

## 13. Emerging Issues in CRS: Using Artificial Intelligence to Defeat Tax Evasion, and the Nonparticipation of the US

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Several years ago, we saw the beginning of a big push by the Organisation for Economic Cooperation and Development (OECD) to encourage countries to agree to tax information exchange agreements (TIEAs). Soon thereafter, the US and the OECD started promoting automatic and spontaneous information exchange on a cross-border basis. This effort culminated in the OECD's Common Reporting Standard for the Automatic Exchange of Financial Account Information in Tax Matters (CRS), which will allow participating jurisdictions to exchange tax information with each other in a uniform, standardized way.

There are two very interesting issues around CRS currently. One issue that has troubled me for quite a long time is whether gathering and transmitting all of this data will be effective in having an impact on tax enforcement. The quantum of data being collected and transmitted alone will be so large that it will be extremely difficult to cull into usable information. Another perhaps even more interesting issue is that the US, which started the push for automatic and spontaneous information exchange as part of FATCA, has refused to participate in the CRS system. One wonders how this will affect both the implementation of CRS and FATCA going forward.

### CRS Data and Artificial Intelligence

CRS will result in massive amounts of data being transmitted between different nations and will require incredible computing power to make the information received usable. In the past, making sense of such large amounts of tax information data typically required huge audit teams and forensic experts, meaning that in larger countries, most tax returns were never reviewed simply because there was not enough time or people to do so. The ability to use vast computing power to analyze huge quantities of data in a short period will be vital to make use of the information collected by CRS. Information that would take teams of individuals months to go through could be analyzed by a computer program in a very short time. However, given the complexity of some modern tax evasion schemes, one wonders if raw computing power alone will be enough to thoroughly and efficiently analyze the data for signs of non-compliance.

At the same time that these tax information exchange measures have come into existence, we have seen significant advances in artificial intelligence (AI). The question becomes, could artificial intelligence impact the ability of governments to root out tax evasion? The study of AI is an area of computer science that aims to create technology that can perceive its environment and take actions that maximize its chance of success at some goal. One way to define AI is as an artificial creation that possesses the "cognitive" functions people associate with the mind, such as "learning" and "problem solving."

Researchers have also begun to look at how AI could be used to combat tax evasion, and they have had some success. Unlike traditional audit processes, this AI approach does not initially require pre-existing evidence of tax non-

compliance. It focuses on "rule mining," the process of analyzing the underlying rules and regulations themselves to see where loopholes exist. The AI identifies types of situations and structures where tax evasion is likely to occur, and then those parameters can be compared to the data on existing taxpayers. Such strategies could be used in the context of the data collected by CRS to efficiently identify incidences of non-compliance.

In fact, the full impact of CRS can only be achieved if tax authorities can cull and utilize the information collected efficiently. CRS is designed to cause repeated declaration of the same income for the same taxpayer, so computer systems will need to be able to accurately collate this data and compare multiple entries to check for discrepancies. It also focuses on "controlling persons" to determine if they are the actual economic owners of the income. AI will allow for this vast amount of information to be efficiently analyzed to determine whether tax compliance goals are being met. Thus, in the future, AI could not only impact how we drive, but also how we enforce and collect taxes.

### The Nonparticipation of the US in CRS

One could get upset that the US is not participating in the CRS global initiative to implement tax transparency, and could even argue that the actions of the US, which are contrary to what it is demanding of other jurisdictions through its own legislation, FATCA, are hypocritical. In fact, the behaviour of the US and mismatches between its domestic laws and its international agreements has, ironically, caused some movement of funds to the US from other jurisdictions with the purpose of avoiding disclosure.

The US can, of course, continue to take the position that it will not participate in CRS and one can clearly argue that this position is a reasonable one given that the US has in place many Model 1 reciprocal Intergovernmental Agreements (IGAs) under FATCA. Model 1 reciprocal IGAs are designed to have the US and partner jurisdictions exchange taxpayer data with each other, mirroring the effect of CRS. However, one major flaw that exists with the reciprocal Model 1 IGAs is that the definitions that are in place create situations in which similarly situated taxpayers from different jurisdictions are not reported in the same way.

Take the following example: If a US citizen owns 100% of the shares of a British Virgin Islands (BVI) company that has an account in Mexico City, that US citizen would be reported to the Mexican government and then on to the IRS under the relevant Model 1 IGA. In contrast, a Mexican resident owning 100% of the shares of a BVI company with an account in New York would not be disclosed to the Mexican authorities. This is a direct result of the technical approach taken by lawyers focusing on the US tax concepts of beneficial ownership.

These types of mismatches need to be addressed and corrected, or the rest of the world will likely not continue to accept the United States' nonparticipation in CRS. Absent these corrections, the FATCA system will lack legitimacy and the US will not be able to rely on its IGAs as a reason to excuse

its nonparticipation. I have been to meetings in recent months where the discussion has been to consider moving structures and accounts to the US to avoid disclosure. This type of regulatory arbitrage needs to stop if the system is to work.

In the course of the next few years, the US will face mounting pressure to modify its Model 1 IGAs to come into some type of conformity with the CRS notions of information exchange and to provide truly reciprocal information exchange. The US has acknowledged in the text of the Model 1 IGAs the need to achieve equivalent levels of reciprocal automatic information exchange with its FATCA partners. The Model 1 IGAs already provide that the parties will consult in good faith to implement such reciprocity by December 31, 2016, which deadline has already passed. The failure to take concrete steps toward such reciprocity at least in the coming years could cause FATCA partner jurisdictions to reconsider the terms of the IGAs and potentially trigger unilateral termination, following a 12-month notice period as permitted by the IGAs. Such termination of FATCA IGAs by any major FATCA partner jurisdictions would be devastating to the international tax enforcement efforts of the US.

### **Conclusion**

Having said all this, do any of these concerns really matter? Irrespective of whether governments are able to effectively use the data collected or whether the US participates, CRS has in fact already shown that it works, because taxpayer behavior has changed. The number of tax regularizations around the world over the last decade has increased significantly. Thus, CRS has had the desired impact, namely that people with undeclared funds have made their tax declarations and repatriated their assets back to their home countries—and en masse. CRS has had its impact. Of course, there is fine-tuning that can be implemented to improve the process and to get the most out of the data collected, but the real success is the path, not the final destination.

#### **About the author:**

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