Cooperative Compliance Program for Individuals and Trusts: A Proposal for a Compliance Passport

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ABSTRACT

Tax and beneficial ownership transparency regimes result in substantial costs and risks for many law-abiding individuals, family trusts, and private investment vehicles. Such parties suffer from substantial direct and indirect costs, legal uncertainties, and risks to their privacy. This article develops a proposal for a voluntary program which draws upon cooperative compliance programs such as the International Compliance Assurance Programme. Under the proposed program, the authorities of the relevant jurisdictions would determine on a joint basis whether the participant is in full compliance with their tax obligations and whether there are any money laundering concerns. The proposed program would ensure the participants' compliance while reducing the costs and risks for the participants and the relevant governmental authorities.

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I. INTRODUCTION

Tax and beneficial ownership transparency regimes result in substantial costs and risks for many law-abiding individuals, family trusts, and private investment vehicles. Such parties suffer from substantial direct and indirect costs, legal uncertainties, and risks to their privacy. This article develops a proposal for a voluntary program which would ensure the participants' compliance with tax and anti-money laundering laws while reducing the costs and risks for the participants and the relevant governmental authorities.

Under the current trend toward tax and beneficial ownership transparency, governments are increasingly engaged in the collection and sharing of individuals' personal and financial information. Governments exchange financial account information of foreign tax residents under the U.S. Foreign Account Tax Compliance Act (FATCA) and the international Common Reporting Standard (CRS).[4] This automatic exchange of information (AEOI) is described by the OECD as "the largest exchange of tax information in history" (OECD, 2019a). Under anti-money laundering (AML) laws,[5] countries maintain beneficial ownership registers, an increasing number of which are accessible by the public (Mor, 2019). This trend toward transparency has accelerated rapidly in the past decade. It will likely continue as more jurisdictions are under pressure to adopt public beneficial ownership registers,[6] and more transparency measures are promoted by the OECD,[7] analysts,[8] and non-profit organizations.[9]

This trend toward transparency has an important policy goal: increasing governments' ability to deter and detect tax noncompliance and money laundering.[10] However, transparency has a high price tag. The high implementation and compliance costs of these tax reporting and AML regimes put their cost-effectiveness in question (Byrnes, 2020; Noked,

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[4] For background about FATCA and CRS, see Byrnes (2020); Noked (2018a).

[5] All the references to anti-money laundering in this article also refer to counter-financing of terrorism.

[6] For example, Cayman Islands announced that it will set up a public beneficial ownership register for companies by 2023 (Cayman Finance, 2019).

[7] For example, see OECD (2018a)'s proposal for CRS mandatory disclosure rules. Mandatory Disclosure Rules.

[8] For example, see Zucman (2013)'s proposal for a global financial register.

[9] For example, see the Tax Justice Network's work on tax transparency, including the Financial Secrecy Index (https://fsi.taxjustice.net/en/) and trust registration (Knobel, 2016); see also Transparency International's initiatives (Martini, 2019).

[10] For the link between tax evasion and money laundering, see Foo (2019); Storm (2013).

2018b). Another substantial non-monetary cost is from compromising the privacy of law-abiding individuals (Hatfield 2018a, 2018b). Also, individuals and entities whose information is shared might face an increased risk of legal uncertainties where multiple jurisdictions examine their information and investigate them. Other costs are incurred when behaviors are distorted when parties try to avoid these costs and risks (Noked 2018a).

In addition to the high costs, transparency regimes might have limited effectiveness. While transparency regimes put a spotlight on certain types of assets and behaviors (e.g., holding undeclared offshore financial assets in compliant financial institutions (FIs) in participating jurisdictions), bad actors might exploit loopholes to avoid detection; Noked, 2018b, 2019). This means that the current transparency regimes impose high costs on compliant parties while bad actors might be able to continue engaging in tax evasion and money laundering.[11] Although governments may try to close all loopholes and increase transparency until all bad behaviors are detected, it is unclear whether the costs of complete transparency might exceed the benefits (Noked, 2018b).[12]

This article develops a proposal that could ensure compliance while reducing costs and risks for participating individuals, family trusts, and private investment vehicles. The suggested approach draws upon cooperative compliance programs and the International Compliance Assurance Programme (ICAP) in particular. Under the proposed program, the authorities of the relevant jurisdictions would determine whether the participant is in full compliance with their tax obligations and whether there are any money laundering concerns. A successful participant would be granted a "Compliance Passport" documenting the finding of compliance. A Compliance Passport holder will be able to present this document to FIs, authorities, and other parties in order to show its compliance in the jurisdictions that granted the Compliance Passport.

The process under this program could be structured similarly to ICAP with the following stages: pre-entry, scoping, compliance review, and issuance of a Compliance Passport. After the issuance of a Compliance Passport, the compliance status should be reviewed periodically. This program is feasible and can be implemented within the existing international legal framework. It could be offered as a pilot by several

[11] The transparency regime may increase the general level of compliance by incentivizing taxpayers to avoid negligent mistakes and by increasing the awareness of the need for tax compliance.

[12] A comprehensive comparison of the benefits and costs of transparency is outside the scope of this article. This article focuses on the impact of transparency regimes on *compliant* individual taxpayers, their closely related entities, and family trusts.

jurisdictions, or even by one jurisdiction at the start. These jurisdictions could include members of the Forum on Tax Administration, as well as other jurisdictions and offshore financial centers.

This program offers several advantages for its participants. A Compliance Passport holder should have a greater legal certainty because the relevant authorities have already reviewed their tax compliance and money laundering risks. In addition, a Compliance Passport holder would be able to carry out activities such as opening bank accounts more easily because FIs and other parties would consider the Compliance Passport holders as posing lower money laundering risks. Such FIs would incur lower compliance costs because they could apply simplified AML measures to low-risk Compliance Passport holders. This could reduce the costs of financial services.

Policymakers should consider amending the tax and beneficial ownership transparency regimes to provide Compliance Passport holders with a greater protection to their privacy. Where the relevant authorities have concluded that a Compliance Passport holder is in full compliance with their tax obligations and that no money laundering concerns have been identified, there is less need for information collection, sharing, and disclosure. In such situations, the interest of protecting legitimate privacy concerns should prevail. For example, instead of identifying the name and the information of a Compliance Passport holder in a public beneficial ownership register, this information could be kept in a private register so that the beneficial owner's privacy would be protected while ensuring compliance and access to the information by the relevant authorities if needed. Providing a greater protection to the participants' privacy would increase the attractiveness of the program and encourage cooperative compliance.

By reducing these costs and the risks, this program has the potential to reduce the distortions caused by transparency regimes. Potential participants would participate in this program if the expected benefits outlined above exceed the costs of participating in the program, including the fees charged by tax authorities, expenses on professional advisers, and the risk that participating in the program could result in disputes or findings of noncompliance.

Tax authorities and the authorities in charge of AML enforcement are expected to benefit from this program because it would ensure compliance among the participants through a cooperative process that could

free scarce enforcement resources.[13] If the authorities' cost of administering this program exceeds the cost-saving, the net cost could be borne by the participants, similar to charging user fees to applicants for advance pricing agreements (APAs).

Addressing both tax and money laundering risks under one program would be advantageous. The tax compliance issues and the money laundering issues are closely related, and there would be potential synergy gains from addressing both tax compliance and money laundering risks in one program. A program that covers both tax and money laundering risks would be more valuable for participants because it would address more related problems. However, a combined tax-AML program could be harder to implement as it would require the participation of more authorities. If policymakers find that it is not feasible or desirable to have a program covering both tax and money laundering risks, they should consider launching a cooperative tax compliance program for individuals, family trusts, and private investment vehicles.

This article is organized as follows: Part II describes the costs and risks incurred by law-abiding individuals, family trusts, and private investment vehicles under the current tax reporting and AML regimes. Part III provides an overview of cooperative compliance programs. Part IV sets forth our proposal for a Compliance Passport Program. Part V offers a conclusion.

II. CURRENT CHALLENGES

Much of the recent research on wealthy taxpayers focuses on bad actors who engage in tax evasion and avoidance.[14] However, many wealthy taxpayers are compliant and many have a low-risk appetite to engage in illegal or aggressive tax behaviors or money laundering. A recent study found that most "wealthy individuals felt that the goal in arranging their tax affairs was to pay the legally-correct amount of tax" (IFF Research, 2019). Such compliant individuals face significant challenges under the current tax reporting and AML regimes.

[13] For a discussion on the benefits of cooperative compliance, see Szudoczky & Majdanska (2017) and Part III *infra.*

[14] For further discussion of this literature, see Gangl and Torgler (2020).

A. Privacy

The tax reporting and beneficial ownership transparency regimes compromise privacy.[15] First, the information of beneficial owners of corporations and similar entities is publicly available in public beneficial ownership registers of an increasing number of jurisdictions. Following a G20 summit in November 2014 that called to increase the transparency of beneficial ownership (G20, 2014), many governments have set up or are in the process of setting up beneficial ownership registers. Some countries have government-run registers, while other countries require companies to maintain their registers and share the information with governmental authorities upon request.[16] Some countries have established publicly-accessible registers, while others allow restricted access to the registers (Mor, 2019).

The international pressure to make the registers accessible by the public has been increasing. Since January 2020, under the Fifth AML Directive, all EU Member States are required to maintain public registers for the beneficial owners of companies.[17] Starting in March 2020, the EU Member States are also required to maintain beneficial ownership registers for trusts and equivalent legal arrangements, although each Member State can decide on the applicable level of transparency with respect to the register for trusts.[18] The British Overseas Territories and Crown Dependencies, including the British Virgin Islands and the Cayman Islands, are under pressure to maintain public registers for companies, although the timeline is uncertain (Mor, 2019, pp. 14-18). The UK government aims to make public registers the global norm by 2023 (Mor, 2019, pp. 3, 17). The UK government is also planning to set up a beneficial ownership register

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[15] This article focuses on individuals' privacy, which also extends to closely-held entities and family trusts. For an in-depth discussion on tax privacy, see Blank (2011). Different considerations may apply with respect to other corporations and entities. See, e.g., Avi-Yonah and Siman (2014); Blank (2014); Domp (1993); Kornhauser (2005); Lenter, Slemrod & Shackelfold (2003); Thorndike (2002). The question of privacy of corporations and other entities that are not closely held is outside the scope of this article.

[16] For example, Hong Kong companies are required to maintain their beneficial ownership register and share the information with governmental authorities only upon request.

[17] EUR-Lex, *Directive (EU) 2018/843 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing* (May 30, 2018) [hereinafter "Fifth AML Directive"]. Retrieved from https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L0843&from=EN

[18] Under the Firth AML Directive, Member States can determine the level of transparency with respect to trusts and similar legal arrangements that are not comparable to corporate and other entities.

for certain UK real estate owned by legal entities including foreign companies (Mor, 2019, pp. 9-12).

In addition, there are substantial privacy risks concerning information meant to be disclosed to tax authorities only. Tax authorities around the world are now collecting and sharing an unprecedented amount of information under FATCA, CRS, and non-public government-run registers. If the taxpayer data obtained through FATCA, CRS, and other initiatives that increase transparency towards tax authorities remains confidential, then there should be no impact on taxpayer privacy. However, this information collection and sharing by tax authorities pose risks of leaks, hacking, and other privacy-related risks.[19] For example, the Bulgarian National Revenue Agency's information technology system was hacked in 2019 (OECD, 2019b). Hacked information, including information obtained through CRS information exchange, was leaked to the media.

Law-abiding individuals, who are not involved in tax noncompliance or any other illicit activities, could have legitimate interests in protecting their privacy (Blum, 2004; Cockfield, 2016; Hatfield, 2018b). People may want to keep their financial and beneficial ownership information private because of a variety of personal and business reasons. Compromising privacy might result in serious personal safety risks for high-net-worth individuals (HNWIs) in certain jurisdictions. EU Member States can provide exemptions from public beneficial ownership disclosure in exceptional situations where the disclosure "would expose the beneficial owner to a disproportionate risk of fraud, kidnapping, blackmail, extortion, harassment, violence or intimidation."[20] However, it is unclear how these exemptions will be granted in practice. Also, there is still a risk of information leakage from tax authorities (that collect and exchange the FATCA and CRS information) and government-run registers even if the information is not accessible to the public. There are no other exceptions or exemptions to protect other privacy concerns.

Interestingly, at the same time governments have been eroding privacy through these transparency regimes, many countries try to protect privacy by regulating the use of personal data.[21] These trends appear to have contradictory motivations and goals, even if the relevant privacy protection

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[19] For example, the U.S. IRS has been subject to massive data breaches. Pagliery (2016). For discussions on transparency vs. privacy, see generally Hatfield (2018a, 2018b), Oei and Ring (2018); Noked (2018c).

[20] Fifth AML Directive § 36.

[21] See, e.g., General Data Protection Regulation (EU) 2016/679 (GDPR).

regimes and transparency regimes are compatible from a technical legal perspective.[22]

B. Legal Uncertainty

HNWIs'[23] tax affairs have been subject to an increasing interest by tax authorities, which leads to more tax uncertainties. Furthermore, the tax reporting and beneficial ownership regimes result in greater legal uncertainties for individuals and family trusts. The following example demonstrates the uncertainty created under CRS.

Example 1

Assume the following facts: a family trust was settled by a Hong Kong citizen and tax resident who has the power to revoke the trust. The settlor settled the trust as part of his succession planning. The applicable law is the law of the Cayman Islands. The trustee is an individual, a French tax resident, who has no beneficial interest in the trust. The trust has a protector, an Australian tax resident, who has no beneficial interest in the trust. The trust holds its assets through a company organized in the British Virgin Islands. The trust has discretionary beneficiaries in the United States and Canada. The trust's main asset, held through the company, is a bank account with a balance of 10 million US dollars in Hong Kong. The trust has never made any distribution to the discretionary beneficiaries. The trust and the company are classified as passive non-financial entities (Passive NFE) under FATCA and CRS.[24] The trust is classified as a foreign grantor trust under U.S. tax law.[25]

Under FATCA and CRS, the Hong Kong bank can classify and report the beneficiaries as a controlling persons even in years they have not received any distribution from the trust.[26] The trustee and the protector will be classified as controlling persons even though they have no beneficial interest in the trust. Following the classification as controlling persons, the

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[22] The discussion on whether or not there is a conflict between these trends and legal frameworks is outside the scope of this article.

[23] OECD (2009) noted that that report on HNWIs "uses the term 'High Net Worth Individuals' to refer to individuals at the top of the wealth or income scale. The term is used broadly and thus includes both high wealth individuals and high income individuals." This article adopts a similar definition.

[24] For a discussion on when a trust should be classified as a Passive NFE, see Noked (2018a).

[25] For more background about the U.S. taxation of trusts, see DePasquale and Fox (2016).

[26] The Hong Kong bank may classify the discretionary beneficiaries as controlling persons only in years they receive distributions, but it is not under obligation to do so.

information of the trustee, the protector, and the beneficiaries will be reported to their jurisdictions of tax residence. The reporting for each of them should include the full balance of the account (10 million USD).

This reporting might trigger audits and investigations against them even though they have not failed to comply with any legal obligation. The French and Australian tax authorities might investigate whether the trustee and the protector have beneficial interests in the trust's assets and income which they failed to report. The U.S. and Canadian tax authorities might investigate the beneficiaries whether they have failed to comply with any obligation that applies to the reporting of interests in, and distributions from, foreign trusts.

Even if these audits and investigations end without any finding of wrongdoing, these individuals might incur costs from being subject to such proceedings. Also, there may be cases in which individuals would prefer settling investigations into them although they have not breached any rule. As demonstrated in this example, AEOI reporting could increase the exposure of compliant taxpayers to legal uncertainty and associated risks.

C. Compliance Costs and Difficulties Doing Business

Business and wealth owners must navigate an increasingly complex web of reporting and related requirements associated with exchange of information rules, AML rules, public registers, and more. Many family trusts and private investment entities are classified as FIs under FATCA and CRS, and their owners incur the compliance costs (Noked 2018a). These compliance costs may include the costs of professional assistance by tax and legal advisers, accountants, and other service providers. Owners of complex private and business assets may need professional assistance when they fill out forms and provide documents and information to banks and other FIs. Complexity of compliance is increased where the relevant beneficial owners, entities, and assets are spread in more than one jurisdiction, which is frequently the case given that it is common to invest cross-border, use investment and business vehicles that may be located abroad, and to have family members living or working in multiple countries.

The tax reporting and AML regimes have resulted in more indirect costs and difficulties doing business. As a result of the tax reporting and AML regimes, FIs (such as banks and funds) incur substantial compliance costs and risks with respect to clients who are HNWIs, family trusts, and private investment vehicles. FIs incur substantial compliance costs in the implementation of FATCA and CRS (Byrnes, 2020). FIs also face more challenges and higher costs when applying the AML rules to HNWIs and

trusts. Private banking (defined as the "provision of banking and investment services in closely managed relationship to high net worth clients") is considered by regulators as "vulnerable to money laundering" because private banking services typically include "current account banking, high-value transactions, use of sophisticated products, non-standard investment solutions, business conducted across different jurisdictions and offshore and overseas companies, trusts or personal investment vehicles" (U.S. Financial Services Authority, 2017). The AML obligations are generally greater when the money laundering risk is higher as FIs and other parties that are required to conduct AML customer due diligence (CDD) must implement a risk-based approach, (FATF, 2019). In the wealth management industry, FIs and other parties "must exercise a greater degree of diligence throughout the relationship" including at the onboarding stage[27] and on an ongoing basis.[28]

FIs might try to shift these costs onto their clients which would result in higher costs of financial services (Byrnes 2020). In addition, it has become harder to open bank accounts or transfer funds across jurisdictions. This might be the result of higher compliance costs for FIs or the risks associated with servicing clients who might come under scrutiny. A recent report of the U.S. government found that U.S. persons living overseas have encountered reduced access to financial services as a result of the enactment

[27] JMLSG (2020) § 5.11, states that firms in the wealth management industry "must endeavour to understand the nature of the client's business and consider whether it is consistent and reasonable, including: the origins of the client's wealth; Where possible and appropriate, documentary evidence relating to the economic activity that gave rise to the wealth; the nature and type of transactions; the client's business and legitimate business structures; for corporate and trust structures - the chain of title, authority or control leading to the ultimate beneficial owner, settler and beneficiaries, if relevant and known; Where appropriate, the reasons a client is using complex structures; the use made by the client of products and services; the nature and level of business to be expected over the account. The firm must be satisfied that a client's use of complex business structures and/or the use of trust and private investment vehicles, has a genuine and legitimate purpose."

[28] JMLSG (2020) §§ 5.23-5.24 ("…In view of the risk associated with wealth management activities, it is appropriate that there should be a heightened ongoing review of account activity and the use made of the firm's other products… An illustrative (but not exhaustive) list of matters firms should carefully examine includes: substantial initial deposits proposed by prospects for business; transactional activity - frequent or substantial activity that is inconsistent with the normal levels associated with the product or purpose - unusual patterns of activity may be evidence of money laundering; wire transfers - frequent or substantial transfers not in keeping with either normal usage for the product or the verified expectations of the client's business requirement; cash or other transactions - which are not in line with either the normal usage for the product or the verified expectations of the client's business requirement; significant increase or change in activity – increased values, volumes or new products required, which do not align with the firm's profile of the client; accounts of financial institutions not subject to supervision in an assessed low risk jurisdiction; and any activity not commensurate with the nature of the business…").

of FATCA (U.S. GAO, 2019). The unwillingness of many FIs to open and maintain accounts to foreign tax residents may have expanded following the implementation of CRS. For example, it has become harder for non-Hong Kong individuals and entities to open bank accounts with FIs in Hong Kong.[29]

D. Distortions of Behaviors and Activities

Law-abiding people might change their succession planning, ownership structures, investments, and domicile as a reaction to transparency regimes. Is it worth having a trusted family member as a protector of a family trust if there is information disclosure to the country of that family member that will trigger costly tax investigations notwithstanding that the protector has no economic interest in the structure? Is it wise to invest in countries where such investments may attract public disclosures of beneficial ownership?

Here are a few examples for actions that compliant people might take to avoid the costs and the risks discussed above:

a) Revoking or terminating a family trust: The settlor or the trustee (depending on who holds the relevant powers) can revoke or wind up the trust. A settlor that revoked his trust might adopt a different succession plan (e.g., bequeathing assets under a will or gifting the assets during the settlor's life).[30]

b) Removing protectors and beneficiaries: The trustee can remove the protectors and beneficiaries from a trust so they will not be reported.

c) Winding up companies: An owner of a foreign company can liquidate that company and hold the assets directly or through a domestic entity.

d) Avoiding holding assets that are subject to transparency regimes: Instead of holding investments that are subject to disclosure under

[29] *See, e.g.*, Winn (2015). The Hong Kong Monetary Authority noted in a circular from 2016 that some banks "applied stringent CDD measures that are disproportionate to the likely risk level of the customers, resulting in many unsuccessful account opening applications and/or unpleasant customer experiences." Hong Kong Monetary Authority (2016).

[30] Many family trusts are settled for succession purposes. The decision to use a trust organized under the laws of another jurisdiction is frequently not tax-driven; popular trust jurisdictions typically have more developed and certain trust laws. For a discussion on the use of trusts in succession planning, see Marcovici (2016), pp. 166-178.

AEOI and public registers, investments can be made in jurisdictions and assets that are not subject to disclosure requirements.[31]

e) Relocating and immigrating to other jurisdictions: Especially in countries where wealthy families would face higher safety risks as a result of increased transparency, such families might move to other jurisdictions.

These reactions may reflect distortions of people's preferences for succession planning, investments, holding structures, and location of assets. This means there is a greater deadweight loss because of the distortion of the behaviors of law-abiding individuals who take steps to avoid the costs and risks discussed above.[32]

III. COOPERATIVE COMPLIANCE PROGRAMS

The proposal developed in this article draws on elements from existing and proposed cooperative compliance programs. This part provides a high-level overview of these programs.

A. Cooperative Compliance Programs

There is a growing number of countries that offer voluntary cooperative compliance programs to their *corporate* taxpayers (de Widt, Mulligan and Oats, 2019; Hein and Russo, 2020; OECD, 2013). These countries include Australia, Denmark, Ireland, the Netherlands, the United Kingdom, and the United States, among others. The OECD has been actively promoting the adoption and development of such programs (Huiskers-Stoop and Gribnau (2019), pp. 66-67). In general, these programs aim to shift from the traditional compliance model to a more cooperative model (OECD, 2018a, p. 40; OECD 2017b, p. 21). The OECD notes that

[31] For example, real estate in jurisdictions that do not have a public register for real estate, precious metals, collectibles, cryptocurrencies, etc. For further discussion and empirical evidence documenting these trends, see De Simone, Lester and Markle (2020). Several studies (including Ahrens and Bothner, 2019; Casi, Spengel, and Stage 2019; O'Reilly, Ramirez and Stemmer, 2019) documented a decline in deposits in offshore financial centers which could be the result of FATCA and CRS. While this article focuses on the potential reactions of compliant taxpayers, these could also be the reactions of noncompliant taxpayers.

[32] It could be argued some people's decisions regarding these matters have been distorted by the low tax rates and intransparency offered by some jurisdictions. While this may be the case for some people, these may not be the drivers for other people's choices. In addition, the tax and beneficial ownership transparency regimes create distortions because they increase transparency for certain types of assets and activities and not for others.

"[c]o-operative compliance approaches can best be characterised as 'Transparency in exchange for certainty'" (OECD, 2013, p. 29).

For example, under the U.S. Compliance Assurance Process (CAP), "the IRS and taxpayer work together to achieve tax compliance by resolving issues prior to the filing of the tax return."[33] This program is available to large corporate taxpayers that are not under tax investigations or disputes.[34] Participants must sign a memorandum of understanding that details their obligations under the program.[35] As part of these requirements, participants must disclose "completed business transactions, proposed tax positions, the tax issues within the transactions and other material items or issues and pertinent facts regarding material items" as well as certain items (such as the use of tax shelters) that are subject to review regardless of materiality thresholds.[36] If the IRS and the taxpayer disagree on the appropriate reporting position, they should attempt to resolve the disagreement before the tax return is filed.

From the taxpayers' perspective, one of CAP's main advantages is tax certainty.[37] By resolving all potential disagreements with the IRS prior to the filing of the tax returns, the taxpayers know the IRS will accept the returns. The real-time review and pre-filing resolution of issues could save time and resources for both the IRS and the participants.[38] Both the participants and the IRS appear to participate in the program because of their self-interest: both sides can potentially benefit from a timely dispute settlement, increased certainty, and greater administrative efficiencies (de Widt et al., 2019, p. 156; OECD, 2013, pp. 73-83). The government audit and compliance costs are expected to be lower because participants are less likely to adopt weak tax positions, and the tax authority is less likely to challenge participants' well-grounded tax positions (De Simone, Sansing and Seidman, 2013).

Cooperative compliance programs are typically offered only to large businesses (OECD, 2013, pp. 31-32). However, countries may offer similar

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[33] IRS, Compliance Assurance Process (last updated Aug. 27, 2020), https://www.irs.gov/businesses/corporations/compliance-assurance-process.

[34] IRS, Compliance Assurance Process (CAP) - Frequently Asked Questions (FAQs), FAQ 3 (last updated March 20, 2020), https://www.irs.gov/businesses/corporations/compliance-assurance-process-cap-frequently-asked-questions-faqs.

[35] FAQ 8.

[36] FAQ 9.

[37] For further discussion on the benefits of cooperative compliance programs for large businesses and tax administrations, see Larsen and Oats (2019), pp. 165-170.

[38] FAQ 6. However, it is unclear whether the program actually results in lower compliance costs; Dolan and McCormally (2018).

"trusted taxpayer" programs to smaller businesses. For example, in South Korea, small and medium businesses can also be designated as "trusted taxpayers" (Suh, Lee, Kuk and Ryu, 2019). The designation of a business as a trusted taxpayer is made after a process that includes tax investigations and evaluations as well as a public hearing. Trusted taxpayers receive several benefits: they should not be subject to tax investigations for three years; they receive special treatment with respect to certain tax issues; and in case they were involved in certain types of tax noncompliance, they would typically be subject to lower penalties. A recent study found that firms designated as trusted taxpayers by the Korean tax authority are less likely to engage in tax avoidance (Suh et al., 2019, pp. 121-126). There have been proposals for "trusted taxpayer" programs to incentivize compliance among small businesses in Australia and New Zealand.[39]

B. OECD's Proposal to Engage with HNWIs on Tax Compliance

The OECD published in 2009 a report aiming to improve tax administrations' understanding of the HNWI taxpayer segment, including tax planning strategies used by HNWIs (OECD, 2009). The report also details detection and response strategies that tax administrations can adopt.

The report recommended that governments should consider applying the concept of cooperative compliance to HNWIs (OECD, 2009, pp. 53-63). Similar to other cooperative compliance programs for corporations, enhancing cooperative compliance by HNWIs should ensure their compliance while providing them with greater tax certainty and safeguarding confidential information. The OECD envisages that, in most cases, the dialogue would be between the tax authority and the HNWIs' tax advisers (OECD, 2009, 53-54).

The report considered offering a comprehensive program for HNWIs that would be similar to the U.S. CAP (i.e., a voluntary pre-filing program). However, the report concluded that it would be premature to recommend adopting such programs at that stage because it was unclear (based on the relatively new experience with CAP in 2009 when the report

[39] The Australian Black Economy Taskforce (2017) has recommended that Australia should adopt a "trusted taxpayer" program for businesses which operate cash-free in order to incentivize small businesses to adopt non-cash business models by offering several benefits such as a lower installment rate and simplified reporting. Nigel Jemson (2019) presented a similar proposal for small businesses in New Zealand under which participating small businesses that are mostly cash-free would give the tax authority real-time access to their financial information through an approved accounting software in exchange for a lower tax rate.

was published) whether such programs would be beneficial and attractive for tax authorities and HNWIs.[40]

The report recommended improving certain aspects of co-operative compliance. It recommended establishing dedicated HNWI units within the tax administrations that would be the designated contact points for HNWIs. It also mentioned the use of individual rulings to increase tax certainty, noting, however, the low demand by HNWIs for individual rulings (OECD, 2009, pp. 58-61).

Following the OECD (2009) report, IMF researchers also recommended considering a cooperative compliance approach to HNWIs (Buchanan and McLaughlin, 2017). There have been other proposals to promote compliance among wealthy taxpayers by granting them reputational rewards (e.g., by labeling them as 'honest taxpayers'; Gangl and Torgler, 2020, pp. 136-137).

OECD (2017a) noted that one-third of the 55 jurisdictions surveyed reported having units or programs for HNWIs, which mostly focus on audit. It stated that "[t]he establishment of dedicated HNWI units by tax administrations reflects the recognition that a small number of taxpayers are typically responsible for a disproportionate share of the wealth and assets held within the economy…. This concentration of wealth and income, with its significant tax implications, is likely to see more tax administrations establishing HNWI units and/or programmes in the coming years" (p. 58). However, it appears that only a few countries have cooperative compliance programs for HNWIs.[41]

C. ICAP

ICAP could be described as a multi-jurisdictional cooperative compliance program which provides participating MNEs more tax certainty with respect to international tax matters. The OECD's project on base erosion and profit shifting (BEPS) has increased the tax uncertainty for MNEs.[42] As a result of country-by-country (CbC) reporting and other

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[40] The report noted the following reasons: (a) similar programs for corporations are rather new, and therefore tax authorities may not know if the CAP model is generally successful; (b) this program might increase the tax administration resources (c) it is uncertain what would be the update of this program; and (d) there is a risk that such programs would create a public perception that HNWIs receive a special treatment from the tax authorities. OECD, 2009, pp. 56-57.

[41] These countries include the Netherlands (OECD, 2017a, p. 59) and Romania (OECD, 2019c, p. 53).

[42] OECD (March 2017) lists several factors that contribute to tax uncertainty: the increased internationalized nature of business activities, the emergence and spread of new

international tax developments, tax authorities have more information about MNEs' worldwide operations (OECD, 2015).[43] Tax authorities may use this information to claim more taxing rights to MNEs' income. As a result, there is a higher risk of disputes between tax authorities and MNEs, as well as disputes between tax authorities of different jurisdictions where different jurisdictions claim taxing rights to the same MNE income (Hanlon, 2018). In addition to risks related to CbC reporting and transfer pricing, MNEs have been facing other international tax risks, which may concern permanent establishments, hybrid mismatch arrangements, treaty benefits, withholding taxes, etc. (OECD, 2019d, p. 18).

The OECD introduced ICAP with the aim to increase multilateral cooperation between tax authorities and tax certainty for participating MNEs.[44] ICAP is described by the OECD as a "voluntary programme for a multilateral co-operative risk assessment and assurance process" (OECD, 2019d, p. 5).[45] The first ICAP pilot was initiated in January 2018 with the participation of eight jurisdictions (OECD, 2018b).[46] The second ICAP pilot launched in March 2019 with the participation of 17 jurisdictions and is currently underway.[47]

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business models (such as the digital economy), unilateral and fragmented policy and court decisions, and the BEPS project transition.

[43] An MNE's CbC report shows the following information for each of the jurisdictions where the MNE conducts business: revenues divided into revenues from related and unrelated parties, profit (loss) before income tax, income tax paid (on cash basis), income tax accrued in the current year, stated capital, accumulated earnings, number of employees, and tangible assets other than cash and cash equivalents.

[44] The OECD lists six key drivers for the introduction of the ICAP risk assessment and assurance process. The first driver is to improve tax certainty for MNEs. This follows the G20's agenda to promote measures that increase tax certainty. The second driver is to improve dispute resolution by resolving potential disputes through the ICAP so fewer disputes will arise. This could reduce the need for agreement procedures (MAP) and other forms of dispute resolution. The third driver is to utilize well-established MNE compliance frameworks and best practices. The fourth driver is to advance international collaboration. The fifth driver is to improve and standardize the information for transfer pricing risk assessment. The sixth driver is to provide more assurance to tax administrations by capitalizing on greater opportunities for multilateral engagement. OECD (2019d), pp. 5-6. For an in-depth discussion of ICAP, see Russo and Martini (2019); Hein and Russo (2020).

[45] For further discussion on risk assessment in the context of cooperative compliance, see de Widt and Oats (2017).

[46] The jurisdictions are Australia, Canada, Italy, Japan, the Netherlands, Spain, the United Kingdom and the United States. *See* the OECD webpage https://www.oecd.org/tax/forum-on-tax-administration/international-compliance-assurance-programme.htm.

[47] The jurisdictions are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, Norway, Poland, Russia, Spain, United Kingdom, and United States.

ICAP is designed to facilitate a multilateral process that can increase tax certainty, reduce the risk of disputes or resolve them at an early stage, and reduce compliance and implementation costs by following clear procedures and templates and resolving issues in a multilateral manner.[48] Tax administrations could spend less on enforcement efforts targeting ICAP participants and more on other taxpayers Tax authorities may also benefit from MNE cooperation and disclosure of information that goes beyond the statutory obligations (Russo and Martini, 2019, p. 460).

Two recent case studies of MNEs that participated in the first ICAP pilot provide initial evidence that ICAP succeeds in achieving its goal of increasing tax certainty through a multilateral process (Stanley-Smith, 2019a, 2019b). Joe Stanley-Smith, the author of these case studies, noted that "[w]hat companies love about ICAP is that it gives them advance certainty in multiple countries in the often uncertain area of transfer pricing. It does this more quickly and comprehensively than other options like advance pricing agreements (APAs) and tax rulings (or 'comfort letters')" (Stanley-Smith, 2019c). As areas for improvement, some MNEs noted that the process in the first pilot took longer than expected, and that certain tax administrations could have improved their internal communication (Stanley-Smith, 2019d).

The ICAP process includes four stages: pre-entry, scoping, risk assessment and issue resolution, and outcomes. The pre-entry stage starts when an MNE voluntarily indicates its interest to participate in ICAP to the tax administration in the jurisdiction of the MNE's ultimate parent entity (the "UPE tax administration") (OECD, 2019d, p. 21). Tax administrations may also approach relevant MNEs to discuss their possible participation. To participate in ICAP 2.0 pilot, MNEs were required to contact the relevant UPE tax administrations by 30 June, 2019. The MNE and the UPE tax administration should discuss whether the UPE tax administration agrees to act as "lead tax administration," which is the tax administration that leads the ICAP process. The discussion should also identify the "proposed covered tax administrations, covered periods and any covered risks the MNE would like included in its ICAP risk assessment in addition to transfer pricing risk and permanent establishment risk" (OECD, 2019d, p. 12). The UPE tax administration, if it agrees to assume the role of a lead tax administration, should then contact other relevant jurisdictions to enquire

[48] OECD (2019d) lists the following as the anticipated benefits from ICAP: (a) "Fully informed and targeted use of CbC reports and other information held for risk assessment", (b) "An efficient use of resources", (c) "A faster, clearer route to multilateral tax certainty", (d) "Co-operative relationships between MNEs and tax administrations", and (e) "Fewer disputes entering into MAP" (pp. 6-7).

whether they agree to act as "covered tax administrations" in the ICAP risk assessment of the relevant MNE. At this stage, MNE should provide high-level information using certain templates (OECD, 2019d, pp. 39-40).

The scoping stage begins when the MNE submits the so-called "scoping documentation package," which includes the most recent CbC report and master file, as well as standard ICAP templates provided to the MNE by the lead tax administration. The scope of the ICAP risk assessment may include various international and cross-border tax risks, such as transfer pricing risks, permanent establishment risks, and other categories of tax risks as agreed by the relevant jurisdictions and the MNE. Each of these risks may comprise of various transactions. The OECD refers to these risks and transactions as covered risks and covered transactions. After the scoping documentation package is submitted, the relevant tax administrations should discuss and agree on the scope of the ICAP risk assessment, the target timeline for the risk assessment, and any special information requirements (OECD, 2019d, pp. 18, 40-42).

The risk assessment and issue resolution stage, according to the OECD, is "at the heart of ICAP, and involves a multilateral risk assessment and assurance of the covered risks by the lead tax administration and other covered tax administrations" (OECD, 2019d, p. 13). This stage, which starts when the MNE submits the main documentation package, typically includes one or more multilateral meetings or calls between the lead tax administration, the covered tax administrations, and the MNE. The lead tax administration and the covered tax administrations should communicate until each of them can conclude either that the covered risks are low or that it cannot reach such a finding. This stage should normally be concluded in less than 20 weeks. The ICAP process can be used to resolve disagreements between the MNE and the relevant jurisdictions regarding the appropriate tax treatment of the covered transactions in question. This issue resolution process enables resolving potential disputes as part of the ICAP process (OECD, 2019d, pp. 13, 40-42).

At the outcomes stage, the lead tax administration should issue to the MNE a completion letter confirming the conclusion of the ICAP risk assessment process. Each of the covered tax administrations should provide the MNE with an outcome letter which should include the relevant tax administration's risk assessment and assurance concerning the covered risks in the covered periods. The outcome letter should reflect situations where a covered tax administration is unable to reach a conclusion with respect to a covered risk or cannot determine that the risk is low. This stage should be concluded in four to eight weeks (OECD, 2019d, pp. 13-14).

IV. PROPOSAL FOR A COMPLIANCE PASSPORT PROGRAM

This article proposes a new cooperative compliance program for HNWIs, family trusts, and private investment vehicles. Under this program, the authorities of the relevant jurisdictions would determine whether the participant is in full compliance with their tax obligations and whether there are any money laundering concerns. Similar to ICAP, this program is intended to cover multiple jurisdictions in a multilateral manner, although it could also be offered by one jurisdiction. A successful participant would be granted a "Compliance Passport" documenting the finding of compliance. A Compliance Passport holder will be able to present this document to FIs, authorities, and other parties in order to show its compliance in the jurisdictions that granted the Compliance Passport.

A. Process

The multilateral process under the proposed program could be structured similarly to ICAP with stages including pre-entry, scoping, compliance review, and issuance of a Compliance Passport. After the issuance of a Compliance Passport, the compliance status should be reviewed periodically. In order to conduct a coordinate process within a reasonable time, the program should provide a time frame for each stage, similar to ICAP.

<u>Stage I. Pre-entry</u>

An individual taxpayer, a trustee (in respect of a trust) or a director (in respect of a company) could contact a tax authority that acts as a lead tax administration to initiate the process. A lead tax administration could be the tax authority of the tax jurisdiction of the individual (in the case of an individual participant) or the tax jurisdiction of the individual who is the primary beneficial owner (in the case of a company or a trust). Alternatively, the lead tax administration could be the tax authority of the jurisdiction where most of the underlying assets are located.

If the relevant tax authority agrees to act as the lead tax administration, the next step would be to identify the potential covered tax administrations. These would include the tax authorities of the following jurisdictions: the jurisdictions of tax residence of the beneficiaries; the jurisdictions where the assets are located; the jurisdictions where the relevant entities are organized; and the jurisdictions where the relevant entities are resident for tax purposes.

The program could also be applied by one tax authority of one jurisdiction only. A single-jurisdiction Compliance Passport could help

individuals and private investment vehicles when they hold assets and carry out activities in other jurisdictions. Such other jurisdictions could be added to the Compliance Passport after their tax authorities conduct the required review.

At this stage, the participant should provide basic information, such as a list of assets, beneficial owners, a description of the relevant structure, a trust deed for a trust, and articles of association for a company.

Stage II: Scoping

The standard scope should include tax compliance risks and money laundering risks for a specific number of years (e.g., three years). However, the relevant jurisdictions could change the scope if so agreed. The relevant tax issues in the scope would depend on the domestic tax laws of the relevant jurisdictions and the applicable tax treaties. For example, the tax issues in the scope could include the tax status and residency of individuals, trusts, and entities, the application of controlled foreign corporation rules and other anti-deferral regimes, tax obligations of beneficial owners and other parties, withholding obligations, and treaty benefits.

Stage III: Compliance review

As part of this stage, the participant should provide documents, certifications, and information that shows it has been compliant with their tax obligations and that it has not been involved in money laundering. The participant could be required to provide the following information: financial accounts; history of distributions, gifts, loans, asset transfers, and transactions; information regarding the source of funds, assets, businesses, and investments; and tax returns filed in the relevant jurisdictions. The relevant jurisdictions could raise issues and questions with the participant.

The compliance review could be done by the relevant authorities: the tax authorities in the relevant jurisdictions could review the tax compliance and the authorities in charge of AML enforcement could review the money laundering risks. Alternatively, the compliance review could be done by third parties appointed by the authorities. For example, accounting firms or other service providers could confirm compliance with the relevant legal obligations and assess the money laundering risks. The cost of such third parties could be borne by the participants.

Engaging such third parties could be a practical solution where the relevant authorities do not have sufficient resources to administer the program. Also, using third parties could ameliorate privacy concerns where such parties can safeguard the information obtained through this program

better than the relevant governments. Subparts C and D below elaborate on the considerations of the compliance review.

Stage IV: Issuance of a Compliance Passport

After completing the compliance review successfully, the lead tax administration should issue a Compliance Passport to the participant. Each of the covered tax administrations that endorses the issuance of the Compliance Passport should be identified in this document. The Compliance Passport would note that the participant is in full compliance with their tax obligations in the relevant jurisdictions and that no money laundering concerns have been identified.

Stage V: Periodic review

There should be a periodic review of the compliance status after a specified period (e.g., three years). The periodic review should likely be less rigorous than the compliance review in stage III, although it should identify whether there are material changes in the tax compliance and AML risks. Upon completing the periodic review successfully, the Compliance Passport should be renewed.[49]

B. Other Design Considerations

The eligibility criteria for the proposed program should be flexible. Individual taxpayers, family trusts, and private investment vehicles (including foundations, companies, partnerships and other entities) should be able to participate in this program. Parties that are subject to international sanctions should not be eligible to participate in the program. The lead tax administration should check as part of Stage 1 whether the primary beneficial owner and the relevant individuals and entities are subject to any international sanctions.

When an individual taxpayer participates in the program, there would be a need to review entities in which the individual has a substantial beneficial interest. For example, assume that an individual owns a private investment vehicle through which various investments are held. To confirm that individual's tax compliance and assess the money laundering risks, the private investment vehicle should be reviewed. Similarly, in order to confirm that a trust or another private investment vehicle is tax compliant and that there are no money laundering concerns, the review of other parties

[49] A participant could choose not to renew its Compliance Passport and then there should be no periodic review. However, dropping out of this program might trigger scrutiny as to the reason for this decision because it might indicate that the participant's past or future actions raise tax or money laundering concerns.

might be required. For example, as the settlor is typically the person who transfers assets into a family trust, reviewing the trust's source of funds should likely require information about the settlor and how he obtained the relevant assets. Therefore, the review should be holistic and cover all relevant persons, entities and assets that need to be reviewed in order to ensure the compliance of the participant in the program.

It is unclear whether the tax authorities' cost of administering the program is higher than the potential cost-saving from the program because of fewer audits and disputes, increased compliance, and greater cooperation. If the cost of administering the program is higher than the cost-saving, the net cost could be borne by the participants by charging fees that would cover the program's cost. Each tax administration could determine its fees based on the estimated costs of the case, although it would be advantageous to standardize the applicable fees. The fees should be communicated by the lead tax administration to the prospective participants as part of stage I above. As the program is voluntary, potential participants will choose to participate only if their expected benefits from the program exceed the costs. One possible model for this would be the IRS' user fees for applicants for advance pricing agreements (APAs).[50]

Similar to ICAP, this program could be initially offered as a pilot by one jurisdiction or several jurisdictions. These jurisdictions could include members of the Forum on Tax Administration, offshore financial centers, and other jurisdictions.

C. Review of Tax Compliance

Under this proposal, the tax authorities of the relevant jurisdictions will determine whether the participant has been in full compliance with their tax obligations based on the information the tax authorities have. This determination is not a pre-filing review but a review of the fulfillment of the tax obligations in a specified past period (e.g., the past 5 years). Also, the tax authorities should reach a finding of compliance where there have been no tax obligations including reporting obligations.

For example, consider the facts of Example 1 above: a family trust was settled by a Hong Kong citizen and tax resident who has the power to revoke the trust. The applicable law is the law of the Cayman Islands. The

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[50] See IRS, Rev. Proc. 2015-41 (Procedures for Advance Pricing Agreements). Retrieved from https://www.irs.gov/pub/irs-drop/rp-15-41.pdf. The current user fee for an initial original APA is $113,500 (Wrappe and Kramer, 2020). The applicable fees of the proposed program should be determined based on the expected costs of the relevant tax administrations.

trustee is an individual, a French tax resident, who has no beneficial interest in the trust. The trust has a protector, an Australian tax resident, who has no beneficial interest in the trust. The trust holds its assets through a company organized in the British Virgin Islands. The trust has discretionary beneficiaries in the United States and Canada. The trust's main asset, held through the company, is a bank account with a balance of 10 million US dollars in Hong Kong. The trust has never made any distribution to the discretionary beneficiaries. The trust and the company are classified as passive non-financial entities (Passive NFE) under FATCA and CRS. The trust is classified as a foreign grantor trust under U.S. tax law.

After presented with these facts and supporting documents, the tax authorities in all relevant jurisdictions (Hong Kong, Cayman Islands, British Virgin Islands, France, Australia, United States, and Canada) should be able to confirm that all the relevant parties (the settlor, trust, trustee, company, protector, and beneficiaries) have not been subject to any tax obligations.

As part of the compliance review, the tax authorities could choose whether to carry out a full audit or to rely on the representations, responses, and evidence provided by the participants. If a tax authority later finds that the information it relied upon during the compliance review is incorrect, it should be able to revoke the Compliance Passport, notify the other relevant jurisdictions, and assess taxes and penalties, including potential penalties for providing incorrect information to the tax authority.

D. Review of Money Laundering Risks

In general, there are four core elements in AML CDD: "(1) Customer identification and verification, (2) beneficial ownership identification and verification, (3) understanding the nature and purpose of customer relationships to develop a customer risk profile, and (4) ongoing monitoring for reporting suspicious transactions and, on a risk-basis, maintaining and updating customer information."[51]

Following the FATF recommendations' risk-based approach, the CDD obligations are greater when the risk is higher and vice versa (FATF, 2019). Under this proposal, the relevant governmental authorities (directly or through third parties engaged by them) will conduct a review that overlaps three out of the four core elements of CDD: identification and

[51] U.S. Department of the Treasury, Financial Crimes Enforcement Network, 31 CFR Parts 1010, 1020, 1023, 1024, and 1026, RIN 105-AB25, Customer Due Diligence Requirements for Financial Institutions, Final Rules, 29398 Federal Register, Vol. 81, No. 91 (May 11, 2016), https://www.govinfo.gov/content/pkg/FR-2016-05-11/pdf/2016-10567.pdf

verification of the beneficial owners and the relevant parties/entities, as well as an analysis of the participant's money laundering risks based on an in-depth review of the source of funds, business, structure, and other relevant factors. As the relevant authorities will not carry out an ongoing monitoring of transactions, their review of the money laundering risks will not overlap the fourth core element of "ongoing monitoring for reporting suspicious transactions."[52]

How should FIs apply the AML requirements to Compliance Passport holders? It is suggested that FIs[53] will continue to satisfy the four core elements of CDD with respect to Compliance Passport holders. However, following the FATF recommendations' risk-based approach, Compliance Passport holders should generally be considered as posing lower money laundering risks than similar parties who have not been subject to a similar review.

Practically, there should be no change in the first two core elements of identification and verification of the customers and beneficial owners.[54] As part of the third core element, at the onboarding stage, a Compliance Passport holder should generally be considered as posing a low risk by FIs, especially if these FIs are in the jurisdictions that granted the Compliance Passports. Such FIs should still require information about the source of funds, the structure, business operations, activities, and other relevant factors because they would need to understand these facts in order to effectively monitor transactions. However, the onboarding process should be simpler and quicker where the FIs can consider the Compliance Passport holder as posing a lower risk from a money laundering perspective.

FIs should carry out the fourth core element of ongoing monitoring for reporting suspicious transactions and maintaining and updating customer information on a risk-basis (which should be considered as lower risk). FIs can consider the low-risk assessment of a Compliance Passport holder when determining whether a transaction is suspicious. For example, assume that an offshore company held under a family trust transfers a substantial amount of cash between accounts in different jurisdictions, and this cash is from the trust fund that has been reviewed by the relevant authorities as part of the compliance review. An FI reviewing this

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[52] The relevant authorities can review the transactions as part of the periodic review, but this will not be a real-time review similar to the monitoring conducted by FIs.

[53] In addition to FIs, there are certain designated non-financial businesses and professions that are required to carry out CDD. The references to FIs in this discussion also refer to these parties.

[54] FIs needs to first identify the customers and beneficial owners before considering the effect of these parties having a Compliance Passport.

transaction might identify it as suspicious because it involves an offshore entity that transfers of an unusual amount of cash across jurisdictions. However, the FI could also consider the fact that this trust (including the offshore company and the trust fund) has been reviewed by the relevant authorities. This could be considered as a non-conclusive factor supporting the finding that this transaction is not suspicious. Of course, it is still possible that parties with Compliance Passport could be engaged in money laundering, so there should be effective monitoring and reporting of suspicious transactions.

This proposed program should achieve the goals of the AML regime following the FATF recommendations. Under the current AML rules, FIs carry out CDD to identify money laundering risks and report suspicious transactions to the authorities who then investigate them. Under the proposed program, the relevant authorities (or third parties appointed by them) will assess the money laundering risks, and if they find that there are no money laundering concerns they will issue a Compliance Passport. Following the FATF recommendations' risk-based approach, FIs should be able to rely on this low-risk assessment which could simplify the AML compliance by FIs, although they would still be required to monitor and report suspicious transactions. This proposal is consistent with the AML framework as implemented by countries following the FATF recommendations.

E. Why Covering Both Tax and Money Laundering Risks?

It is possible to set up a cooperative tax compliance program for HNWIs, family trusts, and private investment companies without including reviewing the money laundering risks in the program. Similarly, it is possible to offer a cooperative compliance program covering only money laundering risks. Why would it be advantageous for the proposed program to cover both tax and money laundering risks?

The answer is twofold. First, the tax compliance issues and the money laundering issues are closely related, and there would be potential synergy gains from addressing both tax and money laundering risks in one program. Both the tax reporting regimes and the AML regime impose obligations on FIs to satisfy certain due diligence requirements and report information about account holders to government authorities. Under both regimes, governmental authorities use the information received to identify tax noncompliance or other financial crimes. In many jurisdictions, tax evasion is a predicate offense for money laundering, which means that dealing with the proceeds of tax evasion could constitute money laundering (Storm

(2013); Foo (2019). Therefore, a cooperative compliance program covering both tax and money laundering risks could be more efficient and effective than separate programs where one covers tax and the other covers money laundering risks.

Second, from the participants' perspective, a program that covers both tax and money laundering risks would be more valuable because it would address more related problems. The costs and risks discussed in Part II arise from the tax reporting and AML regimes. Therefore, having a program that covers both tax and money laundering risks would better reduce these costs and risks. This would create a stronger incentive for potential participants to participate in the program.

However, administering a combined tax-AML program could raise some challenges. A program covering both tax and money laundering risks would require coordination between tax authorities and the authorities that enforce AML laws which are typically law enforcement units. A program that involves two governmental authorities in each country would likely be costlier and harder to implement than a program that only involves one authority in each jurisdiction. Also, the authorities that enforce AML laws typically investigate suspected crimes; they do not conduct a CDD-like review (as suggested in this article) because this review is typically carried out by FIs and other parties that alert the relevant authorities only where a suspected transaction has been identified.

Although we believe it would be beneficial to offer a program addressing both tax and money laundering risks, policymakers could consider implementing a program with a narrower scope. If policymakers find that it is not feasible or desirable to have a program covering both tax and money laundering risks, a cooperative tax compliance program for HNWIs, family trusts, and private investment vehicles should be considered.

F. Potential Advantages for Participants

1) Privacy

Policymakers should consider amending the transparency regimes to provide Compliance Passport holders with a greater protection to their privacy. Where the relevant authorities have concluded that a Compliance Passport holder is in full compliance with their tax obligations and that no money laundering concerns have been identified, there is less need for information collection, sharing, and disclosure. In such situations, the interest of protecting legitimate privacy concerns should be stronger than

the public interest in transparency. Therefore, there should be a different balance between privacy and transparency with respect to Compliance Passport holders.

For example, beneficial owners who are Compliance Passport holders could be exempted from disclosure in public beneficial ownership registers. Their identities could be kept in a private register which would be accessible by governmental authorities upon request. As a result, the Compliance Passport holder's privacy would be protected while addressing the tax and money laundering risks.

The approach that not all beneficial ownership information should be publicly accessible has been suggested by the United Kingdom with respect to trusts (HMRC, 2020). In a consultation in early 2020, HMRC proposed that obliged entities[55] should not have direct access to the governmental trust register. Instead, when obliged parties enter into a new business relationship with a trust, the trustee would provide these parties with the required registration information. HMRC noted that "[t]his means that the trustee has control over who sees the information" (HMRC, 2020, § 4.29). Following a similar approach, it is possible to limit the public access to the information of Compliance Passport holders.

Another example concerns the AEOI reporting of trust protectors, which is generally required even where the protector does not have any beneficial interest in the trust. Where a trust holds a Compliance Passport, it is possible to consider exempting the reporting of protectors.[56] This, also, would provide better protection to legitimate privacy interests where there is little public benefit from information collection and exchange.[57]

Notably, participants in the program might be required to provide the relevant tax authorities more information than what they already obtain. The disclosed information should be kept confidential, but as noted above, there is a risk of leaks, hacking, and other privacy-related issues. If the information disclosed as part of this program is not protected properly, participating in the program could result in higher risks for privacy. Therefore, governments that cannot be trusted to keep the information confidential should not be allowed to participate in this program. Also, as

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[55] These entities (which include financial institutions and other parties that need to conduct AML customer due diligence) are required to collect from the trust a proof of its registration or an excerpt of the register.

[56] A similar exemption could also apply to trustees of trusts holding Compliance Passports.

[57] However, if this information is disclosed to the tax authorities as part of the review under this program, then the value of excluding the protectors from the AEOI reporting might be limited. This said, avoiding undue investigations will be of considerable value.

noted above, using third parties (such as accounting firms) to carry out the compliance review could ameliorate privacy concerns where such parties can safeguard the information obtained through this program better than the relevant governments.

2) Legal Uncertainty

Similar to ICAP, the Compliance Passport Program is expected to provide greater legal certainty for Compliance Passport holders. The risk for investigations and disputes should be lower where the relevant authorities have already reviewed the participant and found it to be fully compliant.

3) Compliance Costs and Difficulties Doing Business

The Compliance Passport Program has the potential to reduce compliance costs and difficulties doing business. Under AML laws which follow the FATF recommendations, FIs and other parties that conduct customer due diligence must implement a risk-based approach (FATF, 2019). Where the money laundering risk is low, simplified due diligence procedures may be permitted. A Compliance Passport holder should probably be classified as posing a low money laundering risk. This could reduce compliance costs for FIs and other parties. To the extent the current compliance costs are shifted onto the account holders, this could reduce the cost of the relevant financial services. Also, Compliance Passport holders may be able to open financial accounts and transfer funds across jurisdictions more easily. However, participating in this program would entail costs as noted in paragraph 5 below.

4) Distortions of Behaviors and Activities

As the Compliance Passport Program could reduce the costs and the risks discussed above, it has the potential to reduce the distortions caused by transparency regimes. This means that participants' decisions regarding their succession planning, investments, holding structures, types of assets, and location of assets are less likely to be distorted by transparency regimes.

5) Comparing Costs and Benefits

Participating in the programs entails several costs and risks. Participating in the program would require time investment and expenses on professional advisers. There is also a risk that participating in the program would result in finding of noncompliance or other risks that the

participant was not aware of. It is suggested that the participants would bear the net cost of the program if the cost of administering the program exceeds the cost-saving for the tax authorities. Potential participants would participate in this program if the expected benefits outlined above exceed the costs of participating in the program.

G. Potential Advantages for Governmental Authorities

This proposal follows the OECD 2009 report's recommendation to enhance cooperative compliance with HNWIs while providing them with greater tax certainty and safeguarding confidential information (OECD, 2009, p. 53).

The benefits for authorities from this proposal are similar to those of ICAP. This proposal would ensure compliance among the participants through a cooperative process in which the participants provide the requested information voluntarily. Ensuring compliance through audits and investigations might involve higher enforcement costs. Conducting the compliance review in multiple jurisdictions in a multilateral manner can resolve issues more efficiently. This program could free enforcement resources that could be used to investigate other individuals and entities that do not participate in the program. If the net cost of this program would be covered by fees charged to the participants, then the relevant governments are not expected to incur any additional cost from operating the program.

V. CONCLUDING REMARKS

Ensuring compliance among HNWIs is an important policy goal for many tax authorities. The OECD noted that HNWIs "pose significant challenges to tax administrations because of the complexity of their affairs, their revenue contribution, the opportunity for aggressive tax planning… and the impact of their compliance behaviour on the integrity of the tax system" (OECD, 2009, p. 5). At the same time, many governments have been implementing cooperative compliance programs, typically for large corporations.

The proposal outlined in this article applies the cooperative compliance approach to HNWIs and their family trusts and private investment vehicles. As these parties typically face challenges in multiple jurisdictions, the proposal here is to adopt a multilateral program, similar to ICAP. Also, as these parties face challenges created by AML laws, this program would address money laundering risks as well as tax risks. This proposal could enhance a culture of cooperative compliance and free

enforcement resources. For participants, this proposal could improve privacy, increase certainty, and reduce compliance costs and distortions.

This proposal is feasible and could be done within the existing international framework. Policymakers could experiment with this proposal by running a pilot program similar to the ICAP pilots. As this proposal has the potential to ensure compliance while reducing costs and risks for both tax authorities and taxpayers, it deserves serious consideration.

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