DENTONS

The Erosion of the Right to Privacy Through Global Steps to Improve Tax Compliance and Prevent Money Laundering

Part 2: What might be next—and how high net worth individuals and family offices can respond

Grow | Protect | Operate | Finance

This is part two of a two-part series on the tension between the fundamental right to privacy and global improvements in tax compliance, as well as the prevention of money laundering and terrorist financing.

Privacy is protected by law and is a basic human right. The right to privacy essentially involves freedom from intrusion of others in a person's private life or affairs.

However, there is no absolute right to privacy. Various laws override the right to privacy for certain reasons, such as to combat corruption, hypocrisy and crime. Therefore, total privacy does not exist.

Recent developments in technology and business have changed the social landscape of privacy. Personal data is increasingly available and valuable and has become a commodity. Data sharing has become a central and necessary part of business and regulation. These new developments pose new threats to privacy and present challenges to regulators in protecting individual privacy and data protection rights. Further, high net worth individuals (HNWIs) and the family offices that serve them are increasingly at risk of inadvertent or illegitimate disclosure of their information.

What might be next?

Governments are already experiencing positive economic results from the Common Reporting Standard (CRS) and related measures. For example, in the UK, His Majesty's Revenue and Customs (HMRC) experienced a 14 percent rise in recoveries in 2018-2019 as compared to 2017-2018, due to the increase in resources and data. These results may encourage governments to push further into the realm of transparency.

The impact of the COVID-19 pandemic will likely lead to increased and new taxes, given the huge fiscal stimulus pumped into economies around the world to mitigate the economic disruption caused by the pandemic and, potentially, new mechanisms to collect and analyze taxpayers' information to enforce such taxes.

The future of the right to privacy is expected to involve:

Increased enforcement activity: Until recently revenue authorities in some countries have taken a restrained approach to enforcing compliance with CRS and Foreign Account Tax Compliance Act (FATCA), but audit and enforcement activity is increasing. The Cayman Islands legislature recently vested the territory's Tax Information Authority (TIA) with comprehensive FATCA and CRS audit powers for "monitoring compliance" with the Cayman FATCA and CRS laws. These provisions authorize "scrutiny of returns, on-site inspections or audit reports, or in such other manner as the [TIA] may determine, the affairs or business of any person." Switzerland has also imposed statutory CRS audits. The Swiss Federal Tax Administration audit team requests and reviews written documents related to the CRS compliance of Swiss financial institutions, such as policies and procedures, training materials, IT updates and form templates. In New Zealand, there is also evidence of Inland Revenue (the national tax authority) increasing its enforcement activity in this area, and the authors are aware of situations where trustees in New Zealand have been requested by Inland Revenue to provide evidence of compliance in relation to trusts under their administration. In the US, the Internal Revenue Service (IRS) received funding of US$58.4 billion over ten years as part of the Inflation Reduction Act in 2022.[1] The IRS has since focused additional resources on enforcement of HNWIs with overdue tax bills. Over the last year and a half, the IRS claims to have collected US$482 million owed by 1,600 millionaires with work still ongoing in this area.

Closing the tax gap: In May 2022, HMRC embarrassingly conceded that it had no accurate estimate of the "offshore tax gap," the scale of taxes unpaid by UK tax residents in relation to their offshore interests. The significant embarrassment caused by this concession, and the subsequent political pressure, sparked a major push by HMRC to ascertain a more accurate estimate. Through analyzing information gathered by the CRS, Pandora Papers and Joint Chiefs of Global Tax Enforcement

1 This amount initially was US$80 billion, but was subsequently reduced by US$20.2 billion.

(J5), HMRC is now aware that about GB£570 billion is held in offshore tax havens by UK residents. This new knowledge has enabled HMRC to commence enforcement action in respect of tax irregularities, seemingly targeting taxpayers who reside in wealthy areas first.

Naming and shaming: In June 2012, the British comedian Jimmy Carr was the subject of an investigation by *The Times* newspaper for his involvement in a tax avoidance scheme. Then-Prime Minister David Cameron commented:

> **People work hard and pay their taxes; they save up to go to one of his shows. They buy tickets. He is taking the money from those tickets and he is putting that money into some very dodgy tax avoidance schemes.**

This led to Jimmy Carr pulling out of the scheme (which was not illegal) and apologizing for "a terrible error of judgement." Rather than leave the matter for the tax authorities or even engage Parliament to pass laws to prevent such activities, the prime minister saw fit to comment on the morality of the steps taken by Mr. Carr.

Wealth inequality is a major social issue of our time. Families and businesses are increasingly protective of their reputations and wary of being vilified by the press. The authors predict that naming and shaming in this way will become a tactic used in the future not only by journalists and politicians, but also by revenue authorities.

Unexplained wealth orders: Unexplained wealth orders (UWOs) are a recent measure to combat tax evasion and money laundering. Issued by British courts, the orders allow law enforcement agencies to ask taxpayers with assets valued over a certain threshold to provide evidence of how they can afford these assets if their income seems insufficient. UWOs have already been implemented in several jurisdictions. In 2018, the UK introduced UWOs with a threshold of GB£50,000. Several UWOs have already been ordered in the UK against both politically exposed persons and suspects involved in organized crime.

Mandatory disclosure requirements: Many jurisdictions have introduced mandatory disclosure requirements (MDRs) for foreign or offshore tax structures. This measure has been introduced to address CRS non-compliance, tax avoidance and opaque offshore structures. In 2018, the Organisation for Economic Co-operation and Development (OECD) released a document containing public comments on the proposed mandatory disclosure rules for CRS, released at the end of 2017. The majority of responses raised concern with the wide ambit of the proposed MDRs, as they were proposed to apply to tax structures without regard to whether they were standard or inoffensive arrangements. The OECD proposal also raises retrospectivity issues, as it will require information about activities dating back to July 2014.

Corporate tax overhaul: In July 2023, the German Ministry of Finance announced a draft bill, the Growth Opportunities Act, that, if passed, would represent the most significant corporate tax reform in Germany since 2008. Importantly, the bill proposes a reporting obligation for domestic tax arrangements which would replicate the already in-force MDR regime for international tax arrangements.

Global asset registry: In March 2019, the Independent Commission for the Reform of International Corporate Taxation (ICRICT) released a paper proposing the implementation of a global asset registry (GAR). The ICRICT has not provided specific details for how the GAR would look in practice, but has indicated that it would essentially take the form of a global beneficial ownership register (BOR) with information relating to a wide range of areas including companies, securities, land and trusts.

Further work on BORs: The UK, the EU and the US have made significant progress on the introduction of BORs:

- **The UK**: The UK is a world leader when it comes to BO transparency. In 2016, the UK established the Persons with Significant Control Register (PSC), requiring UK companies and other entities to register and report on their (direct and indirect) ownership. In 2022, the UK set up the Register of Overseas Entities (ROE), conferring the same obligations on UK companies and other entities captured by the PSC to overseas entities who own UK property.
    - Recently, the House of Lords amended the *Economic Crime and Corporate Transparency Bill,* which reforms the PSC and ROE in the interests of even greater transparency, to require property-owning overseas entities to notify the ROE of any changes in ownership within 14 days (rather than the previous limit of once a year) and the names of parties to trusts which own overseas entities in the ROE.
- **The EU:** As noted above, 4AMLD required EU member states to establish BORs, which are accessible (a) to those demonstrating "legitimate interest" in the information, in respect of trusts, and (b) until the Court of Justice of the EU (CJEU) Judgment, to the public, in respect of companies. In January 2024, the European Council of Ministers and the European Parliament agreed on the terms of the 6th EU Anti-Money Laundering Directive (6AMLD) and associated regulations. 6AMLD was proposed in 2021 as part of reforms to improve the EU's anti-money laundering regime. Under 6AMLD certain supervisory and public authorities, "obliged entities" (entities that are regulated under anti-money laundering legislation), and those with "legitimate interest" in the information, including journalists, will have access to BOR. Unsurprisingly, it seems that 6AMLD will confirm that public access will not be granted, in accordance with the CJEU Judgment.
- **The US:** The recent enactment of the US Corporate Transparency Act (CTA) also represents a major step towards a new global standard on BO transparency. The CTA applies broadly, capturing financial institutions, service providers and private clients and family offices. The CTA distinguishes between company applicants, the persons involved in the formation of the entity, and beneficial owners, the persons who hold a high degree of control over a company's activities or have more than 25 percent ownership. Under the CTA, companies must disclose exhaustive information, including but not limited to full names, business and residential addresses and IRS identification numbers.

Extension of FATCA/CRS to other asset classes: FATCA and CRS only apply in respect of "financial assets" which, broadly, includes assets such as shares, partnership interests, commodities and swaps. However, it is likely that they will be extended to other asset classes:

- In August 2022 the OECD released Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard to bring cryptocurrency within the scope of the CRS. The OECD is working on a timeframe for implementation of the changes.
- The OECD has also announced a proposal this year to extend CRS to real estate. This comes as a result of growing concern about the role that real estate transactions may play in tax evasion and money laundering.

United Nations (UN) High-Level Panel on International Financial Accountability, Transparency and Integrity: A report in February 2021 from the UN High-Level Panel on International Financial Accountability, Transparency and Integrity (the FACTI Panel) provides insights into future developments in this area. The report is very significant, as it includes recommendations that could eventually lead to harmonized global tax rates, public BORs, unitary taxation and a global tax authority. Following the FACTI Panel report, on July 1, 2021, it was announced that a number of jurisdictions had joined an OECD statement,

setting out "a two-pillar solution to address the tax challenges arising from the digitalisation of the economy." This proposed solution included:

- Reallocating some taxing rights in relation to certain multinational enterprises from home countries to countries where they actually operate
- Implementing a global minimum corporate tax rate of 15 percent

Additional member jurisdictions joined the statement after the announcement, with 137 having joined as at November 4, 2021. The OECD intends to implement the technical work done on the proposals in 2023.[2]

OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS): Following the FACTI Panel report, on July 1, 2021, it was announced that a number of jurisdictions had joined an OECD statement setting out "a two-pillar solution to address the tax challenges arising from the digitalisation of the economy." This proposed solution included:

- Reallocating some taxing rights in relation to certain multinational enterprises from home countries to countries where they actually operate
- Implementing a global minimum corporate tax rate of 15 percent

Further member jurisdictions joined the statement after the announcement, with 143 having joined as at June 9, 2023. The OECD intends to implement the technical work done on the proposals in 2023.

In July 2023, 138 members of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) agreed to an outcome statement, representing a major step towards reform of the international tax system. The outcome statement aims to implement the remaining aspects of the "two-pillar solution" first raised in 2021.

A global standard on company ownership: Previously a niche concept, in recent years BO transparency has advanced to the top of the global anti-corruption and anti-money laundering and countering the financing of terrorism (AML/CFT) agenda. However, despite significant progress, not all key financial centers have taken the steps to tackle BO secrecy. Transparency International's analysis of the issue, first released in 2019, suggests that there are significant weaknesses in terms of ensuring BO transparency across the global network of Financial Action Task Force (FATF) countries. Transparency International has called on FATF to impose the following five key requirements on its member countries to ensure that the new global standard on BO transparency is effective:

- Make BORs a requirement
- Clearly define "beneficial ownership"
- Require independent verification of BO
- Close loopholes that allow anonymity in relation to bearer shares and nominees
- Increase ownership transparency of foreign companies

Tax authorities trawling transaction flows: Tax authorities such as HMRC have long had access to information from bank accounts, pension savings and foreign tax offices. But it is less well known that they also access data from credit card transactions, travel records, passports and the driving license authority. Some experts say they also monitor social media and loyalty programs.

With the growing power of digital communications and computing, together with new regulatory powers, tax authorities can now mine financial data deeper and faster than ever imagined. The COVID-19 pandemic has hastened this trend as the volume of electronic (as opposed to cash) transactions has increased. For taxpayers this could make dealing with tax authorities more efficient as tax reporting processes are made more automatic. Nonetheless, it could also increase tax officials' scrutiny into the lives of citizens.

2 For a glimpse into the government response to OECD Pillars One and Two of more than 40 countries, please refer to each chapter's section on "international tax reform" in the 2024 edition of the *Dentons Global tax guide to doing business in...* *www.global-tax-guide.com*.

Sanctions: Russia's unprovoked invasion of Ukraine in February 2022 led to the global impositions of sanctions against Russia. Sanctions are generally used for political purposes and involve increased transparency in relation to the affairs of sanctioned individuals and entities. Many countries have passed sanctions legislation preventing certain interactions with specified Russian individuals and entities, in order to bring economic pressure on the Russian government to end the war. Sanctions impose information-gathering obligations on, and restrict the business and other interactions of, private individuals and entities. Generally, businesses need to adopt a process for the screening of sanctioned individuals into their AML/CFT procures, or risk significant penalties if they (inadvertently or otherwise) breach sanctions. Sanctions are a common tool used by governments to influence the behavior of foreign governments and individuals. A number of countries, including the UK, US, EU, Canada, Australia and Japan, have also imposed sanctions on individuals and organizations associated with Hamas, in response to the escalation of the Gaza crisis.

What can HNWIs and family offices do to ensure data privacy?

The information disclosure regimes traversed in this article are not optional and, despite some success in the courts on the part of privacy advocates, are likely here to stay. However, there are some steps that HNWIs and family offices can take to minimize the risk of inadvertent or illegitimate disclosure.

Engage professionals with data protection expertise and promote privacy awareness

HNWIs and family offices should engage or employ trusted advisers with experience and expertise in privacy protection. An understanding of privacy issues is increasingly necessary for tax and legal advisers, and these professionals are upskilling themselves in this area. These individuals can provide advice on how to minimize the risk of inadvertent or illegitimate disclosure and provide ongoing support to manage risks, as well as ensure that expert advice is obtained in every jurisdiction in which assets are held.

These professionals, as well as the management team of family offices generally, should be responsible for developing a culture of privacy awareness within the family office. Educating family members, staff and third parties (e.g., business partners) about the importance of privacy and protecting personal information is key to avoiding inadvertent disclosure.

Adopt robust cybersecurity systems and processes

It is vital that HNWIs and family offices have systems to prevent cyberattacks and to secure private information. They should invest in suitable encryption technology, multifactor authentication and secure data storage solutions. They should also undertake regular security audits to ensure that technology and processes are up to date and adhere to current best practice.

Conduct regular privacy risk assessments

As part of a cybersecurity strategy, family offices should conduct regular privacy risk assessments to identify and proactively mitigate potential vulnerabilities. This should include reviewing policies, assessing third-party relationships (and third parties' own privacy procedures) and staying up to date regarding privacy risks.

Re-think HNWIs' relationships with countries with a poor record of privacy protection

In extreme cases, it might be necessary to consider severing links with countries with a poor record of privacy protection and a culture of corruption and exploitation. For example, the authors are aware of situations where HNWIs residing in countries that cannot guarantee the confidentiality of private information have left those countries prior to CRS and FATCA (and therefore the exchange of information those regimes require) applying to them. This is due to the fear that their personal information will be illegitimately accessed and used to facilitate their kidnapping or extortion.

Concluding comments

It is likely that governments will continue to seek to maximize tax revenues to repay debt incurred as a result of the COVID-19 pandemic and will rely on both existing, and potentially new, information disclosure regimes to ensure that all tax payable is in fact paid. It is unlikely that we are yet at the peak of transparency, at least in relation to tax matters.

However, arguably we are reaching a point at which requirements to disclose additional information could be unduly onerous and potentially counter-productive. Only a small proportion of the population is guilty of the crimes that current disclosure regimes seek to uncover, yet we are all subject to them.

This is not to say that preventing these crimes does not justify the imposition of information disclosure regimes, but it is important that transparency is balanced against the right to privacy. The importance placed on privacy can be seen both in recent privacy protection measures, such as the EU's General Data Protection Regulation 2016/679, and a general public concern about privacy.

Geopolitical events, including Russia's invasion of Ukraine, are likely to continue to be relevant to the tension between privacy and transparency. The goal with tools such as sanctions is not to collect tax or other revenue but instead to impose political pressure, and so the cost involved is unlikely to ever be considered to outweigh the desired outcome.

The transparency agenda as it applies to private wealth has become an important consideration for HNWI and family office clients and their advisers. The authors submit that not only are transparency requirements here to stay, but they are set to strengthen, broaden and deepen as data gathering and sharing becomes more sophisticated and immediate than ever before. This situation creates a risk of inadvertent or illegitimate disclosure, and HNWIs, family offices and their advisers are obligated to take steps to reduce the risk as much as possible.

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