lower-income countries. This may be true, for example, if assembling data of adequate quality proves prohibitively difficult across a sufficient number of countries; or if low income countries are unable to mobilise the technical capacity to make consistently effective use of available data. It may equally be true if further reform of international rules is judged to be politically unlikely. There may be little international appetite for the broad adoption of public registries in

the short-term, or insufficient political will to push non-compliant jurisdictions to expand meaningful collection and sharing of information on beneficial ownership.

Where changes to international rules appears to be unfeasible or inadequate, the broad alternative is for low-income countries to adopt domestic measures that seek to achieve similar objectives in taxing high new worth individuals and international companies. Little, if any, research appears to have directly addressed this question in these terms, and additional research, discussion and pilot programmes appear sorely needed. Ultimately, the wisdom and value of investing in strengthening access to beneficial ownership information for tax purposes depends in part on the potential of alternative options. It seems possible to imagine two broad types of approaches:

1. **"Taxes on secrecy":** One potential option is to impose additional taxes on activities that involve assets, individuals or firms that are shrouded in secrecy about their beneficial ownership. Conceptually, the goal would be to collect some additional revenue from secretive activities, based on a presumption of tax evasion or avoidance, and to encourage legitimate activities to become more transparent, or to explicitly justify continued use of structures that obscure beneficial ownership. This would amount to shifting the burden of establishing the legitimacy of these structures and transactions onto taxpayers.[4] So, for example:

   a) If real estate were held by a holding company, rather than an identifiable beneficial owner, higher rates of property tax could be applied, subject to the taxpayer providing adequate evidence of the identity of the beneficial owner.

   b) Alternatively, where a firm operating locally transacts with a firm for which key information around beneficial ownership is unavailable (or which is registered in certain secrecy jurisdictions) the government could impose additional taxes (for example, a higher rate of withholding), impose an increased risk of audit, or prevent the claiming of certain tax incentives.

These types of approaches are comparatively crude in assessing tax liabilities. But in contexts of limited information and capacity they may reduce effective inequity and inefficiency in existing collection, while nudging the system toward greater transparency. Likewise, such an approach would not address the entire range of issues targeted by global initiatives to expand beneficial ownership transparency. It would not, for example, help in cases where anonymity prevents wealth held abroad from being identified at all. But it may achieve meaningful gains within a subset of areas.

[4] Credit to James Henry for some of the specific language and framing used here.

2. **Wider use of taxes on assets, or corporate revenues:** A broader and less targeted alternative is to focus on simplified measures to more effectively tax groups that are at high risk of exploiting the international tax system to reduce effective tax burdens. Some recent research has focused on the potential role of alternative minimum taxes (AMTs), which generally levy a flat rate tax – often 1% – on corporate *revenues* for any corporation that declares taxable profit below a pre-defined threshold.[5] The core logic is that firms declaring extremely low taxable profits, particularly over a series of years, are much more likely to be artificially reducing reported profits. AMTs can put a floor under those efforts, while leaving firms reporting profits above the threshold entirely unaffected.
   With respect to individuals, there is growing international consensus on the importance of strengthening property tax regimes. While property taxes are most commonly raised at a flat rate on property values, property tax rates could be made to rise with property values in order to better tax the very wealthy. One could, in principle, imagine alternative efforts aimed more explicitly at those at high risk of engaging in tax evasion or avoidance. Governments could, for example, impose higher rates of property taxation on owners of valuable properties who declare taxable income over time below a certain relative threshold. This would again shift the burden onto taxpayers of explaining the discrepancy between the value of their real estate and reported income in order to be exempted from the higher rate.

It is important to stress again that these proposals are, with the exception of AMTs, largely untested. Even AMTs have been subject to a still limited body of research. More information is needed, while any of these measures would encounter important political challenges at the domestic level. However, if there is evidence that beneficial ownership transparency may not bring immediate benefits to lower-income countries, there is a compelling case for then giving greater consideration to potential "second-best" alternatives that might deliver greater benefits at lower costs.

Finally, if low-income countries find global advocacy to be ineffective, but are also reluctant to impose the kinds of alternative measure noted above, they also face a third option: effective disengagement. In this scenario low-income countries, and their allies, may continue to offer in-principle support for beneficial ownership transparency – as well as supporting calls for reform or improvement. But beyond that general support, they may simply opt to direct scarce resources toward other avenues for mobilising additional revenue, concluding that the likely costs of investing

[5] Best, Michael, Anne Brockmeyer, Henrik Jacobsen Kleven, Johannes Spinnewijn, and Mazhar Waseem. 2015. "Production versus Revenue Efficiency With Limited Tax Capacity: Theory and Evidence from Pakistan." *Journal of Political Economy* no. 123 (6):1311-1355.

heavily in collecting, receiving and deploying beneficial ownership information are too high relative to potential returns. While seemingly straightforward, such a course of action may, in fact, be quite challenging: it would imply a move away from a large-scale global initiative that has been touted, in part, as promising important benefits to developing countries. However, *if* it becomes clear that few benefits are likely to accrue to (some) low-income countries in the short-term, effectively disengaging may be an appropriate strategy for redeploying limited resources. That said, efforts to strengthen beneficial ownership information also aim to curb corruption and money laundering, and those broader benefits would need to be included in any calculus of the costs and benefits of broader disengagement.

Conclusions

The past five years have witnessed wide-ranging and relatively ambitious reform of international rules shaping tax collection around the world, including the BEPS recommendations, AEOI, and measure to expand beneficial ownership transparency. This has been accompanied in many quarters by hopes of significant revenue gains for low-income countries, with a correspondingly substantial investment of resources – both by international actors and national governments – in seeking to implement these reform measures in practice. However, there has been quietly mounting concern that for low-income countries the successful implementation of new rules may

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be comparatively costly, and the benefits comparatively limited. This reflects limited resources, limited capacity and, in some cases, an imperfect match between international initiatives and the most immediate needs of low-income countries. Yet there is a striking absence of systematic and publicly available research evidence with which to assess the likely benefits (and costs) of these initiatives for low-income countries. It is an important moment at which to take honest stock of these initiatives for low-income countries, in order to chart the most appropriate way forward.

Further reading

Elsayyad, M. and Konrad, K. (2012) *Fighting Multiple Tax Havens*, Journal of International Economics. 86(2): 295–305

Kangave, J., Nakato, S., Waiswa, R. and Lumala Zzimbe, P. (2016) *Boosting Revenue Collection through Taxing High Net Worth Individuals: the Case of Uganda*, ICTD Working Paper 45, Brighton: IDS

Best, M., Brockmeyer, A., Kleven, H. J., Spinnewijn, J. and Waseem, M. (2015) *Production versus Revenue Efficiency With Limited Tax Capacity: Theory and Evidence from Pakistan*, Journal of Political Economy no. 123 (6):1311–1355

Credits

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