



Privacy vs Transparency

Countries must strike the right balance as they combat illicit financial flows

Jay Purcell and Ivana Rossi

In 2011, Pakistan's finance minister gave a budget speech to the National Assembly, explaining that the country's ratio of tax revenue to GDP, at 9.2 percent, was ranked lower than that of all but 1 of 154 jurisdictions. In a country of 180 million, just 1.2 million people and firms filed income tax returns.

Widespread tax evasion started at the top; 70 percent of Pakistani lawmakers had not filed returns that year, the Center for Investigative Reporting in Pakistan found. So stiffening existing laws and penalties would have been a challenge. And increased

enforcement would ultimately depend on action by Pakistani judges—many of whom had also neglected to pay their taxes.

Undeterred, the Ministry of Finance took a bold step. In 2014, it authorized the Federal Board of Revenue to make public how much income tax every company and individual pays each year. This unusual approach appears to have had an effect; while compliance remains low, there is some evidence that it improved as a result of the ministry's transparency initiative. Still, that improvement came at a price. To shame tax evaders into paying their fair share—and enable civil society and journalists to hold them to account if they do not—all Pakistanis had to give up some of their privacy.

Around the world, national authorities are increasingly aware of the value—and cost—of

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using transparency to combat illicit financial flows. Transparency improves enforcement, brings better accountability and trust in processes and institutions, and deters wrongdoing by increasing the risk of detection. Inevitably, though, it also brings some loss of privacy for people who may have legitimate reasons to keep their financial dealings discreet, such as fear of nosy neighbors, gossip columnists, and even kidnappers.

But before we explore the tradeoffs that come with the solution, let's define the problem. "Illicit financial flows" is an umbrella term generally understood to encompass at least three types. First, there are funds *generated by* illegal acts, such as corruption, smuggling, and drug trafficking. Next are funds whose *transfer* constitutes an illegal act; for example, transferring money to hide income from the authorities constitutes tax evasion, even if the income was generated legally. Finally, there are *funds destined for an illegal purpose*, such as the financing of terrorism.

Turning to transparency to stem these flows isn't a new idea, even if countries are still working to refine their use of this powerful tool. The following examples provide a range of approaches to managing the resultant loss of privacy as an admittedly complex but nevertheless critical component of success.

Disclosure by public officials

World Bank statistics show that more than 90 percent of countries have introduced legislation requiring financial disclosure by at least some public officials. However, the specific requirements and level of implementation vary widely. Most often, the officials must disclose all income, assets, and liabilities held by them or close family members, such as a spouse, whether in the country or abroad. In other cases, they must also disclose assets for which they are the ultimate or "beneficial" owners. Such disclosures can help to advance multiple anti-corruption objectives, from prevention to enforcement. They can also help fight money laundering; for example, by helping determine if a

customer is a politically exposed person, facilitating customer due diligence procedures, or advancing asset-tracing and recovery efforts.

In modern internet-speak, providing public access to financial disclosures represents a valuable crowdsourcing opportunity. Watchdogs, journalists, and others monitor declarations alongside dedicated civil servants, often generating leads and findings that spur or strengthen significant corruption investigations. For example, in 2009 a Croatian prime minister had to resign in the wake of media reports questioning the source of his wealth; the reports themselves were prompted by photos showing him wearing expensive watches that were not listed in his declaration of assets. Similarly, it was members of the media who found Swiss bank accounts a French budget minister had not declared to the fiscal authority. That scandal not only led to an investigation and, ultimately, the minister's conviction on charges of tax fraud and money laundering, it also triggered a comprehensive reform of the French asset declaration system for public officials, incorporating public access for the first time. In short, public access improves accountability and enhances disclosure's impact on the discovery and prosecution of corrupt acts.

Despite the benefits of transparency, some countries are still reluctant to make useful information easily accessible; only about 50 percent of those that require disclosure allow public access by law, and a much smaller percentage actually grant that access in practice. Preserving privacy is a common reason; another concern is that information could be exploited by would-be thieves or kidnappers. However, it is certainly possible to strike the right balance between those concerns and the clear benefits of public access. Here are some important considerations:

- Public access does not necessarily mean publishing the entire content of declarations submitted by public officials. Highly sensitive information, such as bank account numbers, is always kept confidential.
- Ways of approaching public access may be tailored to a country's specific circumstances. One

example: making public only the declarations of high-level public officials.

- There is growing recognition, including in case law, that the public interest outweighs personal privacy for high-level officials.

Beneficial ownership

Revealing the owners of companies and other legal entities, such as trusts, is another way to combat illicit financial flows. Research by Damgaard, Elkjaer, and Johannesen (2018) estimated that \$12 trillion—almost 40 percent of all foreign direct investment—passes through empty corporate shells associated with no actual economic activity (see “The Rise of Phantom Investments” in this issue of *F&D*). While not all of these flows are illicit, a lack of information about the real person who ultimately owns, controls, or benefits from these structures—the so-called beneficial owner—can be used to mask questionable dealings.

The international anti-money laundering standard issued by the Financial Action Task Force (FATF), which helps stem illicit financial flows, includes specific recommendations for enhanced transparency of legal entities and their beneficial ownership. Basic information typically held in company registers, such as the company name, type of incorporation, legal status, address, and list of directors, should be public. Beneficial ownership information should always be available to the competent legal authorities, whether it is held in a registry, by financial institutions, or by the companies themselves. Building on the FATF standard, other salient international efforts, including on the part of the Group of Twenty and the Organisation for Economic Co-operation and Development’s Global Forum, have also focused on enhancing the transparency of beneficial ownership.

Yet the continued misuse of anonymous companies for illicit purposes has prompted growing calls for governments to accelerate efforts and go a step further by making beneficial ownership information available to the public. Heeding those calls, the European Union decided that member states must establish publicly available beneficial ownership registries as of 2020.

Public access has myriad benefits. It supports financial institutions in conducting due diligence on their customers. It also enables the public to

monitor and analyze purchases of goods and services by government agencies (to see, for example, whether contractors have ties to public officials), check the financial disclosures of officials, and help verify the accuracy and timeliness of the information in registries.

A few countries, including the United Kingdom and Denmark, are pioneering the creation of public beneficial ownership registries. Many others have committed to developing them. To prioritize transparency and open data, while managing privacy concerns, due consideration should be given to providing enough information to identify beneficial owners without offering unnecessary details and establishing ways to request case-by-case exemptions from publication, such as when there is evidence of a serious risk of violence or intimidation.

Geographic targeting orders

Buying and selling real estate can be a particularly effective way to move, launder, and invest illicit proceeds. The reasons are straightforward: it is often possible to launder or invest large sums of money in a single transaction while obscuring the identity of the beneficial owner via the use of corporate vehicles. This risk has not escaped the notice of national authorities, especially in countries where property markets are large and open and prices are rising fast.

Enter geographic targeting orders, a tool harnessed by the US Treasury Department to address this risk. In early 2016, the department’s Financial Crimes Enforcement Network (FinCEN) issued temporary orders requiring “certain US title insurance companies to identify the natural persons behind companies used to pay ‘all cash’ for high-end residential real estate” in parts of New York and Florida. The objective was to pierce the veil of secrecy surrounding cash purchases of luxury real estate in the name of shell corporations and other legal entities. Of course, secrecy may safeguard the privacy of legitimate actors just as it obscures the actions of illegitimate ones. Some of the affected homeowners would surely be celebrities or other public figures seeking a reasonable degree of privacy; others might be criminals attempting to hide their dealings from law enforcement.

FinCEN’s solution, which, in other countries, could be implemented with respect to land

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registries, was to require beneficial ownership information to be provided to the government but not to the general public. This means that relevant US (and through them, relevant foreign) authorities have access to this sensitive data, whereas potential stalkers, solicitors, and protestors do not. In 2017, FinCEN indicated that more than 30 percent of the purchases reported pursuant to its geographic targeting orders were conducted by people already suspected of involvement in questionable dealings. Meanwhile, FinCEN has consistently renewed the orders and expanded their scope to cover other major metropolitan areas—all without unduly compromising the privacy of buyers.

Tax records

Tax evasion costs governments more than \$3 trillion a year, according to a 2011 estimate by the United Kingdom–based Tax Justice Network. Lower tax revenue diminishes the resources available for productive purposes, such as building roads, schools, and hospitals, which makes it difficult for governments to deliver sustainable and inclusive growth. That is why national authorities invest substantial efforts in combating tax evasion, including by auditing tax returns and exchanging relevant information with other countries.

One little-used approach to promoting tax compliance is to make taxpayers' incomes and returns public, as Norway has done since at least 1863 and Pakistan started doing, to a somewhat lesser degree, 150 years later. Unsurprisingly, what is generally promoted as a measure to strengthen transparency, equity, and accountability has also been decried as an invasion of privacy that engenders envy and promotes “salary snooping” by colleagues and neighbors. Indeed, November 1, the day the Finnish government publishes citizens' income and tax payments, is known as “National Jealousy Day.”

To help address privacy concerns, Norway requires individuals to log in to a dedicated system that tracks their searches; taxpayers can see who has viewed their information, and users are limited to searching 500 records a month.

Sweden maintains similar controls. These attempts to improve the balance between transparency and privacy may have achieved the intended result: frivolous record requests appear to have declined after controls were introduced, while members of the media, who are able to search anonymously in certain cases, have continued to perform a critical investigative function in furtherance of the public interest.

Potent weapon

These examples show that transparency is a potent weapon in the battle against illicit financial flows, in part because it allows journalists, academics, and others to scrutinize large amounts of data and report possible abuses. It also builds trust in institutions, increases accountability, and may diminish perception of public corruption. Yet concerns about privacy should not and cannot be ignored. Failing to address them can fuel fierce opposition to transparency initiatives, both from well-intentioned activists and from cynical actors who may cite privacy in a disingenuous attempt to obscure questionable dealings.

There is no universal formula for achieving a perfect balance between transparency and privacy, but there are international standards and broadly applicable good practices to guide the process. The relevant authorities must have ready access to complete information and should aim to maximize public availability, considering how best to tailor that availability to different stakeholders, safeguard certain personal details, and discourage frivolous searches or commercial data mining.

Trade-offs can and should be managed, not used as an excuse for inaction on illicit financial flows. [FD](#)

JAY PURCELL and **IVANA ROSSI** are financial sector experts in the IMF's Legal Department.

Reference:

Damgaard, Jannick, Thomas Elkjaer, and Niels Johannesen. 2018. “Piercing the Veil.” *Finance & Development* 55 (2).