



tax us

if you can

2nd
Edition

tax justice network



INTRODUCTION TO THE TAX JUSTICE NETWORK

The Tax Justice Network (TJN) brings together charities, non-governmental organisations, trade unions, social movements, churches and individuals with common interest in working for international tax co-operation and against tax avoidance, tax evasion and tax competition. What we share is our commitment to reducing poverty and inequality and enhancing the well being of the least well off around the world.

In an era of globalisation, TJN is committed to a socially just, democratic and progressive system of taxation. TJN campaigns from a national and internationalist perspective for a tax system which is favourable for poor people, which finances public goods and taxes public bads such as pollution whilst tackling unacceptable inequality. More information in our objectives can be found on our web site (www.taxjustice.net). Our network originally grew out of the world social forum process and the international Attac movement. It is now represented in many countries on all continents except Antarctica.

TJN is a pluralistic, diversified, non-governmental, non-partisan and multilingual network comprising expertise in a wide variety of disciplines and professional spheres with local, regional and national civil society and social movements. The network includes tax justice campaigners, researchers, journalists, development specialists, trade unionists, concerned business people, tax professionals, politicians and public servants. Many of our members and supporters work through national based organisations which share our common name or through other NGOs that have adopted the cause of tax justice and the relief of poverty as a key part of their own work.

TJN's objective is to promote change through public debate and education. We think that public understanding of tax matters is the precondition for tax justice. As a result TJN makes information available through mass media, conferences and seminars, the internet, newsletters, publications in print and through advocacy. What characterises our work is a commitment to expertise and sound research.

TJN research network is spread far and wide in many countries and our campaigning partners can be found throughout the world. A list of organisations working on tax justice issues can be found on our website www.taxjustice.net. If you are interested in working on these issues or want to know what is happening in your country these organisations are your best point of local contact, but if in doubt please contact the research team and we'll do what we can to help.

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FOREWORD TO THE SECOND EDITION

The first edition of *tax us if you can* was published in September 2005. TJN was then in its infancy and this was our first major publication. It has served us well over the intervening period, but the time has come for a second edition.

For those interested in tax justice the past seven years have seen enormous change. The global economy was booming in 2005. Now it is in either recession or depression in many countries. The Global Financial Crisis of 2008 has dramatically changed the tax justice agenda. In 2005 it was possible to ignore tax justice issues because there appeared to be enough tax revenue to go round in most countries: many of the problems we address could be ignored by politicians, or at least be papered over by throwing cash at the problem. This is no longer the case: tax revenues are amongst the scarcest commodity in most countries. It is that shortage of tax revenue, and not excessive state spending, which has plunged public finances around the world into deficits.

Against this background it is no surprise that interest in the connected subjects of tax havens, tax avoidance, tax evasion and how to collect the trillions of dollars of tax that goes missing each year is now so high up the political agenda. This increased public awareness demands a second edition of *tax us if you can*.

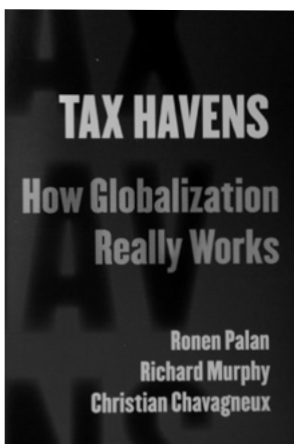
TJN has also moved on. Some of the ideas we have put to governments in the face of this crisis already existed in 2005. The idea of Country-by-country reporting, for example, was created in 2002 when TJN was conceived. Other policy proposals have been developed since 2005. Our research into financial secrecy and the volumes of personal savings held in offshore accounts has stimulated public interest across the world.

Our research tells a compelling story about why poverty persists in a world of plenty. We know that tax losses to poorer countries exceed the amount they receive in aid annually. We also know that up to US\$3 trillion a year may be lost to tax evasion worldwide, with more than 25 per cent of these losses occurring in the European Union. In an era of austerity budgets, tax dodging by wealthy people and powerful companies means hardship and loss of hope for hundreds of millions of people, especially young unemployed people who face lives of high debt, low wages and minimal welfare support.

For all these reasons, the issues on which we campaigned in 2005 remain just as important, probably more so, today. We hope this revised and updated version of *tax us if you can* will explain what we do and why and how you might get involved in our work to tackle poverty and inequality.

John Christensen,
Richard Murphy

Recommended reading:



“More than simple conduits for tax avoidance and evasion, tax havens actually belong to the broad world of finance, to the business of managing the monetary resources of individuals, organisations and countries. They have become among the most powerful instruments of globalisation, one of the principal causes of global financial instability, and one of the large political issues of our times.”

INTRODUCTION

The associated problems of collapsing tax revenues, capital flight, tax avoidance and evasion and tax competition have emerged as major issues on the global economic agenda. As public concern about the widening divide between the rich and poor escalates, both within and between countries, and the international community comes under increasing pressure to eradicate poverty, not least in the face of deepening crises in many countries, global civil society is paying far greater attention to the rising share of global wealth held in tax havens – or

The scale of capital flight to the offshore economy is immense. In July 2012 TJN published research findings showing that not less than US\$21 trillion hidden by the world's wealthiest people in the world's tax havens. The figure may be as high as US\$32 trillion and, importantly, this estimate does not include the vast amount of wealth held in the form of real estate, superyachts, works of art and even racehorses that is “owned” by secretive offshore companies, trusts and foundations.

Millions of people have come to realise that secrecy jurisdictions, and the culture of tax abuse they promote, are part of a much deeper problem facing the globalised economy

secrecy jurisdictions as we prefer to call them (we use both terms more or less synonymously throughout this briefing paper) – beyond the reach of national tax authorities and the tax dodging that accompanies this phenomenon.

In the space of a decade millions of people have come to realise that secrecy jurisdictions, and the culture of tax abuse they promote, are part of a much deeper problem facing the globalised economy. It is now widely understood that as a result of technological change and capital market liberalisation that allows the free flow of money around the world, rich individuals and multinational corporations (MNCs) can move their money to wherever they wish. Many have relocated their wealth and their profits to offshore secrecy jurisdictions that offer minimal or zero tax rates. This has created enormous problems because, in a world of tax havens and globalised markets, tax regimes remain largely based on national laws and whilst attempts to crack open secrecy jurisdictions by international cooperation have made some slight improvements it is important not to overstate the progress made in tackling this issue: much of that progress is superficial, having been undermined by intense lobbying from powerful vested interests seeking to protect the status quo.

We should of course offer an immediate word of caution: these figures are estimates and we have always erred on the side of caution when publishing estimates. We also publish all our workings. And since we based the estimate on four different methods of calculation no one can accuse us of not being rigorous.

A large proportion of this wealth is managed from approximately 70 tax havens in order to either minimise tax or avoid paying tax altogether. If the income from this wealth was charged to tax in the countries where those rich individuals were resident or derived their wealth, the additional tax revenue available to fund public services and investment around the world would range between US\$190-280 billion annually. Importantly, this estimate of revenue loss does not include tax losses due to avoidance of inheritance or wealth taxes, taxes on capital gains or stamp duties on real estate sales. Nor do these estimates include tax avoidance by transnational corporations or the lowering of revenue income caused by tax competition.

To put our estimate of tax revenue losses from personal wealth held offshore into perspective, the UN Millennium Project report stated that a tripling of the global aid budget to US\$195 billion a year by 2015 would be enough to halve world

poverty within a decade and prevent millions of unnecessary deaths in poorer countries. In absolute cash terms the cost has probably increased a little since this estimate was made but the point is clear: eliminating tax haven abuse could provide the resources to relieve half of the world's acute poverty.

Until the turn of the millennium international initiatives to tackle the problems posed by offshore finance and secrecy jurisdictions, the majority of which are directly or indirectly connected to financial centres in OECD countries, have paid insufficient attention to the position of developing countries. This situation changed in June 2000 when a major

investment flows through paper subsidiaries in tax havens provides them with a significant tax advantage over their nationally based competitors. Trends in international taxation over the last decade have made this much easier since limitations in the use of what are called "controlled foreign companies rules", especially in Europe, have allowed much more money to flow offshore. In practice this biased tax treatment favours the large business over the small one, the international business over the national one, and the long-established business over the start-up. It follows, simply because most businesses in the developing world are smaller and newer than those in the developed world and

If countries are to benefit from globalisation, governments must regain the capacity to tax their citizens as well as businesses operating within their borders, and to use the revenues to finance infrastructure, essential public services and necessary wealth redistribution.

Economic Policy Institute (2004) *Rethinking Growth Strategies* EPI Books

development NGO published a report drawing attention to the harmful impact of tax havens on developing countries and identifying why their negative impacts are felt most forcefully in the global South. Since then significant work has been undertaken on this issue, much of it at well-respected academic institutions. It is now fairly widely agreed that tax havens impact upon developing countries in four major ways.

First, secret bank accounts and offshore trusts encourage wealthy individuals and companies to escape paying the taxes they owe. Studies of offshore wealth holdings have shown that rich individuals in developing countries hold a far larger proportion of their wealth in offshore secrecy jurisdictions than their North American and European counterparts. For example, over one quarter of African and Middle Eastern wealth is believed to be held offshore, which is well above the European average. This is a trend almost certainly encouraged by the widespread growth in internet usage which makes the management of such accounts far easier while also making them harder to detect.

Second, the ability of transnational corporations to structure their trade and

typically more domestically focussed, that this inbuilt bias in the tax system generally favours multinational businesses from the North over their domestic competitors in the developing countries.

Third, banking secrecy and trust services provided by global financial institutions operating offshore provide a secure cover for laundering the proceeds of political corruption, fraud, embezzlement, illicit arms trading, and the global drug trade. The lack of transparency in international financial markets contributes to the spread of globalised crime, terrorism, bribery of under-paid officials by western businesses, and the plunder of resources by business and political elites. Corruption harms development processes, and tax havens provide the facilities that support money laundering of the proceeds of corruption and all types of illicit commercial transactions. There is little evidence that initiatives to tackle these issues over the last 15 years succeeded in curtailing this activity.

Fourth, the offshore economy has contributed to the rising incidence of financial market instability that can destroy livelihoods across the world. Offshore

financial centres (OFCs) are used as conduits for rapid transfers of portfolio capital in to and out of national economies that can have a highly destabilising effect on financial market operations. Many developing countries are required to hold large hard currency reserves to protect their economies from financial instability. These reserve holdings are an expense that few countries can afford but, in the absence of international agreement on other more effective measures to reduce market volatility, they have little choice.

Faced with the pressures of the globalisation of capital movements and loudly voiced threats that companies will relocate unless given concessions on 'light-touch' regulation and lower taxes, governments around the world have responded by engaging in tax competition to attract and retain investment capital. Some states with limited economic options have made tax competition a central part of their development strategy. This inevitably undermines the growth prospects of other countries, as they attract investments away from them, and has stimulated a race to the bottom. The role of tax competition as a sustainable development strategy is considered further in section I of this report, but a recent empirically based study in the United States has found:

There is little evidence that state and local tax cuts – when paid for by reducing public services – stimulate economic activity or create jobs. There is evidence, however, that increases in taxes, when used to expand the quantity and quality of public services, can promote economic development and employment growth.

If this conclusion applies even to a relatively high tax economy like the United States, it is doubly applicable to economies in south Asia and sub-Saharan Africa, where social and economic development is held back by under-investment in infrastructure, education and health services.

Proponents of tax competition have never answered the crucial question of how far it should be allowed to go before it compromises the functioning of a viable and equitable tax regime. Taken to its logical extreme, unregulated tax competition will inevitably lead to a race to the bottom, meaning that governments will be forced to cut tax rates on corporate profits to zero and subsidise those companies choosing to invest in their countries.

This already happens in some countries.

The implications of this for tax regimes and democratic forms of government around the world are dire. Indeed, this is one of the biggest threats to freedom the world may now face.

The problems that capital flight, tax avoidance and tax competition pose for poorer countries have been exacerbated by what appears to have been a failure on the part of multilateral institutions to protect the tax regimes of developing countries when promoting trade liberalisation policies. Political pressure from the World Trade Organisation (WTO) and the International Monetary Fund (IMF) to liberalise trade regimes caused a dwindling of revenues from trade taxes on imports and exports. Poorer countries have also been severely affected by weak international rules relating to taxing multinational companies, which enable the latter to avoid tax by shifting their profits to tax haven-based subsidiaries. Faced with dramatic falls in their tax incomes, governments have responded by raising VAT rates and generally shifting the tax burden onto poorer and middle income households. The process has accelerated since 2008, with disturbing implications for inequality and social stability.

The problems outlined above were also discussed in the report of the United Nations International Conference on Financing for Development which called on developing countries to mobilise resources, especially domestic resources, for development.

The Monterrey Consensus included a call for:

- Strengthening international tax cooperation... and greater coordination of the work between the multilateral bodies involved and relevant regional organisations, giving special attention to the needs of developing countries and countries with economies in transition.
- Strengthening international tax cooperation is a crucial part of remedying the current imbalance between globalised businesses and nationally based tax regimes. This does not require common tax rates, but it does need agreement on a set of universal ground rules that will enable countries to reduce the scope for tax avoidance and illicit activities. If developing countries are to benefit from globalisation, governments must regain their capacity to tax citizens

and businesses operating within their borders, and to use the revenues to finance infrastructure, public services and necessary wealth redistribution.

In their joint report on *Developing the International Dialogue on Taxation*, the IMF, OECD and World Bank have referred to providing technical assistance to improve the effectiveness of tax administrations in developing countries. What their report did not make clear, however, is how developing countries can effectively tackle the far more pressing issue of how to prevent capital flight to tax havens, the majority of which are closely linked both politically and economically to OECD countries.

Recent initiatives to abolish banking secrecy in tax matters, whether de jure or de facto in the case of offshore companies and trusts, or to implement a global framework for automatic information exchange of relevant tax information have not been carried forward with the necessary level of political determination, and are being actively blocked by countries like the UK, which in 2012 signed an agreement with Switzerland which permits the latter to retain its banking secrecy laws. The absence of a global policy framework for discouraging capital flight and aggressive tax avoidance by TNCs has left nationally based tax regimes floundering.

The legions of tax planners who operate through secrecy jurisdictions are able to run

circles around tax officials who are constantly hampered by the lack of transparency and cooperation from the financial services industry. Lawyers, accountants and bankers abuse their professional status to facilitate harmful and anti-social behaviour purely for the sake of the high fees that they can earn from working in the tax avoidance industry. Their attitude towards democracy and society in general was perfectly summed-up by a British accountant who told the press: "No matter what legislation is in place, the accountants and lawyers will find a way around it. Rules are rules, but rules are meant to be broken." This attitude is unacceptable in any context, but is particularly inexcusable when the victims of this predatory culture are the poorest and most vulnerable people on the planet.

The aim of this briefing paper is to help readers understand the issues underlying the global campaign for tax justice. The paper begins, in section one, by exploring the meaning of tax justice before moving on to examine why tax justice matters – particularly for poorer countries. Section two sets out the key systemic causes of tax injustice, and section three builds on this discussion by looking at the key players in the tax avoidance industry. The roles of the principal agencies that are trying to tackle global tax injustice are discussed in section four, and a range of options that TJN proposes to address these problems are outlined in section five. Finally, a glossary of terms is included to help with understanding the language of tax.

I. TAX JUSTICE: AN OVERVIEW

Tax justice means different things to different people.

Some people think it means paying little or no tax. Others think it means that each person should pay the same tax, either in absolute amount, or more likely, at the same fixed percentage rate whatever their income. And some people think it means that taxes should only be paid on a limited range of things, such as income from employment or consumption expenditure, whilst other sources of income, such as that from savings and investments, should be untaxed. None of these options offer a system that most people would regard as socially just or fair. Nonetheless, this diversity of views demonstrates the need to be clear about:

- what a tax is;
- what tax justice is;
- what duties these create in combination for governments, individuals, corporations and other tax payers.

I.1 What is a tax?

A tax is any payment made to a government for which no direct benefit is provided in exchange. For example, a payment to government required by law based on a percentage of income earned from an employment is a tax. Conversely, the payment of a licence fee to a government, for example, to enable a person to use a car on the highway, is not a tax: it is a service charge. There may be justice or injustice in such charges, but this is not what we are addressing here.

I.2 What is tax for?

It is important when people are asked to pay their taxes that they know what tax is for. We suggest that there are five reasons for paying tax. They are that tax:

- Raises revenue;
- Reprices goods and services that are incorrectly priced by the market such as tobacco, alcohol, carbon emissions, etc.;

- Redistributes income and wealth;
- Raises representation by encouraging participation in the democratic process;
- Calibrates the economy through fiscal policy.

I.3 Is tax necessary?

In theory taxes aren't necessary in any economy. Any government could, if it wished, simply print its own money to buy the goods and services it desires without ever taxing anyone. The reality is that the track record of printing money without economic constraint is not good because hyperinflation can result; taxes are needed to make sure the right balance between state and private spending is achieved by broadly matching tax revenues with a government's spending plans.

There are two other reasons to tax. The first is to achieve the social objectives noted above. The other, often unnoticed, reason is that taxes are essential to give credibility to a government's currency. If tax has to be paid using that currency then there is no choice but to use it for most other money-based transactions. This underpins a government's control of the economy

I.4 The concept of tax justice

Tax justice, like an elephant, is hard to define though you recognise it when you see it.

Tax justice is built on the basis of mutual obligations from:

- the taxpayer to the state;
- the state to the taxpayer;
- states to each other.

The taxpayer

For taxpayers, tax justice means they accept their duty to the states in which they trade or reside to declare all their income and other transactions fairly and openly and to

pay all taxes owed as defined by the spirit of the law of that country or countries. This means that:

- they never evade their taxes;
- they do not seek to avoid their taxes;
- they seek to comply with the spirit of the tax laws of all the states that applies to them so that they pay the right amount of tax in the right place at the right time.

The state

Tax justice is a game with two players. It's not enough for the taxpayer to play their part: the state to which taxes are paid has a duty to create a tax system that:

- Requires each person (whether a real person or a corporate entity or trust) to pay tax according to their means;
- Imposes no undue cost on them to comply with that law;
- Provides them with reasonable certainty as to what is due;
- Limits the opportunities for tax avoidance that otherwise provides some taxpayers with discretion about how much tax is paid;
- Is as clear and concise as possible;
- Provides a system of access to information and arbitration when the law is not clear;
- Imposes a duty to ensure that taxes are applied impartially, meaning that:
 - administration of tax has to be and be seen to be free of corruption;
 - collection of tax is enforced, within the spirit of the law;
 - taxes received are openly and transparently accounted for;
- Ensures state expenses are budgeted and accounted for through democratic and transparent processes.

In addition a state has to avoid the following:

- Regressive tax systems that charge people on lower incomes to a higher proportional rate of tax than those on higher incomes;
- Oppressive tax systems that charge a source of income to tax more than once;
- Inconsistent tax systems that charge similar types of income in different ways or at substantially different rates. Examples include taxing identical income at different rates when received by individuals or the corporations they own;
- Incomplete tax systems that are either not comprehensive in their scope or allow income to fall through loopholes. Both encourage tax avoidance and non-compliant tax behaviour.

The international dimension

Tax justice has an international dimension: states must cooperate to ensure the following are avoided:

Competing tax systems. Nation states are not in competition with each other in the same way that firms compete for clients. Competition can only exist in that way when consumers (in this case entire populations) can choose between competing suppliers. Trying to apply the microeconomic theory of the firm to nation states is therefore false in theory and dangerous in practice; in microeconomic theory, if a company fails it will be replaced by another company. That is not true when nation states fail; then the international community must intervene to prevent social and economic meltdown. What this suggests is that the notion of tax competition is based on political ideology rather than economic theory, and it promotes economic injustice. In practice it favours the interests of the tiny number of people who own the majority of the world's businesses. Far from promoting the efficient allocation of the financial capital, tax competition encourages mobile capital to scour the world in search of tax breaks and subsidies, which negates the entire basis of globalisation theory. As a result tax competition invariably results in social harm and has to be curtailed.

States offering their sovereign space for hire to the citizens and legal entities of other states for the purpose of enabling the latter to avoid their obligations to the state in which they either reside or trade. This is effectively the service provided by secrecy jurisdictions to their clients. Acting in this way undermines the right of other governments to exercise their own sovereign will and as such is tantamount to economic warfare.

This report seeks to explore ways in which taxpayers and states can act in accordance with these principles of tax justice.

Taxes have to be planned as part of a system which includes welfare benefits and not in isolation, and they have to cover the broad scope of economic activity. In tax terms this means a just tax system has to have what is called a 'broad tax base.'

1.5 What is a just tax?

A just tax is:

- Part of a system of taxes that meets the overall objective of tax justice. This means a variety of taxes are required. Taxes are applied to populations made up of different people with a wide variety of incomes, values, consumption preferences and savings choices. In such real world circumstances governments should not rely on just one or even one or two taxes to meet all or most of their tax objectives. In practice, however good a tax is it cannot be judged in isolation.
- Comprehensive on the source of revenue that it is supposed to charge. Income taxes that allow some income to be untaxed, sales taxes that ignore some sales, and tax systems that ignore gains from the sale of capital assets all provide opportunities for abuse because they are not comprehensive. Importantly, however, comprehensiveness must also take into account exemptions

and reliefs in support of a government's social policy.

- Progressive when viewed as part of the whole system of taxes. This means that overall, taking all taxes into account and having regard to those who are likely to pay, taxes must start at low overall rates and with low absolute amounts due from those on low income and both the absolute amount of tax due and the absolute percentage rate at which it is paid increase with the income a person has or can command, including incomes arising from ownership of companies, and from trusts and foundations.
- Not significantly different in rate from other taxes on the nearest equivalent form of income charged by the same state. Charging substantially different rates of tax on earned and unearned income, or on corporations and individuals will inevitably provide opportunities for tax avoidance.

This means that taxes have to be planned as part of a system (which includes welfare benefits) and not in isolation, and they must cover the broad scope of economic activity. In tax terms this means a just tax system has to have what is called a 'broad tax base'.

1.6 Why tax justice matters

Tax justice matters because a modern economy requires that the state has sufficient revenue over time to fund the physical and social infrastructure essential to economic welfare. It should also enable a degree of wealth redistribution between rich and poor people to promote equity and security. Failure to achieve the first objective because of poorly designed, unfair or leaking tax systems is likely to yield economic failure, while failure to achieve the second objective will lead to social failure. In either case the costs to society are enormous. Tax justice is, therefore, at the heart of stable and democratic forms of government.

Box 1 provides a startling indication of the scale of global wealth that escapes taxation and the losses, in terms of tax revenue, that are involved. This indicates just how far we are from achieving tax justice at present.

Box I: The value of wealth held offshore

At least \$21 trillion and possibly as much as \$32 trillion of hidden financial assets is held offshore by high net worth individuals (HNWIs), according to TJN's report *The Price of Offshore Revisited*, which is thought to be the most detailed and rigorous study ever made of financial assets held in offshore financial centres and secrecy structures. We consider these numbers to be conservative. This is only financial wealth and excludes a welter of real estate, yachts and other non-financial assets owned via offshore structures.

The research commissioned by TJN from former McKinsey & Co Chief Economist James Henry draws on data from the World Bank, the IMF, the United Nations, central banks, the Bank for International Settlements, and national treasuries, and triangulates his results against data reflecting demand for reserve currency and gold, and data on offshore private banking studies by consulting firms and others.

Other main findings of this wide-ranging research include:

- that at the end of 2010 the Top 50 private banks alone collectively managed more than \$12.1 trillion in cross-border invested assets for private clients, including their trusts and foundations. This is up from \$5.4 trillion in 2005, representing an average annual growth rate of more than 16%.
- the number of the global super-rich who have amassed a \$21 trillion offshore fortune is fewer than 10 million people. Of these, less than 100,000 people worldwide own \$9.8 trillion of wealth held offshore.

If this unreported \$21-32 trillion, conservatively estimated, earned a modest rate of return of just 3%, and that income was taxed at just 30%, this would have generated income tax revenues of between \$190-280 bn – roughly twice the amount OECD countries spend on all overseas development assistance around the world. Inheritance, capital gains and other taxes would boost this figure considerably.

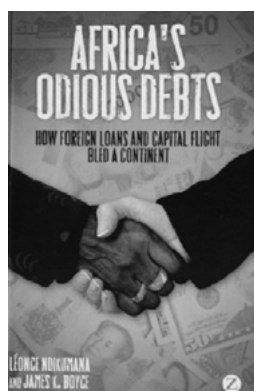
- For our sample frame of 139 mostly low-middle income countries, traditional data shows aggregate external debts of \$4.1 tn at the end of 2010. But take their foreign reserves and unrecorded offshore private wealth into account, and the picture reverses: they had aggregate net debts of minus US\$10.1-13.1 tn. In other words, these countries are big net creditors, not debtors. Unfortunately, their assets are held by a few wealthy individuals, while their debts are shouldered by their ordinary people through their governments.

1.7 Tax justice and inequalities of income

Global tax systems have become increasingly regressive over the past thirty years. This is largely due to a policy shift away from taxing business towards taxes on consumption and labour, such as VAT and payroll and income taxes. Much of the blame for this increase in the number of regressive taxes can be fairly laid at

the door of the IMF and World Bank, both of which have required governments to drop tariffs on imports and to substitute taxes like VAT on consumption in their place. In many cases these substitute taxes have not raised as much as the taxes they have replaced. This has resulted in less spending on education, health and other crucial services, which in turn has led to increased unemployment.

Recommended reading:



“Africa is actually a net creditor to the rest of the world. Of the money borrowed by African governments, more than half departs in the same year, with a significant portion of it winding up in private accounts at the very banks that provide the loans. Meanwhile, debt-servicing means less money for public health and other needs.”

These changes have been regressive because business profits and capital income are largely paid to richer people, whereas poorer households spend proportionately far more of their disposable income on consumption and have been paying more of their income in tax as a result. The poorest households in the world are, of course, in poorer countries where this trend towards regressive taxation has been most marked. This trend towards more regressive tax systems partly explains why income and wealth inequality has increased in so many regions of the world. That same trend has also forced more people to borrow to make ends meet: this has worsened the debt crisis which has caused severe social and economic disruption since 2008.

This shift towards regressive taxation has been accompanied by a significant increase in the use of secrecy jurisdictions by wealthy people and corporations seeking to dodge their tax obligations. This is illustrated by the case of the British Channel Island of Jersey, a major secrecy jurisdiction closely linked to the City of London.

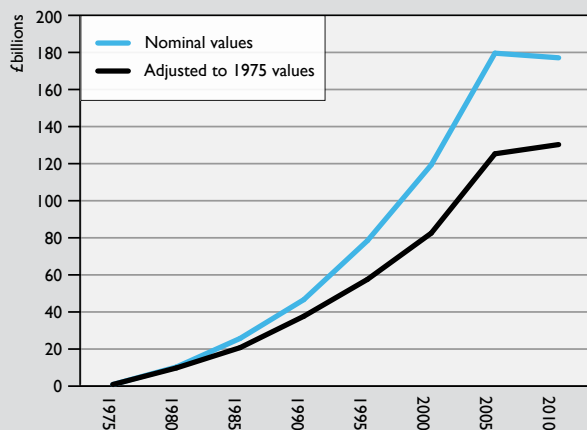
The subjects of every state ought to contribute toward the support of government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.

Adam Smith

In combination, more regressive taxes being charged on most households coupled with lower top rates of tax on income and corporate profits, and greater use of tax havens for dodging taxes due, has resulted in a significant shift in the distribution of the tax burden, with a large number of super-rich people being able to simply avoid paying tax or being given preferential treatment.

Box 2: Funds in Jersey

Growth of banking deposits in Jersey since financial market liberalisation

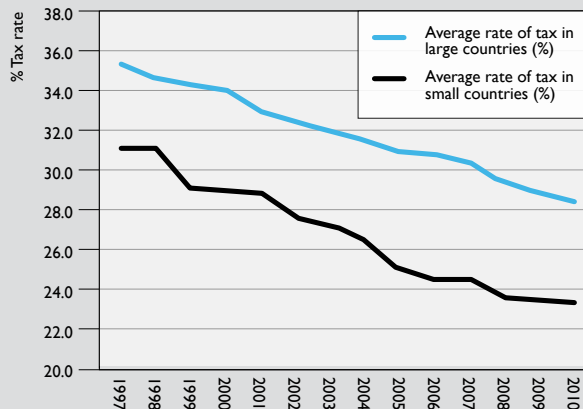


Jersey is a major tax haven. As this graph shows, with figures also adjusted for inflation, the volume of offshore deposits it held rose enormously from 1980 onwards as the capital market liberalisation introduced by Prime Minister Thatcher in the UK and President Reagan in the USA and which spread throughout the world saw tax havens flourish. Only the 2008 global financial crisis slowed the growth.

Source: Jersey Finance.

Box 3: The decline in corporate tax rates

Corporate tax rates 1997–2010



The tax rate on the profits of corporations has been falling steadily since 1997. The following graph is based on tax rate data for nearly 70 countries. They have been split for presentational purposes between those with populations of more than 15 million (large countries) and those with smaller populations (small countries). What is clear is that in both cases the trend in corporate tax rates has been heavily downward. Companies are paying less tax as a result. Evidence since 2010 suggests the trend is continuing.

Source: KPMG.

Tax havens are justified by their proponents on the grounds that they offer a legitimate way for people and companies to avoid unfair tax burdens and regulation. This assumes, however, that all citizens and companies are equally mobile, which is not the case, and also ignores the free-rider problem. In practice tax havens simply help those who are already wealthy to shelter at least part of their income and wealth from taxes that might be due. The result is that such places deliberately and knowingly promote inequality and injustice.

Promoting equity through the tax system

- Justice requires that people be treated alike if their circumstances are similar. Unhappily, many tax systems around the world encourage differential treatment of people who should be treated alike. Examples include:
- Not all income is subject to tax. If people on similar income derive it in different ways and some income is taxed and some (for example, from capital gains) is either not taxed, or is taxed at lower rates, then they will have different tax bills;
- Different tax structures are taxed in different ways e.g. in some countries self-employed income received through private corporations is taxed more favourably than that received directly by an equivalent self-employed taxpayer;
- Unclear law allows different tax deductions to different people. If the law is badly drafted or poorly administered it may be possible for some people to claim deductions against their income that others cannot secure;
- Corruption is a fact of life in many parts of the world. Some people may resort to bribing tax officials when others do not;
- Advantages are given to foreigners. Many tax systems provide benefits to people temporarily resident in a country that are not available to those born in it. This is the case in the UK, where the so-called “domicile rule” discriminates between people on the basis of their national origin;

- Those with different consumption patterns pay significantly differing amounts of sales tax. Most especially, those who are well off and who can save automatically pay less as a proportion of their income in consumption taxes than do those who have to spend all their income to make ends meet.
- Issues such as these can be a serious cause of political tension and conflict.

The gender implications of tax justice

Tax injustices impact on individual welfare across the world, but especially on poor and lower income households, many of which are headed by women. Inequality of tax treatment matters to such households in particular because:

- poorer households must to be able to survive on their after-tax income;
- income is unfairly distributed around the world; 2.5 billion people lived on less than US\$2 a day in 2008, the latest year for which data is available;
- the distribution of tax as well as the distribution of income has an impact on household welfare;
- some taxes, especially those on consumption, can have a greater impact on welfare than others.

These issues are of particular importance to women. Women typically earn less than men, but the bulk of the responsibility for childcare falls on women in most societies and, in many cases, the financial burden of bringing up children also falls on mothers. This means women are especially vulnerable to a variety of unjust tax measures:

Sales and consumption taxes are particularly penal on women and children who often suffer the lowest levels of income in society. This happens because sales taxes are charged on everyone, regardless of whether their household income falls below the threshold at which income tax becomes payable.

The shift towards greater use of sales taxes has arisen in response to increased tax competition. Because multinational businesses can exploit opportunities for tax competition

which consumers and normal citizens cannot, corporation tax rates have been falling steadily and the shortfall in government income is often made up by increasing sales taxes or by cutting state expenditure.

Women and children almost always suffer most from cuts in government spending. Both require more healthcare services than men, and children need education, which is expensive.

Benefit systems are often badly designed and poorly integrated within the tax system resulting in many women and children being effectively trapped into patterns of poverty. This occurs even in wealthy countries because the effective rates of tax they suffer as they start to work are punitive due to the combination of tax being charged and benefits being withdrawn.

The insidious impact of tax competition

Many business lobbies urge countries to compete with one another to attract inward investment by offering:

- lower tax rates on profits;
- tax holidays;
- accelerated tax allowances for spending on capital assets
- subsidies;
- relaxation of regulations;
- the absence of withholding taxes;
- other forms of tax inducement

This process, called tax competition, has been widely adopted across the world and has become a key element in shaping world-wide investment flows. The IMF, World Bank and EU have all, in varying ways, encouraged developing countries to compete in this way for inwards investment. Tax competition is, however, fundamentally flawed as a development strategy because it limits the control any country can have over taxation policies and creates harmful distortions.

Nations do not compete with each other for the loyalty of their citizens. Nor do they compete in the provision of services. The vast majority of people must use the services of the state in

which they live and the concept of introducing 'competition' between states makes no sense in terms of promoting meaningful choice for users of public services. Instead, by creating downward pressure on tax rates, tax competition reduces the capacity of states to finance public services effectively and in an equitable way.

In addition, tax competition does not, contrary to the argument of those who support it, exert competitive pressure on governments to be more 'efficient'. Governments are not profit-maximisers in the economic sense of that term and do not collude with one another to raise tax levels in the way that businesses frequently collude to raise price levels. In a democratic system governments are accountable

Women and children almost always suffer first when there are cuts in government spending.

to their electorate, who are highly conscious of tax levels and must be allowed to decide between high tax / high spend and low tax / low spend governments. Seeking to create an artificial 'competition' between different states undermines the ability of electorates to choose between these options and is fundamentally anti-democratic.

Distorting the international trading system

In addition to being fundamentally anti-democratic, tax competition is also harmful to the functioning of global trade in two ways. First, tax competition distorts investment flows by diverting investment to territories where, in many cases, it is used inefficiently. That inefficiency is only compensated by the tax subsidies the investment attracts. The only winners in such a process are the mobile businesses that can play one government off against another in order to secure tax advantages and subsidies. This is why the rise of tax competition has been so closely related to the growth of globalised business, and in turn to the increase in global wealth inequality that has been intimately related to the process of globalisation.

Large, old, international companies obtain many tax advantages that small, new and nationally based companies do not, which undermines any possibility of there being a level playing field in trade taxation.

In combination, tax competition, aggressive tax avoidance, tax evasion and the associated illicit capital flight to offshore finance centres imposes a massive cost on developing countries. This cost exceeds aid flows by a considerable order of magnitude and also distorts investment patterns to the extent that it undermines growth in developing countries whilst also stimulating asset market bubbles in developed and developing countries.

Second, poor taxation systems can affect the international trading regime because:

- Most tax systems are biased towards larger companies that can:
 - set up offshore companies without question in cases where individuals or small companies cannot.
 - afford complex legal advice to make it appear they acted in accordance with the law.
- Most tax systems are biased towards older companies that have frequently been set up using structures that are now illegal, but which remain unchanged since the time they were created. This often allows them to operate offshore when new companies cannot.
- Tax systems are biased towards multinational companies:
 - MNCs find it much easier to abuse transfer-pricing rules since these require at least two countries to be involved.
 - MNCs are more able to lower their tax rates using licensing and royalty arrangements for intellectual property, the use of thin capitalisation arrangements to provide intra-group funding from tax haven based internally owned treasury functions (effectively the MNC's own internally owned bank) and through hedging and derivative trading operations.
 - MNCs can exploit tax arbitrage techniques.

Very often all three characteristics combine so that large, old, international companies obtain tax advantages that small, new and nationally based companies do not, which undermines any possibility of there being a level playing field

in trade as a result of distortions inherent in taxation systems. As a result start-up businesses are placed at a disadvantage and additionally suffer higher tax compliance costs in proportion to their trade.

This tax distortion is to be found around the world in countries large and small, developed and developing, tax haven or not. Since the global economy is driven as much by small businesses as large ones, tax injustice is clearly a significant impediment to businesses around the world as well as to a more just international trading system.

Small investors are disadvantaged

Ordinary stock market investors, not all of whom are wealthy, can also be prejudiced by current taxation practices. A significant part of the wealth invested in stock exchanges around the world is controlled by pension funds and life assurance companies. Many of those who save through such institutions are on relatively modest incomes.

Tax justice concerns arise for many ordinary people because their savings are being invested in companies that are not transparent about the taxation risks they face. Recent research in the UK shows that at least 80% of the largest UK based companies do not pay tax at the rates expected of them. This situation is worse in the USA, where Citizens for Tax Justice and the Institute on Taxation and Economic Policy analysed 280 of America's most profitable companies and found that 78 of them paid no federal income tax in the period 2008-2010. It's worth mentioning that the 280 companies also received a total of US\$223 billion in tax breaks. In fact, the report unearthed 30 companies that enjoyed a negative income tax rate over the three year period, while reporting profits totalling US\$160 billion.

These companies suggest they exploit tax breaks to deliver shareholder value. In reality they do so to artificially lift the share price. If that share

price ever fell because these tax breaks were closed it is the saver and not the company directors who would lose as a consequence. That is why the claim that tax is just another cost to these companies that must be minimised on shareholders' behalf is wrong on a number of counts:

- First, shareholders benefit from tax paid by corporations. That tax provides health, education, welfare, the maintenance of peace and stability and other benefits on which communities depend. While brokers, analysts and company directors might argue for tax minimisation this does not necessarily reflect the views of the real shareholders, who are seldom if ever consulted on this matter.
- Second, because corporations have to make very little disclosure about the taxes they pay in most countries there is no way of knowing whether the tax liability they declare to be due is sustainable or not. If the figure is not sustainable a current under-declaration will lead to an overvaluation of shares because companies tend to be valued on post-tax earnings. If companies are overvalued those with long-term savings, such as people saving for retirement, will eventually lose out.
- Third, the possibility for inflating share prices by reducing tax charges encourages senior management to aggressively avoid tax because their share options are triggered by increases in the stock value. This puts their interests in direct conflict with those of shareholders seeking long-term rates of return on their investment. This led to many of the problems of corporate abuse of the tax system seen in the US, in particular in the late 1990s, which imposed a heavy price on many shareholders in the subsequent collapse of the stock market. This pattern recurred in 2008.
- Fourth, investors might want to invest in companies that are managed on an ethical basis. Many aggressive tax avoidance practices would be considered ethically unacceptable, but without greater disclosure investors do not know which companies are engaging in such practices.

Sustainable development depends on tax justice

Tax policy is an essential element of the sustainable development agenda and tax injustice represents an important obstacle to poverty reduction.

Tax competition imposes direct costs on governments, and the biggest losers are amongst the poorest countries. TJN-Africa and Action Aid International have estimated that just four East African countries, Kenya, Rwanda, Tanzania and Uganda, lose tax revenues amounting to US\$2.8 billion a year from unnecessary tax exemptions and incentives provided to foreign companies. In many cases

The outcome of these failures has been the creation of the gaps, spaces and loopholes in which abuse occurs. The entire tax avoidance industry is based on exploiting these gaps, spaces and loopholes. Sustainable development is not possible without their removal.

governments are forced to provide these unnecessary tax breaks, either because the companies concerned use their political bargaining power to play one country off against another, or because governments are told to offer reduced rates by the IMF or World Bank as a condition of obtaining financial support. Guided by its ideological fervour, the World Bank even lists lowering tax rates as one of its guidelines for identifying "business-friendly" countries.

Much of the money lost to poorer countries as a result of the actions of multinational corporations is moved to tax havens. The sums noted are, of course, estimates, but real examples like the Vodafone case in India illustrate the problem. By routing the sale of an Indian telephone network through the Cayman Islands, Vodafone shifted some \$2.9 billion of tax away from India. The Indian government is still trying to collect this sum.

How to test tax justice?

It is important to have simple tests available that will help assess the tax justice of an action. Two such tests are needed.

The test for a taxpayer is that they should

ask this question: If any reasonable person, newspaper or government knew what I am doing, is it likely that they would either:

- consider it illegal, or
- consider it legal, but might want to change the law to prevent others acting in the same way in the future.

If either of these are true then clearly the action is not consistent with tax justice.

The test for anyone in government considering their taxation system is also in two parts: is our tax law just to all those who might have to pay it, taking all its components into consideration?

- if another government behaved as we do would we consider their actions a threat to the welfare of our state or its taxation revenues?

If there are doubts in either case then action is needed to remedy the defects.

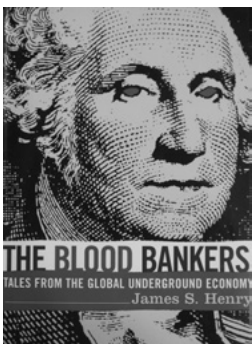
Conclusions

Unjust tax practices incur costs that fall most heavily on poor people. They also threaten the fabric of our society and undermine the commercial trust that is the basis of modern economies.

Unjust tax practices do not happen by accident. While the majority of people suffer as a result of tax injustices, a small minority benefit enormously from them. It is to these people that we now turn our attention and ask fundamental questions such as:

- Who creates unjust taxation practices?
- What exactly do these practices consist of?
- Who now promotes unjust taxation practices?
- What can be done about them?

Recommended reading:



“The ownership of Third World wealth onshore and offshore is now even more concentrated than it was before the debt crisis in the 1980s and the privatisation wave of the 1990s. Depending on the country, the top one percent of households now accounts for seventy-five to ninety percent of all financial wealth and real estate.”

2. CAUSES OF TAX INJUSTICE

Tax injustice is widespread and occurs on a massive scale. But tax injustices happen for specific reasons, all of which arise from human interventions. So who are the people that benefit from tax injustice and how have they shaped tax policies to obtain their goals? Before we consider this question we need to identify in broad terms the reasons why tax injustices occur.

The most common roots of tax injustice are:

- the failure to promote comprehensive tax systems;
- the promotion of regressive taxes;
- the failure to charge all income to tax;
- failures of tax administration;
- the promotion of tax havens to hide income from tax and to shelter criminal practices;
- the existence of professions willing to undermine the tax system.

The outcome of these failures has been the creation of the gaps, spaces and loopholes in which abuses occur. The entire tax avoidance industry is based on exploiting these gaps, spaces and loopholes. Sustainable development is not possible without their removal.

2.1 Onshore is important

The most obvious thing to say about this list is that more of it relates to what happens within states than what happens offshore or in the international arena. Tax justice is both a domestic and an international issue. The two are related, but it is important to remember that most people never leave their country of birth, never have income arising outside that country and never engage with the international tax system, but that does not mean they don't suffer from tax injustice. Therefore, for the vast majority of people, tax is a domestic issue determined by their place of birth, but so too in that case is tax justice.

2.2 Comprehensive taxation systems are crucial

Tax is the ultimate political battleground. Conflicting interests need to be resolved equitably if justice is to be achieved. It is important that no government is allowed to prolong systems of tax injustice on the entirely false basis that "there is no alternative". There are always alternatives in tax.

Any government seeking to pursue the cause of tax justice would promote the following taxes:

- An income tax, probably split between federal (or national) and local levels and charged on income from:
 - employment;
 - self-employment in any form of trade;
 - investment income from savings, dividends and speculation of all sorts;
 - rents, royalties and licence fees;
 - profits not taxed by other taxes;
- A corporation tax on company profits unless they were charged to income tax;
- A financial transaction tax designed primarily to curtail socially useless high volume, low margin trading;
- Property taxes, preferably based on the taxable value of the land;
- A capital gains tax on the increase in the value of assets over time, paid on their sale;
- An inheritance or gift tax on the disposal of assets by gift during lifetime or on death;
- A wealth tax;
- A sales tax (although with specific exemptions for essential items such as food, housing, heat and light, education, health, and basic clothing, at least for children).

- Environmental taxes, including taxes on waste and carbon usage.
- Withholding taxes on income paid abroad.

Payroll taxes may discourage employment, but in many cases they also raise substantial revenue. If it is necessary to ensure overall tax rates are kept at a reasonable level, then a payroll tax may be added to the list. For our purposes we do not consider the withholding of income tax from wages to be a payroll tax. Such taxes have a variety of names, most commonly including national insurance and social security.

Make everything as simple as possible, but not simpler.
Albert Einstein

Such a wide variety of taxes does not necessarily make for a simple tax system, and the situation is further complicated by the fact that any tax system must be integrated with the welfare benefits system for the relief of poverty and care for the disabled and unemployed. This integration is essential to ensure penal taxes are not imposed when benefits are withdrawn as earnings increase. There are, however, good reasons why such comprehensiveness is essential:

- with a broad range of taxes no single tax is excessively important in the income of the government. That means each tax can be charged at a reasonable level, thus reducing the incentive to avoid or evade it;
- with a comprehensive range of taxes charged at broadly compatible rates if one tax is avoided there is a reasonable probability that another tax will catch that income instead. For example, if income which a taxpayer seeks to reclassify as a capital gain is caught by a capital gains tax at a largely similar rate then whole exercise of avoiding the income tax becomes a waste of time. In the absence of a capital gains tax the temptation to wrongly describe income in an attempt to avoid tax increases substantially;
- different taxes address varying sections of the taxpaying population, and in combination achieve an equitable and progressive spread of taxation across society as a whole;

- some taxes are included less for their contribution to revenues (this is probably true of most capital gains and gift and inheritance taxes) but more because the opportunity for avoidance is much higher without them and because the information they provide helps to ascertain whether other tax liabilities are being fairly assessed.

Comprehensiveness is also required in the design of the taxes. In principle the base for each tax should be as broad as possible, meaning that the tax applies to as wide a range of transactions as possible, is not limited in scope, and is subject to as few exemptions and incentive deductions as possible. A major objective must be the prevention of unnecessary loopholes, subject always to the need for those allowances needed for the implementation of social policy.

2.3 Regressive taxes should be avoided

All comprehensive tax systems will include some regressive taxes. Sales and carbon taxes, for example, may well be regressive in their impact on poorer households, but, if they form part of a comprehensive system of taxes and benefits, regressive outcomes can be mitigated through other parts of the fiscal system.

Arguments put forward in favour of having just one or two 'simple' (typically 'flat rate') taxes must be treated with suspicion. Almost invariably such taxes are promoted either by the wealthy or by those who act on their behalf. Research has shown that a 'flat rate' tax system is likely to result in a considerable overall shift of the tax burden on to households with lower incomes.

2.4 The challenges posed by international income

Even when a country has established fair taxation within its boundaries there remains a significant risk that the resulting system could be unjust because it may not charge international income to tax appropriately. This problem might arise for two reasons:

- first, the tax system may fail to charge to tax income arising within its territory but which belongs to people resident elsewhere, or;
- second, it may fail to charge to tax income belonging to people who are resident in its territory when that income is earned elsewhere.

Both these failings are commonplace, and both give rise to tax injustice. It is contrary to the principle of fairness that people should be treated differently when they have similar sources of income because:

- they live in different places that happen to be divided by an international border even though the income they enjoy is earned in the same place, or;
- they can shift the source of their income outside the country in which they live but it is otherwise similar in all respects to an income that would have been taxed within that country if it had arisen within it.

For this reason countries have to adopt rules to tackle these issues. No single rule can tackle this problem comprehensively: just as a range of taxes are needed to ensure tax is fair, so a range of rules are needed to ensure different sorts of income are taxed fairly when international issues are taken into account.

Around the world business lobbies argue for simplification of the tax codes, suggesting that all that is needed for tax injustices to be solved are simpler rules. Sadly, this is not realistic: in a complex, globalised world tax systems have to reflect the complexity that business and internationally mobile people deliberately create. Tax systems also have to explicitly permit the complexity that business creates because much of it is necessary to permit international trade. Einstein famously proposed that we “make everything as simple as possible, but not simpler”, and this applies to tax policy as much as any other policy area: simplicity for the sake of simplicity is likely to create more loopholes for multinational businesses and wealthy people to exploit, meaning that more of the tax burden will fall on ordinary people who are not internationally mobile.

In this case the first requirement of an international tax system is a comprehensive way of determining where a person, company, partnership, trust or foundation might be resident for tax purposes, and if it is resident in more than one place. This is not always easy because far too many of the rules currently in use were designed in the steamship age and are inappropriate for the internet era.

A second requirement, when activities being carried out in country A can be managed

remotely from country B using sophisticated IT systems, is to recognise that many of the concepts on which international tax is currently based, such as physical presence in a place being the factor determining whether someone is taxable or not, are irrelevant. Once again most tax administrations remain stuck in the age of the steamship and telegraph.

Much of the work undertaken on tax havens, and a large part of the tax planning industry, involves exploiting legal loopholes for tax planning purposes, which ultimately involves tens, and maybe hundreds, of thousands of trained accountants, lawyers, and bankers in an activity that is wholly unproductive and anti-social.

The result is that if we are to have comprehensive tax systems some complexity is needed and some principles have to be agreed. To begin with, all countries should have the right to charge income, gains, sales, gifts and financial transactions arising in their territories to tax there, whoever makes them. This is called a source basis for taxation. What it means is that even if the person being taxed might be resident in another country, the country in which the transaction is taking place must have first right to tax the income arising on it.

Traditionally, and appropriately, source based taxes are either levied on sales or by withholding tax from payments made out of a territory. The first is essential to ensure a level playing field with local businesses; the second reduces the risk of double taxation, while withholding taxes eliminate the risk of non-taxation. Source based taxes are an essential component of the international taxation armoury.

Residence based taxation is also vital. Under this concept a person or company who is considered to be located in a jurisdiction is taxable there. Ideally they should be taxed there on their worldwide income: a remittance basis where income from overseas is only taxed when brought into a person's place of residence simply encourages tax haven activity. Territorial bases of tax, which only tax income that is actually earned in the place that a person or company is resident are even worse: such bases merely encourage those with control over their income streams (largely the preserve of wealthy people and large companies) to relocate that income out of the country where they are resident.

In the real world a country cannot rely on just a source or residence basis of taxation. A combination of both is needed and the remittance and territorial bases of tax should be avoided. Even then, a further set of provisions may be required to capture those who want to exploit any remaining gaps. This might require a citizenship basis for individuals and a unitary basis for companies, both needing to be used when the taxpayer or company has a substantial international dimension to their taxation affairs. It is only through such a 'layering' approach to taxation that the problems of tax injustice on international income can effectively be tackled.

It is not possible to have flourishing, corruption free states without strong administrations to provide them with the revenues they need to fulfil the reasonable expectations of their peoples.

Strengthening tax systems should therefore be a high priority.

2.5 How tax administrations might fail to ensure tax justice

Tax administrations can fail at numerous levels:

- tax law is not clearly written meaning what is taxed is not clear;
- tax law is not readily available to everyone who wants it;
- tax law is not fairly applied;
- there are few or excessively expensive means of appeal against decisions made by taxation authorities;
- tax is not collected in an even-handed manner;
- tax authorities fail to coordinate with each other, either within a country or internationally to ensure fair taxation is applied to a source of income either within, or from outside, the country;
- tax administrations do not have the resources they need to conduct their work properly;

- the burden of tax administration is passed to the private sector without clear guidance being given, but with penalties being imposed for failure to comply with the law. There is particular risk of this in the administration of payroll taxes, taxes on employed income and all forms of sales tax;
- the tax administration is corrupt.

These are serious issues. If a tax system is not backed by fair law it cannot yield tax justice. While the tax administrations of many countries are reasonable, those in other countries are not. This is not, it should be stressed, necessarily due to corruption: the root cause is often the scarcity of skilled and experienced revenue officials, who are all too often poached by the private sector to work on 'the other side'.

Tax justice requires that tax administrations receive the resources they need to fulfil the tasks required of them. It is not possible to have flourishing, corruption-free democracies without strong tax administrations. Strengthening tax systems and the agencies that deliver them must become a high priority, not least among the international funding agencies and donor countries who, thus far, have paid insufficient attention to building sustainable public finances in poorer countries.

2.6 Secrecy jurisdictions are a root cause of tax injustice

There is little that has contributed more to tax injustice than the promotion of secrecy jurisdictions by bankers, lawyers and accountants wanting to profit from abusive tax practices.

Secrecy jurisdictions are, in many senses, fictional spaces. Of course there is a physical place that bears their name, but secrecy jurisdiction operations have a common characteristic: the transactions they record do not really take place in the secrecy jurisdiction where the accounting takes place. Those transactions actually take place somewhere else, and it is 'elsewhere' that defines offshore. 'Offshore' does not refer to small islands set in wide oceans, it simply means 'not here'. As a result secrecy jurisdictions are primarily used as 'booking locations'. All they provide is a place to record a transaction whose impact is elsewhere. As a result the use of secrecy jurisdictions invariably involves a degree of sham or pretence.

In the secretive, parallel universe of tax havens, structures can be set up to carry out real functions in the real world but without any requirement for a transparent legal presence to confirm their existence or the nature of their activities. This creates the opportunity for all sorts of illicit activities.

A common factor of all secrecy jurisdictions is that a company registered in one need put almost no information about its affairs on public record and very often it need supply no account of its activities to any office of the government of that jurisdiction. Even if the names and addresses of the shareholders and directors must be reported, it is almost never required that these be on public record, and nominees are allowed. A nominee name is a person who is paid a small fee to say she is a director of a secrecy jurisdiction company when in fact she has no real involvement in its operation.

To add to this air of secrecy and artificiality, many secrecy jurisdiction companies are owned by trusts. These trusts are themselves set up offshore, typically in a different territory from that in which the company they own is registered. The trustees of that trust (who will, almost certainly, also be nominees) will usually be located in a third secrecy jurisdiction. To add yet more complexity, the bank account of the company or trust may be located in yet another secrecy jurisdiction. Within the tax avoidance industry it is generally thought that involving three or more secrecy jurisdictions in a tax evasion structure will make it nigh on impossible for outside authorities to investigate what is really happening, and who is benefiting from it.

There is a further advantage to the person who sets up such an arrangement. Officially the company, trust, and trustees, and bankers

might each be located in different territories, but equally each of them might suggest that their activities do not record transactions that actually take place in the country in which they are located. The outcome is that the activity appears to take place nowhere. That is the ultimate goal of such arrangements, for the aim is to make them accountable to no one, pay tax to no one, and to have no duty to report anything to anyone because it can deny it is anywhere.

The result is that in the secretive, parallel universe of secrecy jurisdictions, structures can be set up to carry out real functions in the real world but without any requirement for a transparent legal presence that confirms their existence or the nature of their activities. This creates the opportunity for all sorts of illicit activities by:

- allowing tax evasion to take place largely undetected;
- facilitating capital flight;
- allowing other crimes such as money laundering, insider trading, drug trafficking, people trafficking and more to take place largely undetected.

All these things undermine civilised society. The offshore economy of secrecy jurisdictions is a massive root cause of social and tax injustice.

“They say that the ancien regime in France fell in the 18th century because the richest country in Europe, which had exempted its nobles from taxation, could not pay its debts. France had become . . . a failed state. In the modern world the nobles don’t have to change the laws to escape their responsibilities: they go offshore.”

Nick Shaxson, Treasure Islands, 2011

Recommended reading:



3. KEY PLAYERS IN TAX INJUSTICE

Tax injustice does not happen by chance. It typically occurs as a result of careful and deliberate planning, especially in the case of the tax avoidance industry. Huge resources are devoted to this industry because the profitability of tax avoidance is far higher than that of most other types of financial services activity.

The following are the main players who promote tax injustice:

- accountants;
- lawyers;
- banks;
- multinational companies;
- tax haven governments;
- individual tax dodgers.

The following are trying to tackle the problem:

- the Organisation for Economic Cooperation and Development;
- the United Nations;
- the European Union;
- the G20;
- national tax authorities;
- civil society.

Other agencies e.g. the International Monetary Fund and Financial Action Task Force also have a

role in regulating money laundering and related activities in secrecy jurisdictions. Here we concentrate on tax issues.

At present those who promote tax injustice have the upper hand in this battle because globalisation and technological change have made it easier for rich individuals and businesses to avoid paying taxes. It is for this reason that civil society organisations around the world must intervene to tackle this issue. By raising the issue on the international agenda for the past decade civil society aims to generate the political will to tackle abusive tax practices.

3.1 The origins of the tax avoidance industry

It is important to understand some of the historical background to the current situation.

The 'offshore' phenomenon probably began in the US in the late nineteenth century when states such as New Jersey and Delaware realised they could lure businesses from more prosperous states by offering tax advantages on condition that they register in their states. Incredibly, although this practice began so long ago it was and still is similar to many modern tax haven practices.

The first real international use of tax havens probably started in the early twentieth century in the British Empire when wealthy people started to use offshore trusts established in places like the British Channel Islands to exploit the curious British phenomenon of the separation of taxation residence and domicile. This abuse resulted from two causes. The first was the spread of the British Empire, and British

Don't be evil: Google Inc. cut its taxes by US\$3.1 billion using a technique that moves most of its foreign profits through Ireland and the Netherlands to Bermuda.

Google's income shifting – involving strategies known to lawyers as the “Double Irish” and the “Dutch Sandwich” – helped reduce its overseas tax rate to 2.4 per cent.

capital with it. The second cause was the increase in tax rates during the World War One.

In the 1920s the UK created new ways for internationally mobile capital to avoid tax. This was precipitated by a UK court ruling that a company incorporated in the UK was not subject to UK tax if its board of directors met in another country and it undertook all its business overseas. At a stroke, the concept of the separation of the place of incorporation of a company and its obligation to pay tax had been created. This concept survived in UK law until the 1990s, by which time it had become the basis for the operation of most tax haven corporations throughout the world.

The idea of splitting the duty to pay tax from the concept of taxation residence was next severed for individuals in the 1930s, when Switzerland began to offer internationally mobile people residence in that country and only required them to pay a fixed amount of tax a year, agreed in advance and not varying with income, details of which did not need to be disclosed. This concept has been widely copied.

The other major Swiss contribution to tax injustice is banking secrecy, a concept which they developed at the time of the French Revolution (for the benefit of the French aristocracy) but which became enshrined in Swiss law in the 1934. The Swiss move was not, as popularly claimed, an attempt to help German Jews hide their assets from the Nazis as this had not become a significant issue in 1934. It was, instead, a response to a French tax scandal a year or two earlier when a long list of names of prominent French citizens using Switzerland to hide their income from the French tax authorities was published in France. The Swiss responded by passing its bank secrecy laws to protect the identity of tax evaders outside Swiss borders.

None of these things happened by chance. They were thought up by lawyers and accountants and exploited by them and their bankers for commercial gain.

3.2 The accountants

Accountants have played the largest part in promoting tax injustice. Much of the planning that has created the current environment of tax injustice took place within the British commercial and legal environment in which

accountants rather than lawyers tend to be at the forefront of tax advice. Accountants have increasingly organised themselves into transnational companies or partnerships, largely driven by the need to be able to audit their transnational client companies under the statutes of most developed countries.

After many consolidations, mergers and the failure of Arthur Andersen, there are now just four large firms of accountants in the world. They are (in current order of size):

- PricewaterhouseCoopers (PWC)
- Deloitte Touche Tohmatsu
- KPMG
- Ernst & Young

These firms have combined annual revenues of US\$110 billion. Research has shown that each operates in more than 130 jurisdictions. They are notable for significant presence in all the major secrecy jurisdictions surveyed by TJN and many of the minor ones as well. TJN research has shown a marked correlation between secrecy and the concentration of the presence of these firms in a location.

Each of these firms is involved in promoting secrecy jurisdiction activities. PWC, Ernst & Young and most particularly KPMG were heavily criticised for promoting the sale in the US of what the US Senate Permanent Subcommittee on Investigation called 'tax products' in 2003. That committee found that some of these products were almost certainly illegal. They also found that KPMG may have made at least US\$180 million from the sale of some such schemes and that collectively the schemes they sold had probably cost the US Treasury up to US\$85 billion in lost revenue. KPMG were heavily fined as a result.

Deloitte and Andersen (a firm it has now substantially absorbed) were criticised for the work they did for Enron by the US Senate in its report on the failure of that company. Enron declared profits of US\$2.3 billion between 1996 and 1999 but paid no tax. It employed a network of up to 3,500 companies to achieve this aim, at least 440 of these being registered in the Cayman Islands alone.

respectability their presence bestows on many of the world's secrecy jurisdictions provides a veneer of legitimacy they do not deserve;

- These firms wish to appear to be bastions of society, frequently promoting the arts, academic chairs, and even institutes of ethics, but they take extreme measures to evade scrutiny of their own activities. For example, KPMG is operated from a secretive Swiss base while PWC's international operations are hidden behind an obscure company in London that claims to have no income but does operate its global web site. Although the firms do publish accounts, this has been a very reluctant move which has only happened in the last few years and the data supplied is by no means sufficient to understand and scrutinise commercial operations of their size;
- These firms use their privileged positions as government advisers to promote their own and their client's special interests.

Because of this, these firms have a special responsibility to:

- abandon their support for tax haven practices;
- stop all forms of taxation planning that are not tax compliant;
- cease promoting taxation policies that increase tax injustice.

They have a further duty. Their members dominate the administration of the most of the professional institutes of accountants around the world. These professional bodies promote 'ethical codes of conduct'. TJN research has not found a single ethical codes of conduct that condemns the use of secrecy jurisdictions and tax avoidance by its members. In view of their privileged position, the Big 4 firms of accountants have a duty to support a change in the ethics of the accountancy profession to ban these activities.

3.3 The lawyers

Lawyers have undertaken the following critical roles in creating tax injustice:

- they have written the laws that have allowed much of it to take place;
- they have sought to enforce those rules;
- they have created a climate of fear in which it is believed that a person must act in tax non-compliant ways if -
 - they are to act in accordance with the law (although that is not true)
 - they are to meet shareholders expectations (although shareholders are not asked if that is true)
 - they are not to breach the secrecy rules that lawyers have themselves drafted in many of the tax haven territories;
- they write the commercial contracts which incorporate the use of offshore and other steps that seek to use the secrecy space of the offshore world;
- they usually create the trust deeds and other documents that allow the abuse that these types of structure enable;
- they act as nominee directors and shareholders, or arrange the services of those who do.

As is the case with many accountants, there are lawyers who prefer to avoid using the offshore and tax haven world. Sadly this is not true of the profession as a whole, and many of the larger commercial law practices are heavily involved in developing abusive offshore structures. This particularly applies to members of the self-styled 'Offshore Magic Circle' of law firms who not only promote abusive tax structures to their clients, but also actively shape the laws and

Detailed analysis of the world's top 50 international private banks reveals that at the end of 2010 they collectively managed more than US\$12.1 trillion of cross-border invested assets on behalf of their private clients, including via trusts and foundations. Almost of all of these clients will have been engaged in 'tax minimisation.'

regulatory practices of the secrecy jurisdictions they operate from.¹

3.4 The banks

The world of offshore finance, and the tax abuse that goes with it, is dependent upon the presence of mainstream banks in the offshore territories. Detailed analysis of the world's top 50 international private banks reveals that at the end of 2010 they collectively managed more than US\$12.1 trillion of cross-border invested assets on behalf of their private clients, including via trusts and foundations. Almost of all of these clients will have been engaged in 'minimising' their taxes.

The banks tend to cluster in havens that are geographically located close to the regions in which they operate. Thus the Cayman Islands attract South American banks, for example, whilst Bermuda and the Bahamas have a large presence of US banks, the Channel Islands have strong British and European representation and the Pacific territories see more Australian and New Zealand banks. But nowhere does a territories' banking service operate in isolation.

People bank offshore because they recognise and trust the names of the banks to whom they give their funds. Without these banks operating in this way the offshore world could not exist. And without the banking secrecy which all these banks support, the administration of the world's tax system would be substantially cheaper and more effective. For this reason the leading transnational banks, without exception, play a major role in the offshore world.

They also play a substantial role in the world of aggressive tax avoidance and evasion. In the official reports in the US that have criticised the roles of most of the major firms of accountants in supplying abusive tax products many major banks were named for knowingly providing the funding to facilitate these transactions. Those named included Deutsche Bank which knowingly financed tax products produced by KPMG. JP Morgan Chase and Citigroup were also criticised in various ways for their role in the Enron debacle, including providing finance through offshore vehicles.

¹ <http://www.tackletaxhavens.com/2012/02/offshore-law-firm-boasts-of-its-conflicts-of-interest/>

3.5 Multinational companies

Multinational companies deserve special mention amongst those who promote tax injustice. Their role can be highlighted for several reasons:

- they are, or should be, the largest taxpayers: all too often they avoid taxes in most countries where they operate;
- they have greater opportunity to abuse the world's tax systems within the letter of the law than any other taxpayer;
- when they transgress it is eventually very obvious, and imposes costs on a great many people.

This gives multinational corporations a special responsibility to ensure that they pay the taxes they owe in the countries in which they make profits. There is however overwhelming evidence that this is not what they do. Instead in almost every case MNCs argue that:

- tax is a cost;
- costs must be minimised;
- their duty to their shareholders requires them to do this;
- they must in consequence avoid tax wherever possible.

This is a disingenuous argument. First, tax is not a cost and accountants demonstrate this when they declare a pre-tax profit in the profit and loss account and subsequently show two distributions from that figure. The first distribution being tax and the second being dividends paid to shareholders. The tax due on a company's profits is not described as a cost in any accepted accounting standard. Like dividends, it is a return to a stakeholder out of the surplus made by the company.

In that case it cannot follow that there is an obligation to minimise the tax cost in a company because tax is not a cost. This statement is consistent with company law in most countries in the world. That law says, in most cases, that a company must be run for the benefit of the shareholders. In many cases that obligation is also qualified

by a requirement to take the interests of other stakeholders into account. What is certain, however, is that company law does not require a company to:

- operate outside the spirit of the law;
- take the risk of breaking the law;
- hide what it does from view (including that of the shareholders);
- undermine national tax systems and free-ride of facilities funded by others.

Nor, unfortunately, is there evidence that MNCs or their tax advisers have consulted shareholder views on this matter. It is fair to assume that many shareholders in pension funds, mutual funds and structured savings schemes, who own – albeit indirectly – the shares in most MNCs, would not want a company to minimise its tax bill. They most certainly would not want it to do so if that involved risk of:

- illegal action, as much tax planning does;
- underpayment to developing countries, as much transfer pricing does;
- the creation of artificially inflated short-term share prices which the understatement of current tax liabilities usually will;
- higher taxes being paid by all other members of the community.

3.6 Secrecy jurisdictions

Secrecy jurisdictions contribute towards creating a system which worsens the imbalance of wealth distribution in the world, which hinders sustainable development.

Some of microstates involved see no way out of the dilemma which they have created for themselves. In places like Cayman and Jersey more than 50 per cent of the economy is dependent upon the financial services industry. If tax haven activities were to stop their economies would collapse in the short-term. However, these places are small and the cost of providing them with economic support during a transition to the creation of a more gainful economy is miniscule in proportion to the costs they impose upon the world economy.

For secrecy jurisdictions such as Austria, Luxembourg and Switzerland the problem is one of political will. The OECD and European Union have tried to take action against some of the smaller states which abuse the world tax system through the use of harmful tax practices, but neither the OECD nor the EU have been successful at bringing their own members to book when they have undertaken the same activities.

There is an urgent need to create consistency in the approach towards harmful tax practices including low tax rates, the failure to apply withholding taxes for non-residents and the refusal to exchange tax data between countries. All havens, large and small, developed and developing, share this responsibility without exception, but the richer nations have the greater responsibility because they maintain their systems at the cost of imposing a direct burden upon the poorer people of the world.

3.7 Tax payers

Of course, tax injustices of the type we have described above would not occur without individuals who want to exploit the system. In a just world one might hope that an appeal to reason and the common good would discourage those who use tax havens and other aggressive tax planning practices. In reality, however, where an opportunity exists some will exploit it.

That is why we concentrate the recommendations we make later in this report upon:

- stopping the supply of these services;
- making it harder to benefit from them;
- ensuring the penalties from seeking to exploit such activities are sufficient to discourage those considering doing so.

There is an urgent need to create consistency in the approach towards harmful tax practices including low tax rates, the failure to apply withholding taxes for non-residents and the refusal to exchange tax data between countries.

Box 4. Secrecy Jurisdictions with an opacity score exceeding 60 (ranked alphabetically) Source: 2011 Financial Secrecy Index

	Jurisdiction	Secrecy Score
1	Andorra	73
2	Anguilla	79
3	Antigua & Barbuda	82
4	Aruba	74
5	Austria	66
6	Bahamas	83
7	Bahrain	78
8	Barbados	79
9	Belize	90
10	Bermuda	85
11	Botswana	79
12	British Virgin Islands	81
13	Brunei Darussalam	84
14	Cayman Islands	77
15	Cook Islands	75
16	Costa Rica	77
17	Dominica	80
18	Ghana	79
19	Gibraltar	78
20	Grenada	83
21	Guatemala	81
22	Guernsey	65
23	Hong Kong	73
24	Isle of Man	65
25	Japan	64
26	Jersey	78
27	Lebanon	82

	Jurisdiction	Secrecy Score
28	Liberia	81
29	Liechtenstein	81
30	Luxembourg	68
31	Macao	83
32	Malaysia (Labuan)	77
33	Maldives	92
34	Marshall Islands	90
35	Mauritius	74
36	Monaco	75
37	Montserrat	86
38	Netherlands Antilles	83
39	Panama	77
40	Philippines	73
41	Samoa	85
42	San Marino	79
43	Seychelles	88
44	Singapore	71
45	St Kitts & Nevis	81
46	St Lucia	89
47	St Vincent & Grenadines	78
48	Switzerland	78
49	Turks & Caicos Islands	90
50	United Arab Emirates (Dubai)	79
51	Uruguay	78
52	US Virgin Islands	68
53	Vanuatu	88

Secrecy jurisdictions assessed with an opacity score exceeding 60

Source: 2011 Financial Secrecy Index



4. AGENCIES ADDRESSING GLOBAL TAX ISSUES

The problem of tax injustice is rising on the agendas of many organisations and civil society groups. The principle agencies tackling tax injustice are:

4.1 The OECD

The Organisation for Economic Cooperation and Development (OECD) issued its report called Harmful Tax Competition in 1998. It defined the factors to be used in identifying these harmful tax practices, many of which it associated with tax havens and made wide-ranging recommendations to curtail such practices. In doing so the OECD added its voice to that of the Financial Action Task Force, which has been criticising tax havens for their role in money laundering since 1989.

Since the early 2000s the OECD has largely concentrated on promoting the Global Forum on Transparency and Exchange of Information for Tax Purposes. This forum is tasked with trying to promote cooperation and information exchange, but its critics – not least TJN – argue that it has devoted too much energy to promoting weak bilateral tax information exchange agreements (TIEAs), much favoured by the forum's secrecy jurisdiction members, rather than multilateral information exchange based on automatic exchange of tax information.

From 2001 until 2009 the OECD attempts to tackle tax havens were seriously hampered by the pro-tax haven approach of the administration of US President George W Bush. The election of President Obama as the 2008 financial crisis erupted changed the US approach to this issue and in April 2009 at the G20 London Summit the OECD was asked to spearhead a new campaign against tax haven abuse.

Unfortunately its chosen instrument for this policy was the TIEA. The structure of the TIEA had been negotiated with tax havens during the very darkest period of the OECD's tax haven campaign when it looked as if any progress on the issue would be blocked by the USA. Not

surprisingly, they have proven weak, cumbersome and ineffective as a deterrent to tax evasion.

TIEAs incorporate fundamental flaws in their design. The first flaw is that the information exchange is not automatic: the state needing information has to request it. The second flaw is the considerable difficulty put in the way of making that request. A request for information under a TIEA must provide or state:

- (a) the identity of the person under examination or investigation;
- (b) what information is sought;
- (c) the tax purpose for which it is sought;
- (d) the grounds for believing that the information requested is held within the jurisdiction to which request is made;
- (e) to the extent known, the name and address of any person believed to be in possession of the requested information.

The number of successful TIEA requests remains low: Jersey has admitted that since 2005 when it became engaged in this process it has still to exchange more than 100 pieces of information.

The reason for the low number of information requests lies with the difficulties imposed on requesting countries. There is considerable secrecy within tax havens. This is either created by law e.g. through legal banking secrecy, or through the combination of legal entities and professional services designed to ensure that the activities of those availing themselves of those facilities are opaque. As a consequence it is, for example, nigh on impossible to link bank accounts operated by a company in turn controlled by a trust with a particular taxpayer in another jurisdiction who may or may not be settler and / or beneficiary of that arrangement.

In reality TIEAs have little or no practical value because the 'smoking gun' required to trigger

the information request either does not exist or cannot be created to the standard required by courts in the secrecy jurisdictions. Not surprisingly, the concept of TIEAs based on the 'by request' model is widely regarded as a failure.

The situation was made worse when the OECD decreed in 2009 that a secrecy jurisdiction could achieve what it described as internationally acceptable levels of transparency by signing just twelve TIEAs even though there are around 200 tax administrations in the world. In many cases secrecy jurisdictions met this target by signing agreements with microstates like the Faroe Islands and Greenland, or with one another, reducing the OECD's unambitious programme to the level of farce.

Since 2009 the OECD has tried to enforce an inspection regime to ensure compliance with standard double tax agreements (principally between major states) and TIEAs (mainly with tax havens). However, seeking to enforce a fundamentally flawed system is not the same as taking effective measures in the first place.

Worse, under pressure from some parts of the business community the OECD has rejected the concept of Country-by-Country reporting since it (rightly) sees this concept as being linked to the issue of unitary taxation, to which it is vehemently opposed. This is because the OECD remains committed to the arm's length method of transfer pricing allocation of profits between states. This is despite the widely recognised problems that arise when trying to apply the arm's length method in practice.

Until the OECD acts to substantially change its approaches to tax havens, information exchange and profit allocation in multinational corporations, it will remain an obstacle in the path of tax justice.

4.2 The European Union

The European Union (EU) also identified problems of harmful tax practices within its borders during the 1990s. It made little sense for the EU to promote a single market between its members if they were competing with each other on tax.

The EU took two steps in the late 1990s to tackle tax abuse. First, it demanded that its member states put an end to what it calls preferential tax regimes. This has curtailed some

of the more esoteric tax structures offered by various EU member states, especially in Ireland and the Benelux countries. Unusually this step, under what is called the EU Code of Conduct on Business Taxation, also extended to the dependent territories of EU member states, including the British Channel Islands and dependencies of the Netherlands.

Under EU pressure, Guernsey, the Isle of Man and Jersey, were required to offer the same tax rates to companies owned by their citizens as those offered to companies owned by non-residents. The attempts of all these jurisdictions to comply with the Code of Conduct have been long drawn out and complex, largely because of TJN's resolute efforts to expose their failures to comply. Compliance has had dramatic impact on the tax systems of all three islands, all of which have experienced budget crises of varying significance. Importantly, and in stark contrast to the OECD, the EU has demonstrated that effective external pressure can be brought to bear on tax havens.

The second initiative the EU promoted was the European Union Savings Tax Directive. This promoted the automatic exchange of information between member states on bank and other deposit holdings held in other member states. Again, this initiative faced considerable political difficulty, partly because this it applies beyond the EU to the dependent territories of the UK and the Netherlands, and also extends to non-EU countries such as Switzerland and Liechtenstein.

Unfortunately, to secure the introduction of the scheme in 2005 some compromises had to be made meaning that some EU countries (initially Belgium, Luxembourg and Austria, but now just the last two) refusing to participate in full. As a result they, Switzerland and Liechtenstein plus some (but not all) of the UK's dependent territories opted for a two-track scheme. Under this arrangement a person with an account in those places but who was resident in another EU country could opt out of automatic information exchange with their domestic tax authority and opt in to a withholding tax provision. Initially this withholding was set at a rate of 15%; now it is at 35%. A number of jurisdictions, like the Isle of Man and Guernsey subsequently opted in to automatic information exchange, but Austria, Jersey, Luxembourg and Switzerland persist in refusing to cooperate.

The current state of the European Savings Tax Directive is far from ideal. The withholding tax option undermines the system of automatic information exchange, but more importantly the Directive only applies to accounts held by individuals. It does not relate to funds held in trusts and companies, which is how most offshore assets are held. Since 2008 the EU has been working to extend the scope of the system and much technical progress has been made towards closing the current gaps and loopholes.

Since creating these two measures the EU has also made progress on three other fronts relating to tax justice. The first relates to adoption of a Financial Transaction Tax. At time of writing this measure has the support of at least twelve EU member states and consent to apply the FTT in those countries is imminent. EU countries linked to tax haven activities, such as Ireland and the UK, oppose this move which represents a key component in a just tax system.

Secondly, the EU Parliament supports country-by-country reporting, the merits of which are noted elsewhere in this report. A version of country-by-country reporting for the extractive industries is likely to become EU law in 2013.

Thirdly, the EU has been promoting unitary taxation in the form of the EU Common Consolidated Corporate Tax Base. The EU's work on this vital measure is pioneering and reinforces its role as a leading promoter of tax justice.

4.3 The United Nations

The role of the United Nations (UN) in taxation is not widely known. Its first contribution has been to encourage nations to agree double tax treaties to ensure the smooth running of international taxation. The League of Nations began this process in the 1920s. The UN published a model double tax treaty although this has largely been supplanted by the OECD model treaty, on which most double tax treaties are now based.

The UN's second role is as host of a little known committee called the Committee of Experts on International Cooperation in Tax Matters. First formed in 1967 as an ad hoc group of experts, the Committee was upgraded to Committee status in 2004, in accordance with the wishes of the then UN Secretary General Kofi Annan. Many countries would like this Committee to be enhanced to an inter-governmental political body,

but OECD countries persist in blocking efforts to achieve this upgrade. Unlike the OECD, which is a rich countries' think tank, the UN Tax Committee is fully open to all countries, and therefore can fairly claim a legitimate mandate to represent the interests of poorer countries. The potential exists for this Committee to gradually expand its remit to perform the functions of a World Tax Authority (discussed in section 5).

4.4 Governments

Some governments promote tax haven activities. Others expend great efforts in challenging them. Strangely, some do both; for example the British Crown dependency of Jersey introduced draconian anti-avoidance tax measures in 2005 to stop its own citizens taking advantage of tax haven services that Jersey offers to citizens of other countries.

This suggests how we might assess whether or not a country is promoting tax justice or condoning unjust tax practises. If it is consistent in its approach, making it hard for anyone to participate in harmful tax practices while seeking to provide a fair tax system for its own citizens and businesses operating within its territory then it is on the right path.

For the past three decades the trend has been towards increasing tax injustice in most countries. Happily there are signs that this trend might be ending. Facing budget crises, and mounting pressure from civil society, governments are starting to:

- introduce general anti-avoidance provisions in taxation law;
- apply stiffer penalties to tax avoidance and evasion;
- restrict the scope for accountants, lawyers and others to sell tax planning schemes without disclosing what they are doing to taxation authorities;

The European Union Savings Tax Directive has established the principle of automatic information exchange between nations and is therefore a welcome step towards a global framework for automatic information exchange.

- strengthen international cooperation to tackle tax abuses, both at a multilateral and bilateral levels;
- take effective action to tackle tax haven abuse.

Regrettably, however, many countries, and international organisations, remain committed to policies which result in tax injustice, such as tax competition. The US and UK, for example, are committed to tax competition, as is the OECD. This means that their parallel attacks on harmful tax practices are intellectually flawed. All governments need to have a consistent approach to these matters so that their commitment to tax justice is unambiguous. Around the world civil society needs to draw attention to these flawed policies and the harm they cause.

4.5 Civil society

Civil society is increasingly engaging with the issues of capital flight, tax avoidance, tax evasion and tax competition, which are widely seen as impediments to sustainable public finances and equality. In June 2000 Oxfam, one of the major development NGOs, published a report

entitled *Tax Havens: Releasing the hidden billions for poverty eradication*. The creation of TJN was partly a consequence of the publication of that report. In the US Citizens for Tax Justice has been undertaking a not dissimilar job, though with a national focus. TJN was purposefully created with an international focus.

When TJN was formally launched in March 2003 it was unique in its focus on campaigning on international tax policy. The extent to which this subject had previously been neglected was evident later that year. When the G8 countries held their summit meeting in Evian in June 2003 over 300,000 people demonstrated in nearby Geneva, and 3,000 NGOs registered to lobby the delegates: Geneva literally ground to a halt. When the UN Committee of Tax Experts met in Geneva four months later, TJN was the only civil society organisation to attend and address the meeting.

Things have improved remarkably since then. TJN is now active on six continents. We have flourishing networks in Africa, Australia, Europe, Central, South and North America, and several Asian countries. Within ten years tax justice has become firmly established on the political agenda.

5. TOWARDS TAX JUSTICE

Much can be done to tackle tax injustices at both the national and international levels. All that is required is the political will to go ahead. The role of civil society campaigners is to create the environment in which that political will exists.

TJN can fairly claim to have made significant progress towards that goal since we published the first edition of *tax us if you can* in 2005. This is largely because we have adopted a solutions focussed approach to our campaigning: we have not just described problems when undertaking our work; we have consistently sought to offer solutions as well. We hope this is apparent in the suggestions for campaigning that we outline in this chapter.

A wide range of issues must be addressed, including the following:

- Country-by-country reporting
- Automatic information exchange
- Citizenship and personal taxation
- Corporate taxation
- Country level actions to improve personal and corporate taxation
- General anti-avoidance principle
- World Tax Authority (WTA)
- Tax assistance for developing countries
- Holding governments to account
- Publish who you are
- Trusts
- The national agenda

5.1 Country-by-country reporting

The campaign for country-by-country reporting has become virtually synonymous with TJN; indeed, its very existence arises from the very first conversation between the two authors of this report.

Country-by-country reporting is an accounting concept. It simply requires multinational corporations to include the following information in their accounts, without exception:

- a list of all countries and jurisdictions where they operate;
- a list of the names of all their principal subsidiaries in each country or jurisdictions where they operate;
- a profit and loss account for every country or jurisdiction where they operate;
- limited balance sheet and cash flow data largely relating to assets employed and tax liabilities and payments made.

Importantly, the profit and loss account would have to analyse tax charges between their current and deferred tax elements and, vitally, they would also be required to split the data used to calculate profit before tax between trades with third party customers and suppliers and intra-group trades.

These issues are important. The aim of country-by-country reporting is to:

- disclose where multinational corporations trade, record their sales, employ their staff, declare their profits, declare and pay their taxes (or not, as the case may be) and hold their assets with the aim of holding them to account locally for what they currently declare globally;
- disclose how intra-group trading is potentially used as a mechanism for shifting profits around the world;
- disclose the information needed to hold governments to account for the tax revenues they receive from companies, thus reducing the risk of corruption;
- enhance governance in multinational corporations by making them accountable for their use of tax havens.

Crucially, all companies already have the first two categories of information, though it is

notoriously difficult to obtain this information. Having it publicly available would be a first, important, step towards making global businesses accountable locally.

After a decade of discussion on country-by-country reporting in accounting and other arenas there is near universal agreement that the data needed to prepare the accounting information demanded by country-by-country reporting should also be available (though some multinational corporations still deny this!). The reason is straightforward: if multinational corporations did not have the data to allocate all their transactions to specific jurisdictions they would not have the information they needed to prepare their tax returns. If that were the case they would not be keeping the books and records required by company laws across the world.

Importantly, if country-by-country reporting was not readily achievable it would be politically hard to demand it since it imposes costs on business. As it is, the only significant additional costs would be those of auditing this data, and that audit cost would be more than offset by the reduced risk to shareholders resulting from this information being available to them.

The campaign for country-by-country reporting is a success story. The issue is now on the agenda of the International Accounting Standards Board, the OECD, the EU, the Securities and Exchange Commission in the USA, and other bodies.

Due to the untiring efforts of the Publish What You Pay campaign a form of country-by-country reporting is now on the US statute book as section 1504 of the Dodds Frank Act and a

Box 5: A Case Study in Transfer Pricing – SABMiller

In October 2010 Action Aid revealed that the world's second-largest beer company, SABMiller, was avoiding millions of pounds of tax in India and the African countries where it makes and sells beer by routing profits through a web of tax-haven subsidiaries. ActionAid estimated that SABMiller may have reduced its African corporation tax bill by as much as a fifth, depriving poorer countries of up to £20m (US\$31m) in tax. The report outlines several ways in which tax is avoided, via transfer pricing schemes:

- **Dutch detour:** The company holds its brands in the Netherlands. In one case, it's brands such as Castle, Stone and Chibuku: venerable African beers, for sale to Africans in Africa. The Ghana subsidiary will pay royalties to these subsidiaries, where they pay minimal corporation taxes (and the same royalty payments can then be deducted against tax in Africa.)
- **Swiss sidestep:** SABMiller's African and Indian subsidiaries pay 'management service fees' to sister companies in European tax havens, mostly Switzerland, where effective tax rates are much lower. The head of the Ghana Revenue Authority told ActionAid that "management fees is an area that we know is being used widely [to avoid tax] ... it's difficult to verify the reasonableness of the management fee".



- **Mauritius manoeuvre:** A Mauritius subsidiary sees its trading profits taxed at 3% compared to 25% on its trading partner in Ghana.

Thin capitalisation: another transfer pricing scheme, where the African subsidiary borrows from the Mauritius subsidiary, deducting its interest payments from the final tax bill, while the Mauritius subsidiary's lending profits (derived from those same interest payments) are taxed minimally.

Any move towards a global framework for tax cooperation should involve the extension of the principle of automatic information exchange to corporate bodies and trusts as well as to individuals since a lot of tax planning involves trusts and corporations.

similar law will probably be passed by the EU in 2013. Admittedly both laws relate only to the extractive industries and are restricted to tax payments made on a country-by-country reporting basis, but both are steps in the right direction. In addition, both laws suggest that the time for a broader application of country-by-country reporting has arrived.

TJN will continue to campaign for that broader version of country-by-country reporting.

5.2 Automatic information exchange

Information exchange between countries would go a long way towards deterring tax evasion and tax avoidance.

As explained in chapter four, there are two forms of information exchange. The first is information exchange on request. This occurs when one country requests data from another country with whom it has a double tax agreement or tax information exchange agreement. These are usually bilateral i.e. between two countries. Occasionally they are multilateral. The USA now has some variations on this theme, such as the Foreign Account Tax Compliance Account arrangements, but they are exceptional.

The alternative to these 'on request' agreements is automatic information exchange. Under such arrangements one country agrees to automatically supply data they collect from their financial services sector and others on income earned in their jurisdiction that is paid or payable to people who are tax resident in the other jurisdiction.

The best known example of automatic information exchange is the European Savings Tax Directive. However, as we noted in chapter 4, this is restricted in the range of income that it addresses and in its geographical coverage.

TJN wants automatic information exchange to become the global standard for international cooperation to tackle tax avoidance and

evasion. The reason for wishing this simple: evidence from the USA has shown that when a taxpayer knows that a source of income will be automatically declared to their tax authority they are highly likely to be deterred from trying to evade taxes. When the taxpayer knows that the income is not automatically disclosed to the tax authority the deterrent effect falls significantly.

5.3 Ensuring that information on the beneficial ownership of companies, trusts, foundations and charities is available on public record

As previously noted, across the world laws are being introduced to require financial services providers to know their clients and the true identity of the owners of the companies, trusts, foundations and charities that they might provide services to, manage or account for. The driving force behind this change is the anti-money laundering agenda of the IMF's Financial Action Task Force. Ideally this enhanced disclosure regime would have contributed to tackling tax evasion, but three barriers have prevented this from happening:

Firstly, even when ownership data exist it is difficult for tax authorities to access this information under the terms of Double Tax Agreements and Tax Information Exchange Agreements. That is because under the terms of those OECD inspired agreements the tax authority making an enquiry of another country has to prove they know the beneficial ownership of an offshore company or trust before they can ask what that beneficial ownership might be, making the whole exercise somewhat futile. The absurdity of this situation would be almost comical were it not true.

Secondly, the information is also of limited value because many secrecy jurisdictions (Switzerland being a prime example) do not treat tax evasion as a crime for money laundering purposes. The obvious solution to this problem is that the Financial Action Task Force should now demand that all countries make tax evasion a crime

for money laundering purposes (technically tax evasion should be made a 'predicate crime' under anti-money laundering legislation).

Thirdly, the relevant information must be obtained and made available on public record. The right to use limited liability companies, trusts, foundations and charities is a right granted by a state. That right has valuable privileges attached to it, including (and not exclusively) the right to not pay debts in some cases and to secure tax advantages in others. In view of these privileges it is vital that full information is put on public record about all companies and other limited liability entities, trusts, foundations and charities in all jurisdictions. That information would include:

- the constitution of the organisation;
- its registration number;
- the names and addresses of all real, beneficial owners of organisation and if necessary the names of their nominees as well;
- if there are no owners, the name and address of the founder(s) of the organisation;
- if there was no founder of the organisation the name and address of the person who issues instructions to the management of the organisation (this possibility exists in the case of some offshore foundations and trusts);
- the names and addresses of those who manage the organisation, whatever their titles, and if they are nominees then the names and addresses of those for whom they act must be disclosed. If a company manages the organisation then full details for its ownership and management structure must also be disclosed;
- the names and addresses of those who benefit from trust and foundation structures;
- the annual accounts of the organisation.

It is only if this information is available that the abuse permitted by the use of companies and other structures can be curtailed.

Finally, requiring information disclosure is inadequate if resources are not provided to enforce compliance with disclosure requirements.

This might involve charging a small annual fee to the companies, trusts and other legal entities involved. This is a small contribution to make towards enjoying the tangible benefits enjoyed by legal entities.

5.4 Citizenship and personal taxation

The problems associated with tax haven usage are frequently linked to a growing number of high net worth individuals (hen-wees) who globe trot in pursuit of paying little or no tax. These hen-wees are supported by a tax avoidance industry of professional people (mainly bankers, lawyers and accountants) who service their needs through tax havens. It's important to note that the hen-wees concerned may, or may not, live in tax havens: their itinerant life styles allow them to officially live nowhere for tax purposes. Alternatively, they may base themselves in countries like the UK that offer them highly preferential tax treatments. It is also important to note that the professional people working in tax havens are rarely of local origin: they are also itinerants playing a game of tax abuse.

Both the hen-wees and those who service their offshore wealth, which we estimate at between US\$21 trillion to \$32 trillion, can play these games because most countries allow them to do it. With only few exceptions, notably the USA, most countries determine tax residence for individuals on the basis of whether a person is present in their country for more than 183 days a year. This allows hen-wees to become stateless with relative ease, enabling them to receive large parts of their income subject to little or no tax. This gives rise to several problems:

- prominent hen-wees, including rock stars, set a poor example by engaging in tax avoidance;
- as a consequence the people most able to pay tax in the world often pay little or no tax;
- it stimulates a parasitical industry of lawyers, accountants and bankers who enable hen-wees to live as economic free-riders;
- it undermines democracy and the ability of governments to tax their citizens on a progressive basis.

This situation, which was unacceptable in the days when travel was difficult and the number of truly mobile people in the world amounted to a few thousand, has deteriorated to the point of being a global crisis. The collapse of public finances in Greece starkly illustrates the consequences of allowing tax evasion by wealthy elites to become endemic. Greece is a harbinger of what will happen in other countries unless effective measures are taken to curtail tax avoidance and evasion.

Thankfully there is an answer to this problem, and it is provided by the USA. The USA applies strict rules on residence based on physical presence for those who are not citizens of that country but who choose to live there. Importantly, its rules on determining the tax status of its own citizens are different from almost all other jurisdictions because anyone holding a US passport is liable to US tax, whether or not s/he actually lives in the country and has US source income.

This principle provides an effective way of tackling tax abuse by hen-wees. If it were applied worldwide, the world's itinerant population of globally wealthy people would be caught by the tax systems of their home states even if they claimed to live in a tax haven. As an added benefit, the footloose accountants, lawyers and bankers who operate from tax havens would also be caught in the tax net of their own home states.

5.5 Corporate taxation

Revelation after revelation in recent years has shown that the current approach to taxing multinational companies is deeply flawed. The situation has deteriorated considerably since countries started competing with one another in a vain attempt to entice foreign investors by offering tax incentives, many of which involve turning a blind eye to how profits are shifted to tax havens.

A new approach to taxing corporations is required. A national basis for corporate taxation makes no sense when multinational companies might operate in 150 or more states simultaneously. It is illogical to treat each company within a group as a separate entity when the constituent parts of a multinational corporation clearly do not function independently from one another. Taxing locally when companies act globally has given rise to a crisis in taxing capital. For the sake of economic justice, that crisis must now be addressed.

In reaction to this crisis some think-tanks and academics, typically those sponsored by multinational business, have suggested that the solution to this problem is to simply stop taxing companies. The basis for their argument is that tax is always eventually paid by people. In theory there is merit to this argument: in practice it is completely illogical for three reasons.

The first is that because of the myriad layers of secrecy that wealthy individuals use to hide their ownership of companies actually finding who to tax when the profits of companies are distributed as dividends may be impossible, meaning that no tax is paid. It may also be impossible to decide who owns shares when they are, for example, held by pension funds, or are traded rapidly on stock exchanges. In the real world it is nigh on impossible to attribute tax liability to anyone on any reasonable basis.

Secondly, this logic assumes that tax should be paid where the owner of a company is located and not where the profit arises. So, for example, if a major Brazilian trading company is owned by a Cayman resident person this argument would suggest that all tax on the profits of the Brazilian activity should be paid in Cayman (where the tax rate is zero). This completely ignores the fact that the company benefits enormously from services provided by the Brazilian state. That is illogical: a company should make a contribution towards the infrastructure, education, health, welfare, pensions and other services the state provides to its workforce. If it does not it is free-riding services paid for by others.

Thirdly, this proposal ignores the fact that society grants a valuable privilege to companies in the form of limited liability that individuals do not enjoy. In return for that privilege, which has tangible benefits, the company has a duty to pay tax. The often cited notion that companies are simply collections of individuals simply does not hold true: individuals do not enjoy the benefit of limited liability.

Taxing locally when companies act globally has given rise to a crisis in taxing capital. For the sake of economic justice, that crisis must now be addressed

Happily, there is a viable alternative to the current approach to tax multinational companies, and this alternative, which is already used at state level in the USA, ignores the cleverly crafted use of tax havens to avoid tax and takes account of the genuine economic substance of the companies' activities. This approach, known as unitary taxation, works as follows:

- trading profits are allocated to countries according to an agreed formula which typically takes account of where a company employs its staff, where it owns physical assets, and where its customers are;
- interest and other investment income will initially have to be taxed on a source basis;
- a residence basis will be required to tax investment income and gains.

The advantages of this approach include:

- corporations would pay tax on all their profits without possibility of double taxation;
- profits are allocated to the countries where they are earned;
- countries would regain sovereignty over the setting of their own tax rates and would not suffer from profits shifting to tax havens.

Unitary taxation faces intense lobbying by multinational companies, their tax advisers (who earn very high fees from the current OECD-led approach), and from other vested interests. EU attempts to adopt a form of unitary tax are fiercely resisted, not least by European tax havens like Ireland. It is time for civil society to build a counter lobby in support of unitary taxation.

5.6 Country level actions to improve personal and corporate taxation

In order to enhance equity as well as the effectiveness of taxation systems, as a minimum countries should:

- have a precise definition of who is and is not resident in its territory;
- tax its residents on all their world-wide

income and gains, without exception. This means adopting what is called the 'residence basis of taxation';

- ensure that all income that arises in their country is subject to tax before it is paid to a person who is not tax resident. So, for example, bank interest paid by a bank within the country should be subject to a withholding tax before being paid to a non-resident person. This means that the country also uses a 'source basis of taxation'.
- give credit to all their resident people and companies for any tax they pay on a source of income in another country when taxing it on a residence basis in their own jurisdiction to avoid double taxation;
- ensure that all groups of companies with international income that operate within its territory are taxed on a fair part of their world-wide income. This means that most issues arising from transfer pricing, thin capitalisation and licensing abuses cease to be a concern;
- commit to international cooperation on tax which as a minimum would require arrangements for automatic information exchange, full cooperation with other tax authorities who request assistance with tackling tax avoidance and evasion, and assistance to another country seeking to recover tax due to it.

5.7 General anti-avoidance principle

Tax avoidance is the process of using loopholes to circumvent the spirit of the law with the intention of paying less tax than would otherwise be due. The loopholes exploited may be in a country's tax law, or between its tax and accounting law, or maybe between the laws of that state and another state. Whatever the cause, abuses happen because it is impossible to draft law that can take account of every possible circumstance while remaining both comprehensible and manageable.

For a long time tax avoiders have said that if the loopholes exist that is not their fault and it is the job of government to close them. Around the world various ways of trying to do this have

been tried but without exception they result in greater complexity in tax law and frequently open up as many opportunities for abuse as they seek to close. The way to cut through this Gordian knot is to adopt a general anti-avoidance principle.

A number of countries have such principles in place, although with varying degrees of success, depending largely upon how rigid they are. The more rigid they are the more accurately they can be described as general anti-avoidance rules. Unfortunately, such rules do not work because they usually create new loopholes that the tax avoidance industry seeks to exploit.

A general anti-avoidance principle adopts the logic that if any transaction is undertaken primarily to secure a tax advantage (which means a reduced tax payment), or, if any step is added into a series of transactions for that purpose:

- then the benefit that transaction creates for taxation purposes can be ignored, and;
- tax can be charged as if that transaction or step had not been included in the arrangement that the tax avoider put in place.

An example might help. Suppose a tax avoider decides to sell a company and is advised by her tax lawyers that shifting its ownership to an offshore trust prior to selling would reduce any tax liability arising from the sale. The presence of a general anti-avoidance principle would allow the tax authority to ignore the existence of the offshore trust and charge tax as if the trust had never been created.

Such a legal principle should, in our view, be a part of the law in every country. It is also an essential part of any tax system that seeks to ensure that all income is subject to tax. This is because whilst any tax system has to be rule-based to make the detail of its arrangements work, rules are not sufficient by themselves to make the system comprehensive. Principles need to be built-in to ensure that the rules do not create their own problems.

This suggestion is unpopular with the tax planning industry. As one tax accountant said to the press in March 2004: 'No matter what legislation is in place, the accountants and lawyers will find a way around it. Rules are rules, but rules are meant to be broken.' It is harder to break principles, which is precisely why they are so useful in this context.

5.8 Codes of Conduct

Codes of conduct covering taxpayers, tax professionals and government can enhance tax justice.

Professional institutes for those engaged in supplying tax advice and services should issue codes of conduct requiring their members to desist from tax avoidance activities. We cannot how see tax avoidance is consistent with any form of professional ethics.

We suggest this should be taken further: companies and taxpayers who can provide evidence of tax compliance should be able to sign up for codes of conduct which reduce their risk of tax audit. The punishment for breaking the code would, however, be more severe penalties than those normally imposed by the courts.

We also propose that governments should be bound by codes of conduct to ensure they are also held to account for their conduct in managing a country's tax system.

5.9 World Tax Authority

Many of the problems we have outlined above arise because of the lack of functional and just rules on how to tax capital in an era of globalised markets. The existing organisations working on international tax policy either lack a global mandate, i.e. the OECD, or lack the political authority to agree new rules, i.e. the UN Tax Committee.

In the same way that the World Trade Organisation sets the rules for international trade, a World Tax Authority (WTA) is needed to monitor the impacts of fiscal policies on trade and investment patterns, and to protect national tax policies from the harmful practices of tax

Unitary taxation faces intense lobbying by vested interests. It is time for civil society to build a counter lobby in support of unitary taxation.

havens. TJN is not alone in seeing this gap in the international institutional architecture: in 1999 former director of fiscal affairs at the IMF, Vito Tanzi, proposed that the prime function of an international tax organisation should be to 'make tax systems consistent with the public interest of the whole world rather than the public interest of specific countries'.

The most appropriate body to take on the functions of a WTA would be the United Nations, which could and should evolve its existing Committee of Experts on International Cooperation in Tax Matters to fill this role. Such a body could undertake the following tasks:

- Work with international accounting bodies to define a common basis for determining profits;
- Work to establish a common basis for determining taxable income;
- Help set rules for allocating the profit income of transnational companies;
- Assist international exchange of taxation information;
- Help to protect national tax regimes from predatory practices such as tax competition;
- Establish dispute reconciliation procedures;
- Assist those countries wishing to adopt unitary taxation to agree appropriate formulas for profit allocation;
- Collate relevant statistics and act as a forum for discussion and sharing of best practice.

These tasks are essential in the interests of tax justice and would reinforce the autonomy of sovereign states, which has been radically eroded by the existence of tax havens.

A WTA could also carry out the task of recommending best practice in creating taxation law. The IMF and World Bank already disseminate best practice in some areas. Tax law should also be an area for application of best practice standards. This would make possible the establishment of an international benchmark for the achievement of tax justice against which progress could be monitored.

5.10 Tax assistance for poorer countries

Poorer countries rarely have the resources to implement appropriate taxation policies. This undermines their ability to develop and implement just tax policies, and to reduce their dependence on external aid and debt. In many cases the weaknesses of their tax regimes stem from factors such as:

- the available cash resources being used for other, more immediate, priorities;
- their senior tax officials being lured away by offers of higher paid employment in the private sector;
- local tax officials feeling unable to challenge powerful multinational companies for fear they will remove their investment.

For these reasons international assistance should be provided to poorer countries to ensure they can establish:

- sound taxation systems based on appropriate law;
- suitable accounting standards;
- data registries for companies, trusts, foundations and charities;
- effective tax administrations;
- rigorous accountability standards for multinational companies;

For a long time tax avoiders have said that if the loopholes exist that is not their fault and it is the job of government to close them. Attempts to remedy this often result in greater complexity in tax law and frequently open up as many opportunities for abuse as they seek to close. The way to cut through this Gordian knot is to adopt a general anti-avoidance principle.

- international enforcement procedures for taxing multinational companies;
- dispute reconciliation procedures;
- attractive career paths for senior personnel.

5.11 Holding governments to account

It is not sufficient to ensure that countries can raise the tax revenues they need. It has to be seen that this is done, that the process is free from corruption, and that the funds raised are used for the purpose for which they are intended.

This means governments have to account openly and transparently for their actions. There are initiatives that seek to do this including, perhaps most notably, the Extractive Industries Transparency Initiative. This is, however, limited in scope to a single industry.

It could also be argued that the OECD's Global Forum on tax information exchange; the IMF's Financial Sector Assessment Programme and the Financial Action Task Force's reviews all, to some degree undertake this task. However, none of these organisations focus on reviewing the overall effectiveness of a tax administration and its ability to uphold its domestic law to collect tax effectively free from corruption and maladministration.

It is partly for this reason that we promote Codes of Conduct for governments, as noted above.

The work of civil society organisations like the International Budget Project, which seek to hold government to account for their spending is crucial, and similar programmes are needed on the revenue raising side. Increasingly, local chapters of TJN are taking on this role.

5.12 The national agenda

The international tax agenda is important, but tax reform has to be national and even local on occasion if tax justice is to be ensured. It is not the role of this publication to offer suggested reform of any individual tax system. Decisions regarding such issues will be decided by those campaigning for reform at a national level. However, the following questions have to be raised when considering whether a national or local tax system is just:

- does the country have a comprehensive system of taxes?
- do tax rates ensure a progressive tax charge?
- are there too many loopholes or significant rate changes that allow income to avoid tax in some way?
- are corporate structures or trusts unduly favoured by the tax system?
- are sales taxes fair and are essential items exempt from tax?
- are the tax and benefit systems appropriately linked to avoid the creation of a poverty trap?
- are the bases on which tax is charged fair and consistent between all citizens, residents and types of entity so that opportunities for abuse do not arise?
- is the country undertaking information exchange with other countries on a fair basis?
- is tax legislation clear, available to all, and is there a fair appeals system in the case of misunderstandings?
- is the administration of tax fair and free from corruption?
- does the country have a general anti-avoidance provision that allows tax abuse to be challenged quickly and effectively?
- are professional firms appropriately regulated and held to account for their actions?
- are appropriate accounting standards in place?

The prime function of an international tax organisation should be to *'make tax systems consistent with the public interest of the whole world rather than the public interest of specific countries'*.

Vito Tanzi, former director of fiscal affairs, International Monetary Fund

- do all companies (however described in law) and trusts have to file details of their constitutions, management and ownership on public record, and do they have to file annual accounts which are audited if their income is above agreed thresholds? Is this information available for public inspection at modest cost?
- does the government offer tax incentives, holidays and other arrangements to attract inward investment and so favour some businesses over others, meaning unfair tax competition is created?
- does the country have a secrecy score of 60 or more on TJN's Financial Secrecy Index? If so, how can it improve on this score?
- does the country measure its tax gap, and are adequate measures being taken to reduce that gap?

Many of these questions will require detailed research but some are easier to campaign on than others. For example, in many countries there is inadequate disclosure of the ownership, management and accounts of companies and trusts, so this is a straightforward target for a campaign on transparency.

The work of civil society organisations like the International Budget Project, which seek to hold government to account for their spending is crucial, and similar programmes are needed on the revenue raising side.

6. GLOSSARY

Accounts

The annual published statements issued by a company in accordance with the legislation and regulation of the country in which it is incorporated for the benefit of shareholders and others (if they are permitted access under local law) who wish to appraise the financial performance of a limited liability company or other limited liability entities such as a limited liability partnership.

If the company is registered on a stock exchange that requires compliance with the rules of the International Accounting Standards Board, then the accounts will also have to comply with their rules. Otherwise they will comply with locally issued accounting standards.

Accounts will normally include a statement from the directors of the company providing an overview of the trading of the entity for the year, a profit and loss account showing its income and expenditure during the period and its net profit plus an estimate of taxation liabilities that will arise from them, a cash flow statement showing how it used the net cash surplus or deficit that it generated during the course of the year, a balance sheet showing its total assets and liabilities at the year-end as represented by the total net investment by the shareholders and notes to the accounts which explain each of the statements.

Accounting standards

Regulations governing the way in which certain transactions are reported within the accounts of companies and other entities. Originally issued on a national basis, and usually by the professional bodies of accountants within each country, they are now being supplanted by International Financial Reporting Standards issued by the International Accounting Standards Board.

Affiliated company

A company likely to be more than 20% owned by another company that does not however own more than 50% of it. The owning company often has significant influence over an affiliate but not absolute control which 50% usually brings

Aggressive tax avoidance

A term used by those who try to argue that some tax avoidance is acceptable by seeking to rank schemes so that some are worse than others.

Aggressive tax avoidance is a term applied to the use of complex schemes of uncertain legality to exploit taxation loopholes. The term tax avoidance is applied by TJN to all schemes that seek to get round the law.

Arising basis

A method for taxing income earned somewhere other than the country where the taxpayer is resident for tax purposes. Under the arising basis income earned outside the country of residence is liable to tax in the year in which that income is earned even if it is not remitted to the country where the taxpayer is resident and liable to pay tax. Compare with the remittance basis.

Associated company

See *affiliated company*

Banking secrecy

Banking secrecy laws strengthen the normal contractual obligation of confidentiality between a bank and its customer by creating criminal penalties that prohibit banks from revealing the existence of an account or disclosing account information without the owner's consent. These laws can be used to block requests for information from foreign tax authorities.

It is important to note that banking secrecy is not just created by law: it can also be created by fact. For example some of the UK linked tax havens do not have banking secrecy laws but by the time a bank account is hidden behind a trust and a company, often with each being in different jurisdictions, the same effect is achieved.

Beneficial owner

The person who actually has the right to enjoy the income or capital that possession of property might provide. The term is used to contrast with the legal or nominee owners of property and with trustees, all of whom might be recorded as having legal title to property without possessing the right to enjoy the benefits of using it. One of the biggest problems in tackling offshore tax abuse is discovering who the beneficial owner of assets might be, especially when they are hidden behind discretionary trusts.

Bilateral information exchange

Exchange of information between the tax authorities of states can be done bilaterally or multilaterally. When done bilaterally, two main types of agreements are used. The first are Double Taxation Agreements (DTAs). The second are Tax Information Exchange Agreements (TIEAs). Bilateral Double Taxation Agreements and Tax Information Exchange Agreements are agreed between the two participating states: no other state is party to the agreement. In multilateral agreements more than two states are parties to the agreement. Bilateral agreements are relatively common; multilateral agreements are rare.

Brass plate company

See *Shell Corporation*.

Capital flight

The process whereby wealth holders deposit their funds and other assets offshore rather than in the banks of their country of residence. The result is that assets and the income derived from them are often not declared for tax purposes in the country in which a person resides. Capital flight and tax evasion are intimately linked phenomena.

Charitable trust A trust established for purposes accepted by law as charitable. This does not stop such trusts being abused: their tax-free status is an attraction to some. They can also be used to pass assets between generations free of inheritance tax whilst keeping them firmly under family control whilst income can be paid from such trusts to family members as fees or salaries meaning that despite the charitable structure little benefit to charity need arise.

Citizenship basis of taxation This is one way of deciding who within a state is liable to pay tax in that place. The citizenship basis of tax ensures tax is paid on the worldwide income of all citizens of the state irrespective of whether they are physically resident or not in the territory of which they are a citizen during the period for which the taxes are levied. The most obvious example of a country using the citizenship basis is the USA.

Company or corporation A legal entity created by law treated as a separate legal person from those who set it up. Almost all countries now allow for the creation of companies but the rules by which they do so vary considerably. Most offer limited liability. That means the members of the company are not liable for its debts if it were to go bankrupt. When companies were first made available it was thought this was a privilege requiring that accounts and information concerning the ownership and management of the company should be put on public record. That principle has been undermined by tax havens. As a result the abuse of anonymous companies is one of the biggest issues for those tackling tax injustice.

Controlled foreign corporation (CFC) A CFC is a subsidiary company or corporation of another (parent) company. The CFC is registered in a tax haven or other territory where little or no tax is charged on the profit the subsidiary makes. This clearly opens up opportunities for profits to be shifted from the parent company to the offshore subsidiary. To prevent this CFC rules provide that profits declared by the subsidiary can in some cases be subject to tax in the country of residence of the parent company even though it is not resident there. These rules reached their heyday at the turn of the millennium. Since then EU court rulings have dramatically undermined their effectiveness, leading to a boom in offshore activity.

Coordination centres A special form of company with taxation advantages, often used to attract corporate headquarters to a country. These types of coordination centres are most notably found in Belgium, the Netherlands and Ireland and are often used by IT and other intellectual property based companies that can sell their services at a distance over the web or by companies that rely heavily on patent income e.g. pharmaceutical companies.

Corporation tax A tax on the profits made by limited liability companies and other similar entities. It is often similar in application to income tax but can also embrace a capital gains tax. Rates charged are often lower than those used for income tax purposes, especially on the most well off, giving them considerable incentive to transfer their income into companies.

Country by country reporting A proposed form of accounting in which a multinational corporation will be required to report in its accounts in which countries it operates, what the names of its subsidiaries are in each and every jurisdiction in which it operates, and to publish a profit and loss account for each jurisdiction where it trades, without exception, showing its sales and purchases, both from third parties and intra-group, the number of employees it has and the cost of employing them, its financing costs both third party and intra-group, its profit before tax, its tax charge split between current and deferred tax, and a summary of its assets and liabilities in the location.

Currency transaction tax A form of financial transaction tax: it is a tax levied by a country that issues a currency on all the trades in that currency worldwide at very low rates e.g. 0.005 per cent. See financial transaction tax for more details

Deferred tax This is maybe the weirdest form of tax in the world for there is actually no such thing as a deferred tax. The term is used for an accounting entry that is made because the rules of accountancy generally require that income be matched with expenses. If an expense is recognised for tax purposes more quickly than it is for accounting purposes (which is common, for example, in the cases of much plant and equipment) this means that the tax cost for the years when this happens are understated. Conversely, when all the tax allowances have been used on the assets there might still be accounting charges to make and the tax cost would then be overstated in the resulting accounts. To balance this equation a notional tax charge called deferred tax is charged to the profit and loss account in the earlier years and put on the company's balance sheet as a liability. The liability is released as a credit to profit and loss account in the later years and supposedly over the life of the asset all should balance out. There are many reasons for deferred tax charges: all have the same purpose. What is misleading is that International Financial Reporting Standards require that deferred tax be provided even when there is only a remote chance that it might be paid. This has led to massively overstated and misleading tax charges in company accounts with regard to tax that is likely to never be paid.

Director Shareholders own limited companies but they do not run them. That job is given to its directors. All limited companies must have at least one director. The directors of limited companies may be other limited companies in many jurisdictions. Directors are responsible for the management of the affairs of a company and its compliance with all laws that apply to it. Directors are usually appointed by the members of the company at General Meetings of the membership. In many offshore arrangements directors are 'nominees' who sell their names to the company so that they can be considered directors. Despite holding that office these 'nominees' actually have little or no knowledge of what the company actually does, its real affairs being managed by other people who are technically called 'shadow' directors, but whose identity is often hard to discover.

Discretionary trusts Most offshore trusts permit payments to be made to almost anyone at the discretion of the trustees, which means that the identity of the beneficiaries of those trusts can remain a secret. In practice, trustees normally follow a 'letter of wishes', provided by the settlor, instructing them who they are to pay money to, when and how. There is, therefore, much less discretion about who actually benefits from those trusts than their trust deeds would suggest is the case.

Domicile The country identified as a person's natural home, even if that person has not been resident there for extensive periods of time. The concept is important in determining who pays tax in some countries, and most especially in the UK where a "non-domiciled" person need not necessarily pay tax on their worldwide income when domiciled people must. This explains why the UK is so attractive to wealthy people for whom it is a highly effective tax haven.

Double tax relief Tax relief given by the country in which a taxpayer resides for tax paid in another country on a source of income arising in that other country to ensure that no more tax is paid on that income than is demanded to be paid by the country with the higher of the two rates that might be applied to it.

Double tax treaty An agreement between two sovereign states or territories to ensure, as far as possible, that income arising in one and received in the other is taxed only once. Includes rules to define Residence and Source, and limits on Withholding Taxes. Also usually includes provisions for cooperation to prevent avoidance, especially information exchange. Many are now being rewritten as attitudes on information exchange develop.

Effective tax rate The percentage of tax actually paid in relation to the total income of the person paying the tax. This can either be calculated for one tax, or for all taxes payable. It is used as a basis for comparison within a state, to see if a system is progressive or regressive, and for international comparison.

EU Code of Conduct on Business Taxation

The EU's Code of Conduct for business taxation was established by its Council of Economics and Finance Ministers (ECOFIN) in December 1997. The Code is not a legally binding instrument though it has political force. By adopting this Code, Member States undertake to roll back existing tax measures that constitute harmful tax competition and refrain from introducing any such measures in the future ('standstill').

The Code was specifically designed to detect only measures that unduly affect the location of business activity in the Community by being targeted merely at non-residents and by providing them with a more favourable tax treatment than that which is generally available in the Member State concerned. The criteria for identifying potentially harmful measures include:

an effective level of taxation which is significantly lower than the general level of taxation in the country concerned;

- tax benefits reserved for non-residents;
- tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base;
- granting of tax advantages even in the absence of any real economic activity;
- the basis of profit determination for companies in a multinational group departs from internationally accepted rules, in particular those approved by the OECD;
- lack of transparency.

The Code has had considerable impact both within member states, but most especially on the tax havens affected associated with the UK or the Netherlands. This has been most clearly seen in the tax reforms imposed on the Crown Dependencies of Jersey, Guernsey and the Isle of Man.

European Union Savings Tax Directive

The EU Savings Tax Directive was adopted to ensure the proper operation of the internal market and tackle the problem of tax evasion. It was approved in 2003 and came into effect on July 1st, 2005.

It is an agreement between the Member States of the European Union (EU) that requires Member States to exchange information with each other about EU residents who earn interest on savings and investments in one EU Member State but live in another. Although the legal scope of the Directive does not extend outside the EU, certain jurisdictions – such as Switzerland, Liechtenstein, Andorra, Monaco, and San Marino,]equivalents – have agreed to put in place legislation that supports the aims of the Directive.

All Member States are ultimately expected to automatically exchange information on interest payments by paying agents established in their territories to individuals resident in other Member States. While the vast majority of EU member states have applied automatic information exchange as their effective system for cooperation, Austria and Luxembourg remain committed to a system of information reporting at the end of an indefinite transitional period, during which they levy a withholding tax at a rate of 15% for the first three years, 20% for the following three years, and 35% thereafter. They transfer 75% of the revenue of this withholding tax to the investor's state of residence. Both Austria and Luxembourg are entitled to receive information from the other Member States. The investor in those places has an option to provide for preliminary information of his or her Member State of residence for tax purposes about the savings held abroad, or to permit the disclosure of the income to the same State, as an alternative to the retention or withholding tax.

The Directive has a relatively broad scope that covers interest from debt-claims of every kind whether obtained directly or as a result of indirect investment via most collective investment undertakings and other similar entities.

The European Commission on 13 November 2008 adopted an amending proposal to the Savings Taxation Directive, with a view to closing existing loopholes and better preventing tax evasion. Progress on this is currently being blocked by Austria and Luxembourg, both of whom refuse to participate in automatic information exchange and prefer a tax withholding option instead.

The major weaknesses in the Directive are that it only applies to interest income and only to income paid to individuals and not to companies, trusts, foundations and other arrangements. The proposed amendments would address many of these issues.

Export processing zones

Artificial enclaves within states where the usual rules relating to taxation and regulation are suspended to create what are, in effect, tax havens within larger countries. The rules that are relaxed may be for import and export taxes or corporation taxes or all three and may also extend to relaxing other regulations e.g. on health and safety or the environment.

Financial Transaction Tax

See *Tobin Tax*

Flags of convenience

The flag of a country with easy or lax maritime regulations and low fees and taxes, flown by ships registered in such countries, even though they have no substantial connection with the country. Liberia was once the best known but many tax havens now offer such services. They are also commonly associated with regulatory abuse e.g. with regard to seafarers pay and work conditions.

Flat tax

A tax system in which as income rises the amount of tax paid remains constant in proportion to total income. Compare with progressive taxes. The term is usually only applied to income taxes.

General anti-avoidance principle

A legal principle that seeks to prevent a taxpayer from obtaining the taxation benefit arising from any transaction if they undertook it solely or mainly to obtain a tax benefit. It does so by looking at the motivation of the taxpayer at the time of entering into the transaction, which is usually determined by the likelihood of any tax advantageous step in a transaction having a commercial explanation. If a commercial motive for each step in a transaction can be offered then it is likely that the person undertaking it will secure the tax benefit inherent in the transaction. If no such motive can be found. Compare with a general anti-avoidance rule.

General anti-avoidance rule

A general anti-avoidance rule seeks to tackle those who try to break the rules of taxation through the use of further rules. Rather than considering intention, it lays down specific limits on the ways of interpreting series of events to determine whether the benefit of tax legislation can be given to the taxpayer. Rules are invariably open to interpretation, hence a general anti-avoidance rule runs the risk of increasing the opportunity for abuse.

Gift tax

Taxes charged on gifts either during life or on death. The charges may be on the donor or on the cumulative value of gifts received by the recipient.

GST

Goods and services tax or sometimes a general sales tax. See sales tax.

Hedging

In theory hedging is a form of insurance involving a variety of complex financial instruments including call options, put options, short selling or futures contracts. Genuine hedging can reduce market risk, for example on the price of a crop to be sold at a future date. In reality much hedging involves socially useless speculative activity, often of a very short-term nature. Its complexity hides the risks latent within it whilst the fact that a lot of hedging is recorded offshore (even though managed from onshore) suggests that a significant proportion of hedging activity is conducted to shift real profits made onshore into offshore locations.

High net-worth individuals	Otherwise known as HNWLs (pronounced hen-wees). Generally categorised as individuals with more than US\$1 million of financial assets (i.e. worth excluding the value of their main home) available for investment.
Holding companies	A company that either owns all or more than 50 per cent of another company, which is then called its subsidiary company. An intermediate holding company is a holding company that has one or more subsidiaries but is itself owned by another company. The term 'ultimate holding company' refers to the company at the top of the pile which is finally not controlled by another company. Some holding companies have thousands of subsidiary companies.
Illicit financial flows	Illicit money is money that is illegally earned, transferred or utilised. Breaking laws at any point during their transmission earns such funds this label. Frequently described as "dirty money". These transfers come in three forms: (1) the proceeds of bribery and theft; (2) criminal activities including drug trading, human trafficking, illegal arms, contraband and more; and (3) commercial trade mis-pricing and tax evasion. The latter is by far the largest, and is believed to comprise two thirds of the total.
Income tax	A tax charged upon the income of individuals. It can also be extended to companies, though this is uncommon. The tax is usually charged on both earned income, whether from employment or self-employment, and on unearned income e.g. savings income from investments and property.
Inheritance tax	A tax charged upon the gifts people make out of their wealth, most commonly (but not always) at the time of their death.
International Business Corporations (IBC)	A type of company once offered by many offshore finance centres and tax havens that receives all or most of its income from abroad. IBCs usually pay an annual registration fee but are subject to minimal or zero tax rates. Now less common than a decade ago as a result of pressure brought to bear on the jurisdictions offering them as a result of the EU Code of Conduct on Business Taxation.
International Finance Centre	See <i>Offshore Finance Centre</i>
Inversion	The act of a parent company whose headquarters are located within one jurisdiction switching registration with an offshore subsidiary they own to secure location within that offshore jurisdiction in order to secure a tax advantage. At one time mainly occurring in the USA, it became a UK phenomenon as well from 2009 onwards and has also been used by corporations such as Glencore, which is technically registered in Jersey as a result.

Land value taxation A tax on the rental value of a site, assessed as if it were undeveloped and unimproved – in other words, as if it were bare land.

Licence. (Licensing) A contract for the use of property, often intellectual property such as a patent, copyright or trademark. If ownership of the intellectual property is placed in a company located in a tax haven the licence fee income paid to that tax haven company may be exempt from tax whilst the fee paid to it may be subject to tax relief in the country from which it is paid, giving a significant tax benefit. This type of tax exploitation is now commonplace in the IT, pharmaceutical and similar sectors where patents are commonplace.

Limited company See *private company* and *quoted company*.

Limited liability partnerships (LLP) A partnership that provides its non-corporate members with limited liability. LLPs are frequently based offshore for tax avoidance purposes.

Loophole A technicality that allows a person or business to avoid the scope of a law without directly violating that law. Loopholes are crucial to tax avoidance since they are the mechanism by which people ‘get round the law’ – which is what tax avoidance really involves.

Money-laundering The process of ‘cleaning’ money from criminal or illicit activities to give it the appearance of originating from a legitimate source.

National insurance contributions See *social security contributions*.

Nominee See directors and shareholders. Nominees are people who undertake such roles for a fee but who act strictly in accordance with the instructions of others who really undertake the duties attached to these functions. As such they are ‘front people’ who pretend to fulfil a role without actually doing so.

Offshore

Offshore does not, contrary, to popular perception, have any physical geographic meaning. It is specifically not a term for small tax haven islands.

Offshore refers to the practice of recording a transaction in one location that actually takes place somewhere else. So, for example, using a Luxembourg company to record sales made in the USA is an offshore activity. A German person banking in London to pay someone in France is also undertaking offshore activity, in London.

The important point is that the activity recorded in an offshore location is always taking place in another location.

Offshore financial centre

Although most tax havens like to call themselves Offshore Finance Centres (OFCs) the terms are not synonymous.

Tax havens offer low or minimal rates of tax to non-residents. This does not however mean that they also host a range of financial services providers.

An OFC offers low tax rates and hosts a functional financial services centre, usually including branches or subsidiaries of major international banks as well as the offices of accountants and lawyers to service offshore clients.

States and microstates that host tax havens and OFCs dislike both terms, preferring to call themselves International Finance Centres.

Offshore world

Those places that without appearing to act in unison coordinate to provide a range of services that can be integrated over one or more locations to ensure that the offshore activities of a person cannot be traced or can only be traced with the utmost difficulty.

Parent company

A company that controls another company (which is then called its subsidiary company) either by owning more than 50% of the second company or by controlling the composition of its board of directors. A parent company may have thousands of subsidiary companies, some of which will themselves be parent companies, in which case they are called intermediate parents. In that case the company not subject to control at the top of the hierarchy is called the ultimate parent company.

Partnerships

Any arrangement where two or more people agree to work together and share the resulting profits or losses. A partnership can be between individuals, companies or a mixture of both.

Payroll taxes

See *social security contributions*.

Permanent Establishment	An office, factory, or branch of a company in a country where it is otherwise non-resident. Under Double tax treaties business profits are taxable at source if attributable to a Permanent Establishment. Rules regarding permanent establishments can be dependent upon arrangements concluded in double tax treaties.
Poll tax	A tax that levies the same sum on each person irrespective of their means to make payment of the sum owing. Poll taxes are profoundly regressive and unjust.
Preferential tax treatment	A situation in which individuals or companies can negotiate their own tax treatment in the state in which they have a tax liability. Pioneered by Switzerland in the 1920s, the arrangement is commonplace in the offshore world.
Private company	A company whose shares are not traded on a stock exchange. In a private company shares cannot usually be sold without the consent of the company or other shareholders; in many countries little or no information need be disclosed on the activities of such companies even though their members enjoy the benefit of limited liability.
Profit laundering	The process of transferring profits from a territory in which they would be taxed to another in which there is either no tax or a lower tax rate. Mechanisms for achieving this include transfer-pricing, re-invoicing, licensing, thin capitalisation, corporate restructurings, hedging, reinsurance and inversions.
Progressive taxes	A tax system in which as a person's income rises the amount of tax paid increases in proportion to the income as well as in absolute amount i.e. the percentage tax rate increases as the income rises. Also referred to as Graduation. Compare with flat and regressive taxes.
Public company	A company whose shares are traded on a recognised stock exchange and are available to be bought and sold by anyone who wishes without consent being required from the company itself. Generally required to be more transparent than private companies.
Quoted company	See <i>public company</i> .
Race to the bottom	The downwards trend of tax rates and regulatory requirements on capital arising from competition between sovereign states to attract and retain investment.

Redomiciliation An increasingly common process where a company moves its country of incorporation from one country to another while maintaining the same legal identity. The problem with the ease with which this can be done is that a company that redomiciles often can stay almost constantly one step ahead of authorities who might be chasing it.

Registered office The official address at which a company may be contacted. Unfortunately this is very often the address of a lawyer or accountant and as a result no clue as to the real whereabouts of the company is provided in such cases, which assist creation of a veil of secrecy over their activities.

Regressive taxes A tax system in which as a person's income from all sources increases the amount of tax they pay reduces in proportion to their income even if it increases in absolute amount i.e. their percentage tax rate falls as their income goes up. Compare with progressive taxes and flat taxes.

Reinsurance Some large companies decide not to insure their risks with the conventional insurance markets but instead set up their own insurance companies. When insurance companies do this it is called reinsurance. By setting up a captive or reinsurance company offshore, a tax deduction for the premiums paid is available in the country where the risk is and the premium is received offshore where there is little or no tax. This can, therefore, be viewed as another form of tax avoidance.

Re-invoicing Re-invoicing involves invoicing a sale to an agent, typically based in a tax haven or OFC, who subsequently sells on to the final purchaser. In practice the agent pays part of their mark up to the original vendor or to the purchaser, usually to an offshore account. This is a widely used process for laundering profits to a tax haven. The process is dependent upon secrecy for its success. It is now commonly denied that such practices occur but it is only secrecy that prevents such claims from being tested.

Remittance basis The remittance basis is one of the ways in which income earned outside the country in which a person resides can be brought within the scope of tax in that place. The remittance basis says that tax is only due in the year when income is remitted to the country in which the taxpayer is resident: it is not taxable when it actually arises. The remittance basis enables a person to avoid tax indefinitely in their country of residence provided their overseas income is kept and / or spent abroad. Compare with the arising basis. Both have relevance within the context of the residence basis of taxation.

Remittance basis, companies

The remittance basis for companies is a compromise between the residence basis for companies and the territorial basis for companies. All the income of the subsidiaries of the parent company subject to the remittance basis can be taxed in the jurisdiction in which it is resident under the remittance basis but only when it is paid by way of dividend back to the parent corporation. The result is that there is a very strong incentive to keep funds subsidiaries outside the parent company jurisdiction and to reinvest them overseas rather than remit them, where they would be taxed. This is having a massive impact on US multinational company behaviour where this system is in operation.

Residence

For an individual, a person's tax residence is their settled or usual home; for simplicity a presumption may be applied based on a rule-of-thumb, such as presence within the country for six months or 183 days in any tax year. It may be possible to be resident in more than one country at one time (though double tax treaties aim to prevent this). Some individuals may also try to avoid being resident anywhere. For companies, residence is usually based on the place of incorporation but can also be where the central management and control of the company is located, if they are different. Tax haven companies formed for non-resident owners are usually defined not to be resident in their country of incorporation. If they use secrecy to deny their presence in another state where they really trade they can achieve non-residence through stealth. This is, of course, tax evasion, and is a major cause of the tax loss attributable to tax havens / secrecy jurisdictions.

Residence basis (individuals)

Under the residence basis of taxation residents of a territory pay tax in that place on all their worldwide income wherever it arises, usually with a credit being given for tax already paid overseas. The aim is to discourage residents from investing abroad in lower tax countries, by ensuring that income is taxed at the resident country rate if it is higher. Compare with source and unitary basis.

Residence basis (companies)

The residence basis for companies is in some ways more complex than for individuals as companies can be made up of many individual subsidiaries all reporting to a parent company. The term 'residence basis' will usually be applied in this situation to the tax regime that applies to the parent company. If it is taxed on a residence basis then the jurisdiction in which it is based will seek to charge the income it earns to tax, either through taxing dividends received from those subsidiaries when they are remitted to that jurisdiction or through the operation of controlled foreign company rules. In combination with transfer pricing arrangements these provided a triumvirate of controls to make sure all group income was likely to be eventually be taxed in the parent company jurisdiction, with credit having been given for foreign tax already paid. Compare with remittance basis and territorial basis for companies.

Ring-fencing	Ring fencing describes situations in which different and preferential tax and regulatory treatments are given by tax havens to companies and trusts owned by non-residents compared to the treatment given to companies and trusts owned by their own residents. In most cases the latter will be prevented from taking advantage of the arrangements available to non-residents.
Robin Hood tax	See <i>Tobin tax</i>
Sales tax	Taxes on sales can be levied in two ways. Firstly, as a general sales tax added to the value of all sales with no allowance for claiming a rebate on tax paid. Secondly, as a value added tax (VAT) (sometimes called a goods and services tax – GST) charged by businesses on sales and services but which allows businesses to claim credit from the government for any tax they are charged by their suppliers. The burden of VAT therefore falls almost entirely on the ultimate consumers. GST and VAT are both regressive taxes since lower income households always spend a higher proportion of their income on consumption and therefore invariably spend a greater proportion of their income on this tax than do better off households. VAT is by far the most widely used form of sales tax.
Secrecy jurisdiction	Secrecy jurisdictions are places that intentionally create regulation for the primary benefit and use of people and legal entities not resident in their geographical domain. That regulation is designed to undermine the legislation or regulation of another jurisdiction. To facilitate its use secrecy jurisdictions also create a deliberate, legally backed veil of secrecy that ensures that the people from outside the jurisdiction making use of its regulation cannot be identified.
Secrecy providers	The accountants, lawyers and bankers working from offshore who sell secrecy.
Secrecy world	Sometimes called the 'offshore world' but better described as the secrecy world.
Shareholders	The owner of the shares in a company. In many secrecy jurisdiction companies the registered shareholders are nominees so the real-life beneficial ownership of the company cannot be identified.

Shell corporation A limited liability entity usually formed in a tax haven / secrecy jurisdiction (including the UK and USA) for the purposes of hiding illicit financial flows, tax evasion or regulatory abuse. The entity is highly unlikely to have a real trade, its sole purpose being to hide transactions from view. No one knows how many such corporations there are, but they are commonplace. Other names are sometimes used e.g. 'brass plate companies', indicating a legal entity whose only real presence is the plaque on the wall of a lawyer's office recording the location of its registered office.

Social security contributions Payments made towards a fund maintained by a government usually used to pay pension and unemployment benefits. Health benefits are sometimes covered as well. Social security contributions are generally considered to be taxes. They are covered by the more generic name payroll taxes since they are often collected alongside income taxes from the payments made to employees but they can also be charged on the self-employed as well.

Source basis This relates to the taxation of income in the territory where it is earned. Under most double tax treaty rules, income attributable to a Permanent Establishment is taxable at source. Some countries tax only on a source basis, and consider income earned outside the country exempt; but some tax on the basis of both source and residence (subject to a foreign tax credit) to ensure a more comprehensive approach and to tackle obvious opportunities for tax avoidance arising from shifting a source of income out of a country if a residence basis is . Compare with residence and unitary bases.

Special purpose vehicles Any company, trust, LLP, partnership or other legal entity set up to achieve a particular purpose in the course of completing a transaction, or series of transactions, typically with the principal or sole intent of obtaining a tax advantage.

Stamp duty A tax on the value of contracts. Usually charged on contractual dealings on shares and other stocks and securities and on dealings in land and property.

Subsidiary company A company 50% or more owned or controlled via its board of directors by another company which is then called its parent company.

Tax arbitrage The process by which a sophisticated taxpayer plays off two systems of regulation to obtain a tax benefit as a result. Most commonly tax arbitrage is between the tax laws of different jurisdictions but it can also relate to exploiting different accounting regulations to achieve tax beneficial effects or to trading one tax off against another within a jurisdiction e.g. income tax against corporation tax.

Tax avoidance

The term given to the practice of seeking to minimise a tax bill without deliberate deception (which would be tax evasion or fraud). The practice may be summarised as 'seeking to get round the law'.

Tax avoidance usually entails setting up artificial transactions or entities to re-characterise the nature, recipient or timing of payments. Where the entity is located or the transaction routed through another country, it is international avoidance. Special, complex schemes are often created purely for this purpose. Since avoidance often entails concealment of information and it is hard to prove intention or deliberate deception, the dividing line between avoidance and evasion is often unclear, and depends on the standards of responsibility of the professionals and specialist tax advisers.

An avoidance scheme which is found to be invalid entails repayment of the taxes due plus penalties for lateness.

Some claim that this term refers to any activity that reduces the amount of a person's income subject to tax, for example, claiming of allowances and reliefs clearly provided for in national tax law. This is not a position with which TJN agrees. If the law provides that no tax is due on a transaction then no tax can have been avoided by undertaking it. This practice is now generally described as tax compliant. TJN instead uses the term tax avoidance to refer to the practice of seeking to not pay tax contrary to the spirit of the law. Some also call this aggressive tax avoidance, although this is not a term we consider useful.

This term is one of the most contentious in the tax lexicon.

Tax base

The range of transactions that a country chooses to tax. A broad base includes a wide range of transactions. A narrow base includes relatively few transactions.

Tax competition

Tax competition is the pressure brought to bear on governments to reduce taxes, usually to attract investment, either by way of reduction in declared tax rates or through the granting of special allowances and reliefs such as tax holidays or the use of export processing zones.

In practice tax competition largely benefits mobile activities or businesses, but the competition to attract investment may result in an overall decline of corporation tax rates and in the amounts of corporation tax paid, often resulting in a switch of the tax from the owners of capital to workers and consumers.

Tax compliance

A term that means making payment of tax due without engaging in tax avoidance or evasion. It is used in contrast to the terms tax avoidance and tax evasion.

Tax compliance in this context is used as a test of a person's intention before they undertake a transaction. It asks whether the person is seeking to comply with the spirit of the legislation concerning the transaction into which they are entering. If they are, then it should be presumed their intent was to be legal.

If, on the other hand, they are seeking to comply with the letter but not the spirit of the law (and it is usually possible to determine this from the form the transaction takes) then it should be presumed their intent was to get round that law, the onus of proof otherwise falling upon them.

This test can be used in connection with a general anti-avoidance principle to determine whether that principle should be applied to a transaction, or not. A person who has used an appropriate motive is 'tax compliant'.

The term can also refer to the process of complying with the administrative requirements of tax law e.g. completing a tax return.

Tax efficiency

A term used by tax professionals to suggest getting away with paying as little tax as possible. It is a euphemism for tax avoidance.

Tax evasion

The illegal non-payment or under-payment of taxes, usually by making a false declaration or no declaration to tax authorities; it entails criminal or civil legal penalties.

Tax gap

The difference between the tax a government would collect if all tax due in accordance with its law was paid and the amount that it is actually paid. The tax gap has three components: tax avoidance, tax evasion and tax paid late.

Tax haven

A tax haven is any country or territory that promotes laws with the intent that they may be used to avoid or evade taxes which may be due in another country under that other country's laws. The low tax rates offered by tax havens are key to their business model, but unless they also promote laws that assist a person to take advantage of them the low tax rate in itself may not be of much attraction. Secrecy is the key product that assists the use of low tax rates, hence the now more precisely defined term secrecy jurisdiction that is replacing the term tax haven in technical use.

The Organisation for Economic Cooperation and Development defines tax havens as jurisdictions where:

1. Non-residents undertaking activities pay little or no tax;
2. There is no effective exchange of taxation information with other countries;
3. A lack of transparency is legally guaranteed to the organisations based there;
4. There is no requirement that local corporations owned by non-residents carry out any substantial domestic (local) activity. Indeed, such corporations may be prohibited from doing business in the jurisdiction in which they are incorporated.

Not all of these criteria need to apply for a territory to be a haven, but a majority must.

Tax holidays

A period during which a company investing in a country does not have to pay tax under an agreement with its government.

Tax information exchange agreement

TIEAs are bilateral agreements under which territories agree to co-operate in tax matters through exchange of information. In practice the model was little used until the G20 applied considerable pressure to tax havens / secrecy jurisdictions to sign such agreements. There have been hundreds signed since 2009 as a result but the evidence is that they are little-used because of the considerable obstacles to making requests that are inherent within the agreements themselves.

Tax mitigation

A phrase used by tax professionals when describing the desire to pay as little tax as possible. Another euphemism for tax avoidance.

Tax planning

A term used in two ways. It can be used as another term for tax mitigation. In this case it is another euphemism for tax avoidance.

When, however, tax legislation allows more than one possible treatment of a proposed transaction the term might legitimately be used for comparing various means of complying with taxation law. If that is the motive then tax planning is consistent with tax compliance.

Tax shelter

An arrangement designed to protect part or all of a person's income from taxation. The offer of such an arrangement may result from a government desire to encourage some types of behaviour or activity, but as commonly it may be a commercial or legal ruse, often artificial in nature, used to assist tax avoidance activity.

Territorial basis

A basis for taxation that only charges the income of the residents of a territory to tax if it comes from a source also located in that territory. The obvious weakness in this basis for tax, which is uncommon for individuals but increasingly common for companies, is that it encourages the artificial relocation of a source of income out of a territory and to a tax haven.

Thin capitalisation

Thin capitalisation describes the process of financing a company with a high proportion of loans rather than shares. Used by transnational corporations to reduce the business profits of a subsidiary in a relatively highly taxed location, since the interest on loans is usually allowed as a deduction against profit, so reducing tax paid, whereas dividends on shares are paid out of after-tax income. The interest is usually paid to another subsidiary of the transnational corporation located in a tax haven where no tax is paid upon its receipt, resulting in an overall reduction in the tax charge of the group of companies.

Tobin tax

A Tobin Tax (also called Currency Transaction Tax, Financial Transaction tax and Robin Hood Tax) is a tax on trading on the foreign exchange markets named after the late James Tobin, the Nobel Prize winning economist, who proposed the idea as a means of reducing high frequency low margin trading on currencies. It may also be applied to trades in other financial products such as shares, bonds, gilts, derivatives and hedges. The case for adopting a financial transaction tax is gaining political support in Europe.

Transfer-pricing

A transfer pricing arrangement occurs whenever two or more businesses (whether corporations or not) which are owned or controlled directly or indirectly by the same people trade with each other. The term transfer pricing is used because if the entities are owned in common they might not fix prices at a market rate but might instead fix them at a rate which achieves another purpose, such as tax avoidance. If a transfer price can be shown to be the same as the market price then it is acceptable for tax purposes. What are not acceptable for tax purposes are transfer prices that increase the cost or reduce the sales value in states which charge higher tax rates and increase the sales value or reduce the costs in states with lower tax rates.

The difficulty for many corporations at a time when over 50% of world trade is within rather than between corporations is that there is no market price for many of the goods or services they trade between their own subsidiaries. This situation arises because they are never sold to third parties. This gives rise to complex models in which attempts are made to allocate value to various stages within the supply chain within a company, which process is wide open to potential abuse. For this reason it is argued that such firms should be taxed on a unitary basis.

Transnational corporations (TNCs)

A corporation with subsidiaries or divisions in two or more nations. Also known as multinational corporation (MNC).

Trusts

A trust is formed whenever a person (the trust settlor) gives legal ownership of an asset (the trust property) to another person (the trustee) on condition that they apply the income and gains arising from that asset for the benefit of a third person (the beneficiary). Trusts can be established verbally but typically take written form. Trustees are frequently professional people or firms charging fees. Trusts are usually of one of three types:

- discretionary trust
 - charitable trust
 - interest in possession trust.
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Trustee

A person who holds the legal title to assets held in a trust and who administers it. The first trustees of a trust will be appointed by the settlor. The trustees may be paid for their work but are not usually allowed to be beneficiaries of the trust they administer. In secrecy jurisdictions trustees are often hired nominees who sign papers sent to them by the real controllers of the trusts they administer. In many cases that is the settlor.

Trust beneficiary

Anyone who may obtain a benefit from a trust. A person who has a right to receive a benefit from the trust has an 'interest in possession'. If someone can receive a benefit but has no legal right to do so they are called a discretionary beneficiary. They only get a benefit if and when the trustees decide to pay it to them.

Trust settlor

The person who establishes a trust by gifting assets to it. Having made the gift they are usually supposed to have no further influence over a trust but in many tax havens that is not the case and the settlor very often remains in complete control of the assets of the trust despite their having supposedly gifted them for the benefit of others.

Unitary basis

Unitary taxation treats the income of a group of companies as being one combined sum subject to tax that is then apportioned to a country for tax to be assessed by applying a formula to determine where it might best be considered to have been earned (hence the term ‘formulary apportionment’ is widely applied to this process). Each state may then apply the rate of tax to it that it wishes. Unitary taxation is an alternative to the residence and source bases of taxation.

Unitary taxation has been used in federal countries such as the USA where an allocation formula based on a ratio of sales, employment costs and assets employed within each state is used. It has been opposed by tax authorities (and MNCs) because they consider that it would be too difficult to reach international agreement, most especially on the formula. However, taxation of highly integrated MNCs may in practice entail a formula-based allocation of profits, albeit through negotiation of the sums allocated to each state under the arm’s length method of transfer pricing for which there is frequently no realistic basis for determination because of the absence of alternative market based evidence of third party pricing.

Value Added Tax

Known as VAT. See sales tax

Washington Consensus

The term ‘Washington Consensus’ was created in 1989 by John Williamson. It originally described the economic policy prescriptions used by Washington DC-based institutions such as the International Monetary Fund and World Bank, but subsequently evolved to denote the vigorous application of free-market theory.

Wealth tax

A tax on a person’s declared wealth, typically imposed annually at a very low rate. Once commonplace in Europe these are currently rarely used since they are thought to encourage people to hide assets offshore. However, there is renewed interest in their use and how they might play a role in reducing inequality and in tackling the worldwide financial crisis.

Withholding tax

Tax deducted from a payment made to a person outside the country from which the payment is made. Generally applied to investment income, such as interest, dividends, rents, royalties and licence fees.

‘tax havens cause poverty’

The Association for Accountancy & Business Affairs

The role played by secrecy jurisdictions in encouraging and profiteering from tax avoidance, tax evasion and capital flight from developed and developing countries is a scandal of gigantic proportions.

A large fraction of global financial wealth – by TJN’s estimate at least US\$21 trillion as at 2010 – has been invested virtually tax-free through the world’s expanding black hole of offshore secrecy jurisdictions. This offshore economy is large enough to dramatically impact on official estimates of inequality of wealth and income; on estimates of national income and debt ratios; and, crucially, on the public finances of countries across the world.

At the same time, free-riding multinational businesses make use of international tax avoidance opportunities to increase their profits and gain a harmful advantage over local competitors. These firms also use their power to force governments to lower tax rates and provide tax incentives to attract investment. This has resulted in a shift of the tax burden to workers and lower-income households and has forced damaging cutbacks in public services.

Tax us if you can is required reading for all who want to understand the role of tax havens/secrecy jurisdictions in the global economy and the workings of the tax avoidance industry that is secretly embedded within it. In an accessible yet rigorous approach, this book offers a guide to the language of international tax policy and shows how lawyers, accounting firms and banks profit from abusive tax practices. It also outlines the numerous policy failures that have encouraged the creation of the shadow economy of secrecy jurisdictions and proposes a range of practical solutions to this cancer in the global economy.

