The period since the onset of the financial crisis has seen a strong push to combat international tax evasion by applying pressure to Offshore Financial Centres. The campaign has been led by the G20, and supported by its member governments and other international organisations. Five years later, this paper asks what progress has been made. Much more tax information is being shared across borders than ever before, but it is uncertain as to whether this has or will translate into more tax revenue. In particular, a key problem remaining relates to finding the real identities of those using shell companies to obscure their financial affairs, i.e. the question of beneficial ownership. More broadly, the paper argues that we need to move away from a focus on laws and regulations, and pay much more attention to questions of practical implementation and measurement to ensure that policies to combat international tax evasion are both effective in an absolute sense, as well as cost effective. As an example of how this can be done, the paper presents a short summary of a global field experiment testing the effectiveness of international standards on beneficial ownership.
In November of this year Brisbane hosts the G20 leaders’ summit. The G20 is very much the child of a financial crisis, but originally it was the emerging market crisis of 1997-98 rather than the larger and more global crisis of the last decade. It was the near-death experience for the world financial system in late 2008 that changed the G20 from a relatively obscure meeting of finance ministers into what it is today: the pre-eminent forum for global economic governance. Perhaps the most consequential G20 leaders’ summit so far was that held in London in April 2009. Despite fiscal problems having little if anything to do with the onset of the crisis, tax and more particularly the topic of tax havens proved to be the most contentious agenda item. Indeed, the summit almost failed thanks to a disagreement between the French and Chinese leaders on whether or not the meeting should endorse a blacklist of tax havens drawn up by the Organisation for Economic Co-operation and Development (OECD) in the days immediately before the meeting (President Obama brokered an eleventh-hour compromise whereby the list was ‘noted’, but not endorsed, by the G20).

This seemingly obscure clash is indicative of a sea-change in international tax policy that has been significantly driven by the response to the financial crisis even though, as noted, tax as such had little to do with the crisis, however important budget deficits have become since. This brief examines the post-crisis politics and implementation of global tax policy (the fact that there now can be said to be such a thing is an innovation of considerable importance in and of itself) with particular reference to efforts to combat offshore tax evasion and tax havens. As can be gleaned from the title, the two major questions are, first, is this campaign against tax
haven-enabled tax evasion effective, and, secondly, how would we know? These questions may seem simple, but in fact they are difficult to answer, so the conclusions must be tentative. A further feature of note is how rarely the first and even more the second question are actually asked by policy-makers, despite the priority this campaign enjoys. A central goal of the paper is to present a short summary of a field experiment to do with beneficial ownership regulations as a model for how policy effectiveness might be assessed.

In the confines of this short paper it is only possible to give a thumbnail sketch of the relevant background on tax havens and the various policy responses to them. There is no settled definition of a tax haven, and what constitutes such a jurisdiction (also known by the synonym Offshore Financial Centre or OFC) is very much in the eye of the beholder. Nevertheless, to the extent that there is any consensus, tax havens have been conventionally said to be small jurisdictions with low or zero-rates of tax for non-residents and tight financial secrecy. They have consistently been accused by large countries of facilitating tax evasion through allowing foreign individuals and companies to hide income and assets in offshore companies, trusts and banks. Because governments find it hard to tax things they do not know about, information exchange from tax havens to foreign governments, or more particularly the lack thereof, has been the crux of the issue. Though havens have irritated large countries like the United States from as far back as before the Second World War, from the early 1990s tax havens were seen to epitomise fears of a ‘dark side’ of economic globalisation among OECD member states. This scenario suggested that there was an imperative for governments to compete for newly-mobile capital would make it impossible for them to raise enough tax to supply the services demanded by their citizens. Alarmed by this prospect, in the late 1990s the OECD and other organisations launched a drive
against tax havens, but this had largely petered out by the time the financial crisis struck.

The anti-tax haven cause was jolted back to life in early 2009 when the OECD began compiling a blacklist of those jurisdictions that either had not committed to exchange information exchange on request with other governments, or had made but not implemented such commitments. The OECD itself has little in the way of sticks to beat even the smallest tropical islands into compliance. What completely changed the game, however, were strong hints from prominent G20 member governments that it was no longer business as usual, and they were willing to use severe economic sanctions against jurisdictions that did not fall into line.

At first blush, this threat proved incredibly effective, with targeted countries falling over themselves to sign up to international Tax Information Exchange Agreements (TIEAs), even those countries that had for years resolutely opposed such a step. OECD officials proudly noted in mid-2009 that more progress had been made in international tax information exchange in the preceding months than in the previous decade. From the perspective of five years’ hence, it might be expected that, because offshore tax evasion was above all a problem of secrecy, and because every single tax haven has begun the process of exchanging tax information with onshore governments, the G20, OECD and others might have declared victory and turned their minds elsewhere. However, this is not the case. In fact, in the years since, the US, UK and various multilateral clubs have felt the need to re-double their efforts. What went wrong?

Part of the answer is technical, to do with the way the information exchange agreements work, but part of the answer also has to do with goal displacement. The more than 1300 bilateral agreements conducted from 2009 were information exchange on request. The last part is crucial because it meant that tax authorities have to ask for information on a case-by-case basis, and each
request then has to be fielded by the recipient government in the same manner. This is a
labour-intensive process, and given that there are presumed to be thousands if not hundreds of
thousands or even millions of tax evaders at large, only a tiny fraction are likely to be caught. By
way of illustration, though they are often too embarrassed to publish exact figures, most OECD
members make less than half a dozen such requests to any given tax haven in any given year. To
make matters worse, the prohibition against ‘fishing expeditions’ means that tax authorities have
to know quite a lot about the suspected tax evader before they make the request, for example the
full name of the individual, the bank they hold an account with, and ideally the bank account
number too. Obviously in many situations the authorities will not have this information.

These limitations of the information exchange on request model led to criticism from
NGOs like the Tax Justice Network and others that the victory of 2009 was a pyrrhic one, or just
a whitewash. In response, the OECD and many national tax authorities, including the ATO, have
a fairly standard response. They admit that the number of tax evaders that can be caught via
information exchange on request is vanishingly small, but say that such agreements are
nevertheless crucially important in creating a deterrent against tax evasion. That is, would-be tax
evaders now know that if they try to hide their money offshore, they could be one of the unlucky
ones who are caught via information exchange, and thus these individuals are deterred from
engaging in tax evasion. According to this logic, the tiny number of actual requests lodged
misses the point, and grossly understates the effect on compliance. This rationale raises the
second major question of the paper: how do tax authorities know that this deterrent effect is
actually working? It is a plausible story, but one can tell all sorts of plausible stories which
nevertheless do not fit what is really going on. From the author’s discussions at least, here tax
authorities in general and the OECD tax outfit in particular seem on very weak ground in having little or no evidence of the deterrent value of information exchange on request. Rationally, tax-evaders might calculate that their chances of being caught by this mechanism are less than one in a thousand, and so the deterrence value might be very slight.

Recently, however, the rise of the automatic exchange of tax information between governments might have seemed to make the above discussion moot. As the name suggests, rather than tax authorities having to make individual requests, instead they receive information on all their citizens within a particular foreign jurisdiction in bulk, which obviously represents a step-change in the volume of tax information being shared globally. There are certainly long-standing precedents for automatic tax information exchange between governments (e.g. in the Nordic area), but this approach has come to supplant information exchange on request thanks to the European Union Savings Tax Directive, coming into force in 2005 after incredibly long and tortuous negotiations, but even more so thanks to the US Foreign Account Tax Compliance Act, or FATCA, passed in 2010. FATCA especially requires third countries, including tax havens, to make annual reports to the US Internal Revenue Service of the income of all US citizens and all US-controlled companies as well. In making their move to automatic exchange mechanisms, both the EU and US have unambiguously signalled that they do not believe information exchange on request is sufficient to ensure tax-payers’ compliance in an increasingly globalised world economy. This development is something of an implicit rebuke to the OECD tax forum, which until 2010 had been insisting that all countries needed to do to meet the prevailing world standard was to exchange information on request.

The first reaction might be that if FATCA and the Savings Tax Directive are the wave of
the future, and it seems like they are, then offshore tax evasion will soon be a thing of the past, at least with reference to rich OECD countries. Tax dodgers have nowhere to hide as their traditional offshore bolt-holes are pried open. Again, however, there are two reservations about this brave new world of transparency and tax compliance. The first is something of a bureaucratic displacement exercise where the means tend to become the ends. Specifically in this case, tax information is valuable only to the extent that it increases compliance and revenue, the information is a means to an end rather than an end in itself. There is no doubt that more information can be helpful in promoting compliance and increasing revenue, but there is no necessary relationship between the two. It seems almost certain that tax authorities in Australia and elsewhere will in the near future receive an order of magnitude more information than they have previously. It is far from certain, however, that this will actually produce more compliance and more revenue. By way of illustration, most observers outside the US Treasury agree that FATCA will cost far more to implement than it will raise in extra tax, and the implementation costs are likely to be passed on to consumers rather than being borne by financial institutions. Though conclusions can only be tentative, it seems that vastly more information will not translate in to a meaningful amount of extra revenue. This has certainly been the experience of the EU Savings Tax Directive so far.

The second and even more important point relates to information availability. All the discussion of information exchange in tax circles sometimes takes precedence over the logically prior issue: you can’t exchange information you don’t have. This issue has come up with particular force when it comes to determining the real individuals owning or in control of shell companies. Shell companies can be formed online within a day or two in dozens of foreign
jurisdictions for as little as a few hundred dollars, and as legal persons these companies can hold
bank accounts or own property or other assets. As long as the shell company cannot be linked
back to the real individual in control, then it acts to screen that individual’s financial affairs from
outside scrutiny. In this way, anonymous shell companies have become a widely-used device for
tax evasion. Recognising this danger, international organisations and national governments
have responded by mandating Know Your Customer (KYC) standards to enable authorities to
‘look through’ shell companies to find the real individuals in control, the beneficial owner. Yet
as important as these KYC rules are, no one has really known how effective these policy
measures have been in achieving their aims. While proponents trumpet the need for corporate
KYC standards, critics allege that the standards are an expensive failure.

In response to this fundamental uncertainty, Michael Findley, Daniel Nielson and I
designed an experiment based on impersonating 21 fictitious low- and high-risk customers and
soliciting offers for shell companies from thousands of Corporate Service Providers in 182
countries to test whether and how KYC standards on beneficial ownership are actually applied in
practice. The section below provides a brief summary of the design of the global field
experiment, as well as the some of the main results, as an illustration of how we can do better in
measuring policy effectiveness (the full results are contained in the book Global Shell Games:

The exercise was based on creating a variety of fictitious customers who exhibited
various types and levels of risk. Using email approaches, we then had researchers impersonating
these customers make 7466 requests for shell companies to 3773 providers. The standard email
explained the customer was a consultant looking for tax savings, limited liability and
confidentiality, and asked how much a company would cost, and, crucially, what identity documents were required. If providers fail to collect KYC documentation on customers forming shell companies, it is very difficult for the authorities to establish the identity of the beneficial owner further down the track, making the company effectively untraceable.

The risk profile of the customer was manipulated in several ways. The baseline approach came from a customer in one of eight small OECD countries, including Australia, with low levels of corruption and terrorist financing. The corruption risk profile instead had the customer come from West Africa or Central Asia, and work in government procurement, features that in combination with the standard shell company solicitation should have constituted an obvious red flag. Similarly, the terrorism financing risk had the customer being a citizen of one of four countries perceived as having a high terrorism risk, and working for an Islamic charity in Saudi Arabia. Other variations included providing more information about international KYC standards, and suggesting various penalties or inducements for breaking these rules.

Having contacted the provider with a request for a shell company, one of five things could happen. Most simply, the provider could decline to reply, either as a product of commercial logic, inattention, or risk aversion. Similar reasoning might lie behind the second outcome, when the provider replied to refuse service. Third, the provider could offer to form a company, but insist on certified official photo identification documents for KYC purposes (typically a passport), a response which we coded as compliant with international standards. If the response asked for some identity documents, but did not specify they had to be certified official photo ID, this was classified in partially compliant. Finally, if the provider offered a company within asking for any official photo identity documents, this was coded as non-compliant.
Overall, international rules that those forming shell companies must collect proof of customers’ identity are relatively ineffective. Nearly half (48 percent) of all replies received did not ask for certified official photo identity documentation, and 22 percent of all replies received did not ask for any photo identity documents at all to form a shell company. We explained many of the results below with reference to a ‘Dodgy Shopping Count’, which measures the average number of providers a particular type of customer would have to approach to receive a non-compliant response, i.e., be offered a shell company with no need to supply any identity documents. A 5 percent non-compliance rate would thus equal a Dodgy Shopping Count of 20. The lower the Dodgy Shopping Count, the easier it is to get an anonymous shell corporation.

Thus at the broadest level, of the 7,466 inquiries sent, the non-compliance level is 8.4 percent, for an overall Dodgy Shopping Count of 12. The 8.4 percent includes non-responses in the denominator, since conceivably some providers may fail to reply in response to risk and thus may be complying with international law in a ‘soft’ way. As a simplified measure, it is important to note that very high Dodgy Shopping Counts (i.e. very low rates of non-compliance) in some cases exist alongside very high rates of compliance (e.g. the Cayman Islands), very high rates of partial compliance (e.g. Denmark), very high rates of refusal and non-response (e.g. US law firms), or some combination of these. Thus, jurisdictions may have highly positive Dodgy Shopping Counts with very different patterns in the other categories.

Against the conventional policy wisdom, those selling shell companies from tax havens like the Cayman Islands, the Bahamas and Jersey were significantly more likely to comply with the rules than providers in OECD countries like Britain, Australia, Canada and especially the United States, which was one of the worst performers. In the United States sample, the
noncompliance level is 9.2 percent and the Dodgy Shopping Count was 10.9, which was almost 10 percent lower than the average in the international sample. Obtaining an anonymous shell company is therefore easier in the US than in the rest of the world.

However, two factors worsen the gap between the US and other countries. First, the US number is elevated by the much higher non-response rate from firms in US sample, which was 77.3 percent in the US compared to 49.3 percent in the international sample. The proportion of providers in the US sample who replied to our inquiries and required no photo identity documents whatsoever was 41.5 percent, which is roughly two-and-a-half times the average of 16.5 percent in the international sample. We followed up with firms failing to reply to any of our emails with an innocuous inquiry basically asking if the firm was still in business and assisting customers but making no mention of confidentiality, taxes, or liability. We learned that the vast majority of non-responses are not soft refusals: they failed to respond to any inquiry, even the most innocuous that we could design. Only a tiny proportion of US providers of any kind met the international standard by requiring notarized identity documents (10 of 1722 in the US sample, less than one percent). Thus our Dodgy Shopping Count measure tends to flatter the US by equating non-response with a form of compliance.

Another surprise was that providers in poorer, developing countries were at least as compliant with global corporate KYC standards as those in rich, developed nations. For developing countries the Dodgy Shopping Count is 12, while for developed countries it is 7.8. The significance of this finding is that it does not seem to be particularly expensive to enforce the rules on shell companies, given that poor nations do better than rich countries. This suggests that the relatively lackluster performance in rich countries reflects a simple unwillingness to enforce
the rules, rather than any incapacity. These results lend support to the results of a similar 2011 study by the World Bank, *The Puppet Masters*, which similarly concluded that rich, developed countries are generally the worst offenders in failing to meet corporate KYC standards.

In some ways the biggest surprise was how little difference there was between the relatively innocuous low-corruption risk email and the obviously high-risk corruption approach, despite the international guidelines specifying that these customers should be subject to enhanced scrutiny. Excluding the US, the Dodgy Shopping Count was 11.5 for the low risk email, 11.3 for corruption, and 18.5 for terrorism financing risk. The results for the United States are 9 for the low risk email, 9.9 for corruption, and 17.4 for terrorism financing.

Varying the email approach to inform providers of the KYC rules they should be following made them no more likely to do so in the U.S or internationally, even when penalties for non-compliance were mentioned. The exception was in the US, where telling providers that the IRS enforced Know Your Customer standards reduced non-compliance (and thus increased the Dodgy Shopping Count from 9.5 to 13.2). In contrast, when customers offered to pay providers a premium to flout international rules, the rate of demand for certified identity documentation fell compared to the low-risk customer profiles.

These results represent by far the most detailed, extensive and reliable test of KYC rules in relation to shell companies ever performed, and the pattern that emerges as a result is worrying. Given the patchy overall level of compliance, the easy availability of formally prohibited untraceable shell companies, and the willingness of hundreds of businesses to supply obvious criminal risks with the corporate anonymity, the existing system seems to be very compromised. Many of these failings can be laid at the door of large, rich countries, especially
the English-speaking OECD members and the United States above all, who conspicuously fail to apply standards that they have so energetically imposed on others.

**Conclusion**

The period since the onset of the financial crisis has undoubtedly seen substantial and important changes in global tax policy. Yet we have surprisingly little idea of what progress, if any, has been made towards solving the problem that motivated the intervention of the G20 and catalysed the existing OECD initiatives: the campaign against offshore tax evasion. For while corporate tax avoidance by firms like Google, Apple, Starbucks, etc. has (very properly) come on to the media and policy agenda with programs like the OECD Base Erosion and Profit Shifting initiative, it is tax evasion that has got most attention. Perhaps the greatest concern is not just that we have so little information on the effectiveness and, importantly, the cost effectiveness of the various information exchange initiatives, but that the responsible national and international agencies seem to have so little interest in evidence at all. So we have the OECD, staffed by professional economists steeped in the tradition of empiricism, and that has done more than any other organisation to diffuse the principle of Regulatory Impact Assessments, that is nevertheless indifferent to measuring costs and benefits of this kind of tax policy. Instead of evidence-based policy, we have policy-based evidence, as when Australia and others decided to adopt anti-money laundering standards and simply asserted in the legislation, with absolutely no evidence, that the benefits would outweigh the costs. Measuring effectiveness in this domain is hard, but not impossible. As the short summary of the *Global Shell Games* field experiment
suggests with reference to beneficial ownership, we can do better in finding out what works when and where in tax policy.