Tax Enforcement in a Globalized Economy: The Compliance Effect of Automatic Information Exchange

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Tax enforcement in a globalized economy

Globalization represents a growing challenge for tax enforcement as more taxpayers have income from foreign sources

Third-party information from employers and financial institutions is key for enforcement (Kleven et al. ECMA 2011) but generally not available from foreign sources

Offshore tax evasion through accounts in tax havens with financial secrecy is particularly challenging

Fighting offshore tax evasion with automatic information exchange

Until recently, little enforcement on financial income earned through accounts in tax havens

- personal wealth in tax havens of $6 trillion (Zucman QJE 2013)
- rarely self-reported to tax authorities (Alstadsæter et al. AER 2019)

Highly ambitious reform with global reach: Automatic cross-border exchange of bank information (FATCA, CRS)

- 100+ countries
- €10 trillion of assets

Does automatic exchange of information (AEoI) increase tax compliance on foreign financial income?

Literature

AEoI: Foreign banks as enforcement agents

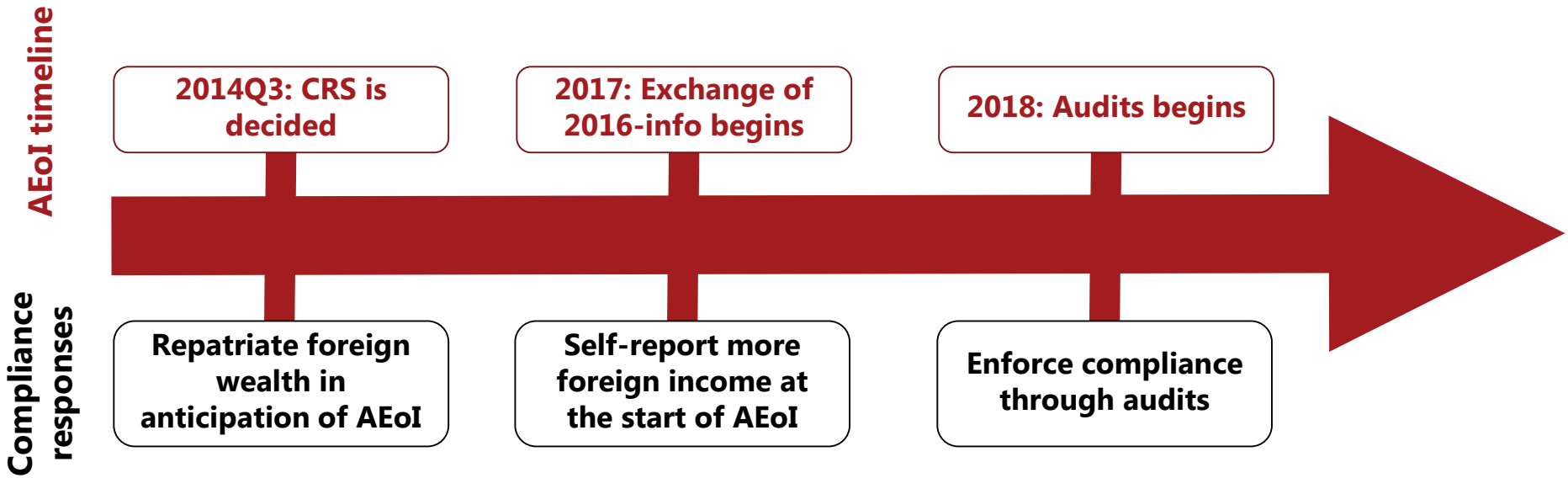
Banks collect information on accounts with foreign owners Regimes

1. Banks must identify the beneficial owners of all accounts held by individuals and most companies
2. Banks collect information on accounts with foreign owners
   - Account balance, interests, dividends, gross proceeds from sales, other income Data Stats
3. Banks share the information with tax authorities in the home countries of the account owner

Limitations:

- Some asset classes are outside the scope (real estate, unlisted shares, gold)
- Limited scope for automated use of foreign reports (no net capital gains, no information about foreign withholding tax)

Compliance responses to the AEoI



This project

Comprehensive analysis of compliance effects of AEoI through all three channels:

1. **Repatriation** of foreign assets in anticipation of AEoI
2. More **self-reporting** following onset of AEoI
3. Better **audits** through use of reports from foreign banks

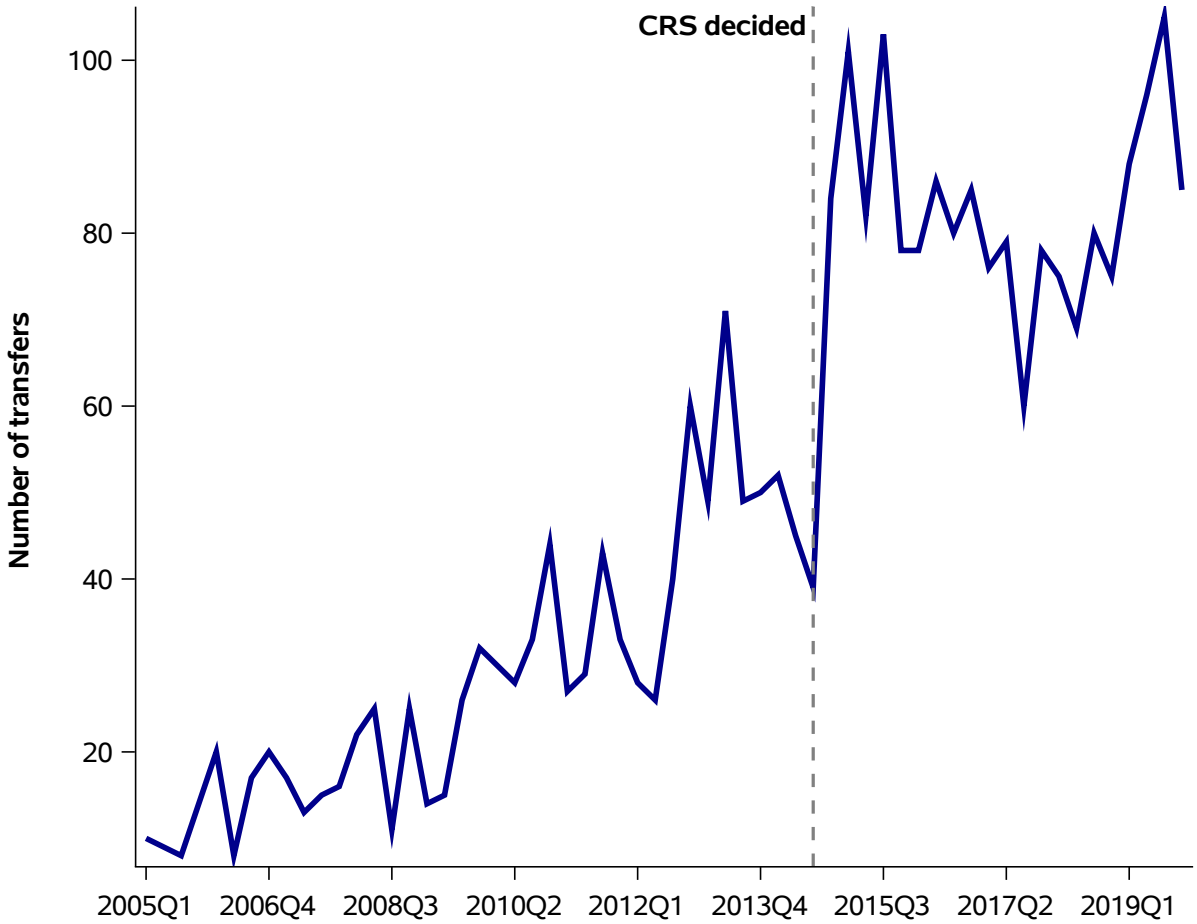
Big collaboration with the Danish tax authorities

Access to Tax returns + CRS/FATCA reports + Cross-border money transfers from ∼50 tax havens since 2005 + Audit experiment w. 500 taxpayers

I. Repatriation

Increase in transfers over DKK 1 million from own foreign accounts after CRS agreement

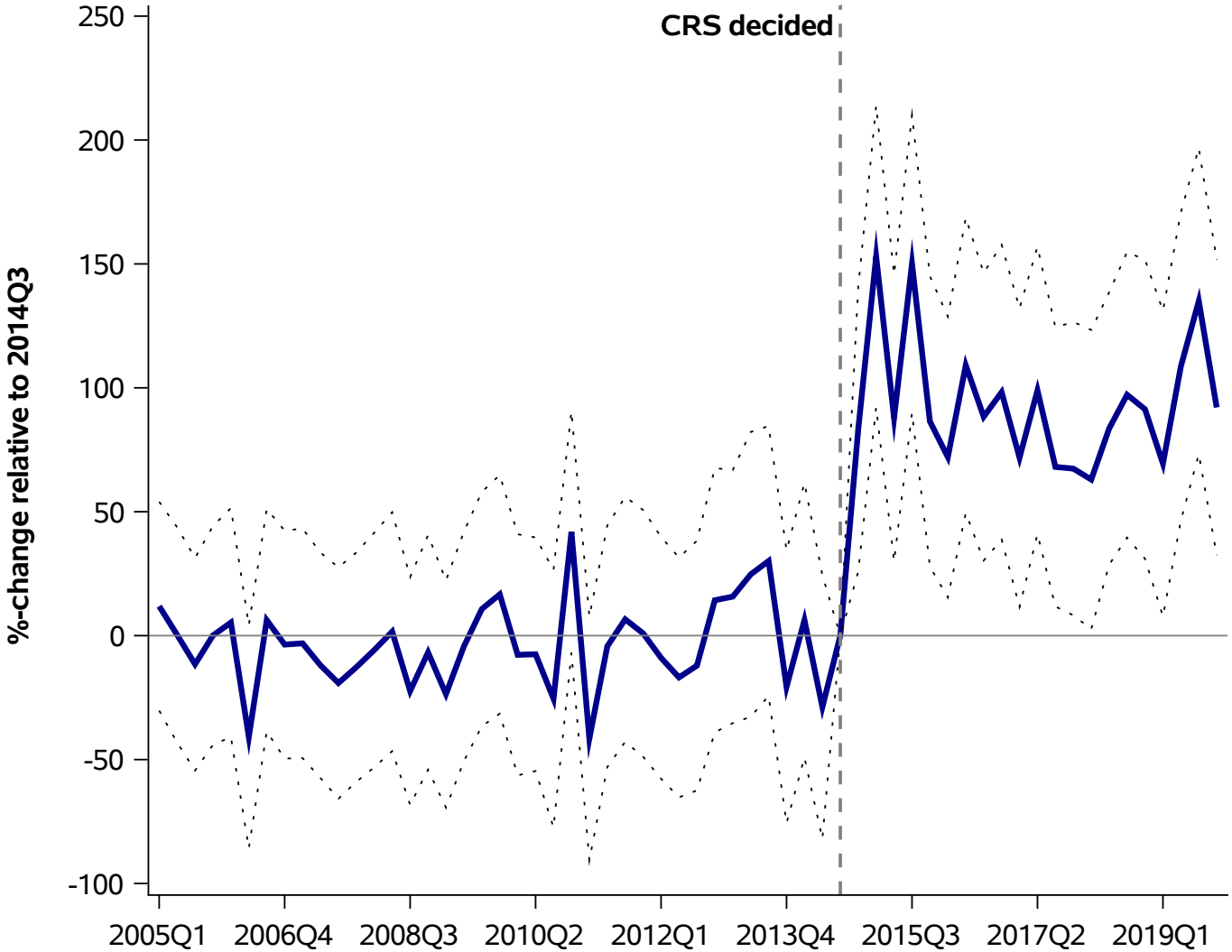
Data



- Average transfer after 2014Q3: DKK 4.3 million

DiD estimate: Own transfers above DKK 1 million rises with ∼120% compared to other transfers after CRS

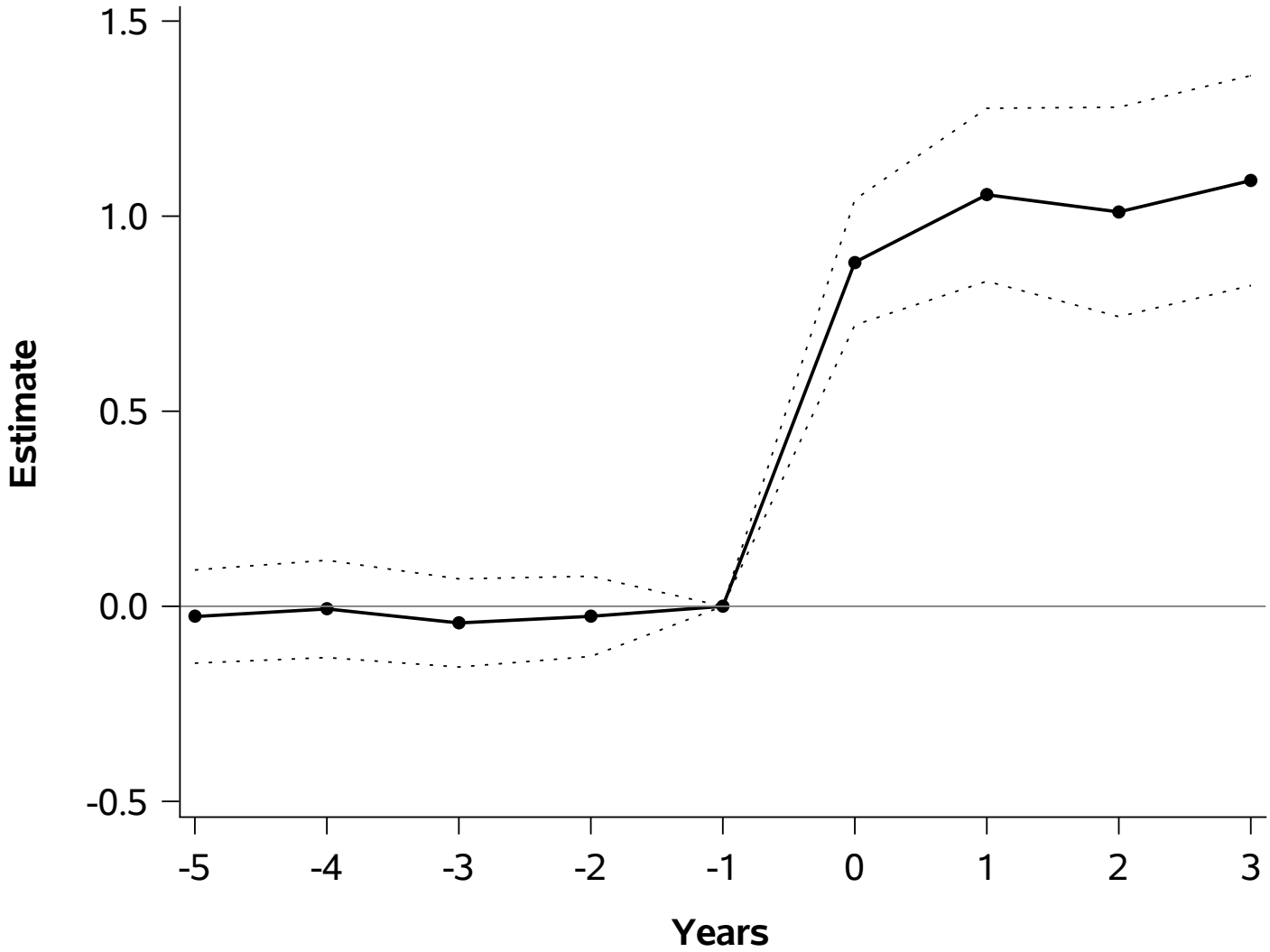
250K-1mil. | 100K-250K | 50K-100K



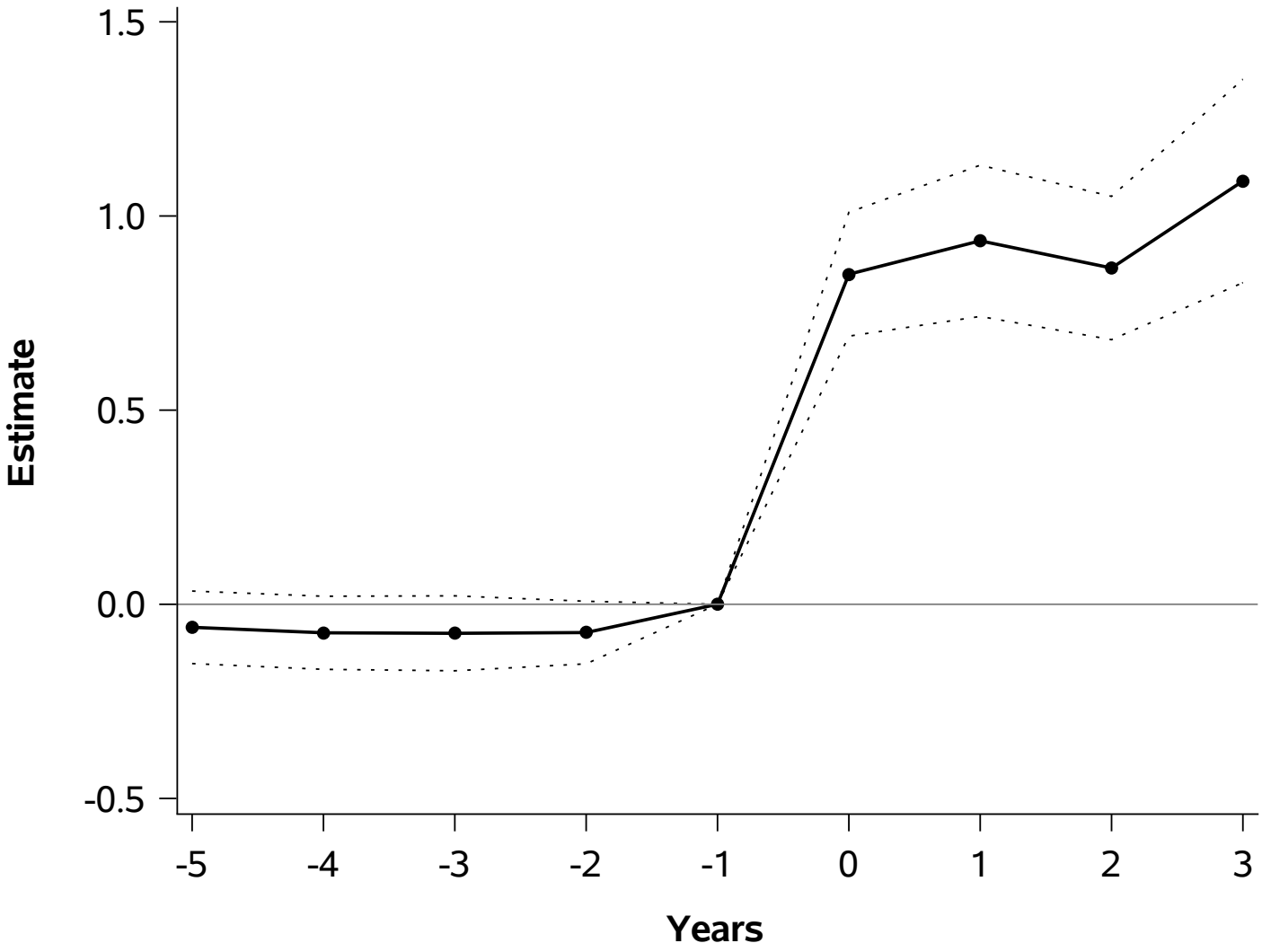
Around DKK 7 billion (∼$1 billion) is repatriated from tax havens in response to AEoI

	Cumulative transfers from tax havens (in DKK billions)			
	Five-year period before 2014q3	Five-year period after 2014q3	Percentage change	Diff-in-diff estimate
Own accounts	5.043	12.171	141%	7.261
Other accounts	8.809	8.577	-3%	

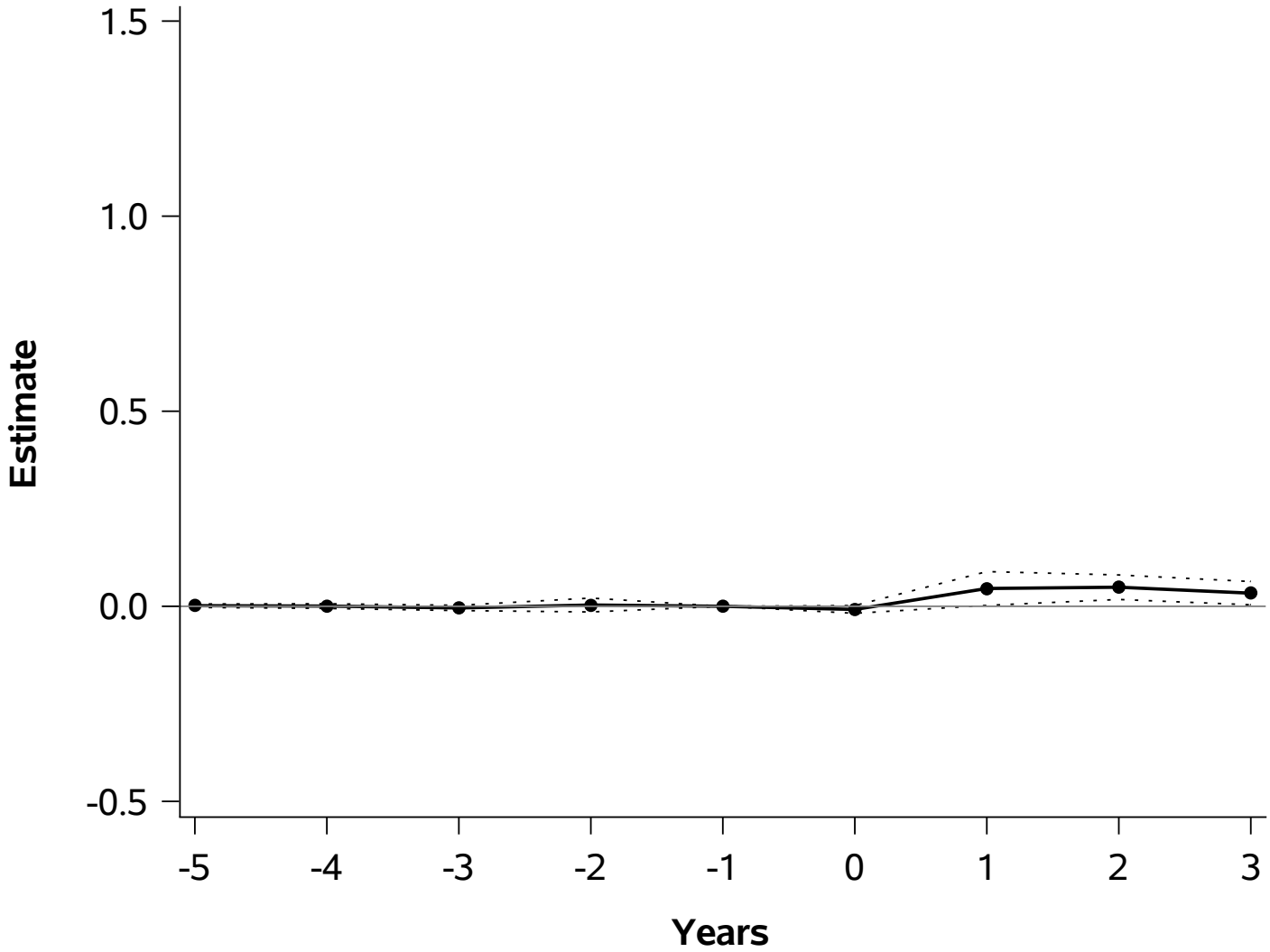
Reported net wealth increases one-to-one with amount repatriated and stays higher



Reported domestic wealth increases accordingly

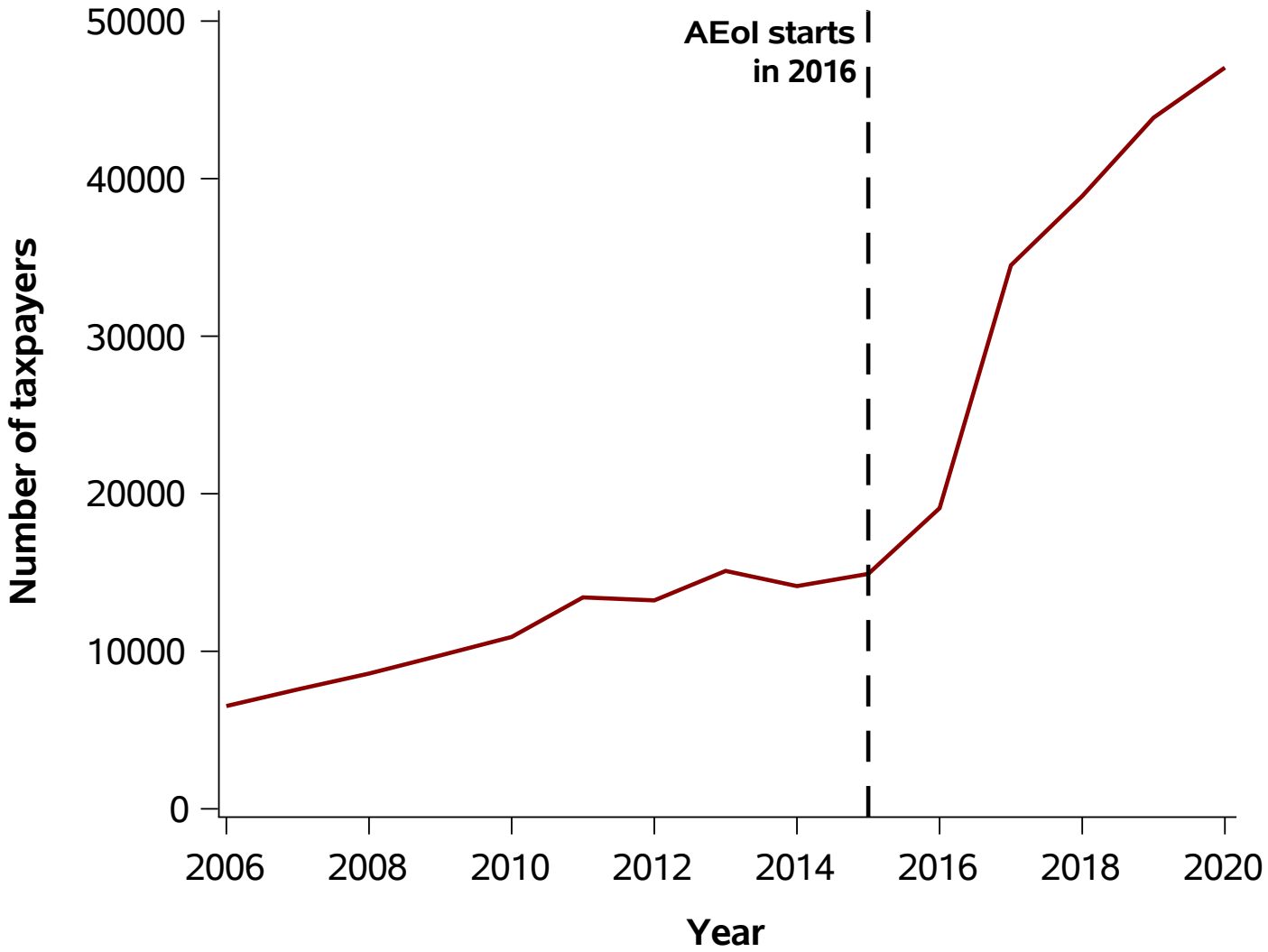


Reported foreign wealth does not decrease - consistent with repatriation of non-compliant assets

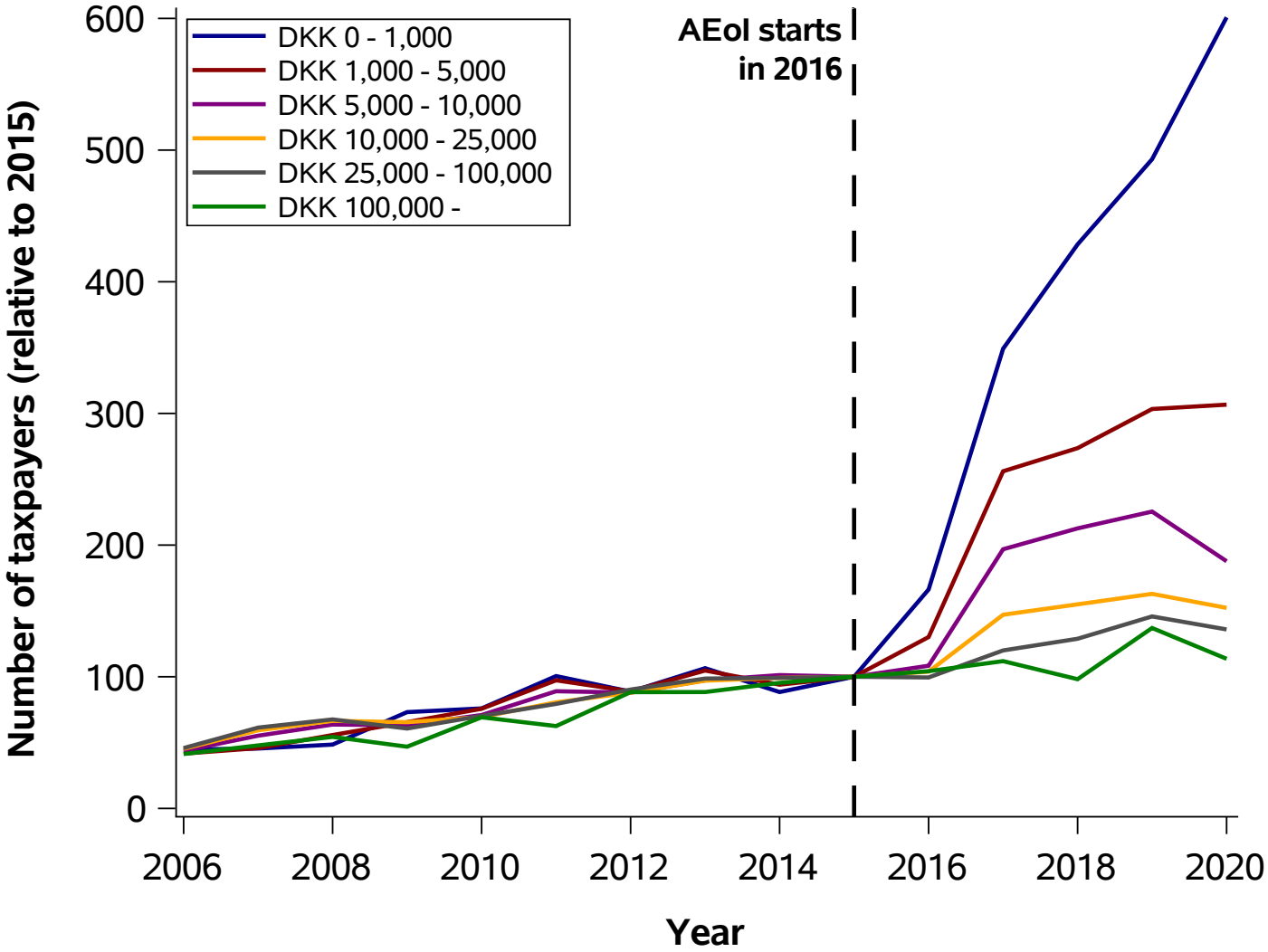


II. Self-reporting

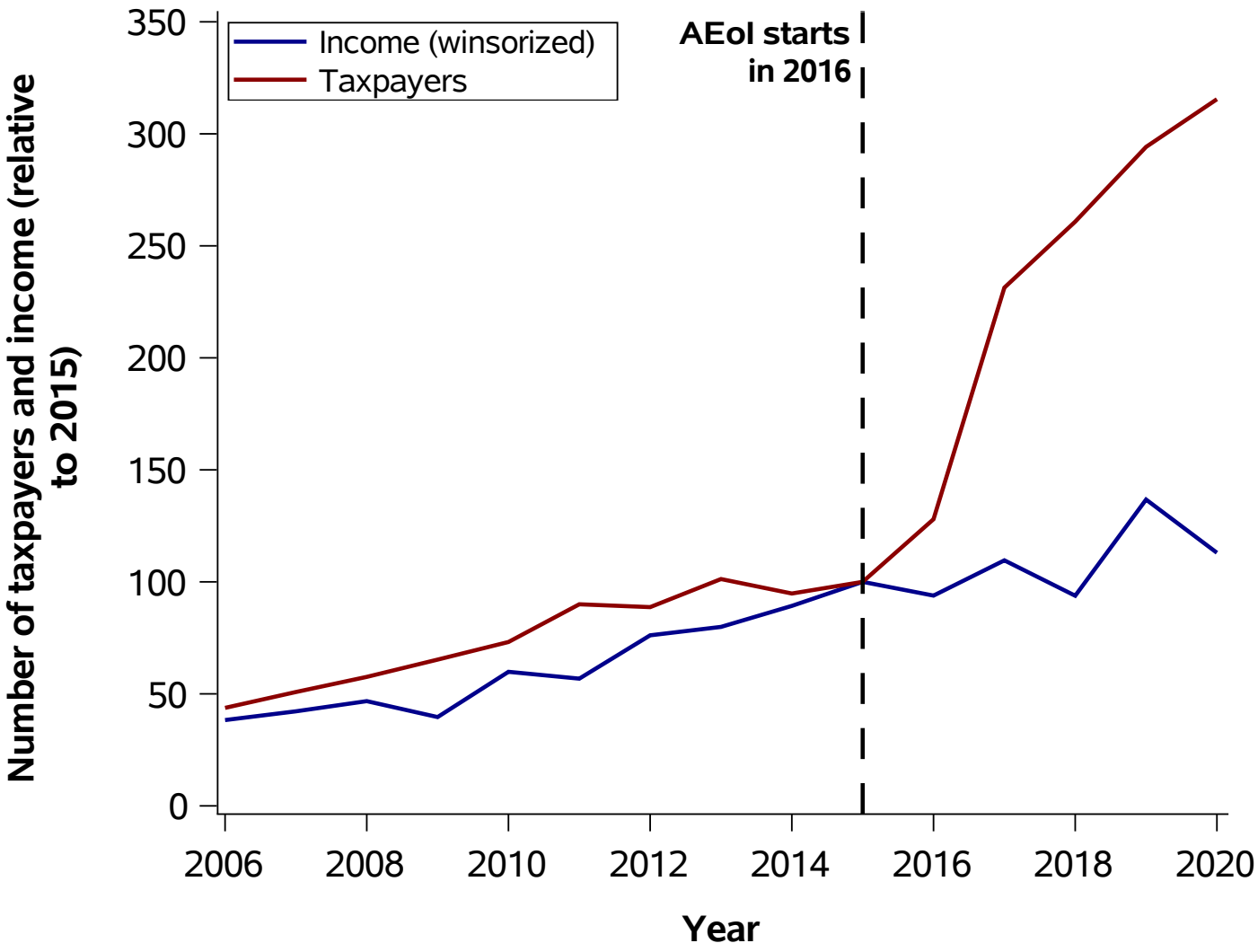
Sharp increase in the number of taxpayers with self-reported foreign income



The increase is driven by taxpayers with low levels of foreign income



Aggregate foreign financial income barely changes



III. Audits

Preliminary audit results

Stratified random sample of 500 taxpayers selected based on Potential Correction of their Foreign Capital Income = CRS - Self-Reported

So far 318 audits processed out of 500 (non-random subsample):

- Cases w. corrections: $\sim 60\%$
- Cond. on correction: correction $\sim 20\%$ of potential
- Non-corrections are due to:
  Errors in the AEoI data: $\sim 1/4$
  Taxpayer is not taxable: $\sim 1/4$
  Income is reported: : $\sim 1/4$

Conclusion

Summing up

Until recently, offshore tax evasion difficult to detect

We find that automatic information exchange enhances tax compliance through three channels:

1. **Repatriation**
   Wealth repatriation of DKK 7 billion ($> 10\%$ of estimated offshore wealth) $\rightarrow$ "The rich" take wealth home
2. **More Self-Reporting**
   Jump in number of taxpayers self-reporting foreign income. But negligible revenue gain $\rightarrow$ "Normal people" become aware of reporting obligation
3. **Better Audits**
   Increase in corrections. But fewer corrections than potential $\rightarrow$ errors in AEoI reports explain a large share of the discrepancy

Appendix

Literature

Pre-AEoI policies: Previous attempts to fight offshore tax evasion have been mostly unsuccessful (Johannesen, 2014; Johannesen and Zucman, 2014; Hanlon et al., 2015; Johannesen et al., 2020)

AEoI policies: Tax evaders responses to AEoI

- shift assets to non-participating countries (Menkhoff and Miethe, 2019; Casi, Spengel and Stage, 2020; O'Reilly et al., 2019)

- invest less through offshore corporations (Omartian, 2018; De Simone, Lester and Markle, 2020

- no direct evidence on compliance effects

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Adopting the new AEoI regime

The U.S. pursue automatic exchange of information under the Foreign Account Tax Compliance Act (FATCA)
- legislative decision in 2010
- negotiation with foreign partners 2012-2014
- first batch of information received in 2015 (concerning the tax year 2014)

100+ countries agreed to emulate FATCA under the Common Reporting Standard (CRS)
- decision at Berlin summit in October 2014
- first batch of information exchanged in 2017 (concerning the tax year 2016)

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Data I

For the full sample of taxpayers in Denmark, we have information from: **tax returns** and **FATCA/CRS reports** from foreign banks

The two data sources are merged by the Danish tax authorities - for each foreign account:
- find the best match based on name and address
- estimate the match probability p
- if there is a TIN number check if it corresponds to the taxpayer

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Data II: 300.000 taxpayers with foreign accounts - most assets belong to firms

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	Holders of foreign accounts	*Million DKK* Aggregate account balances	Aggregate dividend income	Aggregate interest income
All accountholders	299,000	336,000	1,390	700
No match with individual taxpayer				
- Organizations	8,000	258,000	980	450
- Individuals with no match	41,000	24,000	60	60
- Individuals with match but not taxpayer	22,000	4,000	10	20
Individuals with matched tax return	228,000	51,000	300	200

Data III: Money Transfer

We also have information on **cross-border money transfers** that the tax authorities regularly obtain from Danish banks:
- all transfers to and from around 50 tax havens

We use an algorithm to compare names of the sender and receiver to determine what are
- Transfers from own foreign accounts (potentially repatriations)
- Transfers from others' foreign accounts (not repatriation)

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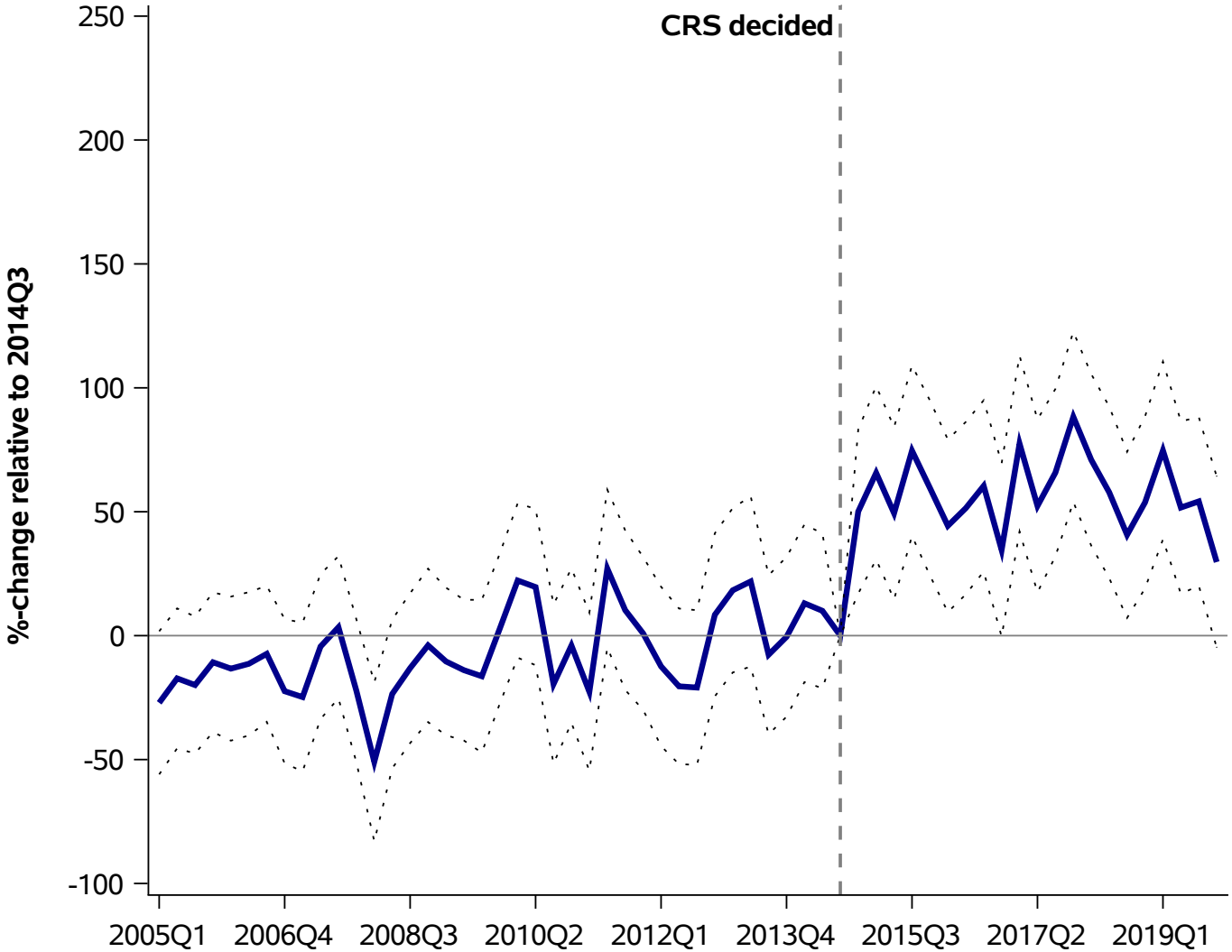
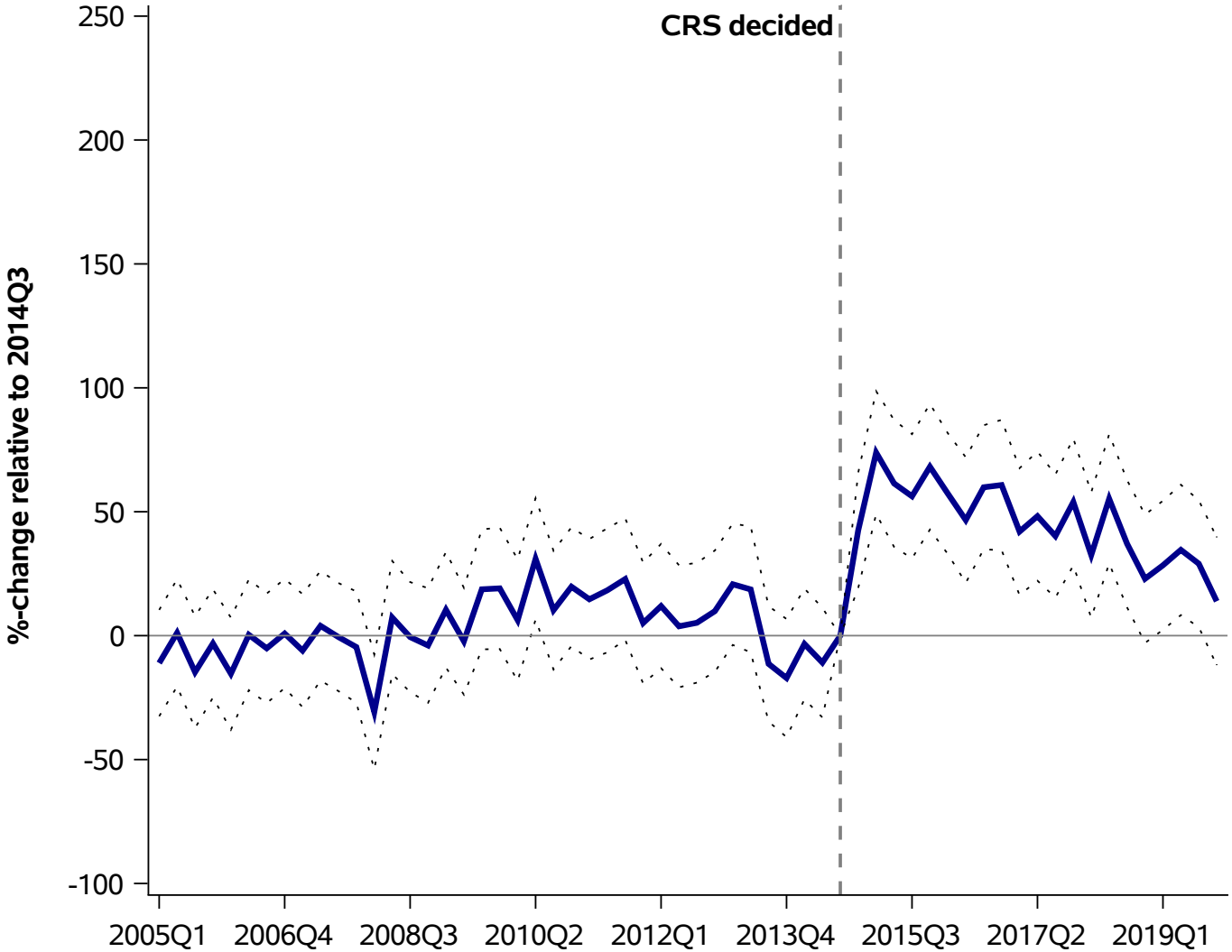
DiD estimate: Own transfers DKK 250K-1,000K rises with ∼50% compared to other transfers after CRS

1mil. 100K-250K 50K-100K



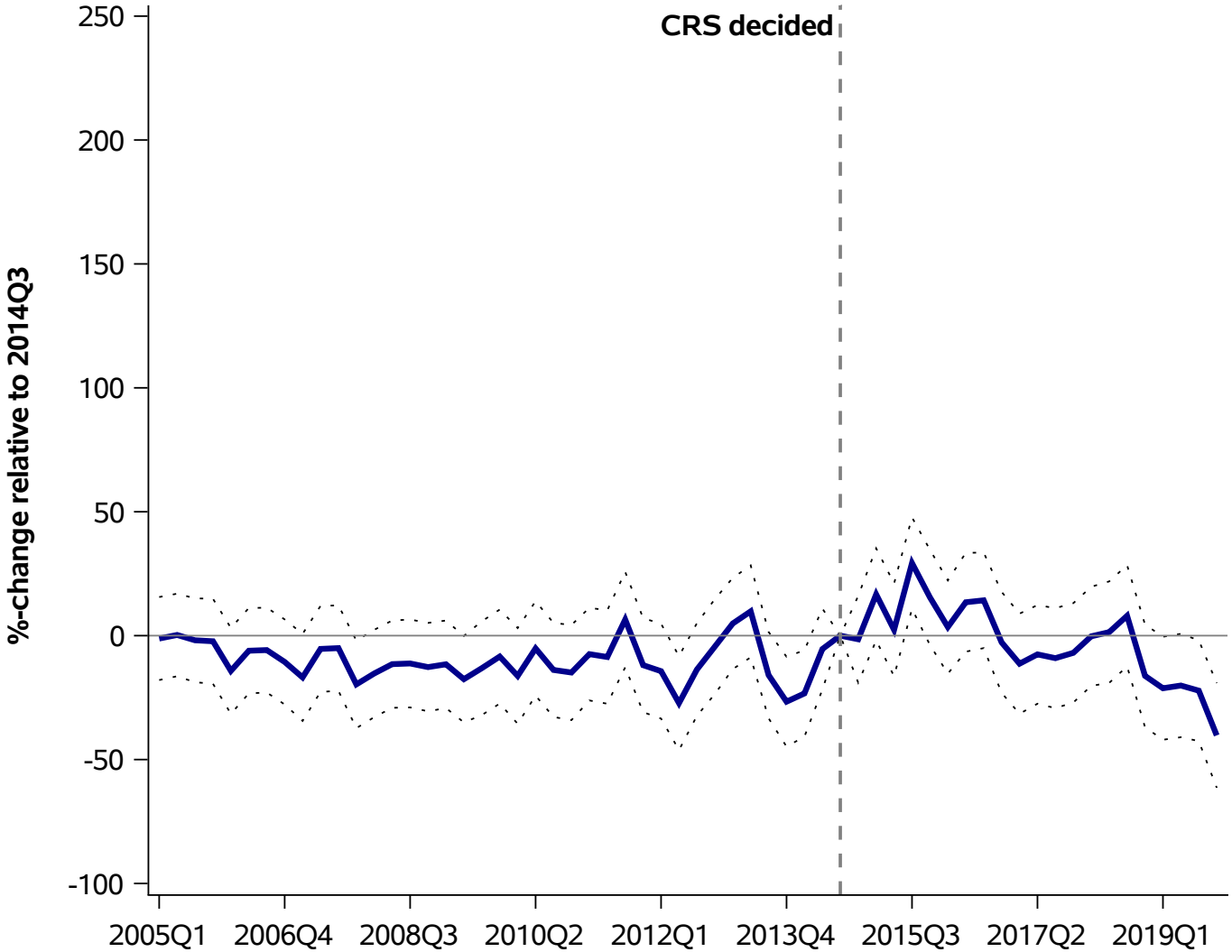
DiD estimate: Own transfers DKK 100K-250K rises with ∼50% compared to other transfers after CRS

1mil. | 250K-1mil. | 50K-100K



DiD estimate: Own transfers DKK 50K-100K does not rise compared to other transfers after CRS

1mil. | 250K-1mil. | 100K-250K



Is repatriation associated with more compliance?

For individuals receiving first transfer ($>$ DKK 50K) from own accounts in havens in year y, we estimate:

$$\text{Wealth}_{i,y+h} - \text{Wealth}_{i,y+h-1} = \alpha + \beta^h \text{Money transfer}_{i,y} + \epsilon_{i,y}$$

β^0 measures the increase in reported net wealth per dollar repatriated from tax havens relative to the year before repatriation