Florida Tax Review

Volume 18 Article 8

Big Haven and Tax Haven Secrecy

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FLORIDA TAX REVIEW

Volume 18 *2016* *Number 8*

BIG DATA AND TAX HAVEN SECRECY

By

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ABSTRACT

While there is now significant literature in law, politics, economics, and other disciplines that examines tax havens, there is little information on what tax haven intermediaries—so-called offshore service providers—actually do to facilitate offshore evasion, international money laundering, and the financing of global terrorism. To provide insight into this secret world of tax havens, this Article relies on the Author's study of big data derived from the financial data leak obtained by the International Consortium for Investigative Journalists (ICIJ). A hypothetical involving Breaking Bad*'s Walter White is used to explain how offshore service providers facilitate global financial crimes. A transaction cost perspective assists in understanding the information and incentive problems revealed by the ICIJ data leak, including how tax haven secrecy enables elites in non-democratic countries to transfer their monies for ultimate investment in stable democratic countries. The approach also emphasizes how, even in a world of perfect information, political incentives persist that thwart cooperative efforts to inhibit global financial crimes.*

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* Professor, Queen's University Faculty of Law (Canada). An earlier draft of this Article was presented at conferences or discussed in panels at Queen's University, University of California, Berkeley, Stanford University Law School, London School of Economics Department of Law, Thomas Jefferson School of Law, and the Annual Meeting of the Canadian Tax Foundation in Montreal. The Author would like to thank participants, as well as Frédéric Zalac, Gerald Ryle, and Christian Leuprecht, for their helpful comments. He is also grateful for the research assistance provided by Craig Zeeh and Natasha Mukhtar, J.D. candidates at Queen's University Faculty of Law.

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I. INTRODUCTION

On April 3, 2013, the International Consortium for Investigative Journalists (ICIJ) announced that it had obtained the world's largest financial data leak.[1] The leak included over 2.5 million documents detailing the tax haven financial dealings of over 70,000 taxpayers and over 120,000 offshore corporations and trusts.[2] This leak had been investigated by over eighty-six

1. *See* Gerard Ryle et al., *Secret Files Expose Offshore's Global Impact*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS, Apr. 3, 2013, http://www.icij.org/offshore/secret-files-expose-offshores-global-impact [hereinafter Ryle et al., *Secret Files*].

2. *Id.* Measured at 260 gigabytes, the total size of the leaked files obtained by the ICIJ is more than 160 times larger than the leak of U.S. State Department documents by WikiLeaks in 2010. *Id.*

journalists in forty-two countries prior to its public revelation, forming what is likely the most comprehensive global journalist collaboration in history.[3] For the first time, the secret world of tax havens was revealed in great detail.

The "big data" derived from the ICIJ financial data leak provided journalists and selected researchers, including this Author, with the opportunity to understand how individuals use tax havens to criminally evade taxes, launder illegal earnings, and finance cross-border terrorism (collectively, "global financial crime"). This Article provides a taxonomy of offshore tax evasion efforts derived from the Author's study and analysis of the data leak, with the ultimate aim of providing insights into the incentive and information problems that make it difficult to inhibit global financial crime.[4]

While there is now a significant literature in law, politics, economics, and other disciplines that examine tax havens and offshore tax evasion, there is little information on what tax haven intermediaries—offshore service providers such as finance and trust companies—*actually do* to facilitate offshore evasion.[5] The gap in the writings can be largely explained by the secretive nature of tax haven activities that shielded them from outside scrutiny. For example, the ICIJ financial data leak revealed that offshore service providers were often not complying with international "know your customer" standards,[6] which creates information problems that significantly raise transaction costs for law enforcement authorities with respect to

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3. *Id.*

4. The following analysis relies on the Author's consulting work from 2012 to 2013 for the Canadian Broadcast Corporation (CBC), which was the Canadian media partner with the ICIJ: both organizations obtained the data leak over a year in advance of the public disclosure in April 2013. While the CBC and ICIJ have encouraged the Author to publish his research results, the views in this Article do not necessarily reflect those of the CBC, the ICIJ, or their employees.

5. For other efforts to assess financial dealings within tax havens, see U.S. S. PERMANENT SUBCOMM. ON INVESTIGATIONS, COMM. ON HOMELAND SEC. AND GOV'T AFFAIRS, MINORITY & MAJORITY STAFF REP., TAX HAVEN ABUSES: THE ENABLERS, THE TOOLS AND SECRECY (2006) [hereinafter SUBCOMM. ON INVESTIGATIONS, TAX HAVEN ABUSES]; Dmitry Gololobov, *The Yukos Money Laundering Case: A Never-Ending Story*, 28 MICH. J. INT'L L. 711 (2007) [hereinafter Gololobov, *The Yukos*]; Jeffery Simser, *Tax Evasion and Avoidance Typologies*, 11 J. MONEY LAUNDERING CONTROL 123 (2008) [hereinafter Simser, *Tax Evasion*]; Douglas J. Workman, *The Use of Offshore Tax Havens for the Purpose of Criminally Evading Income Taxes*, 73 J. CRIM. L. & CRIMINOLOGY 675 (1982).

6. As discussed in Part IV.A, employees of offshore service providers at times tried to identify the source of deposited funds and questioned sources with superiors but there was often either no follow-up or ongoing delays by depositors for periods that potentially could go on for decades.

enforcing tax and criminal laws governing offshore tax evasion and other global financial crime.[7]

A less explored idea is that the secret world dramatically lowers transaction costs for criminals engaged in these offshore activities—the secrecy effectively reduces certain risks facing tax evaders, international drug launderers, and financiers of global terrorism. A transaction cost perspective can assist with understanding the incentive and information problems revealed by the ICIJ financial data leak.[8] The approach emphasizes the ways that offshore service providers take advantage of information problems to facilitate global financial crime.

The ICIJ financial data leak also provides evidence of capital flight from non- or quasi-democratic countries to wealthier democracies such as the United States and other Organization for Economic Cooperation and Development (OECD) nations; it reveals how a small portion of ruling elites in countries such as China use tax haven intermediaries as conduits to invest their monies in stable democracies.[9] The capital-importing countries hence

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7. *See* Markus Brem & Thomas Tucha, *Globalization, Multinationals, and Tax Base Allocation: Advance Pricing Agreements as Shifts in International Taxation?*, *in* INTERNATIONAL TAXATION HANDBOOK: POLICY, PRACTICE, STANDARDS, AND REGULATION 111 (Colin Read & Greg N. Gregoriou eds., 2007) (discussing transaction cost analysis and information problems within the international tax regime); Kyle D. Logue & Joel Slemrod, *Of Coase, Calabresi, and Optimal Tax Liability*, 63 TAX L. REV. 797, 798, 804–09 (2010) (discussing the Coase Theorem and its application to tax policy analysis).

8. *See* R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15–16, 43–44 (1960) [hereinafter Coase, *Social Cost*] (describing how legal rules influence transaction costs as exchanges involve the exchange of rights to perform certain actions and not merely the trade in particular goods and services). Building on insights from Coase and others, transaction cost politics (as developed by Douglass C. North) and transaction cost economics (as developed by Oliver E. Williamson) extend traditional private sector analysis to assist with respect to public policy design. *See* Douglass C. North, *A Transaction Cost Theory of Politics*, 2 J. THEORETICAL POLITICS 355 (1990); Oliver E. Williamson, *Public and Private Bureaucracies: A Transaction Cost Economics Perspective*, 15 J.L. ECON. & ORG. 306 (1999); *see also* AVINASH K. DIXIT, THE MAKING OF ECONOMIC POLICY: A TRANSACTION-COST POLITICS PERSPECTIVE (The MIT Press ed., 1996). This Article extends the analysis of an earlier work that showed how the international tax regime can be conceptualized as a legal and political system striving to address transaction cost challenges facing taxpayers and governments. *See* Arthur J. Cockfield, *The Limits of the International Tax Regime as a Commitment Projector*, 33 VA. TAX REV. 59 (2013) [hereinafter Cockfield, *Commitment Projector*].

9. *See, e.g.*, Michael Hudson et al., *Hidden in Plain Sight: New York Just Another Island Haven*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS, July 3, 2014, http://www.icij.org/offshore/hidden-plain-sight-new-york-just-another-island-

benefit from trillions of dollars of inward foreign direct and portfolio investment, a significant portion of which would not likely take place in the absence of tax haven secrecy.[10]

This environment provides a moral hazard for the capital-importing countries, as the current regime in many ways benefits their economies at the expense of the capital-exporting countries. Tax havens, non-democratic states, and even wealthy democracies all face political incentives to pursue the status quo of tax haven secrecy. This Article shows that, even in a world of perfect information, until political incentives change it will be difficult to make any real progress to inhibit global financial crime.

This Article is organized as follows. Part II provides context by discussing how tax haven secrecy thwarts the laws and policies that govern offshore tax evasion and other global financial crime. In addition, it explores the role of big data in international tax law analysis and how this data could be used to inhibit these crimes, while recognizing that unique national privacy laws present a barrier to enhanced cross-border tax and financial information exchanges among governments.

The ICIJ data set offers a glimpse into the normally secretive world of offshore tax havens. Part III discusses how this data set differs from prior tax haven data leaks, as it provides for the first time detailed documentation of tax haven financial dealings over a roughly thirty-year period. In addition, the ICIJ financial data leak provides evidence of capital flight from certain countries, as well as how taxpayers use offshore corporations and other business entities to facilitate global financial crime while appearing to comply with all relevant domestic and international laws.

Part IV offers a taxonomy of offshore tax haven behavior revealed by the ICIJ financial data leak, including how individuals move and invest illicit proceeds via non-resident corporations and trusts with the aid of offshore service providers. An example involving *Breaking Bad*'s Walter White and his efforts to launder illicit proceeds from crystal meth sales is used to assist the reader in understanding how offshore service providers facilitate global financial crime.

Part V outlines how information and incentive problems promoted by tax haven secrecy (and revealed by the ICIJ financial data leak) inhibit the

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haven [hereinafter Hudson, *New York*] ("High-end New York real estate is an alluring destination for corrupt politicians, tax dodgers and money launderers around the globe."). *See* discussion *infra* Part III.B.

10. Between an estimated one and four trillion dollars of untraced assets has been transferred out of China alone since 2000. Mar Cabra & Marina Walker Guevara, *Unlocking China's Secrets*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS, Jan. 23, 2014, http://www.icij.org/offshore/unlocking-chinas-secrets [hereinafter Cabra & Guevara, *China's Secrets*].

ability of governments to meaningfully enforce their tax, criminal, and other laws governing global financial crime. A final Part concludes.

II. LAWS GOVERNING GLOBAL FINANCIAL CRIME AND THE POTENTIAL FOR BIG DATA

This Part provides context by outlining how tax, criminal, anti-terrorism, and other laws seek to inhibit offshore tax evasion and other global financial crime, as well as how the phenomenon of tax haven secrecy largely thwarts these efforts. It then discusses how government cross-border exchanges of big data (mainly comprised of bulk tax and financial information) are increasingly being used to resolve information problems promoted by tax haven secrecy. Finally, the Part highlights how unique national privacy interests and laws remain an understandable barrier to heightened cross-border flows of personal tax and financial information.

A. Offshore Tax Evasion and Other Global Financial Crimes: An Overview

Governments are increasingly studying how big data can be used to combat offshore tax evasion as well as aggressive international tax avoidance.[11] It is important to note up front the differences between tax evasion and tax avoidance. Most countries tax the worldwide income of their residents. The United States additionally taxes the worldwide income of its citizens.[12] These residents or citizens must normally self-assess their global income and report it to their tax authorities. Offshore tax evasion is a criminal offence that generally involves a taxpayer intentionally not disclosing offshore assets or income to his or her tax authority.

For example, an individual named Walt (of *Breaking Bad* fame) could earn $3 million from his car wash business in New Mexico but choose to report only $1 million to the IRS on his tax return. He could take the remaining $2 million in cash, put it in the lining of his suitcase, and fly to an offshore tax haven to make a deposit in a "secret" savings account at a bank. If the taxpayer purposefully hides the $2 million in this account and never reports these monies or any related interest income, then the taxpayer has committed the criminal offence of tax evasion, which carries sanctions such as fines or imprisonment.[13]

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11. *See* discussion *infra* Part II.B.

12. *See* I.R.C. § 61(a) (indicating that "gross income means all income from whatever source derived"); *see also* I.R.C. §§ 1 (individuals), 11 (corporations).

13. *See* I.R.C. § 7201 ("Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition

In contrast, international tax avoidance involves an attempt by a taxpayer to legally reduce tax liabilities when this taxpayer is engaged in cross-border activities.[14] This tax-avoidance effort may be audited by a tax authority to determine whether the plan complies with domestic tax laws and, in some circumstances, tax treaties. If the tax authority determines that the plan violates these laws, then the taxpayer may have to pay a larger tax liability along with potential interest and other penalties. No crime has been committed; hence, sanctions such as imprisonment are not permissible. As subsequently discussed in Parts III.C and IV, at times taxpayers create cross-border structures that appear to involve legal tax planning but in reality involve a criminal attempt to hide income and assets offshore.

Another initial matter that needs to be discussed surrounds the definition and nature of tax havens. The definition of what constitutes a tax haven remains contentious among academics.[15] According to the OECD, tax havens have the following four attributes: (i) no or low effective tax rates; (ii) no substantial economic activities needed to attract tax benefits; (iii) a lack of transparency of financial and other laws that govern financial dealings; and (iv) a lack of effective exchange of information.[16] In 2001, the OECD removed

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to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution."). The penalties under the Currency and Foreign Transactions Reporting Act of 1970, 31 U.S.C. § 5311 (2012) (commonly referred to as the Bank Secrecy Act (BSA)), for failure to file a foreign bank account report (FBAR) are more severe than the ones imposed by the Internal Revenue Code. For instance, a U.S. person who lives outside of the United States and fails to file an FBAR for one year can attract a penalty of up to 50 percent of the value of any undisclosed taxpayer assets. Two years of non-compliance with FBAR requirements can result in a penalty equalling 100 percent of the taxpayer's undisclosed assets. 31 U.S.C. § 5321 (2012). For discussion of these laws and penalties, see ARTHUR COCKFIELD & DAVID KERZNER, THE MANAGER'S GUIDE TO INTERNATIONAL TAX 115–19 (2009).

14. The ICIJ data leak also revealed aggressive tax planning structures advocated by accounting firms, although there is no suggestion that these structures or tax plans involved criminal activity. *See* discussion *infra* Part III.C.

15. For discussion of the different perspectives, see Dhammika Dharmapala, *What Problems and Opportunities Are Created by Tax Havens?*, 24 OXFORD REV. ECON. POL'Y 661, 664 (2008) (discussing how tax havens may enhance the efficiency of global capital flows).

16. *See* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE 26–30 (1998), http://www.oecd.org/tax/transparency/44430243.pdf [hereinafter OECD, HARMFUL TAX COMPETITION]; *see also* OECD GLOBAL FORUM ON TRANSPARENCY AND EXCHANGE OF INFORMATION, MOVING FORWARD ON THE GLOBAL STANDARDS OF

the "no substantial economic activities" criterion to focus on cross-border tax information exchanges as a mechanism to fight tax haven secrecy.[17]

The academic discussion surrounding the definition of tax havens recognizes, however, that a country can exhibit tax haven behavior even if it has high income tax rates. This outcome occurs because many OECD countries serve as a form of tax haven, because they do not disclose tax or financial information regarding non-resident investors, which encourages offshore tax evasion and other global financial crime to persist.[18] For instance, three of the largest OECD economies (the United States, Germany, and Japan) are ranked in the top 12 countries with the strongest financial secrecy laws, while countries at times labelled tax havens (such as Barbados, the Bahamas, and Liechtenstein) have more favorable rankings.[19]

To help understand how non-residents take advantage of tax haven secrecy to hide and invest monies in stable economies, consider the following

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TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES (2009), http://www.oecd.org/ctp/harmful/43775637.pdf.

17. In a series of communiqués, the G20 endorsed the OECD's perspective on the definition of tax havens. *See, e.g.*, G20 SUMMIT INT'L ORG. COMM. ASS'N (G20), THE GLOBAL PLAN FOR RECOVERY AND REFORM (2009), http://www.g20ys.org/upload/auto/9c0ee8439921b1032fba1b8ca960ba8be8ca4e0d.pdf; G20, DECLARATION ON STRENGTHENING THE FINANCIAL SYSTEM (2009), https://www.treasury.gov/resource-center/international/g7g20/Documents/London%20April%202009%20Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf.

18. B *See* discussion *infra* Part III.B.

19. The United States is ranked at number 3, Germany at 8, Japan at 12, Barbados at 22, Bahamas at 25, and Liechtenstein at 36. Other OECD countries such as Canada (ranked at 29) and the United Kingdom (ranked at 15) also maintain financial secrecy laws and policies that offer stronger secrecy protection than many so-called tax havens, which generally prefer to be known as "International Financial Centers." *See* TAX JUSTICE NETWORK, FINANCIAL SECRECY INDEX 2015: METHODOLOGY 75–79 (2015). The matter becomes more complicated because federal countries such as the United States and Canada grant constitutional powers to subnational units (that is, states and provinces) to develop corporate and tax laws. For example, Delaware and certain other U.S. states deploy corporate laws that enable secrecy by making it difficult or impossible to obtain the names of individual shareholders. A report from Global Financial Integrity also found that the United States was the world's foremost destination for foreign capital, with over $2 trillion in private, non-resident deposits. The United States has also been characterized as "noncompliant" with global financial standards under the Financial Action Task Force because the owners of U.S. limited liability companies are hidden from public view. *See* Ann Hollingshead, *Privately Held, Non-Resident Deposits in Secrecy Jurisdictions*, GLOBAL FIN. INTEGRITY (2010), http://www.gfintegrity.org/storage/gfip/documents/reports/gfi_privatelyheld_web.pdf.

example.[20] Geraldo is a wealthy entrepreneur who lives in a South American country. He has amassed a fortune of $1 billion dollars in cash. He does not wish to pay taxes on any return on this money and also fears that the government may one day expropriate his cash or other assets (in particular, he worries that a more socialist political regime may try to nationalize private businesses, including Geraldo's).

He retains an offshore service provider (that is, a trust, finance, insurance, or other offshore service company that provides financial services to non-residents) called Global Asset Management, which is based in an offshore tax haven and which forms an offshore corporation for Geraldo.[21] He transfers $1 billion to a corporate bank account of this non-resident corporation he now controls. Global Asset Management then assists Geraldo in retaining an investment company (based in another tax haven) to invest the corporation's cash in U.S. treasury bonds that generate a return of 3 percent a year. The U.S. government pays out the annual return of $30 million to the corporate bondholder in the tax haven.

Geraldo never discloses the annual return or offshore account to his own government, which will not know about the offshore evasion unless it conducts an audit of Geraldo and requests the tax haven government to cooperate and report on the secret account and the fact that Geraldo is the owner of the shares of the offshore corporation.[22] The tax haven itself promotes heightened secrecy by passing so-called bank secrecy laws that make it a criminal offence for any individual within the tax haven to disclose personal financial information to third parties: the only small chance that Geraldo's own government can find out about Geraldo's activities is if it somehow knows where Geraldo has hidden his monies and has an agreement (called a tax information exchange agreement or TIEA) with the tax haven government to exchange cross-border tax information.[23]

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20. For more background on offshore tax evasion and related policy concerns, see Arthur J. Cockfield, *Transforming the Internet into a Taxable Forum: A Case Study in E-commerce Taxation*, 85 MINN. L. REV. 1171, 1240–45 (2001) [hereinafter Cockfield, *Transforming the Internet*].

21. *See infra* Part IV.A for a discussion of the role of offshore service providers.

22. International reforms have been underway to combat the usage of tax haven corporations and other business entities to mask the identity of the ultimate (or "beneficial") owners of the investment. These reforms form part of the OECD's ongoing Harmful Tax Practices Project (previously named the Harmful Tax Competition Project). *See* OECD, HARMFUL TAX COMPETITION, *supra* note 16, at 28; OECD, IMPROVING ACCESS TO BANK INFORMATION FOR TAX PURPOSES: THE 2007 PROGRESS REPORT (2007), http://www.oecd.org/tax/exchange-of-tax-information/39327984.pdf.

23. *See* discussion *infra* Part IV.D.

Moreover, the United States and other OECD countries will generally not tax Geraldo's investment or even know the true identity of the investor. In this way, these governments are indirectly facilitating capital flight from less wealthy (and often non-democratic) countries to those that are wealthier.[24] As discussed in Part III.B, the ICIJ financial data leak provided evidence that a portion of the wealthy elites of certain countries use offshore accounts to invest their funds overseas.

In addition to tax evasion, Geraldo has engaged in international money laundering. Money laundering is the disguising of the illicit origin of money and its placement in the conventional banking system (hence the notion that the money has been laundered or "cleaned up").[25] The ICIJ data leak revealed that individuals engaging in offshore tax evasion typically also engaged in international money laundering when they transferred undisclosed monies across borders and when these monies were repatriated for use by the evaders, and their family members or associates.[26]

Geraldo, for instance, must devise ways to bring back the untaxed offshore funds so that he can use them for consumption purposes (e.g., through the use of offshore debit and credit cards).[27] In this way, offshore tax evaders often engage in international money laundering, even if their assets or income were initially derived from legal sources.

Finally, tax haven secrecy facilitates the financing of global terrorism. Assume Geraldo wants to fund terrorist activities at home or abroad. With respect to the latter option, Geraldo could transfer his monies to a tax haven, then anonymously donate these funds to schools, religious institutions, or others who support his extremist political views. Alternatively, tax haven secrecy allows foreign funders to channel their funds to individuals such as Geraldo without detection by local law enforcement officials.

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24. This phenomenon is thought to have increased dramatically since 1984 due to the decision of the U.S. government to reduce withholding taxes on certain cross-border portfolio investments to zero. Deficit Reduction Act of 1984, Pub. L. No 98–369, § 127, 98 Stat. 493, 648–53 (1984). Previously, an individual such as Geraldo would have at least had to pay some tax on his overseas investment (e.g., 30 percent on any interest payments from the U.S. to the tax haven intermediary). After the United States removed withholding taxes in 1984, most other OECD countries, including Canada, followed suit by eliminating withholding taxes on cross-border portfolio interest to encourage more inward cross-border investments.

25. For discussion, see Killian J. McCarthy, *Why Do Some States Tolerate Money Laundering? On the Competition for Illegal Money*, *in* RESEARCH HANDBOOK ON MONEY LAUNDERING 127, 128–131 (Brigitte Unger & Dean van der Linde eds., 2013) [hereinafter McCarthy, *States Tolerate Money Laundering*].

26. *See* discussion *infra* Part IV.B.

27. *See* discussion *infra* Part IV.C.

There is evidence via private and government lawsuits that tax haven secrecy may facilitate financial transfers across borders for terrorism purposes.[28] In addition, law enforcement authorities are beginning to access cross-border tax information to provide leads for investigations into global terrorist financing.[29] In particular, individuals sometimes fund terrorism via "charities" located at home or abroad that are really conduits for extremist activities; tax data at times is accessed to pursue investigations into these activities.[30] These efforts are challenged by the fact that some charities may be involved in terrorist and non-terrorist activities, complicating investigations into terrorist financing.[31] Some terrorist organizations also engage in organized crime, including international money laundering operations.[32] Other research suggests that terrorist financiers can potentially take advantage of domestic and offshore "shell" corporations and tax haven secrecy to engage in their criminal activities.[33]

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28. For discussion of U.S. civil cases where plaintiffs sued foreign banks for financing terrorism, see Paul M. Barrett, *Are Credit Suisse, RBS, Standard Chartered, HSBC, and Barclays Terrorist Banks?*, BLOOMBERG BUSINESSWEEK, Feb. 24, 2015, at 52.

29. *See* Arthur J. Cockfield, *Protecting Taxpayer Privacy Rights Under Enhanced Cross-Border Tax Information Exchange: Toward a Multilateral Taxpayer Bill of Rights*, 42 U.B.C. L. REV. 419, 437–38 (2010) [hereinafter Cockfield, *Protecting Taxpayer Privacy Rights*].

30. *See, e.g.*, Anita I. Anand, *Combating Terrorist Financing: Is Canada's Legal Regime Effective?*, 61 U. TORONTO L.J. 59, 59–61 (2011) (recommending further scrutiny of the legal framework on terrorist financing); David G. Duff, *Charities and Terrorist Financing*, 61 U. TORONTO L.J. 73, 76 (2011) (arguing for enhanced disclosure obligations for charities to assist with terrorist investigations); Kent Roach, *The Air India Report and the Regulation of Charities and Terrorism Financing*, 61 U. TORONTO L.J. 45, 53–53, 56 (2011) (claiming more prosecutions of terrorist financing are needed).

31. Aviv (Cohen) Dekel, *The Unique Challenge of Dual-Purpose Organizations: Comparative Analysis of U.S. and Israel Approaches to Combating the Finance of Terrorism*, 35 LOY. L.A. INT'L & COMP. L. REV. 389, 400–01 (2013) (arguing for a more aggressive pursuit of the connection between charities and terrorist financing).

32. *See* Christian Leuprecht et al., *Hezbollah's Global Tentacles: A Relational Approach to Convergence with Transnational Organised Crime*, TERRORISM AND POL. VIOLENCE, Nov. 23, 2015, at 1, 1–2, http://dx.doi.org/10.1080/09546553.2015.1089863.

33. Shima Baradaran, Michael Findley, Daniel Nielson & Jason Sharman, *Funding Terror*, 162 U. PA. L. REV. 477, 519 (2014) (noting that tax haven governments often follow international regulations whereas U.S. domestic laws at times do not do so).

B. Legal and Policy Response

Due to the illegal and secretive nature of global financial crime, it is difficult to measure the volume of cross-border flows or associated tax revenue losses and other adverse policy outcomes. Even the amounts of monies held in the world's tax havens remain largely unknown, with estimates ranging from $10 to $32 trillion of unreported private financial wealth.[34] The literature on the economics of money laundering also reveals estimates that range between roughly $500 billion and $2.9 trillion a year that flows through the money laundering market.[35] U.S. revenue losses from individual offshore tax evasion amount to between $40 and $100 billion per year.[36]

In the United States and many other countries, a complex legal environment governs offshore tax evasion, international money laundering, and financing global terrorism. U.S. federal statutes include the Internal Revenue Code, the Money Laundering Control Act, the Bank Secrecy Act, and the USA Patriot Act.[37] In addition, there have been a number of reform efforts directed at regulating tax haven financial behavior. Most prominently, the U.S. Congress passed a 2010 law known as the Foreign Account Tax Compliance Act[38] (FATCA) to force foreign financial institutions to collect bank account

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34. *See* James S. Henry, *The Price of Offshore Revisited*, TAX JUST. NETWORK, July 2012, http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore_Revisited_120722.pdf [hereinafter Henry, *Offshore Revisited*]; *see also The Missing $20 Trillion: How to Stop Companies and People Dodging Tax, in Delaware as well as Grand Cayman*, THE ECONOMIST (Feb. 16, 2013).

35. For a summary of estimates of the scale of the money laundering industry, see McCarthy, *States Tolerate Money Laundering*, *supra* note 25, at 128–29.

36. *See* SUBCOMM. ON INVESTIGATIONS, TAX HAVEN ABUSES, *supra* note 5, at 1 (reviewing evidence that suggests Americans illegally evade between $40 and $70 billion in U.S. taxes each year); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-13-318, OFFSHORE TAX EVASION: IRS HAS COLLECTED BILLIONS OF DOLLARS, BUT MAY BE MISSING CONTINUED EVASION 1 (2013) [hereinafter GAO, OFFSHORE TAX EVASION]; *see also Tax Haven Banks and U.S. Tax Compliance: Hearing Before the S. Permanent Subcomm. on Investigations of the Comm. on Homeland Sec. and Gov't Affairs*, 110th Cong., 2d Sess. 1 n. 1 (2008) (estimating a $100 billion annual loss from both individual tax evasion and corporate tax planning "abuses").

37. 18 U.S.C. § 1956 (1986); Currency and Foreign Transaction Reporting Act of 1970 (Bank Secrecy Act), 31 U.S.C. 5311 et seq.; Intercept and Obstruct Terrorism (USA Patriot Act) Act of 2001, Pub. L. No. 107–56, 115 Stat. 272 (2001). The relevant laws and regulations are reviewed in JOHN MADINGER, MONEY LAUNDERING: A GUIDE FOR CRIMINAL INVESTIGATORS 23–68 (3rd ed. 2012) [hereinafter MADINGER, MONEY LAUNDERING].

38. *See* Foreign Account Tax Compliance Act of 2009 (FACTA), H.R. 3933, 111th Cong. (1st Sess. 2009). FATCA initially failed to be enacted. The legislation was subsequently passed within a large omnibus legislative package that

information on any "U.S. persons" (that is, U.S. citizens, residents, former green card holders, and others) and send this information directly to the IRS.[39] FACTA, which came into effect for many countries in 2015, seeks to solve the information problem noted earlier: tax and law enforcement authorities generally cannot access needed information concerning their residents' and citizens' financial dealings with offshore tax havens (although FATCA primarily targets U.S. taxpayers who reside abroad while the bulk of offshore tax evasion is conducted by ones living within the United States).[40]

Moreover, the United States seeks to inhibit offshore tax evasion through various policies:[41] (a) a voluntary disclosure program (that brought in $5.5 billion in revenues from 2003 to 2012); (b) enhanced taxpayer reporting (e.g., the Report of Foreign Bank and Financial Accounts under the Bank Secrecy Act[42]); (c) a whistleblower program that pays individuals for information leading to offshore tax evasion convictions; (d) "John Doe"

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was mainly directed at job creation. *See* Hiring Incentives to Restore Employment Act, H.R. 2847, 111th Cong. § 501 (2d Sess. 2010). The provisions to implement FATCA are now contained in sections 1471 to 1474 of the Internal Revenue Code.

39. To implement FATCA, the U.S. government began to enter into intergovernmental agreements (IGAs) with foreign countries so that the foreign bank account information would first go to the tax authorities where the banks are located. The information would then be transferred to the IRS. Because IGAs are unilateral in nature and foreign governments receive nothing in return for signing these agreements, the U.S. governments threatened a withholding tax that would effectively shut down the financial industries of foreign countries such as Canada. For discussion and critique, see Scott D. Michel & H. David Rosenbloom, *FATCA and Foreign Bank Accounts: Has the U.S. Overreached?*, 62 TAX NOTES INT'L 709, 712 (May 30, 2011) [hereinafter Michel, *FATCA*]; Cockfield, *Commitment Projector*, *supra* note 8, at 97–111; *see also* Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FACTA, 2012, https://www.treasury.gov/press-center/press-releases/Documents/reciprocal.pdf.

40. Critics have pointed out that FATCA is a blunt instrument that will likely not raise significant revenues in part because information sharing goes one way (from the foreign country to the United States) and there are no reciprocal benefits that encourage a meaningful implementation by foreign governments. *See, e.g.*, Michel, *FATCA*, *supra* note 39, at 714; Allison Christians & Arthur J. Cockfield, Submission to the Department of Finance on Implementation of FATCA in Canada: Submission on Legislative Proposals Relating to the Canada-United States Enhanced Tax Information Exchange Agreement (March 10, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2407264.

41. For discussion of these programs, see GAO, OFFSHORE TAX EVASION, *supra* note 36, at 1–9.

42. Under the BSA, U.S. taxpayers file FBARs if they have a financial interest in or signature authority over offshore accounts with an aggregate value exceeding $10,000. 31 U.S.C. § 5314 (2012). *See* discussion *supra* note 13.

summons, which are court-ordered summons that allow the IRS to find out information about offshore taxpayer activities without knowing individual identities beforehand; and (e) public disclosures of successful prosecutions.

With respect to international tax reform efforts directed at inhibiting offshore tax evasion, the United States and other countries generally work through, and seek guidance from, the OECD, a Paris-based international organization that serves as the main informal "world tax organization."[43] The OECD has ongoing reform efforts directed at offshore tax evasion and the related phenomenon of aggressive international tax planning.[44] Since 2002, for instance, the OECD has concentrated on promoting information exchanges between OECD countries and tax havens through agreements based on the OECD model tax information exchange agreement (TIEA). [45]

With respect to efforts to inhibit international money laundering, the main international regulatory body responsible for such reforms is the Financial Action Task Force (FATF), which was established by the G7 in 1989. FATF sets international standards surrounding issues such as "know your customer" rules for financial institutions and seeks to force other countries to comply with these standards in part by "blacklisting"

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43. The OECD has engaged in outreach to non-OECD countries to ensure they play a role in reform deliberations since global e-commerce reform efforts of the late 1990s. Increasingly, the G20 group of countries also plays a significant role in international tax reform, often in cooperation with OECD efforts. For discussion of the OECD's reform efforts and how it influences international tax law developments, see Allison Christians, *Hard Law, Soft Law, and International Taxation*, 25 WIS. INT'L L.J. 325, 331 (2007); Arthur J. Cockfield, *The Rise of the OECD as Informal 'World Tax Organization' Through National Responses to E-Commerce Tax Challenges*, 8 YALE J.L. & TECH. 136 (2006).

44. The main current focus of the OECD is to develop a common standard for participating governments to exchange cross-border tax information to identify whether resident taxpayers are not disclosing offshore accounts to their domestic tax authorities. *See* OECD, STANDARD FOR AUTOMATIC EXCHANGE OF FINANCIAL INFORMATION IN TAX MATTERS (2014), http://dx.doi.org/10.1787/9789264216525-en [hereinafter OECD, STANDARD FOR AUTOMATIC EXCHANGE]. On October 29, 2014, fifty-one countries signed a multilateral competent authority agreement to automatically exchange information based on Article 6 of the OECD Multilateral Convention on Mutual Cooperation in Tax Matters. The United States has so far refused to sign on, preferring to rely on its own domestic anti-tax haven initiatives. For discussion of cross-border tax information exchange and OECD reforms surrounding aggressive international tax planning, see *infra* Part III.D.

45. OECD, AGREEMENT ON EXCHANGE OF INFORMATION ON TAX MATTERS (2002), http://www.oecd.org/ctp/harmful/2082215.pdf; *see also* discussion *infra* Parts II.C, IV.D.

uncooperative countries.[46] For example, the U.S. Financial Crimes Enforcement Network (FinCen) has recommended, based on anti-money laundering standards developed by the FATF, new regulations whereby U.S. financial institutions will need to identify, on a current basis, the individuals who are the ultimate (or "beneficial") owners of corporations and accounts, whether or not there is any suspicion of a crime.[47]

This Section has provided an overview of the complex domestic and international regulatory regime that governs offshore tax evasion, international money laundering, and global terrorist financing. In legal writings, these different criminal activities are generally studied as distinct spheres in part because observers tend to rely on their narrow areas of expertise in tax, criminal, anti-terrorism, banking, and other laws. Yet the description above shows how global financial criminals regularly cross the boundaries among these different legal regimes, and hence their actions violate laws in multiple overlapping areas. This Article addresses this challenge by providing an integrated perspective that combines traditional international tax law concerns with views from criminal law and other writings.

C. Big Data and International Tax Analytics

While the last Section discussed the laws and policies that govern global financial crime, this Section assesses the ability of cross-border exchanges of "big tax data" to reduce the harmful effects of tax haven secrecy. While the definition of big data remains unsettled within the academic community, it is sometimes described with reference to its characteristics.[48]

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46. FINANCIAL ACTION TASK FORCE, INTERNATIONAL STANDARDS ON COMBATING MONEY LAUNDERING AND THE FINANCING OF TERRORISM & PROLIFERATION (2012), http://www.fatf-gafi.org/recommendations.html.

47. *See* Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. 45151 (proposed Aug. 4, 2014) (to be codified at 31 C.F.R. pts. 1010, 1020, 1023, 2024, 2026). These reforms have been promoted under the view that more regulation is needed to curtail apparent abuses such as the UBS Swiss bank scandal. *See* discussion *infra* Part III.A. The United States and other members of the Egmont Group of Countries have agreed to implement FATF reforms as a way to coordinate international efforts. For a view that such reforms lead to a "fundamental reordering of global finance in ways that . . . would reduce social welfare," see Richard Gordon & Andrew P. Morriss, *Moving Money: International Financial Flows, Taxes and Money Laundering*, 37 HASTINGS INT'L & COMP. L. REV. 1, 3–4 (2014) [hereinafter Gordon & Morriss, *Moving Money*].

48. The definition of the term big data remains unsettled within social science perspectives in part because of the relative newness of the concept. In addition, different academic disciplines such as law, accounting, and economics appear to have different conceptions of big data at this early stage in its analysis, presumably

First, the size of the data should be large, hence the adjective "big." The ICIJ financial data leak, which is discussed in detail in subsequent Parts, fits the "big" category, as it was comprised of 260 gigabytes of data (over 160 times the size of the Wikileaks data leak of U.S. State Department documents).[49]

Second, big data normally connotes an ongoing flow of information (such as ongoing Internet browsing data accessed by government surveillance and security initiatives). The ICIJ financial data leak does not have this "flow" characteristic, as the data set is static in the sense it covers a finite thirty-year period from roughly 1980 to 2010. Accordingly, the ICIJ financial data leak will not allow for analysis, beyond 2010, of the evolution of offshore service provider practices under a changing regulatory and tax environment.

Third, big data is often combined with data analytics by businesses, governments, and others. For instance, accountants increasingly use tax data analytics to sift through and exploit reams of financial data to assist with financial analysis, planning, and reporting.[50] In contrast, the ICIJ data leak was illegally copied from offshore service providers without such goals in mind.[51]

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reflecting the different ways these disciplines approach policy analysis. For example, management science emphasizes the ways that big data can be used to predict customer behavior. Big data can be constituted by social network user data compiled to generate advertisement sales. A typical revenue generating strategy of a "free" online social network such as Facebook is to gather data about a user's social networking or web browsing habits and then, after stripping away all personal identifiers, sell the aggregated information—the information compiled anonymously about multiple or potentially millions of user behaviors—to a third party direct marketing company (that in turn tries to sell products or services to members of the social network and others). For discussion of big data and regulations, see VIKTOR MAYER-SCHÖNBERGER & KENNETH CUKIER, BIG DATA: A REVOLUTION THAT WILL TRANSFORM HOW WE LIVE, WORK, AND THINK 73–78 (2013).

49. Ryle et al., *Secret Files*, *supra* note 1.

50. *See, e.g.*, Ernst & Young, *Managing Indirect Tax Data in the Digital Age: Diagnostic Tools and Data Analytics*, http://www.ey.com/GL/en/Services/Tax/VAT--GST-and-other-sales-taxes/EY-managing-indirect-tax-data-in-the-digital-age-2-diagnostic-tools-and-data-analytics. In the most sophisticated effort to date, IBM has partnered with the University of Toronto to allow researchers at the latter institution to develop an artificially intelligent tax lawyer based on the software of Watson, a super-computer and former *Jeopardy!* champion. *See* Jeff Gray, *University of Toronto's Next Lawyer: A Computer Program Named Ross*, GLOBE & MAIL, Dec. 11, 2014, http://www.theglobeandmail.com/report-on-business/industry-news/the-law-page/university-of-torontos-next-lawyer-a-computer-program-named-ross/article22054688/.

51. The countries where the offshore service providers that stored the data were based (e.g., Singapore and the Virgin Islands) have laws that prohibit the access, copying, and disclosure of personal financial information. Accordingly, the individual

Nevertheless, the ICIJ revised the financial data leak to create a publically searchable data set, which can be combined with data analysis for research or other policy purposes.[52]

Big data has thus far not been used extensively for international tax purposes, although there has been analysis concerning the amount of bulk taxpayer information shared between governments.[53] Governments exchange bulk taxpayer information mainly to ensure that resident taxpayers are reporting their global income for tax purposes.[54] Recent international policy reform efforts have focused on automatically exchanging cross-border big data to help combat international tax evasion.[55] In addition, and as discussed elsewhere, large data sets of tax and financial information could be exchanged across borders via global computer networks to counter offshore tax evasion and abusive transfer pricing practices.[56]

The most prominent international reform effort to deploy big data for international tax policy purposes involves proposed cross-border information sharing concerning financial data generated by multinational firms. As mentioned in the previous section, in 2013 the OECD and the G20 launched the most comprehensive multilateral reform effort to date called the base erosion and profit shifting (BEPS) initiative that proposes reforms to address

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or individuals who took this data violated these crimes prior to transferring the information to Gerard Ryle. The identity or identities of this person or people have not been released. *See* discussion *infra* Part III.A.

52. *See* discussion *infra* Part II.D.

53. *See* Michael Keen & Jenny E. Ligthart, *Information Sharing and International Taxation: A Primer*, 13 INT'L TAX & PUB. FIN. 81, 95 (2006) (noting, among other things, how the gross amount of tax information shared between the Netherlands and certain other countries grew on average by 43 percent a year from 1993 to 2001).

54. For a discussion of the history and purpose of tax information exchange, see Steven A. Dean, *The Incomplete Global Market for Tax Information*, 49 B.C. L. REV. 605, 637–46 (2008) [hereinafter Dean, *Incomplete Global Market*].

55. OECD efforts have most recently been directed at standardizing technologies and software protocols for the exchange of cross-border tax information. *See* discussion *supra* note 44.

56. Cockfield, *Transforming the Internet*, *supra* note 20, at 1235–48 (discussing the use of information technologies for cross-border exchanges of big tax data to combat offshore tax evasion and aggressive international tax planning). For earlier discussions of ways that governments could collect big tax data and exchange it across borders, see Duncan Bentley & Patrick Quirk, *A Proposal for Electronic Transactions Tax Collection in the Context of Tax-Driven Reform of Banking Laws*, 14 J. INT'L BANKING L. 327 (1999) [hereinafter Bentley & Quirk, *A Proposal*].

aggressive international tax planning.[57] One proposed OECD reform would impose new disclosure requirements on multinational firms, potentially generating big data compiled from cross-border tax and financial information. Under this initiative, named the country-by-country reporting (CBCR) reform, a multinational firm would have to disclose its tax payments and other financial information in every country where it operates.[58] Pursuant to the current tax law and securities law regime in the United States and many other countries, these multinational firms generally only disclose tax information in the country where they reside.[59]

The enhanced global disclosure obligations would generate aggregated tax information (or big data) that tax authorities could use to improve their taxpayer risk assessment analysis to better target audits of aggressive international tax planning.[60] As subsequently addressed, this reform could be revised at some point to more directly tackle offshore tax evasion and other global financial crime because criminals use offshore corporations and other business entities to mask their illicit activities.[61]

While this Article focuses on teasing out information and incentive problems revealed by the ICIJ financial data leak, the following briefly outlines how big data, including CBCR data, could be used to combat offshore evasion, international money laundering, and terrorist financing.[62] Big tax data

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57. Bentley & Quirk, *A Proposal*, *supra* note 56. To a large extent, however, these reforms rely on intensifying past efforts that have not had much success. *See* Arthur Cockfield, *BEPS and Global Digital Taxation*, 75 TAX NOTES INT'L 933, 936 (Sept. 15, 2014).

58. Country-by-country reporting falls under Action 13 of the OECD BEPS program. *See* OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING 23 (2013), http://dx.doi.org/10.1787/9789264202719-en [hereinafter OECD, BASE EROSION] ("The rules to be developed will include a requirement that MNEs provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template."). *See* OECD, ADDRESSING BASE EROSION AND PROFIT SHIFTING 18–21 (2013), http://dx.doi.org/10.1787/9789264192744-en.

59. At times, multinational firms report on foreign revenues and taxes paid on a regional basis such as Europe, instead of a country-by-country basis. The CBCR initiative would arguably help to enforce national tax laws that govern international transactions. *See* Walter Hellerstein, *Jurisdiction to Tax Income and Consumption in the New Economy: A Theoretical and Comparative Perspective*, 38 GA. L. REV. 3 (2003) (discussing difficulties associated with aligning a country's jurisdictional tax rules with its ability to effectively enforce those rules).

60. *See* Cockfield, *Transforming the Internet*, *supra* note 20, at 1244–48.

61. *See* discussion *infra* Part III.C.

62. *See* H. Gnutzmann et al., *Dancing with the Devil: Country Size and the Incentive to Tolerate Money Laundering*, 30 INT'L REV. L. & ECON. 244, 251–52

could potentially aid investigations into global financial crime by providing more details of cross-border financial dealings with tax havens and other countries.[63] Tax and law enforcement authorities could amass cross-border tax and financial information via:

(i) automatic tax and financial information sharing on a multilateral basis, including CBCR data;
(ii) ensuring this information will be linked to a common taxpayer identification number to associate foreign income with a resident taxpayer's activities;[64]
(iii) reports on suspicious activities filed by financial institutions;[65]

(2010) (noting there are three potential routes to inhibit global financial crimes such as international money laundering: (1) a legalistic approach that focuses on the development of new international regulations; (2) a political approach that focuses on forcing smaller countries and their governments to enact rules and policies to inhibit money laundering; and (3) an economic approach that would force wealthier countries to compensate less wealthy countries for taking steps to inhibit money laundering). *But see* Gordon & Morriss, *Moving Money*, *supra* note 47, at 8–9, 14 (indicating that further global financial regulation will lead to higher transaction costs that will inhibit wealth maximization and reduce financial innovation). Gordon and Morriss accept new regulations only when the cost can be justified as preventing a harmful activity such as money laundering and as long as the connection between the new rules and harm prevention can be made out. *Id.* at 113; *see also* Wayne N. Renke, *Who Controls the Past Now Controls the Future: Counter-Terrorism, Data Mining and Privacy*, 43 ALTA. L. REV. 779, 786 (2006).

63. For discussion of U.S. tax authorities' reforms to expand financial information sharing to combat non-compliance and evasion, see Andrew T. Buckler, *Information Technology in the U.S. Tax Administration*, *in* SCIENCE, TECHNOLOGY AND TAXATION 159, 171–75 (Robert F. van Brederode ed., 2012) ("New analytical tools and processes, many driven by the needs of the intelligence community, make it possible to mine large amounts of unstructured data from multiple sources to identify patterns and provide insights that would previously have gone undetected.").

64. *See* JAMES RAJOTTE, HOUSE OF COMMONS, 41ST PARL., 1ST SESS., REPORT OF THE STANDING COMMITTEE ON FINANCE, TAX EVASION AND THE USE OF TAX HAVENS 31 (2013) (discussing the Standing Committee's findings and recommendations to inhibit offshore tax evasion) [hereinafter RAJOTTE, TAX EVASION].

65. According to a former U.S. federal prosecutor, a Suspicious Activity Report filed pursuant to the Bank Secrecy Act offers the most valuable information to trigger an investigation of international money laundering and offshore tax evasion (in part because there are far fewer of these reports compared to others). *See* MADINGER, MONEY LAUNDERING, *supra* note 37, at 297.

(iv) financial transactions data that details significant transfers of monies across borders (e.g., data collected by FinCEN);
(v) the resident taxpayer's tax return;
(vi) the resident taxpayer's domestic consumption patterns (e.g., invoices for expensive items such as yachts); and
(vii) a resident taxpayer's records of international telephone calls.[66]

Once a tax or law enforcement official has access to this ongoing financial information he or she could design software algorithms to run correlations on all of these sources to determine the risk of offshore tax evasion and international money laundering (as well as other criminal activities such as financing terrorist activities).[67] The correlations may help to avoid the "drinking at the fire hose" problem that occurs when governments are overwhelmed with too much data to generate useful leads.[68] The tax authority or other government branch could then audit or investigate the taxpayer if the correlations determine a higher risk of illegal activities. The most obvious barriers to such reforms, however, are taxpayer privacy interests and the laws that protect these interests, a topic to which we now turn.

D. Taxpayer Privacy and Big Tax Data

Given the fact that tax haven secrecy enables criminal activities, why should the international tax and finance regime tolerate any secrecy at all? The main barrier to widespread government or public access to big data involving offshore taxpayer information is the fact that such access may intrude on

66. As subsequently discussed, residents at times set up offshore trusts that permit oral instructions regarding disbursements (mainly to avoid paper trails). Accordingly, phone records would reveal whether an individual is contacting an offshore service provider based in a tax haven. *See* discussion *infra* Part IV.A.

67. *See* Brigitte Unger & Frans van Waarden, *How to Dodge Drowning in Data? Rule- and Risk-Based Anti-Money Laundering Policies Compared*, *in* RESEARCH HANDBOOK ON MONEY LAUNDERING, *supra* note 25, at 399–425 (discussing the advantages and disadvantages of using risk-based approaches versus rule-based approaches).

68. For discussion, see, e.g., OFF. PRIV. COMM., A MATTER OF TRUST: INTEGRATING PRIVACY AND PUBLIC SAFETY IN THE 21ST CENTURY 18–20 (2010) (providing for privacy guidelines in part to reduce information flows, narrow the ambit of investigations and decrease false positive leads).

individual privacy rights and laws that protect these rights.[69] Taxpayer information, like the broader category of financial information, is considered to be among the most sensitive forms of personal information.[70] Tax information may reveal, among other things, information about income, spending and savings, employment status, personal belongings, disability status, associations and club memberships, donations to charities, mortgage costs, child support and alimony, and the amount and size of gifts to family members and others. This detailed personal information may be used to construct a comprehensive profile of an individual's identity, including her religious beliefs, political alliances, and personal behavior.

To protect this financial privacy, countries such as the United States and Canada have enacted comprehensive laws and policies to govern the collection, use, and disclosure of tax and financial information by government agencies.[71] Privacy rights are also protected as fundamental human rights by constitutional laws in certain countries (for example, the right to be free from an unreasonable state search).[72]

Moreover, it is also clear that taxpayer usage of offshore accounts and business entities is often perfectly legal. Residents and citizens in democracies and elsewhere are permitted to transfer their income and assets around the world for any legal purpose. For instance, taxpayers sometimes set up asset

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69. Cynthia Blum, *Sharing Bank Deposit Information with Other Countries: Should Tax Compliance or Privacy Claims Prevail?*, 6 FLA. TAX REV. 579 (2004); Dean, *Incomplete Global Market*, *supra* note 54, at 668–70 (discussing ways that privacy constraints could unduly inhibit information flows).

70. *See* Cockfield, *Protecting Taxpayer Privacy Rights*, *supra* note 29, at 436–38.

71. I.R.C. § 7213 (providing for criminal penalties for unauthorized disclosure of taxpayer information by federal employees); *see also* Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), s. 241 (Can.) (providing that taxpayer information must be kept confidential with few exceptions). Historically, governments also shared very little tax and financial information across borders (despite the existence of tax treaties that contemplated such sharing). Each government has its own sovereign right under international law to develop tax policies as it sees fit (although as mentioned international reform efforts increasingly seek to impose new reporting standards to increase global transparency). *See supra* Part II.B. For a discussion of U.S. and Canadian privacy laws that govern cross-border personal data flows, see Arthur J. Cockfield, *Legal Constraints on Transferring Personal Information Across Borders: A Comparative Analysis of PIPEDA and Foreign Privacy Laws*, *in* SURVEILLANCE, PRIVACY, AND THE GLOBALIZATION OF PERSONAL INFORMATION: INTERNATIONAL COMPARISONS 50 (Elia Zureik et al. eds., 2010).

72. *See* Paul Rosenzweig, *Privacy and Counter-Terrorism: The Pervasiveness of Data*, 42 CASE W. RES. J. INT'L L. 625 (2010) (discussing how data mining can improperly violate domestic and constitutional laws); Jinyan Li, *Taxpayers' Rights in Canada*, 7 REVENUE L.J. 83 (1997).

protection trusts in tax havens to protect their assets from seizure by creditors. In addition and as mentioned above, multinational corporations routinely form related corporations in tax havens for legal tax avoidance and other purposes.[73]

The ability to transfer capital across borders for any legal purposes is considered to be both an important individual civil liberty and a contributor to global economic growth (as capital is permitted to seek out its most productive use so that global resources are allocated more efficiently).[74] While legal transfers are permissible, resident taxpayers must normally disclose these offshore assets and income to comply with income tax and other laws.[75] The real concern is the criminal use of tax haven secrecy where these reporting laws are not followed. In fact, all global financial crimes share the common traits of individuals transferring and hiding assets or income offshore without disclosure to their home governments.

The searchable ICIJ data set derived from the financial data leak tries to strike a balance between enabling ongoing research and protecting the privacy rights of taxpayers through two main avenues. First, the data set is limited to documents that disclose relationships between taxpayers and offshore service providers instead of allowing full access to all materials such as trust indentures and other taxpayer agreements (that also frequently set out beneficiaries who may be family members of the original trust settlor).[76] Second, the ICIJ website warns site visitors and users of the searchable database that taxpayer usage of offshore service providers does not necessarily constitute illegal usage: users must further click on "I have read and understand these terms" before they are given access to the database.[77]

This brief discussion avoids complexities such as the fact that history and path dependence will influence the ability of each country to enact and enforce regulations to inhibit global financial crime, given privacy concerns. Williamson, for instance, notes how norms, ideologies and culture provide the

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73. *See* discussion *supra* Parts II.A, III.C.

74. *See, e.g.*, Joshua D. Blank, *Reconsidering Corporate Tax Privacy*, 11 N.Y.U. J.L. & BUS. 31 (2014).

75. *See* discussion *supra* Part II.A.

76. *See* Marina Walker Guevera, *ICIJ Releases Offshore Leaks Database Revealing Names Behind Secret Companies and Trusts*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS, June 14, 2013, http://www.icij.org/offshore/icij-releases-offshore-leaks-database-revealing-names-behind-secret-companies-trusts; *see also* Giannina Segnini, *How We Built the Offshore Leaks Database*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS, June 14, 2013, http://www.icij.org/blog/2013/06/how-we-built-offshore-leaks-database.

77. *See ICIJ Offshore Leaks Database*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS, https://offshoreleaks.icij.org/.

premises upon which rules are later implemented and enforced.[78] Benham similarly remarks "The long-term impact of a regulation depends upon historical constraints and the nature of the evolving political and bureaucratic responses, including competition among interest groups."[79] Accordingly, institutional roots influence institutional evolution.[80] For this reason, taxpayer privacy concerns, which vary from country to country, form an understandable barrier to comprehensive cross-border exchanges of big data that includes personal information.

Given these privacy concerns, many countries are reluctant to engage in broad cross-border tax information sharing, as the transferred information may not attract sufficient legal protections. The previously discussed country-by-country reporting initiative envisions privacy protections for exchanged taxpayer bulk data.[81] A multilateral taxpayer bill of rights that mandated an acceptable minimum level of legal and other protections for transferred tax information may be able to assuage these concerns.[82]

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78. *See* Oliver E. Williamson, *The New Institutional Economics: Taking Stock, Looking Ahead*, 38 J. ECON. LITERATURE 595 (2000).

79. Lee Benham, *Licit and Illicit Responses to Regulation*, *in* HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 591, 605 (Claude Ménard & Mary M. Shirley eds., 2008) [hereinafter Benham, *Licit and Illicit Responses*].

80. For a review of the ways that technology affects tax administration and design in developing countries, see Richard M. Bird & Eric M. Zolt, *Technology and Taxation in Developing Countries*, *in* SCIENCE, TECHNOLOGY AND TAXATION, *supra* note 63, at 121, 130–133 (discussing the importance of technologies to track the identities of taxpayers and provide accurate information reporting to tax authorities).

81. For instance, the OECD has proposed a Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports: the purpose of this agreement is to set forth the rules and procedures for governments to automatically exchange the CBCR-mandated information. An Annex to this agreement provides a questionnaire concerning confidentiality and data safeguards to ensure participating nations have adapted acceptable privacy and confidentiality practices. *See* OECD, ACTION 13: GUIDANCE ON THE IMPLEMENTATION OF TRANSFER PRICING DOCUMENTATION AND COUNTRY-BY-COUNTRY REPORTING ¶¶ 7, 9, 15 (2015), http://www.oecd.org/ctp/beps-action-13-guidance-implementation-tp-documentation-cbc-reporting.pdf [hereinafter OECD, IMPLEMENTATION GUIDANCE]. On June 7, 2015, the OECD released a related implementation package. *See* OECD, ACTION 13: COUNTRY-BY-COUNTRY REPORTING IMPLEMENTATION PACKAGE (2015), http://www.oecd.org/ctp/transfer-pricing/beps-action-13-country-by-country-reporting-implementation-package.pdf.

82. *See* Cockfield, *Protecting Taxpayer Privacy Rights*, *supra* note 29, at 422–26 (discussing the inter-relationship between efficiency and equity with respect to cross-border transfers of tax information).

E. Summary

This Part provided context by discussing the relevant domestic and international laws and policies that govern offshore tax evasion, international money laundering, and terrorist financing (collectively, "global financial crime"). This complex regulatory regime is challenged by the reality of tax haven secrecy—taxpayers can anonymously move and hide monies offshore for a variety of illegal purposes. As a result, the legal and policy regime does not effectively inhibit global financial crime.

To assist governments and researchers, the ICIJ created a publically searchable database of its financial data leak that allows, at least to a certain extent, the use of data analytics to discern broad patterns of taxpayer interactions with tax havens. Still, much of the ICIJ financial data leak remains inaccessible to the public to protect the privacy of taxpayers who are engaged in legal cross-border activities.

Such big data regarding taxpayer behaviors with tax havens can nevertheless help to pierce the secrecy norm and inform researchers, taxpayers, governments, non-governmental organizations, and others of the social and economic harm resulting from tax haven secrecy. In addition, this big data could inform more effective political and legal responses. Importantly, unique national tax and financial information privacy concerns will continue to restrict the cross-border sharing of big data until agreement can be reached on international legal or policy protections.

III. IDENTIFYING GLOBAL FINANCIAL CRIMES WITHIN THE ICIJ DATA LEAK

This Part compares the ICIJ financial data leak with other financial data leaks to shed light on some of the advantages and disadvantages of the former. It also discusses how the ICIJ financial data leak provided evidence of capital flight from low-income countries to high-income democracies via offshore tax havens and how taxpayers use offshore business entities to mask illicit activities.

A. Earlier Tax Haven Data Leaks

In recent years, several data leaks from tax havens have been reported in the media.[83] This Section touches on two: the Liechtenstein bank data leak and the Swiss UBS bank scandal.

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83. For background discussion on the pressure to make tax haven transactions more transparent due to data leaks and other revelations, see Maria Flavia Ambrosanio & Maria Serena Caroppo, *Eliminating Harmful Tax Practices in Tax*

In 2007, the first major data leak to generate international media attention occurred in Liechtenstein, which is a Principality bordering Switzerland and Austria and a well-known tax haven.[84] The leak took place when a bank employee surreptitiously copied bank records listing over 1,400 customers with anonymous bank accounts. A CD with this bank account information was purchased by the German government and eventually transferred to governments and tax authorities throughout the world, leading to audits of non-compliant taxpayers.[85] Despite these efforts, in most countries few prosecutions for offshore tax evasion or other crimes have resulted.

For instance, the Canadian Revenue Agency (CRA) conducted a six-year investigation that ultimately resulted in no charges being laid against any individuals.[86] The data leak had revealed 182 Canadian taxpayers with offshore accounts; the CRA audit determined that forty-six family groups had improperly not disclosed account information. Of these taxpayers, twenty-three family groups were assessed penalties of roughly $24 million. The CRA referred two taxpayers for prosecution for offshore tax evasion although the prosecutors decided not to pursue either case. Accordingly, no Canadian taxpayers were charged with a criminal offence despite evidence of secret offshore accounts. The outcome points to the difficulties that many tax

Havens: Defensive Measures by Major EU Countries and Tax Haven Reforms, 53 CAN. TAX J. 685 (2005); Greg Brabec, *The Fight for Transparency: International Pressure to Make Swiss Banking Procedures Less Restrictive*, 21 TEMP. INT'L & COMP. L.J. 231 (2007).

84. For an account, see Mark Ladler, *Liechtenstein Seeks Man Suspected of Selling Information That Led to Tax Scandal*, N.Y. TIMES, March 13, 2008, at C3.

85. The IRS investigated over 100 U.S. taxpayers. In addition, the leak triggered investigations in the United Kingdom, Australia, New Zealand, France, Italy, the Netherlands, and Sweden. *Id.* The German government has purchased other CDs with secret bank information in its pursuit of offshore tax evaders. *See, e.g.*, Matthias Bartsch, *Swiss Bank Data: German Tax Officials Launch Nationwide Raid*, DE SPIEGEL, April 16, 2013, http://www.spiegel.de/international/business/germany-raids-200-suspected-tax-evaders-in-nationwide-hunt-a-894693.html.

86. The Office of the Auditor General of Canada assessed the efforts of the Canadian tax authorities (the Canada Revenue Agency) to enforce Canadian income tax laws in light of revelations concerning Canadian taxpayers from the data leak. *See* OFFICE OF THE AUDITOR GEN. OF CAN., REPORT OF THE AUDITOR GENERAL OF CANADA (Fall 2013), at ch. 9 (Offshore Banking—Canada Revenue Agency). The Auditor General concluded that the Canada Revenue Agency had satisfactorily followed all of its relevant standards and procedures in auditing the identified taxpayers although several recommendations were issued to strengthen audit efforts. *Id.* at 14. Under full disclosure, the Author served as a legal consultant to the Office of the Auditor General of Canada (OAG) concerning a related matter. The views in this Article do not necessarily reflect the OAG or any of its employees.

authorities encounter when they decide to pursue offshore tax cheats—even if they are armed with information concerning illicit financial activities.[87]

In contrast, U.S. tax authorities have had more success in pursuing prosecutions that resulted from a tax information exchange with Switzerland.[88] Earlier U.S. Senate hearings revealed a disgruntled Geneva-based banker from UBS bank, which at the time was partly owned by the Swiss government.[89] The "whistle blowing" employee disclosed that UBS bank was sending bank officials to New York, Los Angeles, and other U.S. cities to promote the use of its services by high-net-worth Americans; these officials told the Americans that they could successfully hide their monies offshore where the monies would remain undetected and untaxed by U.S. tax authorities.[90]

These UBS bank officials themselves were engaged in criminal activities when they aided and abetted criminal offshore tax evasion by U.S. taxpayers. For the first time, the U.S. government successfully convinced the Swiss government to force the disclosure of roughly 4,450 account identities of U.S. taxpayers (hence the information was not technically obtained via a "leak" but rather through this coerced disclosure).[91] This disclosure led to a

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87. In response to critiques, the Canadian government announced that it had convicted forty-four people of offshore tax evasion between 2006 and 2012. A subsequent journalist investigation found that at most eight of these cases potentially involved individuals holding income or assets offshore in tax havens. Other commentators, including a former federal prosecutor, have suggested the actual number of prosecutions is zero. *See* Zach Dubinksky, *Canada Not Targeting Offshore Tax Cheats, Analysis Shows*, CBC NEWS, June 12, 2013, http://www.cbc.ca/news/canada/canada-not-targeting-offshore-tax-cheats-analysis-shows-1.1319268; *see also* RAJOTTE, TAX EVASION, *supra* note 64 (discussing the Standing Committee's findings and recommendations to inhibit offshore tax evasion).

88. *See, e.g.*, Lynnlee Browning, *Tentative Resolution Set in UBS Tax Evasion Case*, N.Y. TIMES, July 31, 2009, at B2 [hereinafter Browning, *Tentative Resolution*]; Evan Perez, *Offshore Tax Evasion Costs U.S. $100 Billion, Senate Probe of UBS, LGT Indicates*, WALL ST. J., July 17, 2008, http://www.wsj.com/articles/SB121624391105859731.

89. This whistleblower was reportedly paid $104 million by the IRS for this assistance. *See* GAO, OFFSHORE TAX EVASION, *supra* note 36, at 7 n. 9.

90. The US Senate hearings also revealed that UBS maintained a "Canada Desk" where Swiss bank officials were flown to Toronto, Montreal, Vancouver, and other Canadian cities to promote offshore bank services. Despite requests from the Canadian government, the Swiss government refused to share any information about these deposits with the Canadian government. See Greg McArthur, UBS Deal in Tax Case Unearths Canadian Connections, Globe & Mail, Feb. 19, 2009 (noting U.S. investigators unearthed up to $5.6 billion held by Canadians in accounts within the Geneva-based UBS bank).

91. *See* Ryle et al., *Secret Files*, *supra* note 1.

host of penalties and prosecutions by U.S. authorities.[92] In 2009, UBS also agreed to pay a fine of $780 million to the U.S. government.[93]

On the one hand, the shared tax information from UBS amounted to the greatest blow against tax haven secrecy in history: Switzerland is ranked number one in the world in 2013 with the most stringent financial secrecy laws[94] and is also estimated to be the world's largest tax haven. On the other, the amount of information shared is less than 10 percent of U.S.-held accounts at *one* offshore bank (as the Senate investigation revealed roughly 52,000 U.S. customers with UBS). In other words, the shared information amounts to a small fraction of secret offshore accounts held by Americans.

There are several related observations concerning these earlier tax haven leaks and the ICIJ financial data leak. The ICIJ financial data leak was illegally obtained from an anonymous source who has never been identified, unlike the other leaks. This source provided the data to Gerard Ryle in 2011 before he became the Director of the Washington, D.C.-based journalist organization.[95] The ICIJ subsequently partnered with media organizations based in countries around the world to form the largest global collaborative journalist investigation ever: there were over twenty partner organizations such as the *Washington Post* within the United States and the Canadian Broadcast Corporation within Canada.[96]

There are a number of differences between the data set obtained by the ICIJ and the earlier tax haven data leaks. First, the amount of information in the ICIJ financial data leak (260 gigabytes) vastly exceeds any prior leak.[97] The ICIJ data leak involved over two million documents and over 70,000 taxpayers.

In addition to the amount of information, the level of detail provided by the ICIJ financial data leak also greatly exceeds prior leaks that generally only disclosed account identity and account information. The ICIJ leak provides detailed information concerning taxpayers' offshore financial behavior. For instance, the file on a particular taxpayer could run for hundreds or even thousands of pages, including copies of all agreements (e.g., trust indentures or indemnification agreements) involving the taxpayer and the offshore service provider, all of the correspondence (e.g., email or notes taken from telephone calls) between the taxpayer and the offshore service provider, and all of the debit and credit records concerning transfers of monies to and from the tax haven accounts. As discussed in Part IV.A, the information

92. Since 2009, the IRS and the Department of Justice have publicized more than forty prosecutions of UBS clients and UBS bankers. *Id.*

93. *See* Browning, *Tentative Resolution*, *supra* note 88.

94. *See* discussion *supra* Part II.A.

95. For background, see Ryle et al., *Secret Files*, *supra* note 1.

96. *Id.*

97. *See id.* and discussion *supra* note 2.

includes copies of all digital information (e.g., emails) as well as digitized copies of all hard copies in a particular taxpayer's file (e.g., copies of various contracts and Post-it notes).

Moreover, the time period for a particular taxpayer file within the ICIJ financial data leak could extend up to roughly thirty years from 1980 to around 2010, providing a detailed study of how offshore service providers responded to client needs and international regulations over time. The earlier leaks generally only disclosed bank account information, including the identity of the account holder(s) and account debits and credits. Finally, unlike other leaks the ICIJ financial data leak has been made partly available to the public within a searchable database.[98] In contrast, the other leaks were only provided to government officials and have not been disclosed to the public or the research community.

B. Capital Flight Revelations

The ongoing journalist investigation into the ICIJ financial data leak has led to a number of revelations and global media attention. Celebrities, politicians, high-net-worth individuals, and others were found to have maintained accounts in the offshore tax havens.[99] This led to calls for reforms by governments, non-governmental organizations, and others to inhibit offshore tax evasion and other global financial crime.[100]

Moreover, evidence from the ICIJ data leak supports the view that tax haven secrecy disproportionately harms the welfare of poorer and often non-democratic countries because wealthy elites within these countries illegally transfer their monies to tax havens for ultimate investment in high-income countries with stable economies.[101] Under one estimate, more monies flow out

98. *See* discussion *infra* Part II.D.

99. *See* Ryle et al., *Secret Files*, *supra* note 1.

100. Bill Buzenberg, *Reform Pushed to G-8 Meeting Agenda After ICIJ's Offshore Tax Haven Investigation*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS, June 6, 2013, http://www.publicintegrity.org/2013/06/06/12782/reform-pushed-g-8-meeting-agenda-after-icijs-offshore-tax-haven-investigation (The European Union Commissioner stated, "I personally think Offshore Leaks could be identified as the most significant trigger behind these developments . . . It has created visibility of the issue and it has triggered political recognition of the amplitude of the problem.").

101. The hypothetical involving Geraldo in Part II.A was meant to describe this phenomenon. For works that review the effects of capital flight on low-income countries, see Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1575, 1576, 1579–85 (2000); John Christensen, *Africa's Bane: Tax Havens, Capital Flight and the Corruption Interface* 1–2 (Elcano Royal Inst., Working Paper No. 1/2009, 2009) (describing how certain African countries, which are vulnerable to capital flight, adopt haven-like tax policies

of developing countries via capital flight than the total inward amount of foreign aid to these countries.[102] Another estimate suggests that individuals within a group of twenty low- and middle-income countries maintained $7.6 trillion in unreported private financial wealth within offshore tax havens.[103] Consider the following two ICIJ stories—focusing on Russia and China—that support capital flight theory.

First, an ICIJ investigation revealed that a Russian government tax official had secret offshore assets in a financial scandal related to the so-called Magnitsky affair. By way of background, in 2007 a Moscow hedge-fund company was raided by alleged Russian government tax officials who suspected fraud.[104] The officials removed a number of documents from the company's offices. The hedge-fund firm then hired a tax lawyer and auditor, Sergei Magnitsky, to investigate the matter. Mr. Magnitsky subsequently produced a report that concluded that the "tax officials" were really a combination of mobsters and government officials who were involved in a large-scale tax scam: the mobsters and officials used the hedge-fund firm's corporate documentation to seize control of the company and fraudulently reclaim $230 million in taxes paid by the firm, the largest tax refund in Russian history. Mr. Magnitsky discovered this tax refund likely ended up in the pockets of government officials and other unknown persons.

In 2008, Mr. Magnitsky was arrested for fraud by Russian officials and spent nearly a year in jail, where he died. According to Western media

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to compete with tax havens); Léonce Ndikumana & James K. Boyce, *New Estimates of Capital Flight from Sub-Saharan African Countries: Linkages with External Borrowing and Policy Options* 27–30 (Political Econ. Research Inst., Working Paper No. 166, 2008) (concluding that a "narrow, relatively wealthy stratum" of the populations of the countries under study maintained assets in foreign countries that exceeded the national public debts of their own countries). *But see* Gordon & Morriss, *Moving Money*, *supra* note 47, at 119 (suggesting that the real solution to offshore tax evasion lies not in more international reform efforts, but in governments reforming their "social contracts" with their citizens so that taxpayers will voluntarily accept tax payments).

102. LLOYD LIPSETT ET AL., INT'L BAR ASS'N, TAX ABUSES, POVERTY AND HUMAN RIGHTS: A REPORT OF THE INTERNATIONAL BAR ASSOCIATION'S HUMAN RIGHTS INSTITUTE TASK FORCE ON ILLICIT FINANCIAL FLOWS, POVERTY AND HUMAN RIGHTS 18–19 (2013).

103. *See* Henry, *Offshore Revisited*, *supra* note 34, at 5–6. Capital flight can take place from wealthy democracies as well. As evidenced by the outcomes of the 2008 financial crisis, certain OECD countries, including Greece, Portugal, and Italy, suffer from domestic and offshore tax evasion that threatens their fiscal viability.

104. For an account of the Magnitsky affair, see *Ballets Russes: Anglo-Russian Relations*, THE ECONOMIST, Dec. 15, 2012, http://www.economist.com/news/britain/21568415-scandal-exposes-delicacy-britains-relationship-russia-ballets-russes.

accounts as well as certain Russian reports, Mr. Magnitsky had been tortured while in jail, leading to his death.[105] The Russian government maintained that he died from poor health. Moreover, this government subsequently tried Mr. Magnitsky on a posthumous basis and convicted him in 2013 of tax fraud.

In response, the U.S. and other governments passed resolutions and laws to deny entry and seize the offshore assets of any Russian officials involved in the Magnitsky affair.[106] The Russian government retaliated by passing a law that, among other things, barred Americans from adopting Russian orphans.[107]

The Russian government has consistently denied any wrongdoing in this matter. The ICIJ financial data leak, however, revealed that the husband of the main implicated Russian tax official had secreted approximately $38 million in assets offshore.[108] In addition, the ICIJ leak revealed an offshore service provider based in a tax haven (the British Virgin Islands) had set up twenty-three offshore companies to assist in transferring the stolen tax refund monies into anonymous offshore accounts.[109] The reporting provided evidence that Russian government officials had stolen the tax refund monies from the Russian treasury. It also showed how tax haven secrecy enabled Russians officials and others to move assets offshore in an undetected fashion where they would evade any future Russian taxes.

In another investigation, the ICIJ leak revealed that over 22,000 Chinese citizens maintained secret offshore bank accounts.[110] Many of the

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105. *See* Maria Tsvetkova & Steve Gutterman, *Russia Convicts Lawyer Magnitsky in Posthumous Trial*, REUTERS, July 11, 2013, http://www.reuters.com/article/2013/07/11/us-russia-magnitsky-idUSBRE96A09V20130711 (noting that a Russian human rights report indicated there was evidence that Magnitsky was beaten to death).

106. The U.S. Congress passed the *Russia and Moldova Jackson-Vanik Repeal and Sergei Magnitsky Rule of Accountability Act of 2012*, Pub. L. No. 112–208, 126 Stat. 1496. The European Parliament and the Canadian Parliament also passed resolutions to deny visas and freeze the assets of Russian officials allegedly involved in the Magnitsky affair.

107. Kathy Lally & Will Englund, *Russia Fumes as U.S Senate Passes Measure Aimed at Human Rights*, WASH. POST, Dec. 6 2012, http://www.washingtonpost.com/world/europe/us-passes-magnitsky-bill-aimed-atrussia/2012/12/06/262a5bba-3fd5-11e2-bca3-aadc9b7e29c5_story.html.

108. *See* Michael Hudson et al., *Caribbean Go-Between Provided Shelter for Far-Away Frauds, Documents Show*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS, April 4, 2013, http://www.icij.org/offshore/caribbean-go-between-provided-shelter-far-away-frauds-documents-show [hereinafter Hudson, *Caribbean*].

109. *Id.*

110. *See* Marina Walker Guevara et al., *Leaked Records Reveal Offshore Holdings of China's Elite*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS, Jan. 21,

individuals identified by the ICIJ are connected to the ruling members of the Communist Party.[111] A separate searchable database for China was created to facilitate identifying offshore corporations and other business entities used by Chinese to transfer monies and assets offshore.[112] The Chinese government responded to these allegations by attempting to censor access to the ICIJ websites that have published reports about this alleged corruption. This government may be trying to conceal that certain elites are illegally sending monies abroad: between an estimated $1 trillion and $4 trillion in untraced assets have been transferred from China since 2000.[113]

The ICIJ data leak also revealed that New York and certain other cities (including Miami, London, Vancouver, and Dubai) attract large numbers of foreign property buyers, including Russians, Chinese, and South Americans, through investments using tax haven intermediaries.[114] For instance, roughly 30 percent of condominium sales in upscale Manhattan developments have been to buyers who listed an international address or bought in the name of a limited liability company or some other offshore corporate entity.[115] Indeed, U.S. federal prosecutors allege that some of the monies stolen from the

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2014, http://www.icij.org/offshore/leaked-records-reveal-offshore-holdings-chinas-elite ("Every corner of China's economy, from oil to green energy and from mining to arms trading, appears in the ICIJ data.").

111. *Id.*

112. *See* Cabra & Guevara, *China's Secrets*, *supra* note 10.

113. *Id.*

114. Hudson, *New York*, *supra* note 9. Under a separate yearlong investigation, New York Times journalists also showed how foreigners are buying New York City real estate via shell companies that mask the identity of the owners. *See* Louise Story & Stephanie Saul, *Hidden Wealth Flows to Elite New York Condos*, N.Y. TIMES, Feb. 8, 2015, at A1 (noting that foreign owners include government officials and close associates of officials from Russia, Columbia, Malaysia, China, Kazakhstan, and Mexico) [hereinafter Story & Saul, *Hidden Wealth*]. Under U.S. anti-money laundering laws, real property can be seized by the government if it was purchased in violation of these laws. *See, e.g.*, Proposed First Amended Verified Complaint, United States v. Real Prop. Known as Unit 5B of the Onyx Chelsea Condo. Located at 261 W. 28th St. N.Y.C., N.Y. 10001–5933, No. 10–CV–05390–GBD-FM (S.D.N.Y. Sept. 13, 2011), ECF No. 38–3 (application to seize property purchased via alleged international money laundering scheme).

115. Story & Saul, *Hidden Wealth*, *supra* note 114; *see also* Kathy Tomlinson, *Foreign Investors Avoid Taxes Through Canadian Real Estate: Wealthy Buyers Taking Advantage of Loopholes by Putting Homes in the Name of Relatives or Corporations*, GLOBE & MAIL, Oct. 5, 2015, http://www.theglobeandmail.com/report-on-business/economy/housing/the-real-estate-beat/foreign-investors-avoid-taxes-by-buying-real-estate-in-canada/article26683767/ (noting one in three multi-million dollar homes in Vancouver purchased by foreigners are registered in the name of a homemaker, student, or corporation, thus masking the identity of the true buyer).

Russian treasury in the Magnitsky affair were used to buy luxury apartments in Manhattan.[116]

The Russian and Chinese examples support the capital flight theory mentioned previously; under this view, tax haven secrecy encourages a wealth transfer from lower- or middle-income (often non- or quasi-democratic) countries to wealthier countries.[117] The capital-exporting individuals may fear that their governments may one day expropriate their assets, or they may be "purged" from the ruling party for political reasons and lose their assets, livelihood, or freedom.[118] For many elites, the risk of these possible outcomes incentivizes outbound capital flight.

The harmful economic outcomes for the capital-exporting countries include lost tax revenues and investment monies that could otherwise be deployed for domestic economic development.[119] The fact that members of the ruling class and other elites are typically the largest beneficiaries of tax haven secrecy provides an obvious incentive problem.[120] From a broader political perspective, tax haven secrecy, which provides an "exit" strategy for elites, may inhibit longer-term democratic reform because the elites benefit from the secrecy, discouraging political change.

A counter-argument exists that tax haven secrecy actually enhances economic development within non-democratic countries and, potentially, the world. Under this view, individuals based in countries without a credible rule of law may not engage in risk-taking entrepreneurial activities if they were unable to secrete their assets offshore where they cannot be seized by their governments. Some observers further maintain that the status quo (including financial secrecy promoted by tax haven secrecy) keeps overall transaction costs low, hence encouraging an efficient allocation of global resources and overall economic development.[121]

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116. Story & Saul, *Hidden Wealth*, *supra* note 114.

117. Due to the fact that only a small sample of the ICIJ financial data leak has been examined by researchers at this point and that the data set focused on a few tax havens (that may be used disproportionality by individuals within certain countries), the revelations thus far may overstate capital outflows from certain countries vis á vis others.

118. For a case study of ways that Russian taxpayers allegedly engage in offshore tax evasion and money laundering, see Gololobov, *The Yukos*, *supra* note 5.

119. For discussion of the ways that the so-called "BRIC" countries (Brazil, Russia, India, and China) are influencing the path of international tax law, see Eduardo A. Baistrocchi, *The International Tax Regime and the BRIC World: Elements of a Theory*, 33 OXFORD J. LEGAL STUD. 733 (2013).

120. *See* Benham, *Licit and Illicit Responses*, *supra* note 79, at 600 (discussing how regulators often actively introduce regulations to promote corrupt exchanges).

121. *See* Gordon & Morriss, *Moving Money*, *supra* note 47, at 3–5.

Like the plight of the low- or middle-income countries, offshore tax evasion provides both a problem and an opportunity for wealthier (mainly OECD) democratic nations. On the one hand, these countries suffer adverse policy outcomes such as revenue losses when their own taxpayers engage in offshore tax evasion and international money laundering. Moreover, national security interests may be threatened by global terrorist financing. On the other, these wealthier nations benefit from the inward portfolio and direct investments by non-residents that are encouraged by tax haven secrecy; the trillions of dollars of investment monies may, for instance, be used to fund new business ventures that promote economic activities and lead to higher employment within OECD countries. The fact that OECD countries benefit from tax haven secrecy provides a disincentive for them to resolve this apparent problem.[122]

C. Disguising Global Financial Crimes via Offshore Entities

This Section discusses how the ICIJ financial data leak revealed that individuals use tax haven-based corporations, non-resident trusts, and other business or legal entities to hide illicit cross-border activities, as well as how a current global initiative might help resolve this information problem.

As discussed in Part II.A, international tax avoidance via tax planning strives to comply with all relevant tax laws, in contrast to offshore tax evasion that violates tax and criminal laws.[123] The ICIJ financial data leak showed that taxpayers and others deployed thousands of corporations, non-resident trusts, foundations, and other entities to attempt to "legitimize" global financial crime. At times, multinational firms launder monies via tax havens to "clean up" illicit proceeds and inject them into the conventional financial system. The data leak provided evidence that small- and medium-sized firms are creating cross-border structures to achieve this outcome.

As discussed in greater detail in Part IV, which provides a taxonomy of offshore tax haven financial dealings, taxpayers use these entities for two main purposes: first, the entities are used to hide the identities of the actual human beings who are engaged in the crimes and, second, the entities provide a lustre of compliance should tax or law enforcement officials begin an audit or investigation of an individual's offshore dealings. Because taxpayers use these same entities in tax havens for legitimate personal or business purposes it can be very difficult for investigators to distinguish between legal and illegal activities.

While business entities like corporations based in tax havens are used to engage in legal cross-border tax planning, governments around the world

122. *See* discussion *infra* Part V.

123. The ICIJ data leak revealed information concerning how accounting firms marketed aggressive tax plans to MNEs. *See* Hudson, *New York*, *supra* note 9.

worry that this planning is leading to unacceptable revenue losses. More specifically, governments are concerned that multinational firms are taking advantage of tax planning to divert taxable income away from high-tax countries and toward low- or zero-tax jurisdictions.[124]

In particular, economists and others have tracked an ongoing rise of international tax planning via tax havens. For instance, in 2010, three tax havens (Barbados, Bermuda, and the British Virgin Islands) had attracted more foreign direct investment than some of the world's largest economies, including Germany and Japan.[125] The ICIJ also uncovered another data leak of secret tax agreements approved by Luxembourgian authorities that provide significant tax breaks for companies around the world (these confidential tax agreements are legal in Luxembourg, which is a well-known European tax haven).[126]

As mentioned in Part II.C, an OECD initiative called country-by-country reporting (CBCR) aims to force multinational firms to disclose financial information concerning all of their offshore dealings, including payments made to tax havens. At this point, however, the reform only contemplates very large multinational firms: there is a reporting exemption for multinational firms with annual consolidated group revenue in the immediately preceding fiscal year of less than €750 million (roughly $825 million),[127] which will likely exclude 85 to 90 percent of the world's multinational firms from the CBCR requirements.[128]

Still, initiatives such as the CBCR reforms that generate ongoing big data for tax authorities may one day be expanded to help to inhibit offshore tax evasion and other global financial crime.[129] CBCR could provide tax authorities with more timely and superior information concerning tax deductions taken in high-tax countries for payments to related affiliates located in tax havens. Armed with better information concerning the cross-border dealings among related parties of a multinational firm, authorities could better gauge whether illegal activities were taking place.

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124. *See* OECD, BASE EROSION, *supra* note 58, at 17.

125. *Id.*

126. *See* Matthew Caruana Galizia et al., *Explore the Documents: Luxembourg Leaks Database*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS, Dec. 9, 2014, http://www.icij.org/project/luxembourg-leaks/explore-documents-luxembourg-leaks-database [hereinafter Galizia et al., *Explore the Documents*].

127. OECD, IMPLEMENTATION GUIDANCE, *supra* note 81, ¶ 9.

128. *Id.* ¶ 10. It is, however, estimated that the remaining 10 to 15 percent of multinational firms that will be required to comply with the CBCR rules control approximately 90 percent of global corporate revenues. *Id.*

129. This expanded initiative could be combined with more recent efforts to begin automatically exchanging broader areas of tax information. *See* discussion *infra* Part. IV.D.

As mentioned, combining big data derived from CBCR with other data sources could also encourage global financial transparency and inhibit offshore tax evasion, international money laundering, and terrorist financing.[130] In particular, the apparent widespread use of tax haven-based entities to engage in global financial crime supports ongoing policy efforts to share tax and financial information on an automated basis among governments.[131] A lack of international agreement on needed tax and financial privacy law protections continues to serve as a barrier to reform.[132]

D. Summary

This Part discussed how one set of big data—the ICIJ financial data leak—differs from earlier leaks by providing extensive and detailed behind-the-scenes information concerning individuals' interactions with offshore financial service providers. The leak revealed, for instance, cases involving Russians and Chinese individuals transferring their monies offshore for illicit purposes via tax haven-based business and legal entities. Moreover, the leak showed how individuals use business entities such as corporations to hide their identities and to provide a lustre of compliance should tax or law enforcement authorities investigate the offshore activities.

The literature on tax havens, along with the revelations from the ICIJ financial leak, demonstrate how tax haven secrecy promotes the following harmful policy outcomes:

(a) revenue losses for all governments as undisclosed income and assets are secreted offshore;
(b) organized crime launders trillions of dollars of proceeds from illicit activities around the world every year;
(c) corrupt elites rob their countries by hiding and investing their monies offshore (where this capital flight often exceeds the amount of inward foreign aid for low-income countries);
(d) democratic reforms are inhibited to the extent tax haven secrecy allows corrupt elites to remain in power; and
(e) wealthy countries benefit from trillions of dollars of inward investment encouraged in part by tax haven secrecy.

130. *See* discussion *supra* Part II.C.
131. *See* discussion *infra* note 44.
132. *See* discussion *supra* Part II.D.

Given traditional tax haven secrecy, the most comprehensive global tax data sharing initiative to date—the OECD's country-by-country reporting reform efforts—could be revised at some future point to more directly tackle the challenges presented by global financial crime. In particular, the reform could help governments identify whether offshore corporations and other business entities are being used to mask and facilitate global financial crime. Ongoing global reforms directed at the multilateral automatic sharing of cross-border big data also have the potential to inhibit global financial crime.

IV. A TAXONOMY OF OFFSHORE TAX EVASION ACTIVITIES

This Part draws from the Author's study of a small portion of the ICIJ financial data leak.[133] It begins by reviewing the role of offshore service providers within tax havens as well as methods devised to transfer monies offshore, followed by a discussion of how foreign corporations and offshore trusts are used to facilitate offshore tax evasion and international money laundering. The discussion of international tax laws and policies in this Part is general in nature with an emphasis on understanding how tax haven secrecy enables offshore tax evasion and other global financial crime.

A hypothetical situation involving an individual who wishes to engage in international money laundering and offshore tax evasion is used to make the Part more accessible. In the spirit of *Breaking Bad*, the hypothetical surrounds Walter White's efforts to launder the illegal proceeds from his sales of crystal meth. Assume Walt wants to launder $10 million in undeclared cash so that his family will have access to this cash for personal purposes. In other words, he wants to use tax haven offshore service providers to clean the monies and inject them into the conventional banking system. He also does not wish to pay taxes on these illicit earnings.

The analysis in this Part focuses on understanding how tax haven secrecy enables individuals to anonymously transfer, hide, and repatriate their monies. For instance, a crook like Walt will need to take three steps to accomplish his goals. First, he will need to move the money offshore without detection by local authorities. Second, once offshore the money will need to be hidden in a tax haven while being invested in a stable economy so that Walt can earn a return on his ill-gotten gains. Finally, Walt will need to bring the

133. *See supra* note 4 and accompanying text. While the entire database has been released to law enforcement agencies in the United States and elsewhere, it has not been released to the public to protect the privacy of individuals who may have been engaged in legal activities. As previously noted, a portion of this database has been publically released within a searchable database. *See* discussion *supra* Part II.D. In addition, a number of specific cases within the ICIJ financial data leak have been reported by members of the ICIJ and are referenced throughout this Article.

money back at some point so that he and his family can spend it. As revealed by the ICIJ financial data leak, offshore service providers often play a critical role in enabling these three steps.

A. Examining the Role of Offshore Service Providers

This Section discusses of the role of tax haven intermediaries or so-called offshore service providers, including finance, trust, and other offshore service companies.[134] Under one estimate, the global earnings from the illegal component of services provided by offshore service providers (that is, services that facilitate global financial crime) were $3 billion a year in the 1990s.[135]

The ICIJ financial data leak was mainly derived from information copied from two offshore service providers: Singapore-based Portcullis TrustNet and British Virgin Islands-based Commonwealth Trust Limited.[136] As a result of the leak, Commonwealth Trust Limited is not currently operating, at least under that name. The ICIJ financial data leak revealed aspects of the operations of these businesses through the paper trail created by their writings on client files.

Much of the information from the ICIJ financial data leak comes from the memos to file written by the workers at the offshore service provider. To encourage compliance and presumably to create a record that would help insulate them from liability, offshore service providers would write down client instructions as well as any telephone comments they made to clients where they asserted concerns about the file. This factor contributed to a significant reduction in the anonymity of communications that would be presumably expected from a client.

For instance, offshore trusts were at times set up so that oral instructions could be used by a client to give effect to trust disbursements of millions of dollars to beneficiaries. A clause in the trust agreement between the offshore service provider and the client would permit such oral

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134. Prior to the leak, other journalists at times interviewed individuals who worked for offshore service providers, providing insights into their activities. Many of these interviewees understandably wished to maintain their anonymity due to worries about career consequences and physical security. *See, e.g.*, NICHOLAS SHAXSON, TREASURE ISLANDS: UNCOVERING THE DAMAGE OF OFFSHORE BANKING AND TAX HAVENS 171–92 (2011) (providing an account of the views of several former employees of offshore service providers).

135. *See* John Walker, *How Big Is Global Money Laundering?*, 3 J. MONEY LAUNDERING CONTROL 25, 26 (1999). IRS officials have noted that future programs may emphasize identifying "promoters of offshore tax schemes" that are not associated with mainstream financial institutions. *See* GAO, OFFSHORE TAX EVASION, *supra* note 36, at 4.

136. Ryle et al., *Secret Files*, *supra* note 1.

instructions. Under this approach, an individual such as the trust protector would call the worker at the offshore service provider to confirm a disbursement to the client pursuant to the terms of the trust agreement.[137] The worker would then make a record—a memo to file—about the oral instructions.

At other times, the workers would engage in gossip about clients through these memos to file, sometimes warning each other, or the next person who would gain custody of the file, about peculiar aspects of the clients' personalities (e.g., "Client X will have a heart attack if you send him an email—only communicate by phone!"). For the most part, however, the memos to file are filled with industry jargon related to their work, often relating to the many forms that clients need to file in their home jurisdictions to remain in compliance, such as "WBEN needed ASAP; ask client to sign."[138]

The ICIJ financial data leak showed a typical offshore worker was an individual with some training in accounting or finance who emigrated to the tax haven for work.[139] The data leak correspondence revealed that these workers followed their client instructions while seeking to comply with any local laws or international standards governing their activities. In the earlier time period of the data set—the 1980s—there was little evidence of due diligence inquiries by offshore service provider employees. As global transparency initiatives and new reporting standards from the FATF were developed in the mid-1990s, however, the offshore workers would increasingly ask "know your customer" compliance questions to the client such as "Where did the trusts funds originate?"[140]

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137. *See* discussion *infra* Part IV.D.

138. In some respects, the jargon-filled memos resembled the fictional discussions among IRS agents as recounted in David Foster Wallace's novel *The Pale King*. *See* Arthur J. Cockfield, *David Foster Wallace on Tax Policy, How to Be an Adult and Other Mysteries of the Universe*, 12 PITT. TAX REV. 89 (2015). Wallace also revealed why the public is disengaged by tax topics despite the fact the stakes are often so high: "the whole subject of tax policy and administration is dull. Massively, spectacularly dull." DAVID FOSTER WALLACE, THE PALE KING 85 (Michael Pietsch ed., 2012).

139. The analysis is this Part suffers from reporting bias (sometimes referred to as data-snooping bias) as the Author has reviewed thousands of pages (out of the over two million pages) of materials revealed by the ICIJ financial data leak. The analysis reflects this limitation in that other documents may reveal different or even contradictory information. Accordingly, the information collected can only be used for anecdotal purposes, as it does not reflect an empirical attempt to gauge the behavior of offshore service providers or clients who use their services.

140. Under international reforms under FATCA (more technically, via intergovernmental agreements that implement FATCA) as well as domestic U.S. reforms via FinCen, there have been evolving standards that increasingly require

At times, a worker would send a query to the client asking where the monies came from; clients would often refuse to answer, which would appear to violate these "know your customer" standards. There may be some follow-up by the offshore service provider, but there also appears to be a fair amount of movement of these workers to other offshore service providers based in different foreign countries as carriage of files was transferred to new individuals every few years. While this movement may or may not have been intentional, it would impede required due diligence efforts on behalf of the offshore service provider as a new person would arrive without the memory of non-compliance (especially if any concerns had been deleted from the file records). A challenge facing investigators in this area is that the offshore service provider workers themselves appear to be generally unaware (in most cases intentionally so) whether the monies they managed were derived from illicit proceeds or not.[141]

Moreover, the offshore workers did not appear to have any discretion over how a client's monies were to be managed, even if they were working as a trustee of a non-resident trust set up by a client. The trust agreements between the offshore service provider and the taxpayer did not contain any clause that would permit such discretion. Rather, the offshore service provider or trustee followed client instructions and focused on issues such as billing and collecting payment for services. If there were uncertainty over whether the offshore service provider was engaging in non-compliant activities, then the offshore service provider would seek indemnification from the client through an indemnification agreement whereby the client assumed full liability. In this way, offshore service providers would at times agree to offer services in areas that may not comply with FATF disclosure obligations.

Contrary to common law convention, it appears that these offshore trustees wield little to no power over the trust assets and were mere "paper pushers" following the will of another party. In a normal trust, the trustee holds the legal title of assets and has a fiduciary duty to manage these assets for the benefit of the trust beneficiary.[142]

Taxpayers also use these passive offshore corporate trustees for legal international tax planning purposes.[143] For instance, in an international tax

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financial institutions to enquire about the identity of clients as well as the sources of their income. *See* discussion *supra* Part II.B.

141. For instance, in the ICIJ revelations surrounding the Magnitsky affair, the owner and operator of the relevant offshore service providers maintained that he had no knowledge that his companies were being used for illegal purposes. *See* Hudson, *Caribbean*, *supra* note 108.

142. See *infra* Part IV.D for a discussion of non-resident trusts legal attributes.

143. *See* discussion *supra* Part II.A.

case, the Supreme Court of Canada noted that KPMG LLP (a large accounting firm) based in Barbados served as the corporate trustee for an offshore trust, but only involved itself with administrative matters and had no real discretion over the trust assets.[144] Under a new "central management and control test," the Barbadian trust was held to be a Canadian resident trust for tax purposes because the trust was in reality managed from Canada.[145] Because these passive offshore corporate trustees are used for both legal tax planning and global financial crime, it can be difficult for law enforcement officials to discern what is really taking place.[146]

B. Moving Money Offshore

The starting point for a would-be offshore tax evader and international money launderer is to transfer monies offshore without the knowledge of local authorities. While most of these techniques are presumably familiar to law enforcement officials, the following discussion is meant to help researchers and others understand how monies are transferred illegally across borders to promote the development of laws and policies to counter the abuse.

1. Straightforward Techniques

In many cases, taxpayers appear to deploy relatively straightforward ways to get their monies offshore without detection.[147] First, they sometimes simply mail cash to a tax haven, which is deposited into their secret offshore accounts. The ICIJ financial data leak, for instance, revealed a situation where a Canadian resident was allegedly sending thousands of dollars via the mail to

144. St. Michael Trust Corp. v. The Queen, [2012] 1 S.C.R. 520 (Can.) (also known Fundy Settlement).

145. It is less clear that the Court's approach will cut down on apparent abuses because trust agreements can grant nominal discretion to the offshore corporate trustee to fulfill the Court's requirements so that the trust will qualify as a non-resident trust. In other words, taxpayers will simply alter the trust agreement to create non-resident trusts while the real management and control will still take place outside of the offshore jurisdiction.

146. *See* discussion *supra* Part III.C.

147. As previously mentioned, the ICIJ's Canadian media partner, the CBC, helped to analyze the financial data leak obtained by the ICIJ. To support these efforts, the CBC also investigated possible offshore evasion through secret videotapes of tax advisors and black market intermediaries involved in offshore tax evasion. For a discussion of the undercover reporter operation, see Timothy Sawa, *Tax Avoidance: Canada-Barbados Tax Deal Loopholes Revealed*, CBC NEWS, Oct. 7, 2013, http://www.cbc.ca/news/canada/tax-avoidance-canada-barbados-tax-deal-loopholes-revealed-1.1913228.

a Cooks Islands offshore service provider.[148] The offshore service provider's lawyers were clearly nervous and gently suggested to the client that mailed cash was fraught with peril—such as potentially being lost in the mail. Nevertheless, the client persisted in sending cash and traveller's checks offshore through the general postal services or, at times, by using courier companies.

Another way that cash is moved offshore is through certified checks drawn in the taxpayer's home jurisdiction and then deposited in an offshore account. Alternatively, smaller amounts can be conveyed electronically as long as they do not exceed the home jurisdiction's prohibited threshold of say $10,000.[149]

Finally, there was some evidence that taxpayers were buying expensive jewelry in their home jurisdictions (say a diamond necklace worth a half million dollars) and later selling it once they disembarked in the offshore jurisdiction like Switzerland. The monies can then be placed in an anonymous account. The taxpayers would presumably guard against the risk of loss by trying to first discern the price differential in different jurisdictions; they can select jewelry in their home country that appears to be selling at a premium in the foreign country. It can be difficult or impossible for Customs officials to detect these illegal efforts.

2. The Old Man Switcheroo

Another fairly straightforward mechanism could be dubbed "the old man switcheroo" because it involved the complicity of an (alleged) elderly gentleman in the target jurisdiction. The scheme appears to be a variant of the well-known "hawala" system that provides informal channels for individuals to transfer monies across borders. The old man switcheroo scheme requires a financial intermediary—typically an individual connected to the financial underworld—to pull it off so Walt would likely have to look to Saul (Walt's crooked lawyer) to find this individual. This intermediary has a network of international contacts that are trying to move money all over the world. This intermediary needs to identify a person—the "old man"—in the foreign target jurisdiction who wishes to send $10 million to Walt's home jurisdiction.

Once identified, the intermediary then creates an oral or written agreement that Walt and the foreign old man enter into. Under this agreement, Walt and the old man agree to switch bank accounts so that Walt becomes the legal owner of the offshore account and the old man becomes the legal owner

148. *See* Fréderic Zalac et al., *Senator's Husband Put $1.7M in Offshore Tax Haven*, CBC NEWS, Apr. 3, 2013, http://www.cbc.ca/news/canada/senator-s-husband-put-1-7m-in-offshore-tax-havens-1.1329197.

149. Under anti-money laundering legislation, U.S. individuals must report any cross-border transfers of $10,000 or more. 31 U.S.C. § 5314 (2012).

of Walt's account. The intermediary takes a fee for his work (generally a percentage of the total amount being transferred with reduced cuts for transfers of larger amounts). At the end of the day, no money has ever actually crossed a border but Walt now owns $10 million in cash in an anonymous account within an offshore location.

3. Cryptocurrencies and the Deep Web

Although apparently not revealed in the ICIJ financial data set (which ended in 2010), more recent global financial crimes are aided by quasi-anonymous forms of digital cash over the Internet. The current most popular so-called cryptocurrency, a form of digital cash generated by the application of cryptography, is Bitcoin.[150] While cryptocurrencies are presumably mainly used for legal purposes, their illegal use is reportedly on the rise.[151] Once a taxpayer converts his or her cash into a cryptocurrency, monies can be used for personal purchases or invested in offshore equity and debt instruments via an offshore account.

Cryptocurrencies help anonymize cross-border financial dealings and hence facilitate offshore tax evasion, international money laundering, and terrorist financing. Anonymity is promoted because cyptocurrencies are not backed by any financial institutions or governments and there is no central control; it is not clear how governments will be able to monitor, track usage, and identify the relevant taxpayer.

In addition, there is evidence that the use of these cryptocurrencies, as well as offshore tax evasion, is taking place in a part of the Internet sometimes referred to as the Deep Web (or Dark Web), a private network that anonymizes many transactions and financial dealings.[152] Due to the increasing technological sophistication concerning offshore evasion strategies, tax authorities will need to devote more resources to hiring, training, and retaining auditors with sufficient technical knowledge of how funds flow through global computer networks.

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150. For discussion on the use of cryptocurrencies and global financial crimes, see Sarah Gruber, Note, *Trust, Identity, and Disclosure: Are Bitcoin Exchanges the Next Virtual Havens for Money Laundering and Tax Evasion?*, 32 QUINNIPIAC L. REV. 135 (2013); Thomas Slattery, *Taking a Bit Out of Crime: Bitcoin and Cross-Border Tax Evasion*, 39 BROOK. J. INT'L L. 829 (2014).

151. *See* Lev Grossman & Jay Newton-Small, *The Secret Web: Where Drugs, Porn and Murder Hide Online*, TIME, Nov. 11, 2013, http://time.com/630/the-secret-web-where-drugs-porn-and-murder-live-online/.

152. *Id.* (discussing government efforts to shut down Silk Road and other sites that facilitate illegal activities).

C. Using Offshore Corporations

1. Legal Usage of Offshore Corporations

In common law countries such as the United States, the United Kingdom, and Canada, a corporation is a legal person distinct from its owner-shareholder.[153] Accordingly, if an individual residing in one country owns all of the common shares of a foreign corporation then, generally, the foreign corporation will be seen as a separate taxable person, subject to the tax and other laws of the foreign jurisdiction.[154]

An initial and obvious point is that taxpayers deploy corporations throughout the world as part of their global investment and trade strategies. For instance, a multinational corporation can form a wholly owned subsidiary in a foreign country to hold the assets of a marketing operation. At times, these subsidiary corporations are deployed in tax havens to help reduce global tax liabilities. As discussed, governments worry that multinational corporations may be engaging in overly aggressive cross-border tax planning to lower tax liabilities.[155]

This planning often relies on related business entities placed within these havens, deploying exotic tax plans such as the "double Irish with a Dutch sandwich" cross-border tax structure deployed by Apple Inc. and other taxpayers.[156] These tax plans, which result in the reduction of billions of tax dollars that otherwise would be collectible, are legal.[157] At most, any non-compliant plans may attract interest and other penalties when successfully assessed by national tax authorities.[158]

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153. *See* MODEL BUS. CORP. ACT (2010).

154. Under U.S. and general international tax law approaches, the individual shareholder will still be taxed on the foreign source passive income (e.g., interest or dividend income) of the foreign corporation even if this income remains offshore. I.R.C. § 952.

155. *See* discussion *infra* Part III.C.

156. *See* ARTHUR COCKFIELD ET AL., TAXING GLOBAL DIGITAL COMMERCE 180–89 (2013) [hereinafter COCKFIELD ET AL., DIGITAL COMMERCE].

157. *See* discussion *supra* Part II.A.

158. At times, aggressive tax planning has resulted in serious sanctions against industry players who promoted the planning. For instance, KPMG marketed a tax shelter called an Offshore Portfolio Investment Strategy, also called a "basis-shift cloned" tax shelter, to high-net-worth individuals. The deal is "cloned" as the same tax shelter is pitched to numerous potential clients. KPMG indicated that it would comply with all relevant laws to generate tax losses of clients that they could use to offset capital gains. The planning was audited by the IRS, and KPMG was subjected to $416 million in fines, over $200 million in settlements for private lawsuits, and was subjected to ongoing review of its tax practice. For discussion, see U.S. S. PERMANENT

2. The Nominee Corporation

While recognizing that foreign related corporations are normally deployed for legal purposes, the ICIJ financial data leak revealed that foreign corporations are at times being improperly used to facilitate global financial crime. The following discussion focuses on the use of corporations to criminally evade taxes as well as to launder illegally earned and undisclosed monies.

The ICIJ data leak provided examples of individuals using nominee or shell corporations formed offshore to help hide the money trail.[159] For instance, in the case noted above involving Russian tax officials, part of the allegedly stolen monies was transferred to a corporation whose sole shareholder was the husband of the tax official who helped perpetrate the hedge fund fraud.[160] The leak also revealed that individuals use "nominee," "shell," or "numbered" corporations (that is, corporations that hold title to assets indirectly owned by the true owners) to hold assets like foreign condominiums.[161]

As writings on tax havens and offshore tax evasion have long maintained, corporations at times are used to try to mask the identity of the ultimate beneficiary of the corporation.[162] The previous example in Part II.A involving Geraldo showed how corporations can be deployed to provide another layer of secrecy within a tax haven: when a corporation holds an account or other assets, it may be difficult or impossible for tax authorities to access the real identity of the shareholder who ultimately benefits from any return on monies invested via the corporation. For instance, a common technique involves forming another related corporation in another secrecy jurisdiction to serve as the sole shareholder of the corporation that own the individual's assets—it may be very hard for law enforcement to pierce this secrecy and identify the human being who really owns the assets. Moreover, offshore corporations at times deploy "nominee" directors to mask the identity of the real directors and managers of the corporation.

SUBCOMM. ON INVESTIGATIONS, COMM. ON HOMELAND SEC. AND GOV'T AFFAIRS, REP. ON THE ROLE OF THE PROFESSIONAL FIRMS IN THE U.S. TAX SHELTER INDUSTRY (2005).

159. *See* David Leigh et al., *How the Nominee Trick Works*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS, Nov. 25, 2012, http://www.icij.org/offshore/how-nominee-trick-done.

160. *See* discussion *supra* Part III.B.

161. *See* Hudson, *New York*, *supra* note 9.

162. *See, e.g.*, MADINGER, MONEY LAUNDERING, *supra* note 37, at 252–57.

There have been international efforts in recent decades to inhibit the usage of corporations to hide the identities of the beneficial (or ultimate) owners of properties held in tax havens. Most recently, the OECD revised the definition of "beneficial owner" for tax treaty purposes to promote more tax information exchanges of the real identities of cross-border investment holders.[163]

3. The Phoney Deduction Corporation

A resident (parent) corporation can also set up a related corporation based in a tax haven. Then, the parent corporation "cooks the books" to fabricate payments made to the tax haven corporation to launder ill-gotten gains and reduce taxable income in a high-tax country. For instance, a phoney management fee paid by the parent corporation (in the high-tax country) to the subsidiary in the tax haven can be used to create a deduction and hence reduction in tax, as well as a corresponding inclusion of this fee in a country that does not impose an income tax.

Legitimate businesses are often used to facilitate these illegal outcomes by adding fictional revenues to make it look like the inflated earnings came from legal activities. The legitimate business is also used to help hide the fact that monies were illegally earned. Accordingly, Walt needs to be involved in a business like a car wash to launder his illicit proceeds within a related non-resident corporation. Walt begins by inflating the car wash's earnings by adding amounts earned through his crystal meth sales; only a careful check of account books and inventory by government auditors would reveal the fraudulent sales.

The car wash then makes phoney payments to a related non-resident corporation based in a tax haven. More technically, Walt can use an offshore corporation to artificially reduce domestic sources of income via payments to the non-resident related corporation, which reduces profits and taxes in the home country (by shifting the profits to the tax haven where they will not attract any taxation). The payments can be structured as cross-border royalties, management fees, interest on loans from the offshore corporation, and so on. The plan can often be designed so that the cross-border payments do not attract withholding taxes by "treaty shopping" (that is, identifying a tax treaty partner where there are no withholding taxes imposed on cross-border payments such as interest, dividends, rents, or royalties).

A variant of the phoney deduction corporation is the "recipe corporation," where the foreign related subsidiary holds intellectual property and sells it back to the parent. Under this approach, an individual such as Walt could own and operate a restaurant business to help launder his monies and set

163. *See* OECD, 2014 UPDATE TO THE OECD MODEL TAX CONVENTION 12–22 (2014); *see also* discussion *supra* Part II.B.

up a related offshore tax haven corporation to hold the intellectual property associated with the restaurant business' secret recipes. The resident corporation then pays (and deducts) cross-border royalties to the related non-resident corporation for the use of the recipe. Under general international tax laws, however, the transfers would normally generate passive foreign source income in the tax havens that is taxed at the resident corporation's tax rate even if the monies are not repatriated.[164] The taxpayers involved in recipe corporations likely hoped their offshore businesses would not be subject to audit, and hence the scheme would not be investigated.

D. Deploying Offshore Trusts

1. Legal Versus Illegal Uses

A trust is a legal entity designed to provide certain benefits to individuals (i.e., "beneficiaries").[165] A trust is set up by an individual or organization (i.e., "settlor") that bestows the trust with an asset such as a cash amount. The individuals or companies that maintain legal title to the asset are generally called trustees. Hence, there is a legal separation between the legal title owner of the asset and the beneficiary. Trustees are normally vested with the power to make decisions concerning how trust assets are invested and to ensure that the trust agreement (sometimes called the trust indenture or trust deed) provisions are followed. In some countries, trustees also have fiduciary duties (that is, duties of utmost loyalty imposed by statute or common law) to pursue the interests of the beneficiaries.

As mentioned in Part IV.A, the offshore service providers, based on client instructions, typically form a corporate trustee and agree to perform all

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164. *See* discussion *supra* note 106. Under the general approach of international tax laws, tax laws ensure that any "passive" foreign source income (e.g., interest or royalties) is taxed on an accrual basis. *See, e.g.*, I.R.C. §§ 951–965 (Subpart F rules); Income Tax Act, R.S.C. 1985, c. 2 (5th Supp.) ss. 91–95 (Can.) (Foreign Accrual Property Income (FAPI) rules). Under U.S. tax law, however, taxpayers can argue that the intellectual property was developed or co-developed within the offshore tax haven and because the intellectual property was partly or wholly developed outside of the United States, the foreign country is entitled to tax some or all of any related cross-border royalties. For the recipe corporation, for instance, the cook who developed the recipe could be based in an offshore tax haven. The taxpayer could then argue that all of the royalties should be taxed by the tax haven, which of course does not impose an income tax. For discussion, see COCKFIELD ET AL., DIGITAL COMMERCE, *supra* note 156, at 150–65.

165. For background on the laws that govern non-resident trusts, see, e.g., JINYAN LI, ARTHUR COCKFIELD & J. SCOTT WILKIE, INTERNATIONAL TAXATION IN CANADA: PRINCIPLES AND PRACTICES 287–302 (3d ed. 2014).

of the needed trustee services. The offshore service provider trustees, as revealed in the ICIJ financial data leak, did not exert any real managerial discretion over the trust assets; rather, the corporate trustee formed by the offshore service provider simply "rubber stamps" the decisions of the settlor or a more unusual character called the "trust protector."

Importantly, offshore trusts are used for a variety of legal purposes. For example, tax laws at times permit a transaction called an "offshore estate freeze" where the appreciation of assets (e.g., shares) will take place in a trust for the benefit of new shareholders (e.g., the children of the original owners of a corporation).[166] Another example involves the use of asset protection trusts that are formed in offshore locations to make it more difficult for creditors to seize assets of an individual or business: for instance, the creditors will have to sue in the offshore location to try to recover any assets held within the trust. The ICIJ financial data leak revealed that non-resident trusts are widely deployed for these purposes.

A final legal structure is sometimes referred to as a "granny trust," as it involves a foreign person (e.g., a wealthy grandmother in the United Kingdom) setting up a trust for the benefit of an individual living in another country (e.g., her grandson in the United States). Because the monies originate offshore, there will generally be no taxation of the trust assets when they are distributed to a trust beneficiary, although this beneficiary would have to disclose the existence of the trust or any interest in the trust when he or she files a U.S. tax return.[167]

Consistent with the legal nature of granny trusts, if funds originate offshore it may be possible to have the trust pay out the capital tax-free to the recipient back home. Some of the scams revealed by the ICIJ data leak thus had two components: getting undeclared cash and other assets offshore so that they appear to originate in a foreign country, and creating a granny trust structure to clean up the monies and return them home on a tax-free basis.

Offshore trust structures at times can be complex and difficult to understand. For this reason, it is sometimes hard to distinguish between the legal usage of an offshore trust and the illegal usage of one to assist in offshore tax evasion. The ICIJ financial data leak revealed that offshore trust structures,

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166. Tax planning is generally required to avoid the application of anti-abuse rules. *See, e.g.*, Rev. Rul. 85–13, 1985–1 C.B. 184 (deeming certain offshore trusts to be invalid).

167. Under the traditional income tax law approach, a "discretionary trust," whereby the trustee has the discretion to distribute trust assets to the beneficiary, ensures that the trustee is liable to pay income taxes from any income generated by the trust assets. If the non-resident trust is set up within a tax haven that does not impose any income taxes then the corporate trustee (managed by an offshore service provider) will not pay any taxes.

especially the more elaborately complex ones described below, are set up so that, upon audit, the taxpayer may be able to argue that the trust structure complies with all relevant laws. Under this view, the non-compliant taxpayer would only be liable for tax avoidance (which can be subjected to payments of back taxes and penalties), instead of criminal offshore tax evasion (which can be sanctioned through fines or imprisonment).[168]

2. The Blatant Scam

Under the most straightforward scam, an offshore trust is set up where the settlor, the protector, and the beneficiary are all one person. The trustee again will be a corporate trustee formed and managed by the offshore service provider. For example, an individual could transfer monies to an offshore trust and set things up so that he is the settlor and also the designated beneficiary of the trust assets.

Moreover, he could appoint himself under the trust indenture as the "protector." Protectors are individuals appointed under the terms of a trust to carry out stipulated duties. At times, trusts can be formed so that only the protector has true management and control over the trust assets, including any decisions to distribute these assets. In addition, the trustee—that is, the corporate trustee formed by the offshore service provider—enters into an indemnification agreement with settlor-protector so that the latter parties indemnify it against any liability resulting from outside audits or lawsuits against the trust. As mentioned, offshore workers often diligently pursued these indemnification agreements before they agreed to offer services to clients.[169]

With respect to the blatant scam, from the settlor's perspective he has not changed his substantive economic relationship with his assets. He will, for instance, continue to control the assets, although the trustee is provided with legal title to the assets. The only thing that has really changed is that there is an offshore trust to provide the lustre of legality should law enforcement or tax officials come knocking.

To create a blatant scam trust, Walt could enter into a contract with an offshore service provider to form a trust in an offshore jurisdiction. If needed, the offshore service provider can prepare the trust deed to Walt's specifications. He could then deposit $10 million in an offshore account that will constitute the sole asset of the trust. The offshore service provider forms a corporation that serves as the trustee and holds legal title to the trust assets. Under this set-up, Walt serves also as the trust protector and simply gets on the phone to the corporate trustee or offshore service provider to send him a

168. For discussion of the difference between legal tax avoidance and criminal tax evasion, see *supra* Part II.A.

169. *See* discussion *infra* Part IV.A.

check or wire him the money from the trust assets. Better yet, Walt can have the offshore service provider set him up with an offshore debit or credit card. The offshore service provider can deposit the requested disbursement in an offshore account and Walt can then access these funds. Offshore debit and credit cards are used to ensure that no paper trail of the transfer exists in Walt's home country.

Because the blatant scam appears clearly illegal, the settlor is likely counting on offshore bank secrecy to protect him or her from outside scrutiny by tax authorities and others. As mentioned, tax haven countries generally have bank secrecy laws that make it a criminal offence to disclose any personal financial information to any third party.[170] Hence, tax haven bank officials could deny requests by foreign tax authorities for the identity of any account holders, so the settlor could be confident the blatant scam would never be discovered.

Under reforms that began in 2002, OECD countries started forcing tax havens to enter into tax information exchange agreements (TIEAs) that contain a clause whereby the tax haven government cannot deny a request on the basis that it violates bank secrecy laws.[171] TIEAs, however, only operate on a request basis so it may be still be very difficult or impossible to discover the truth: in order to make such a request the tax authority must be able to specify the identity of an account and where it is maintained, which tax haven secrecy makes nearly impossible to pull off.[172] As a result of perceived deficiencies, many governments are now emphasizing the need for automatic exchanges of tax and financial information across borders—regardless of whether a request took place.[173]

Until recent years, at least some offshore service providers did not require any reference or listing of the source of the funds. Under current international standards developed by the FATF, these offshore service providers must conduct due diligence to ascertain the source of the funds.[174] As mentioned, the ICIJ financial data leak revealed that offshore service providers were increasingly following these "know your customer" rules by asking settlors for details concerning the origin of the funds.[175]

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170. *See* Cockfield, *Protecting Taxpayer Privacy Rights*, *supra* note 29, at 430; *see also* discussion *supra* Part II.A.

171. *Id.*

172. *Id.* at 424.

173. *See* discussion *supra* note 44.

174. *See* discussion *supra* Part II.B.

175. *See* discussion *supra* Part IV.A.

3. The One-Layer Cake

Most trusts within the ICIJ data leak had more sophisticated structures that involved several individuals other than the trust settlor. This settlor, as mentioned, would normally (but not always) be an individual residing in a jurisdiction outside of the country where the beneficiaries live. A common trust would work as follows. A settlor transfers legal title to donated assets to an offshore trustee. The trustee would be a corporation formed by the offshore service provider. Its tasks were to enforce the provisions of the trust, which in turn dictated that these tasks would be exclusively perfunctory in nature. That is, the trustee is solely interested in compliance with the trust agreement and with all relevant local laws and regulations.

Under this structure, the trustee and the settlor are given no legal powers to exercise any meaningful management discretion over the trust's assets. This discretion is provided to another individual who is a (seemingly) neutral third party who may be called a protector or a director of the trust. Because the settlor, beneficiary, and trust protector appear to be different individuals the trust seems to be a legitimate trust that might pass the initial "smell test" and escape further scrutiny by outside auditors or law enforcement authorities.

For instance, Walt could transfer his monies offshore and claim that a foreign cousin was the settlor who donated $10 million to set up the offshore trust. The offshore service provider will form a corporate trustee that will hold legal title to the assets. Walt could be the only named beneficiary of this trust. The trust protector could be Walt's crooked lawyer Saul (from the prequel spin-off *Better Call Saul*) who is effectively controlled by Walt. Only a careful review of the trust by outside investigators would reveal that the trust involved several non-arm's length individuals and was really created to enable Walt to engage in global financial crime.

4. The Multi-Layered Cake

More sophisticated structures involve creating a trust that appears to comply with all domestic laws as an offshore or non-resident trust under the laws of the home country (e.g., the place where Walter lives).[176] In this scenario, the trust is formed by a settlor who (ostensibly or in reality) resides offshore so that the trust monies appear to originate outside of the home country. The settlor could be related to the beneficiary, or a third party paid to serve as one. The trustee is again a corporation formed and managed by the offshore service provider.

176. For another example of the use of domestic trusts (Nevada) and offshore trusts and corporations (Isle of Man), see Simser, *Tax Evasion*, *supra* note 5, at 126–27.

The protector could be a relative or adviser living outside of the country. In the ICIJ financial data leak, the protector at times was a foreign lawyer residing in a tax haven who is willing to take instructions from another lawyer (e.g., Walt's lawyer Saul) based in the home country; all of their communications will be privileged and protected by lawyer-client confidentiality protections afforded by law or lawyers' rules of professional conduct.[177] This outcome shows how these lawyer rules may at times be abused to aid and abet global financial crime.[178]

Other legal entities can be interposed between Walter and the offshore trust to give the trust a greater lustre of compliance. For instance, the trust can hold the shares in a nominee, shell, or holding corporation (based in the same offshore jurisdiction or another one) that in turn owns all of Walt's assets. This corporation, whose directors are controlled by Walt (or Walt himself is appointed as the sole director), borrows the assets from the trust so that it owes them back. When Walt needs money he calls Saul, his local lawyer, and instructs him to have the offshore corporation pay back $1 million owed to the trust. The trust assets can be distributed to Walt.

Saul then calls the trustee (i.e., the offshore trust company) and tells it that the trust beneficiary has made a request for money—sometimes called a "list of wishes." Saul also contacts the protector to confirm the request. The trustee contacts the protector (ideally another lawyer) living offshore and tells this person of the request. The protector then instructs the trustee to disburse the needed $1 million to the named beneficiary (i.e., Walt). All of these instructions can be conducted over the telephone as long as oral instructions are permissible under a provision of the trust indenture. The trust settlor who created the trust agreement in the first place may have called for oral instructions under the view that there would be no written records of the trust disbursements, hampering law enforcement investigations.

As mentioned in Part IV.A, the ICIJ financial data leak revealed that employees who worked at the offshore service providers made notes of these instructions in the account files so that a written record remained. In addition, records specified how amounts of requested monies were actually debited

177. In the examples, the lawyers will be facilitating crimes so they will be violating their rules of professional guidance as well as criminal laws. For discussion of this tension between lawyer-client privilege and the duty to report criminal activities under European Union law, see Maaike Stouten & André Tilleman, *Reporting Duty for Lawyers Versus Legal Privilege—Unresolved Tension*, *in* RESEARCH HANDBOOK ON MONEY LAUNDERING, *supra* note 25, at 426.

178. Without knowing whether the origin of the trust monies came from licit or illicit sources, it is not possible to determine whether criminal activities are taking place. For a discussion of how clients can dupe lawyers into transferring monies illegally to an offshore tax haven account, and how the rules of professional conduct seek to inhibit such outcomes, see ARTHUR COCKFIELD, AN INTRODUCTION TO LEGAL ETHICS 155–64; 197–201 (2013).

(deducted) from the trust assets. These records could presumably assist investigations by tax authorities and law enforcement officials of alleged global financial crime.

E. Summary

This Part provided a taxonomy of taxpayers' legal and illegal financial activities involving tax havens, as revealed by the ICIJ financial data leak. This leak involved documents and contracts prepared by offshore service providers that, effectively, permit taxpayers to hide, invest, and collect their monies anonymously from offshore locations. Once the monies are transferred to an offshore service provider (or related financial intermediary), then these companies manage the funds pursuant to client instructions and help taxpayers keep the funds hidden through the use of offshore corporations, limited companies, non-resident trusts, and other business entities. Layers of these entities can be used to mask the illicit nature of global financial crime and can provide the gloss of legal compliance in the event of a law enforcement investigation.

The analysis reveals a number of vulnerabilities in the international financial system vis á vis global financial crime, including:

(a) offshore service providers often did little to no due diligence to identify the source of an investor's funds as required by FATF international "know your customer" regulations as well as similar domestic implementing legislation;

(b) for a successful prosecution, a criminal investigation must determine that the monies originated from illicit activities, and there was generally no record of such origin maintained by the offshore service provider (which likely wishes to remain intentionally ignorant to create plausible deniability);

(c) offshore service providers enter into indemnity agreements whereby the investor assumes all liability for any outside government or creditor lawsuits thereby allowing the offshore service provider to continue to provide services that do not comply with relevant international or domestic laws;

(d) complex offshore structures involving layers of corporations, trusts, and other entities make it difficult for law enforcement authorities to determine whether global financial crimes are being committed;

(e) trust agreements that permit oral instructions for trust disbursements are used to reduce the risk of a paper trail that identifies trust financial activities;
(f) offshore service providers (such as one that was the subject of the ICIJ financial data leak) can quickly close down, inhibiting any investigations; and
(g) there were instances where lawyer-client confidentiality was potentially abused for secret communications that facilitate global financial crime.

V. TRANSACTION COSTS AND THE SECRET WORLD OF TAX HAVENS

This Part provides a transaction cost perspective on the information and incentive challenges promoted by tax haven secrecy, as revealed by the ICIJ financial data leak.[179] By way of background, transaction costs are normally considered in the context of private sector exchanges. Transaction costs are the costs associated with discerning, protecting, and enforcing the price of a good or service for a given market exchange, and because transaction costs involve the *right* to a price of an exchange, these costs are heavily influenced by legal rules.[180]

With respect to the public sector, transaction cost economics and transaction cost politics examine how government policies through institutions (i.e., formal and informal rules) and institutional arrangements (e.g., organizations such as the OECD) increase or reduce transaction costs facing actors such as taxpayers.[181] The following asks whether government policies can resolve information and incentive challenges to reduce transaction costs facing governments, and raise them for global financial criminals.

In a world of perfect information and no incentives, governments could resort to tax treaties to resolve the problem of offshore tax evasion and international money laundering.[182] The tax treaty could provide for ongoing

179. The Author is grateful for insights provided by Dan Thornton concerning these tax haven information and incentive problems. *See* Benham, *Licit and Illicit Responses*, *supra* note 79, at 591 (discussing how regulations that raise the costs of engaging in voluntary exchanges can increase the potential gains from illegal activities by making these activities comparably more attractive).

180. *See* Douglas W. Allen, *Transaction Costs*, *in* 1 ENCYCLOPEDIA OF LAW AND ECONOMICS: THE HISTORY AND METHODOLOGY OF LAW AND ECONOMICS 893, 904–06 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000) (describing the transaction cost of "property rights" perspectives by economists, and law and economics researchers).

181. Cockfield, *Commitment Projector*, *supra* note 8.

182. For discussion on the necessary elements for perfect cross-border information exchanges, see *id.* at 98–104. In this ideal world, law enforcement

automatic cross-border tax information exchange, which would enable the resident state to track its resident taxpayers' global income.

The reality of tax haven secrecy, however, creates asymmetrical information where the tax authority of the resident tax evader knows little to nothing about the illicit activities, while the country where the evasion takes place has all of the relevant information (or more specifically, the offshore service provider maintains all of this information, as it is never disclosed to the tax haven government officials themselves due to bank secrecy laws as discussed in Part IV.A). This information secrecy reduces the risk facing global financial criminals, hence lowering their overall transaction costs when they engage in criminal activities.[183]

In a world with information asymmetry but no incentive problems, tax treaties and tax information exchange agreements (TIEAs) would resolve many tax haven secrecy issues as long as the tax haven partner has the resources and political will to assist with the taxpayer investigation. A TIEA permits a country to request tax information held by a tax haven intermediary (e.g., an offshore service provider) so that the requesting country can investigate a resident taxpayer's offshore activities).[184]

Tax havens, however, have an incentive not to cooperate with high-tax country demands. Rather, tax havens have incentives to maintain their financial secrecy laws and to impede or even thwart an investigation from outsiders. If the tax haven cooperates with high-tax jurisdictions, this would likely encourage investors to flee to another market, harming the tax haven's economic welfare: in other words, tax havens offer non-residents a high degree of secrecy to attract investors, and hence a dilution of this secrecy will presumably reduce non-resident investments. For instance, tax havens and other countries at times issue advance rulings to potential investors that clarify how the jurisdiction will treat the invested monies and to offer assurances that the financial information will be kept confidential.[185]

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authorities would face no transaction costs and could effectively monitor and enforce their laws governing global financial crimes. Under the Coase Theorem, when rights are well defined and transaction costs are zero, then resource allocation is efficient and independent of the pattern of ownership (i.e., it does not matter which party assumes liability for its effects on the other party). Coase readily recognized that transaction costs will always exist, and thus play a role in determining how resources are allocated. He noted, for instance, that it is unhelpful to compare markets with "some kind of ideal world" where transaction costs do not exist. Coase, *Social Cost*, *supra* note 8, at 43.

183. Benham, *Licit and Illicit Responses*, *supra* note 79, at 598–600.

184. *See* discussion *supra* Parts II.B, IV.D.

185. *See* Yehonatan Givati, *Resolving Legal Uncertainty: The Unfulfilled Promise of Advance Tax Rulings*, 29 VA. TAX REV. 137 (2009); *see also* Galizia et al., *Explore the Documents*, *supra* note 126 and accompanying text.

Providing an inducement to the tax haven to cooperate (e.g., a share of any recovered U.S. tax revenues)[186] may also not work. If the tax haven cooperates, it will end up sharing a shrinking economic pie as non-resident investors move to other jurisdictions that provide heightened financial secrecy. Again, the tax haven's economic interests will likely be harmed, discouraging cooperation.

If the tax haven will not cooperate, governments can resort to "sticks" such as John Doe summons used by U.S. federal prosecutors to force the disclosure of needed tax haven information.[187] As law enforcement increases its use of sticks against tax haven secrecy, criminals will deploy more resources to protect themselves against this risk. For instance, offshore trusts can be structured with a so-called "flight clause" so that the trusts automatically transfer funds to another anonymous account in some other tax haven if any external legal threat (such as a lawsuit or government audit) seeks to recover the monies.[188]

In these cases, the global financial criminals can also seek out tax havens with more lax regulatory environments.[189] For instance, non-cooperative tax havens could develop new legal entities (e.g., foundations, which are legal entities based in tax havens designed to defeat outside creditor litigation, have become more popular in recent decades) to thwart investigations. Accordingly, the "stick" approach may only work to the extent it raises the transaction costs for tax evasion and international money laundering to the point where these costs exceed the profits earned from illicit activities—this may be difficult or impossible to achieve.

Another incentive challenge arises from the fact that certain elites in low-income or illiberal countries wish to maintain tax haven secrecy. The secrecy facilitates their efforts to transfer legal and illegal sources of income and assets to foreign countries, thereby preventing their home countries from taxing, expropriating, or otherwise taking back these assets.[190] Hence, tax haven secrecy permits elites to continue to work within the system (often as

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186. For discussion of such incentives, see Dean, *Incomplete Global Market*, *supra* note 54, at 650–53.

187. *See* discussion *supra* Part II.B.

188. Fed. Trade Comm'n v. Affordable Media, LLC, 179 F.3d 1228 (9th Cir. 1999) (holding that taxpayers convicted of a Ponzi scheme could be imprisoned for contempt of court for not recovering offshore trust assets due to a trust transfer clause).

189. For discussion, see Niels Johannesen & Gabriel Zucman, *The End of Bank Secrecy?: An Evaluation of the G20 Tax Haven Crackdown*, 6 AM. ECON. J. 65 (2014) (describing how, in light of new bank regulations, investors shifted deposits to tax havens that do not comply with international regulations against bank secrecy laws).

190. *See* discussion *supra* Part III.B.

entrepreneurs or senior government bureaucrats) while protecting their personal and family welfare.

Relatedly, the final incentive challenge is that wealthier and generally democratic countries similarly benefit from tax haven secrecy because it encourages trillions of dollars of capital inflows (by way of foreign portfolio or direct investments) into their countries and away from other (typically poorer) countries. This state of affairs presents a moral hazard for the wealthier democracies, as tax haven secrecy benefits, at least to a certain extent, their economic interests. It also helps to explain why so many OECD countries (such as the United States, Germany, Japan, the United Kingdom, and Canada) maintain laws that promote almost total financial secrecy for non-resident investors in many circumstances.[191]

In summary, transaction cost challenges—information and incentive problems encouraged by tax haven secrecy—make it difficult to achieve the goal of inhibiting offshore tax evasion, international money laundering, and the financing of global terrorism. Moreover, even if the information problems can be resolved, political incentives will continue to promote a non-cooperative environment that inhibits effective reforms. The information and incentive problems are also difficult to overcome because of the international law need to respect the political sovereignty of nations, as well as the perceived importance of financial and tax privacy.

VI. CONCLUSION

The ICIJ financial data leak represents the first time where financial dealings normally hidden in offshore tax havens have been revealed in great detail. By relying on analysis of a small portion of the ICIJ data set, this Article offered a taxonomy of offshore tax evasion behavior to promote an understanding of the ways that offshore service providers (i.e., trust, finance, and other offshore financial service providers) help individuals circumvent national and international laws to engage in global financial crime. By taking advantage of tax haven secrecy, these offshore service providers at times help taxpayers move their monies offshore in an undetected fashion, and assist with the setting up of offshore corporations, trusts, and other business entities to launder or "normalize" the illegal income so that the funds can be invested and eventually brought back home.

The analysis promotes a deeper understanding of the policy challenges presented by tax haven secrecy with the goal of informing more effective legal and policy responses. The complex regulatory environment that surrounds global financial crime is normally studied within discrete doctrinal areas of law such as tax, criminal, banking, and anti-terrorism laws. Similarly, institutional arrangements that have arisen to support these laws—separate

191. *See* discussion *supra* Part II.A.

government agencies, including tax, prosecution, law enforcement, anti-terrorism, and intelligence services—also mainly exist as distinct spheres. This Article showed how a more integrated policy response could help fight global financial crimes that regularly cross boundaries among these different legal regimes.

Still, an effective legal and policy response is difficult. The ICIJ data leak shows how asymmetrical information promoted by tax haven secrecy makes it challenging or impossible for authorities to successfully investigate and convict offshore tax cheats, international money launderers, and financiers of global terrorism. The big data leak also helps to reveal incentive problems that inhibit meaningful global progress. Tax havens rely on tax haven secrecy to promote economic growth in their financial industries. Non-democratic or less wealthy countries use tax haven secrecy to provide an outlet for elites to transfer their assets and income abroad. Finally, wealthier countries with stable economies and a credible rule of law often benefit from the inward investment from these elites.

With respect to tax haven secrecy, governments are faced with different and often conflicting incentives according to their historical, political, cultural, and legal evolution, including different views on financial privacy laws. These perspectives underscore the difficulties in making real progress with respect to reducing offshore tax evasion and other global financial crimes, given the historic and current incentives that help to explain the existing international financial system and its governing international law regime.

All of these factors serve as barriers to effective global reform. While big data provides a potential tool to assist in investigations, history and path dependence reduces the likelihood of progress at both the national and international level. Even in a world of perfect information, current political incentives promote the maintenance of the status quo of tax haven secrecy. Until these incentives change, it may be difficult or impossible for global reforms to reduce global financial crime in any meaningful way.