From LuxLeaks to the Panama Papers: Must We Achieve Complete Transparency in Order to Prevent Illegal Activity?

First, there were the revelations of the LuxLeaks – the leak by an accounting firm employee of confidential information related to previously private Luxembourg tax rulings for more than 300 multinational companies. More recently, there were the Panama Papers – a massive data breach of law firm files detailing various tax planning structures implemented over the last 40+ years by thousands of taxpayers. In both cases, the individuals responsible for the data leaks most likely broke laws in order to release the data. They have separately been reported to state that they did this because essentially they owed it to the rest of society to have this information become public. In the LuxLeaks case, the individual claimed that the leak was in the public interest of all European Union citizens. In the Panama Papers, the anonymous individual who released the data claims that it had to be done due to the "massive, pervasive corruption" that was occurring through tax planning and that global income inequality was resulting from such planning. We are now in a situation where it is socially acceptable (and possibly becoming morally required) to name and shame the tax shirkers – those companies and individuals who are accused of not paying their fair share of tax. Most media reports give the sense that this push towards complete transparency will create a healthier and more sustainable society. But what are we really losing and gaining by this trend?

Lost Privacy

Businesses value their privacy on many levels – from protecting their trade secrets to having a supply chain that maximizes efficiencies better than their competitors. As information related to a company's overall supply chain is laid bare for all the world to see, companies may be concerned that they will lose their competitive edge because competitors can then more easily replicate their business model.

Another way that some companies are trying to better their business model is by reducing the potential regulatory burden in certain jurisdictions. Many offshore financial centers establish "regulation light" regimes to encourage the use of their territory for captive insurance companies, funds or financing vehicles. This enables multinational companies to spend less money complying with heavy compliance regulations and more money on operating the business. That does not necessarily make the use of such a jurisdiction inappropriate, as this approach often makes good commercial sense. Indeed, one could argue that to not take advantage of such an opportunity is failing to act in the best interests of a company or its investors.

Furthermore, businesses have traditionally positioned good tax planning as allowing larger earnings per share, resulting in a more valuable company and bigger shareholder returns. Today, that argument is being eclipsed by the notion that companies have not paid their "fair share" of tax, which is presumably something more than their legally required amount of tax and is supposed to benefit all society, rather than only those fortunate enough to own stocks.

On the individual side, some wealthy or famous individuals feel they can better secure their safety if the scale of their family wealth is hidden from those who would threaten their safety for a share of their wealth. It is also the case that in some parts of the world, what ought to be confidential information held by a government authority, actually ends up being sold by unscrupulous employees of that government for financial gain. Therefore, one can understand a wealthy family's desire to limit public information showing the extent and nature of their wealth. Provided such individuals are paying the tax due in accordance with the local rules, there is a good argument that details of how much money is owned by the wealthy or famous should not necessarily be publicly available.

Benefits of Transparency

Although there are the above mentioned reasons to have privacy in tax planning, the Panama Papers data leak has revealed a weight of evidence that on many occasions secrecy is tied with illegal activity (although, the same was not true of the LuxLeaks). In the vast majority of cases, jurisdictions around the world have signed on to agreements to exchange information. This information is intended to shine a bright light on the offshore affairs of those who use secrecy to facilitate their illegal activity.

Against that background, more than 95 countries have committed to exchanging information with each other under the OECD's Common Reporting Standard (CRS). For the most part, jurisdictions have signed on to the Convention on Mutual Administrative Assistance in Tax Matters, which provides the ideal framework for jurisdictions to automatically exchange information. The CRS Multilateral Competent Authority Agreement sets out the information to be exchanged. Interestingly, the publicity that has arisen from the Panama Papers has led to Panama itself recently agreeing to be part of the common reporting standard (albeit, one of the very last to do so and, it appears, somewhat reluctantly).

As the number of places one can hide money without it being automatically reported to one's home state is reduced, one would expect the bright light of transparency to change behaviors for the better. Having said this, CRS is not a silver bullet. It would be naïve to think that simply because a tax authority will report income to another tax authority it will become impossible to hide money or locate money that emanates from illegal activity.

Finding the Right Balance

While tax evasion in the form of not providing a tax authority complete information about money earned or profits received is illegal, strategic tax planning and tax minimization is not (even if it is unpopular). In an era of citizens being outraged by alleged tax evasion and governments trying to raise more funds to cover basic needs, there will likely be more, rather than less, of a push for transparency to root out tax evasion, and it is likely that legitimate tax planning will be caught up in the mix. As this transparency trend and public shaming continue, we should be mindful that the loss of privacy is not without its costs.

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