tax us if you can

the true story of a global failure

tax justice network

Introduction to the Tax Justice Network

The Tax Justice Network (TJN) brings together organisations, social movements and individuals working for international tax co-operation and against tax evasion and tax competition. In an era of globalisation, the Tax Justice Network is committed to a socially just, democratic and progressive system of taxation. TJN campaigns from an internationalist perspective for a tax system which is favourable for poor people in developing and developed countries, and finances public goods and taxes public bads such as pollution and unacceptable inequality. Our objectives and demands are detailed in the TJN declaration (www.taxjustice.net).

Our network grew out of the global social forum process and the international Attac movement. TJN is a pluralistic, diversified, non-governmental, non-party and multilingual network. Local, regional and national civil society and social movement organisations as well as tax justice campaigners, researchers, journalists, development specialists, trade unionists, concerned business people, tax professionals, politicians and public servants are members and supporters of the network.

TJN is campaigning for social change through public debate and education. Public understanding of tax matters is the precondition for international tax justice. The network makes information available through mass media as well as through conferences and seminars, the internet, newsletters, publications in print, symbolic actions, demonstrations and advocacy. We base our activities on expertise and sound research.

TJN facilitates co-operation, communication and information sharing between its members. Our network organises international exchange and policy debates in order to harmonise the views and concerns of our members. This process forms the basis for powerful global campaigns in international tax policy.

TJN is run by its member organisations as well as individual supporters. The network functions on the principles of participatory democracy, empowerment, transparency, accountability and equal opportunity. TJN encourages and where necessary supports member organisations and individuals to participate in the decision making. The network supports the building of national TJN campaigns in particular in developing countries. An international secretariat coordinates the network's activities.

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FOREWORD

'You see things; and you say "Why?" But I dream things that never were; and I say "Why not?"'

George Bernard Shaw

This is an excellent study on a very important subject, on which both research and policy action has been extremely limited as well as clearly insufficient.

When most economic activity was domestic, national tax authorities covered the majority of relevant economic units. In the era of globalisation, capital, as well as the wealth of rich individuals, has become highly mobile. This mobility has been further enhanced by capital account liberalisation and technological advances. As tax authorities continue to be mainly limited to powers within their own countries, the result has been a massive loss of tax revenue. Indeed, tax us if you can estimates that as much as US$255 billion is lost every year to governments around the world because of the no or low taxation of funds in offshore centres.

With so much tax revenue lost due to international evasion and avoidance, governments are forced to either reduce public spending and/or increase taxation on less mobile small companies or poorer individuals. This outcome is particularly harmful in developing countries where government spending is essential to finance sustainable development and poverty reduction; spending on health, education and infrastructure, subsidies for housing for the very poor and social safety nets are amongst key categories of such essential spending. Cutbacks in public spending are often extremely damaging and inequitable, as is increasing taxation on the less well-off and less mobile.

This state of affairs is by no means inevitable. Strengthening international tax coordination between governments in order to reduce international tax evasion is a very valuable first step. In the longer-term, a single world tax framework may be necessary to deal with some aspects of international tax policy as well as desirable to address large-scale global tax evasion. Steps in this direction by tax authorities – such as those outlined in this study – would make a major contribution to a world economy that would be more equitable, efficient and modern. Above all, those who have so little could potentially gain so much, whilst those who have so much would lose only a little.

Professor Stephany Griffith-Jones
Institute of Development Studies
Sussex University

The associated problems of capital flight, tax avoidance and tax competition are emerging as the next major global issue requiring attention. As public concerns about the widening divide between rich and poor escalate, and the international community comes under increasing pressure to eradicate poverty, civil society is paying far greater attention to the rising share of global wealth that is now held in tax havens beyond the reach of national tax authorities.

Tax havens are part of a much deeper problem facing the globalised economy. As a result of technological change and capital market liberalisation, rich individuals and transnational corporations (TNCs) can move their money freely around the world. Many have chosen to locate their wealth and their profits in offshore jurisdictions that offer minimal or zero tax rates. This has created problems because in a world of globalised markets, tax regimes remain largely based on national laws and attempts to improve international cooperation in tax matters have been undermined by intense lobbying.

Over 50 per cent of the total holdings of cash and listed securities of rich individuals in Latin America is reckoned to be held offshore. This figure rises to 70 per cent in the case of the Middle East.

The scale of capital flight to the offshore economy is immense. In March 2005 the Tax Justice Network (TJN) published research findings showing that US$11.5 trillion of personal wealth was held offshore by rich individuals. 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 be in the region of US$255 billion annually. Importantly, this estimate of revenue loss does not include tax avoidance by transnational corporations or the lowering of revenue income caused by tax competition.

To put this figure 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 poor countries.

Until quite recently international initiatives to tackle the problems posed by offshore finance and tax havens, 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 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 South.

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 taxes. Studies of offshore wealth holdings have shown that rich individuals in the South hold a far larger proportion of their wealth in offshore tax havens than their North American and European counterparts. For example, over 50 per cent of the total holdings of cash and listed securities of rich individuals in Latin America is reckoned to be held offshore. This figure rises to 70 per cent in the case of the Middle East.

Second, the ability of transnational corporations to structure their trade and investment flows through paper subsidiaries in tax havens provides them with a significant tax advantage over their nationally based competitors. 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 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 clearly threatens development, and it is tax havens that facilitate the money laundering of the proceeds of corruption and all types of illicit commercial transactions.

Fourth, the offshore economy has contributed to the rising incidence of financial market instability that can destroy livelihoods in poor countries. Offshore financial centres (OFCs) are used as conduits for rapid transfers of portfolio capital in to and out of national

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.

economies which 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 developing 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 the threat that companies will relocate unless given concessions on lower regulation and lower taxes, governments 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 section1of 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.[i]

If this conclusion applies to a relatively high tax economy like the United States, it is even more 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 is already happening in some jurisdictions. The implications of this for tax regimes and democratic forms of government around the world are dire.

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 the multilateral institutions to pay sufficient attention to the implications for 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 has led to a dwindling of revenues from trade taxes such as taxes on imports and exports. Unable to increase the relatively low revenue yields from direct taxation because of capital flight and tax avoidance, poorer countries have switched the tax burden on to consumers through sales taxes. This trend has become increasingly pronounced over the past 30 years and is widely agreed to be regressive since lower income households spend a higher proportion of their income on consumption. Unfortunately this issue has not been adequately addressed by the multilateral development agencies.

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 organizations, giving special attention to the needs of developing countries and countries with economies in transition. [ii]

Strengthening international tax cooperation is a crucial part of remedying the current imbalance between globalised businesses and nationally based tax regimes. This does not have to mean common tax rates, but it does require 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 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.

In their joint report on *Developing the International Dialogue on Taxation,*[ii] the IMF, OECD and World Bank have referred to providing technical assistance to improve the effectiveness of tax

If developing 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.

administrations in developing countries. What their report did not make clear, however, is how developing countries can effectively tackle the much 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. Nor are there currently any global initiatives under way 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.

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 havens are able to run circles around officials in developing countries 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 by working in tax havens. Their attitude towards democracy and society in general was perfectly summed-up by a British accountant who told the press in 2003 "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".[iv] 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 of 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 believe would help address the problems are outlined in section five. Finally, a glossary of terms is included to help with understanding the language of tax.

1. 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 pays 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, whilst other sources of income, usually derived from investments, are untaxed. None of these options offer a system that most people would regard as socially just or fair. This diversity of view does however demonstrate 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

1.1 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 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.

1.2 The concept of tax justice

Tax justice is like an elephant because you recognise it when you see it but it's hard to define. That may be one reason why the issue has taken so long to come on to the agenda of civil society.

Tax justice has three components:

- the duty of the taxpayer
- the duty of the state
- international obligations

The taxpayer

For the taxpayer, tax justice means that they accept their duty to the states in which they reside to declare all their income fairly and openly and to pay the taxes they owe 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, whether aggressively or not
- they seek to comply with the taxation law of the states that applies to them

The state

The state has to create a system of taxation that:

- Requires each person (whether a real person or a corporate entity or trust) to pay tax according to their means;

Where there is an income tax, the just man will pay more and the unjust less on the same income.

Plato

> 'By eroding the revenue base, tax competition can become too much of a good thing. Bidding wars between countries can undermine the collective revenue base. This increases the tax burden on the less mobile industries and on labour, relative to capital.'
>
> Financial Times

- Imposes no undue cost on them to comply with that law;
- Provides them with reasonable certainty as to what is due;
- 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 has to be enforced, but within the spirit of the law;
  - taxes received are openly and transparently accounted for, as is their use;
- 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 which charge a source of income to tax more than once.
- Inconsistent tax systems which 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 and the "ring fenced" tax regimes of most tax havens, which mean that different tax regimes are offered to companies and trusts owned by non- resident people when compared to those available to people resident in the tax haven.
- Incomplete tax systems that are either not comprehensive in their scope or allow income to fall through loop holes. Both encourage aggressive tax avoidance and non-compliant tax behaviour.

The international dimension

There is an international dimension to the affairs of a state which requires that the following are avoided:

- Creating competing tax systems. Nation states are not in competition with each other in the way that the economic theory suggests should give rise to optimal economic behaviour. As a result competing tax systems can give rise to seriously sub-optimal behaviour on the part of governments. For example, as research referred to in this report shows, governments in tax havens that seek to attract capital to their financial services industries by offering low or no taxes on the income derived from those sources are denying substantial taxation revenues to both developed and developing nations. Since those governments need revenues to relieve poverty and fund healthcare, education and other social services, competing tax systems cannot be beneficial.

- Offering its sovereign space to the citizens and legal entities of other states so that they can avoid any obligation to the state in which they reside or to any other state in which they trade. To do so is an act that undermines the right of other governments to exercise their own sovereign will.

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

1.3 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 bound to be needed. Taxes are applied to populations made up of different people with a wide variety of incomes, values, preferences and consumption and savings choices. In such real world circumstances governments should not rely on one tax to meet all or even most of their needs.
- Comprehensive on the source of revenue that it is supposed to charge. Income taxes that let some income be untaxed, sales taxes that ignore some sales, and tax systems that ignore income flows derived from the sale of capital assets all provide the perfect opportunity for abuse because they are not comprehensive. Importantly, however, this comprehensiveness has also to take into account exemptions and reliefs in support of 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 they are likely to affect taxes start at low overall rates and with low absolute amounts due for those on low income and both the absolute amount of tax due and the absolute percentage rate at which it is paid increase with income. A tax system that derives a high percentage of the total tax revenue from indirect taxes disadvantages poor people as they pay a higher proportion of their incomes in sales taxes than those who are wealthier.

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’.

- Not significantly different in rate from other taxes on the nearest equivalent form of income operated 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 what tax professionals call 'tax planning'.

This means that 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'.

1.4 Why tax justice matters

Tax justice matters because the sustainability of any modern economy requires that the state has sufficient revenue to fund the physical and social infrastructure essential to economic welfare, and also to enable a degree of wealth distribution between rich and poor in order to promote equity and security. Significant issues of social and economic concern are also affected by the tax systems, including:

- income inequality
- inequality of treatment
- gender equity
- international relationships
- the international trading regime
- sound investment management
- sustainable development

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 1: The value of wealth held offshore

Data on the value of wealth held offshore is hard to come by since neither governments nor the international financial institutions seems either able or willing to research the global picture.

The Bank for International Settlements (BIS) records bank deposits by country. According to their estimates, in June 2004 out of US$14.4 trillion total bank deposits, some US$2.7 trillion were held offshore. This means that approximately one-fifth of all deposits are held offshore. However, this figure relates solely to cash. It excludes allother financial assets such as stocks, shares and bonds, and the value of tangible assets such as real estate, gold and even yachts held offshore as well as shares in private companies. These assets are typically controlled through offshore companies, foundations and trusts, the latter not even being registered let alone required to furnish annual statements of account. The value of these assets is therefore unknown and harder to determine.

In 1998, Merrill Lynch / Cap Gemini's *World Wealth Report* estimated that one third of the wealth of the world's high net-worth individuals (HNWIs) is held offshore. According to their most recent wealth report, the value of assets held by HNWIs with liquid financial assets of US$1 million or more was US$27.2 trillion in 2002/3, of which US$8.5 trillion (31%) was held offshore. This figure is increasing by approximately US$600 billion annually, which brings the current figure to about US$9.7 trillion.

A slightly lower estimate was published by the Boston Consulting Group (BCG) in their *Global Wealth Report* for 2003. BCG estimated the total holdings of cash deposits and listed securities of HNWIs at US$38 trillion, which is broken down by geographical region of origin as follows:

Continent	*Total wealth (US$ trillions)*	*Probable amount offshore (US$ trillions)*
North America	16.2	1.6
Europe	10.3	2.6
Mid East and Asia	10.2	4.1
Latin America	1.3	0.7
Total	38.0	9.0

These figures exclude real estate, non-financial assets and privately owned businesses.

There is a third way of estimating the value of liquid assets held offshore. Data published in a report by the research arm of the global consulting group McKinsey & Company, shows that the total global financial capital amounted to US$118 trillion in 2003. This was split by asset type as follows:

Asset type	*Value (US$ trillions)*	*Per cent of total*
Quoted equities	32	27
Private bonds	30	26
Gov't bonds	20	17
Bank deposits	35	30
Total	118	100

Whilst it might appear hard to reconcile the McKinsey figure for deposits with that of the BIS, it should be noted that McKinsey's figure apparently includes the balances banks owe to each other which are not included in the BIS data quoted earlier. This means that the BIS data is a reflection of the sums held by individuals, non-banking corporations and trusts and is therefore more accurate for these purposes.

The ratio of cash to total financial assets has, according to McKinsey's, ranged from between 3.3 to 3.85 over the past 4 years. An average of 3.5 would seem reasonable. Applying this average to the BIS offshore holdings yields a figure for total financial assets held offshore amounting to US$9.45 trillion. This provides a third estimate within the range US$9 to US$10 trillion. However, this estimate does not include real estate and other tangible assets, the ownership of private businesses held offshore, or other intangible assets such as the rights to receive royalties and licence fees. No one can be sure of the precise value of these assets, so they use a modest estimate that would add no more than US$2 trillion to the value of offshore holdings (which in view of the value of real estate may well be very modest indeed).This provides the basis for our estimate that the value of assets held offshore lies in the range of between US$11and US$12 trillion. We consider this to be a conservative estimate.

Income from offshore wealth

According to the various wealth reports already referred to, wealth holders currently expect their assets to grow at between seven and eight per cent annually. An average rate of return of 7.5 per cent would therefore seem appropriate. US$11.5 trillion invested at 7.5 per cent yields a return of about US$860 billion a year. This is a reasonable measure of the offshore investment income each year.

Tax lost on offshore income

The tax loss arising from US$860 billion being held offshore is estimated as follows. In 2003 Cap Gemini stated that 7.7 million people around the world held more than US$1 million in financial asset wealth. Normally these high net-worth individuals would be paying the highest rates of personal tax. Forbes magazine in 2004 stated that the average marginal tax rate for a person earning €100,000 that year was 37.5 per cent. However, this figure would be too high an estimate of overall tax losses since some assets held offshore will have been invested in ways that involve taxes being withheld rom payments made. We estimate that the average withholding on a portfolio of the type Cap Gemini refers to would be in the region of 7.5 per cent, On this basis we use an average tax rate of 30 per cent to calculate the overall tax loss.

US$860 billion at 30 per cent yields an annual tax loss of approximately US$255 billion resulting from wealthy individuals holding their assets offshore. This estimate does not include tax losses arising from:

- tax competition
- corporate profit-laundering

Tax justice and inequalities of income

Global tax systems have become increasingly regressive over the last 25 years. In the developed world this has been caused by a policy shift away from taxing business towards taxes on consumption and labour, such as VAT and payroll taxes. In contrast, the IMF and World Bank have required many developing countries to drop many of their tariffs on imports and to introduce taxes like VAT on consumption in their place. In many cases the new taxes have not raised as much as those they have replaced. This has resulted in less spending on education, health and other crucial services. This in turn has led to increased unemployment.

These changes have been regressive because business profits and capital income are largely earned by the rich, many of whom are concentrated in developed countries, whereas poor 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 are in developing countries. This trend towards more regressive tax systems partly explains why income and wealth inequality has increased in many regions of the world.

At the same time the rise in the use of tax havens by wealthy people and corporations has caused a significant shift in the distribution of the tax burden, with a very large number of super-rich people being able to simply avoid paying tax or being given differential treatment. 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, but this assumes that all citizens and companies are equally mobile, which is not the case, and ignores the free-rider problem.

Promoting equity through the tax system

Justice requires that people be treated alike if their circumstances are similar. Many of the world's current taxation systems do however encourage dissimilar 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 not, then they will have different tax bills.
- Different tax structures are taxed in different ways e.g. in

> 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

some countries self-employed income received through private corporations is taxed more favourably than that received directly by the 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 which others cannot secure.
- Corruption is a fact of life in many parts of the world. Some people may have to bribe tax officials to agree their affairs when others do not.
- Advantages are given to foreigners. Many tax systems, especially in tax havens, provide benefits to people temporarily resident in a country which are not available to those born in it.
- Those with different consumption patterns pay significantly differing amounts of sales tax.

Issues such as these can be a serious cause of political tension and even conflict within society.

The rich pay less and the poor pay more: Cardoso's tax legacy in Brazil

During the years of Cardoso's presidency of Brazil the employee's income tax rate rose by 14 per cent and social security contributions by 75 per cent. Tax on profits, however, were reduced by 8 per cent over the same period.

The regressive nature of Brazil's tax regime has been magnified by a value added tax regime that biases the tax burden towards lower income households, which pay approximately 26.5 per cent of their disposable income on VAT whilst high income households pay 7.3 per cent of their disposable income on VAT.

Source: Assessoria Economica de l'Unafisco, Brazil, 2004

The gender implications of tax justice

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

- people need to be able to live on their after-tax income;
- income is unfairly distributed around the world; 2.7 billion people live on less than US$2 a day;
- the distribution of tax as well as the distribution of income has an impact on welfare;
- some taxes, and especially those on consumption, can have a higher 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 economic burden of bringing up children also falls on mothers. This means women are often particularly vulnerable economically. Many taxation systems exacerbate this in several ways:

- 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 expenditure by all consumers even when the level of income of a household is 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 businesses are mobile they can exploit opportunities for tax competition which consumers and normal citizens cannot. As a result 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 first when there are cuts in government spending. Both use more healthcare than men, and children need education, which is expensive.
- Benefit systems are often poorly designed and badly 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

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

are punitive due to the combination of tax being charged and benefits being withdrawn.

The insidious impact of tax competition

Many in business and pro-business political actors argue that nations should compete with one another to attract inward investment from international business 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 resources. 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.

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 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 inefficiently used. 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.

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

- Most tax systems are biased towards larger companies which 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 which 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 transnational companies:
  - TNCs find it much easier to abuse transfer pricing rules since these require at least two countries to be involved.
  - TNCs are more able to lower their tax rates using licensing and thin capitalisation arrangements.
  - TNCs can exploit tax arbitrage techniques.

Very often all three characteristics combine so that 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. As a result the start-up businesses are placed at a disadvantage and additionally suffer the greatest tax compliance costs in proportion to their trade.

This tax distortion is to be found around the world in

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.

countries large and small, developed and developing, tax haven or not. Since the world 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. Much of the wealth invested in the 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 being transparent about the taxation risks they face. Recent research suggests at least 75 per cent of the largest UK quoted companies do not pay tax at the notional tax rate of 30 per cent that applies to them. Some pay less than half this rate.

Those who manage these companies suggest that tax should be treated as another cost to be minimised in order to maximise shareholder value. But this assertion 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. Whilst 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 figure 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, tend to 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.

- 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 is imposing a direct cost on developing countries. In 2000 a major development NGO estimated this cost to be US$35 billion a year. That is the money lost because developing countries cannot charge the tax rates they would wish because corporations refuse to pay them or they negotiate special rates, or the countries are told to offer reduced rates by the IMF or World Bank as a condition of obtaining financial support.
- US researcher, Raymond Baker, reported in the Financial Times in 2004 that up to US$500 billion of capital flight funds flow out of developing countries each year. He has suggested this figure has three components:
  - US$50 billion of funds flowing from corrupt practices
  - up to US$200 billion arising from commercial exploitation of taxation weaknesses within the developing world e.g. extraction of profits by way of transfer pricing abuses
  - US$250 billion of ‘capital flight’ money arising from criminal activity

Most of this ends up in tax havens where it can be held anonymously.[v]

1.5 How to test tax justice

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

The test for a taxpayer is that they should ask the question: If any government knew of what I am doing is it likely that they would either:

- think it illegal, or
- think it was legal, but they would want to change the law to prevent others acting in the same way in the future?

The test for anyone in government considering their taxation system is also in two parts and is:

1. Is our tax law just, taking all its components into consideration?
2. If another government behaved as we do would we consider their actions a threat to the welfare of our state or its taxation revenues?

1.6 Conclusions

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

These are costs the world cannot afford. But there are winners in this process and it is to these that we now turn our attention and ask fundamental questions such as:

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

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.

2. CAUSES OF TAX INJUSTICE

Tax injustice is widespread. The figures we refer to above makes that clear. 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
- lack of taxation on natural resource use

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.

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 in the world never leave the country in which they were born. This means that for most people tax is a domestic issue determined by their place of birth.

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 preserve systems of tax injustice which could be amended because they can argue, without fear of challenge that 'there is no alterative'. There are always alternatives in tax.

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

- Income tax, probably split between federal (or national) and local levels and charged on income from:
  - employment
  - self-employment
  - any form of trade

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.

    - investment income
    - rent
    - profits not taxed by other taxes
- A corporation tax on company profits if not covered by income tax.
- A capital transaction tax or Tobin tax.
- Capital gains tax.
- Inheritance or gift 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 and especially energy taxation.
- Withholding taxes on income paid abroad.
- Stamp duty.

Payroll taxes may discourage employment, but in many cases they can raise substantial revenue. If it is necessary to ensure overall tax rates are kept at a reasonable level, then a payroll tax may also be added to the list.

Nine or ten taxes do not make for a simple tax system, and the situation is further complicated by the fact that any taxation system must be integrated with state benefits. This integration is essential to ensure very high tax rates are not created 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 overly important in the income of the government. That means each tax can be charged at a reasonable level, so reducing the incentive to avoid or evade it.
- With a comprehensive range of taxes if one tax is avoided there is a high probability that another catches the income instead. For example, income which a tax payer seeks to reclassify as a capital gain is caught by a capital gains tax. But in the absence of a capital gains tax the temptation to wrongly describe income in an attempt to avoid tax rises substantially.
- These taxes address different sections of the economy, and in combination achieve an even spread of taxation across the economy. This increases the chance that taxes are equitable in that each contributes in a progressive way.
- Some taxes are included less for their contribution to revenues (this is probably true of most gift and inheritance taxes and, at present, many environmental taxes) but more because the chance of avoidance is much higher without them because the information they provide

gives an overview of a taxpayer's affairs and therefore helps to ascertain whether other tax liabilities are being fairly assessed.

In principle the base for each tax should be:

- as broad as possible
- subject to as few exemptions and incentive deductions as possible to prevent loopholes being created, 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 include some regressive taxes. Sales and carbon taxes, for example, may well be regressive, but, if they form part of a comprehensive system of taxes and benefits, regressive outcomes can be mitigated through other parts of the taxation system.

It is important that arguments put forward in favour of having just one or two 'simple' (typically 'flat rate') taxes are resisted. Almost invariably such taxes are promoted by those with wealth, or those who act for the wealthy, and are rarely accompanied by any analysis of how the government to whom the proposal is made will raise its income, and what tax rates will be required to enable it to do so. A 'flat rate' tax system is likely to result in a considerable overall shift of the tax burden on to people 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 risk that the resulting system could be unjust because it may not charge international income to tax appropriately. This might arise for two reasons:

- First, it 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 where that income is earned elsewhere.

Both these failings are commonplace, and both give rise to considerable tax injustice. It is obviously contrary to the principle of fairness that people should be treated differently from each other on similar sources of income because either:

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.

- They live in different places which happen to be divided by an international border even though the income in question is earned in the same place.
- 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 which would have been taxed within that country if it had been earned in it.

For this reason countries have to adopt rules to tackle these issues. No one 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. What this means is that a country cannot rely on just a source or residence basis of taxation. A combination of both is needed. Even then, a further set of provisions are required to capture those who might 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 tax payer or company has a substantial international dimension to their taxation affairs. It is only through a 'layering' approach to taxation that the problems of tax injustice can effectively be tackled.

Tax systems can also fail to charge all income to tax even when a government has sought to be comprehensive internally and in its international dimension because the tax law of the country has loopholes and flaws within it which can be exploited by people who aim to abuse the spirit of the laws. This process, called aggressive tax avoidance, occurs when people and companies undertake transactions which fall within the loopholes in the law in order to avoid tax on the transactions. 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.

2.5 How tax administrations might fail to ensure tax justice

Tax administrations can fail at numerous levels:

- Tax law is not clearly written.
- Tax law is not readily available to everyone who wants it.
- It 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 undertake 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 result in tax justice. Whilst the tax administrations of many developed countries are generally good, those in many developing countries are not. This is not, it should be stressed, down to corruption, rather it is the scarcity of resources to tackle the problems of raising tax inside those territories. It is probably for this reason that no African country has raised a successful attack on a transfer pricing arrangement although it is known that transfer pricing abuse is rife within that continent.

Tax justice requires that these administrations get the resources they need to fulfil the task asked of them by their citizens. It is not possible to have flourishing, corruption free states in the developing world without strong administrations to provide them with the revenues they need to fulfil the reasonable expectations of their peoples. Strengthening tax systems in developing countries should therefore become a high priority. Funding and technical assistance is urgently needed to make this possible.

2.6 Tax havens are a root cause of tax injustice

There is little that has contributed more to tax injustice than the promotion of tax havens. Tax havens are, in many senses, fictional spaces. Of course there is a physical reality that bears their name, but the tax haven operations they promote have in most cases an unusual common characteristic: although a company might be registered in a tax haven, under the terms of

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

Strengthening tax systems in developing countries should therefore become a high priority.

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.

its constitution it is not allowed to trade there. The pretence is made that they trade somewhere else, whether that is the case or not.

In addition, although a company might be registered in a tax haven territory almost no information about it needs to be recorded with the government of that tax haven. 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 nominee names are allowed. A nominee name is a person who is paid a small fee to say they are a director of a tax haven company when in fact they have no real involvement in its operation.

To add to this air of secrecy and artificiality, many tax haven companies are owned by trusts. These trusts are themselves set up offshore, but often 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 typically be located in a third tax haven territory. Within the tax planning industry it is generally thought that involving three tax haven territories in such a structure will make it very difficult for outside authorities to investigate what is really happening, and who is benefiting from it.

There is a further benefit in the eyes of the person who sets up such an arrangement. Officially the company, trust and trustees might each be located in a different territory, but equally each of them might suggest that their activities do not take place in the country in which they are located. The outcome is that the tax haven activity appears to take place nowhere. Which means it is accountable to no one, pays tax to no one, and has no duty to report anything because it can deny it is anywhere.

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 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, drug trafficking, people trafficking and so on to take place largely undetected

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

3. KEY PLAYERS IN TAX INJUSTICE

Tax injustice does not happen by chance. It typically happens as a result of careful and deliberate planning, especially in the case of the aggressive 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
- transnational companies
- tax haven governments
- tax avoiders and tax evaders

The following are trying to tackle the problem:

- the Organisation for Economic Cooperation and Development
- the United Nations
- the European Union
- tax authorities who are losing revenue as a result of the abuse
- civil society

At present those who promote tax injustice have the upper hand in this battle because globalisation and technological change has made it easier for the rich and for businesses to avoid paying taxes. It is for this reason that civil society has decided to tackle this issue in order to counteract the trend towards greater tax injustice. By raising the issue on the international agenda, 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 when states such as New Jersey and Delaware realised that they could lure businesses from more prosperous states by offering tax advantages on condition that they register in their states. Incredibly, this practice began in the late nineteenth century but was similar to many modern tax haven practices.

The first real cases of international tax planning occurred in the British Empire in the early twentieth century 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.

In the 1920s the UK added new ways for the internationally mobile person to avoid tax. This happened when a UK court ruled 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 finally 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 1930s. The Swiss believed at the time that it provided them with a competitive advantage as a small, land-locked state in a hostile European environment.

None of these things happened by chance. They were thought up by lawyers and accountants and were 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,

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.

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$55 billion. Each operates in at least 139 countries. KPMG had offices in more than 30 of the states identified as offering unacceptable tax practices by the OECD in 1998, although it has closed or renamed a few of those offices since then. All have offices in all the major tax havens of the world.

Each has been heavily involved in promoting tax haven 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.[vi] That committee found that some of these products were almost certainly illegal. They 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.

Deloittes 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.

KPMG was heavily criticised by the US Bankruptcy Court for its role in creating tax saving schemes which lacked economic substance on behalf of WorldCom before it failed. These schemes were designed to save it billions in tax through what were subsequently considered entirely artificial arrangements involving the licensing of what KPMG called 'management foresight'. Given the spectacular failure of that company it is not hard to see that this management foresight had little real worth.

In addition, the evidence of the inappropriate behaviour of these firms does not come from the US alone. In 2005 the European Court of Justice offered an opinion on a KPMG promoted scheme for avoiding the UK's sales tax, or VAT. In their sales promotional literature for the scheme KPMG admitted that they knew that the UK taxation authorities would consider the scheme to be 'unacceptable tax avoidance'. They nonetheless promoted it as a tax product to people who were not previously clients of their firm. The court opinion concluded that KPMG's tax shelter was an improper attempt to avoid VAT. Of course these firms are not alone in promoting a culture of tax avoidance, or in suggesting the use of tax havens. But they have a particular responsibility to bear for a number of reasons:

- Their size means they dominate the world-wide accounting profession.
- They are so big that another failure would now effectively mean that the world-wide audit market would collapse for lack of choice of firms to undertake the work. They plead special privileges for themselves because of this, but appear not to recognise their duty to society in return.
- They heavily promote the cause of corporate social responsibility, no doubt because they see an opportunity to make money from it, but do not appear to recognise the critical role they appear to play in promoting corporate social irresponsibility in tax avoidance.
- Although they no doubt avoid dealing with the more sordid and more criminal end of the offshore taxation and accounting market, the respectability their presence bestows on many of the world's tax havens means that these are provided with an apparent legitimacy that 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 appear not to wish to have the critical eye of scrutiny passed over their own activities. For example, KPMG is operated from a secretive Swiss base whilst PWC's international operations are hidden behind an obscure company in London which 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 two years in the case of PWC and the data supplied is by no means that needed 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. For example, in 2004 partners from KPMG and PWC in Jersey lent their names to a paper supporting the introduction of a regressive sales tax but lobbied for their own exemption from this tax in order to 'protect their competitive position'. It is clear that these firms are politically active in creating the taxation structures that cause much of the taxation injustice in the world.

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 suggests that none of these ethical codes of conduct condemns the use of tax havens, aggressive tax planning or the promotion of non-compliant taxation behaviour by its members. In view of their privileged position, accountants have a duty to support a change in the ethics of the accountancy profession so that all these activities are banned.

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

None of the ethical codes of conduct promoted by the professional bodies of accountants condemns the use of tax havens, aggressive tax planning or the promotion of non-compliant taxation behaviour by its members.

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 allow
- 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. But unfortunately that is not true of the profession as a whole, and many of the larger, more commercial firms are heavily involved in promoting practices which use offshore structures.

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.

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.

Without banking secrecy the administration of the world's tax system would be substantially cheaper and more effective.

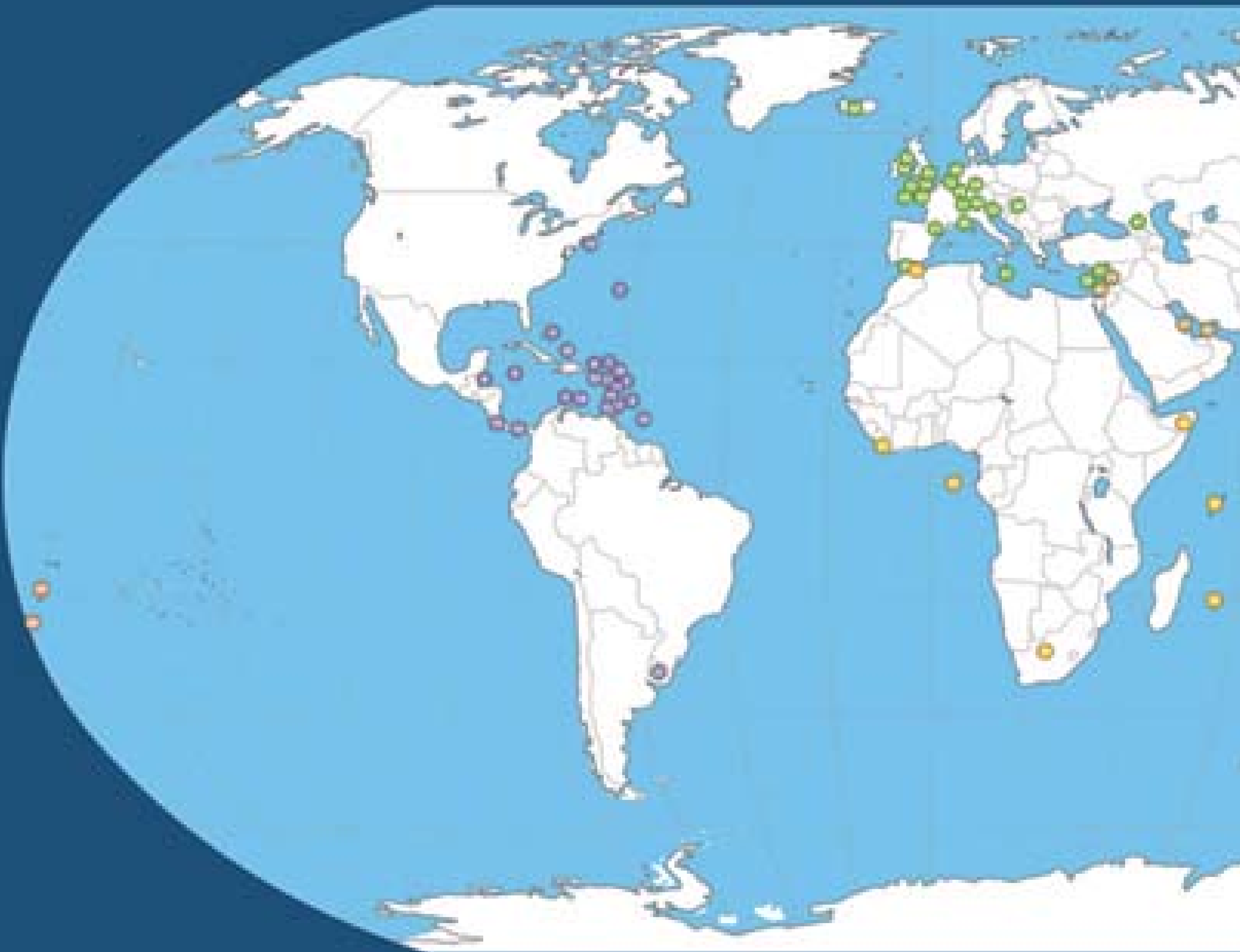
People bank offshore because they recognise and trust the names of the banks to whom they give their funds. Without these banks operating in this way the offshore world could not exist. And without the banking secrecy which all these banks support, the administration of the world's tax system would be 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.

Tax havens by reg

The Caribbean and Americas

1 Anguilla
2 Antigua and Barbuda *
3 Aruba *
4 The Bahamas
5 Barbados
6 Belize
7 Bermuda
8 British Virgin Islands
9 Cayman Islands
10 Costa Rica
11 Dominica *
12 Grenada
13 Montserrat *
14 Netherland Antilles
15 New York
16 Panama
17 Saint Lucia *
18 St Kitts & Nevis *
19 Saint Vincent and the Grenadines *
20 Turks and Caicos Islands
21 Uruguay *
22 US Virgin Islands *



Africa

23 Liberia
24 Mauritius
25 Melilla *
26 The Seychelles *
27 São Tomé e Príncipe *
28 Somalia *
29 South Africa *

Middle East and Asia

55 Bahrain
56 Dubai *
57 Hong Kong
58 Labuan
59 Lebanon
60 Macau *
61 Singapore
62 Tel Aviv *
63 Taipei *

ion

Europe

30 Alderney *
31 Andorra
32 Belgium *
33 Campione d'Italia *
34 City of London
35 Cyprus
36 Gibraltar
37 Guernsey
38 Hungary *
39 Iceland *
40 Ireland (Dublin) *
41 Ingushetia *
42 Isle of Man
43 Jersey
44 Liechtenstein
45 Luxembourg
46 Madeira *
47 Malta *
48 Monaco
49 Netherlands
50 Sark
51 Switzerland
52 Trieste *
53 Turkish Republic of Northern Cyprus *
54 Frankfurt

hotspots

Indian and Pacific Oceans

64 The Cook Islands
65 The Maldives *
66 The Marianas
67 Marshall Islands
68 Nauru *
69 Niue *
70 Samoa *
71 Tonga *
72 Vanuatu

source: Hampton and Christensen

3.5 The transnational companies

Transnational companies deserve special mention amongst those who promote tax injustice. They are, of course, taxpayers, but their role can be highlighted for several reasons:

- they are, or should be, the largest taxpayers
- 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 transnational 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 TNCs 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 the tax systems which support the societies in which its stakeholders live by failing to make appropriate payment towards them

Nor, unfortunately, is there evidence that TNCs 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 transnational corporations, 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 Tax haven jurisdictions

The tax havens and microstates listed in Box 2 carry a burden of responsibility for the problem of tax injustice. All have contributed in some way towards creating a system which contributes to the imbalance of wealth distribution in the world, which hinders sustainable development.

Some of these microstates 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 the economy of the country 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 currently impose upon the world economy.

For countries such as Switzerland, the UK and Luxembourg, all major tax havens, the problem is one of political will. The OECD has tried to take action against some of the smaller states who have abused the world tax system through the use of harmful tax practices, including classic tax haven activities. The OECD and the EU have been less successful at bringing their own members to book when they have undertaken the same activities.

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The OECD has tried to take action against some of the smaller states who have abused the world tax system through the use of harmful tax practices, including classic tax haven activities. The OECD and the EU have been less successful at bringing their own members to book when they have undertaken the same activities.

Box 2. Tax Havens of the World

The Caribbean and Americas

Anguilla
Antigua and Barbuda *
Aruba *
The Bahamas
Barbados
Belize
Bermuda
British Virgin Islands
Cayman Islands
Costa Rica
Dominica *
Grenada
Montserrat *
Netherland Antilles
New York
Panama
Saint Lucia *
St Kitts & Nevis *
Saint Vincent and the Grenadines *
Turks and Caicos Islands
Uruguay *
US Virgin Islands *

Africa

Liberia
Mauritius
Melilla *
The Seychelles *
São Tomé e Príncipe *
Somalia *
South Africa *

Middle East and Asia

Bahrain
Dubai *
Hong Kong
Labuan
Lebanon
Macau *
Singapore
Tel Aviv *
Taipei *

Europe	
Alderney *	Isle of Man
Andorra	Jersey
Belgium *	Liechtenstein
Campione d'Italia *	Luxembourg
City of London	Madeira *
Cyprus	Malta *
Frankfurt	Monaco
Gibraltar	Netherlands
Guernsey	Sark
Hungary *	Switzerland
Iceland *	Trieste *
Ireland (Dublin) *	Turkish Republic of
Ingushetia *	Northern Cyprus *

Indian and Pacific Oceans	
The Cook Islands	Niue *
The Maldives *	Samoa *
The Marianas	Tonga *
Marshall Islands	Vanuatu
Nauru *	

Source: Economist Intelligence Unit, OECD, John Christensen and Mark Hampton (UK academics working in this field)

Note: This list of 73 countries and territories excludes territories which have some tax haven features but are not commonly used as such, e.g. New Zealand. Those 34 territories marked with an asterisk have developed their activities in the last 25 years according to Christensen and Hampton, representing almost a doubling in the number of tax haven territories during that period.

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 poor 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

4. AGENCIES ADDRESSING GLOBAL TAX ISSUES

The problem of tax injustice is rising on the agendas of many organisations and civil society groups. The principal 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 counteract 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. They were joined in this mutual critique of havens in 1999 by the Financial Stability Forum which concentrated on international financial stability through information exchange and international cooperation in financial supervision and surveillance.

The OECD approach has been to seek to eliminate harmful practices, and it largely sought to do this by obtaining mutual undertakings to do so, conditional upon agreement between all the participating jurisdictions by 2005.

That deadline is now approaching and it is clear that whilst progress has been made, much remains to be done. That is largely because of conflicts between the tax havens that the OECD had targeted and the inability of the OECD to stop some of it principal member states from pursuing the very practices the OECD has described as harmful.

Nonetheless, the progress that has been made is to be welcomed. The environment in which tax havens operate has changed because of the OECD initiative.

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 has done two things. First, it has called on its member states to end preferential tax regimes, and this has restricted some of the more esoteric tax structures offered by some of its member states, especially in Ireland and the Benelux countries. This step has also resulted in pressure being brought to bear on the UK to require it to stop some of the more abusive behaviour of some of the tax havens operating in its

Overseas Territories and Crown Dependencies. Because of this pressure these havens are being required to offer the same rates to companies owned by their citizens as they offer to those companies owned by non-residents. In many cases this appears at present to have been counterproductive because these havens have reacted by offering low or zero corporation tax rates, but many of the mechanisms they are adopting appear unsustainable and it is likely that this action might have a serious impact on the future of some of these territories.

The second initiative the EU has promoted has been to facilitate the automatic exchange of information between member states on bank and other deposit holdings held in other member states. This has caused considerable political difficulty, partly because this provision does not just apply to the EU, but also to some dependent territories such as Jersey, Guernsey and the Isle of Man as well as some non-EU European countries such as Switzerland and Liechtenstein. Furthermore some EU countries and Switzerland have not yet accepted the concept of automatic information exchange. As a result Belgium, Luxemburg and Austria have all opted to apply a withholding tax on such interest payments rather than participate in automatic information exchange against the wishes of their banks' customers. As a result bank customers in these countries can choose between their country specific withholding tax or voluntary disclosure. The rate of withholding tax is to increase over time, so encouraging disclosure.

The current state of the European Union Savings Tax Directive (EU-STD) 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. But the EU-STD has established the principle of automatic information exchange between nations and is therefore a welcome step towards a global framework for automatic information exchange. This provides a policy framework that can be expanded to include all bank accounts and extended to include all countries.

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.

4.3 The United Nations

The role of the United Nations (UN) in taxation is not very widely understood. 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 has published a model double tax treaty although it has

Jeffrey Owens, head of tax at the OECD was quoted in the *Financial Times* in November 2004 saying “the emergence of non-governmental organisations intent on exposing large-scale tax avoiders could eventually achieve a change in attitude comparable to that achieved on environmental and social issues: Tax is where the environment was 10 years ago”.

largely been supplanted by that published by the OECD, on which most double tax treaties are now based.

The UN’s second role is as host of a little known committee now called the Committee of Experts on International Cooperation in Tax Matters. This committee has met in several forms since 1967. To date its influence appears to have been limited, but its status was upgraded in 2004, apparently in accordance with the wishes of UN Secretary General Kofi Annan. The significance of this move is high. This is the only global committee that considers international taxation matters and could potentially form the basis of a World Tax Authority, discussed in the final chapter.

4.4 Governments

Some governments promote tax haven activities. Others expend great efforts in challenging them. Some do both; for example the States of Jersey are introducing some of the most draconian anti-avoidance tax measures in the world in 2005 to stop their citizens taking advantage of the tax haven services that Jersey promotes for sale to the citizens of other countries.

This clearly suggests one way in which the attitude of a country towards tax injustice can be assessed. If it is consistent in its approach, making it hard for anyone to participate in such activities whilst seeking to provide as fair a tax system as it can for its own citizens and those who undertake business within that territory then it is on the right path.

There are increasing signs that the governments of the world are willing to tackle the issue of tax injustice, at least to the extent that it might help them to recover lost taxation revenues. As a result there are notable trends towards:

- The introduction of general anti-avoidance provisions in taxation law.
- Stiffer penalties for tax avoidance and evasion.
- Limits upon the rights of accountants, lawyers and others to sell tax planning schemes without disclosing what they are doing to taxation authorities.
- International cooperation to tackle these abuses, both at a multilateral level through the OECD, EU, etc, and also at a bilateral level. For example, the tax authorities of the US, UK, Australia and Canada are now cooperating to tackle international tax avoidance.
- Governments taking action to tackle tax haven abuse. The case study from Ireland included later in this report is a good illustration of this.

These moves are welcome, but it is also true that many countries, and international organisations, remain committed to policies which result in tax injustice, such as tax competition. The US and UK, for example, have such a commitment, as does 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.

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 the mobilisation of domestic resources for developing countries. In June 2000, one of the major development NGOs published a report entitled *Tax Havens: Releasing the hidden billions for poverty eradication.* The creation of the Tax Justice Network 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. In contrast the TJN has a primarily international focus.

ATTAC, which grew out of support for a Tobin Tax in France, has since 2000 developed into an international pressure group which is actively tackling the problems of tax fraud, financial crime and the misuses of tax havens. ATTAC-Deutschland took a lead role in forming TJN.

Until recently international tax policy was a relatively lonely area in which to campaign. Perhaps an example helps demonstrate this. When the G8 met in Evian in June 2003 over 300,000 demonstrated in Geneva, 3,000 registered to lobby the delegates and Geneva virtually ground to a halt. In December 2003 the UN Committee of Tax Experts met in Geneva. The Tax JusticeNetwork was the only civil society organisation to attend and address the meeting.

However, this situation is starting to change. Aid agencies are recognising the importance of these issues and are offering support to TJN or are promoting their own work in this area. Jeffrey Owens, head of tax at the OECD was quoted in the *Financial Times* in November 2004 as saying 'the emergence of non-governmental organisations intent on exposing large-scale tax avoiders could eventually achieve a change in attitude comparable to that achieved on environmental and social issues: Tax is where the environment was 10 years ago.'[vii]

5. TOWARDS TAX JUSTICE

There is much that can be done about the problem of tax injustice at both the national and international levels. All that is needed is the political will to do it. The role of civil society campaigners is to create the environment in which that political will exists. The range of issues to be addressed is huge and includes the following:

- corporate social responsibility
- 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

One of the most successful tax authorities at combating tax evasion and avoidance by its citizens is that in Ireland. In Box 3, they present an outline of their approach and its achievements.

Box 3. Tackling Tax Evasion: Ireland case study

The Irish Revenue Commissioners established the Offshore Assets Group (OAG) in summer 2001. Its role is to:

- identify methods and means of offshore tax evasion and avoidance
- develop appropriate and effective means to counter offshore evasion and avoidance
- develop systems to identify persons who use or have used offshore means of evasion and avoidance

Early research showed it would be difficult to obtain information from offshore jurisdictions, which promote confidentiality and do not have exchange of information agreements with Ireland. OAG focused instead on getting onshore information about untaxed money transferred offshore.

Its first success was to obtain a High Court order in Ireland requiring a clearing bank to provide details of transactions through an account, which OAG knew was used to transfer funds offshore.

Then, the group became aware that an offshore subsidiary of an Irish bank was withdrawing its trust services to Irish clients. It identified how this change might make it possible to get information about untaxed money transferred to the trusts.

The OAG informed the Irish parent company that Revenue would launch a formal investigation, and if its clients with tax liabilities wished to avoid prosecution, avoid being publicly identified as tax defaulters, and have penalties for submitting false tax returns substantially mitigated, they should make a “qualifying disclosure” and calculate and pay their full liability to the Revenue by 28 July 2003. The offshore subsidiary company informed its Irish resident customers of this investigation. Over 250 taxpayers made payments to Revenue totalling €105 million.

OAG obtained another High Court order to get information on money transfers between Ireland and the Isle of Man subsidiary of an Irish financial institution. Following discussions between OAG and the bank’s Irish parent, the offshore subsidiary wrote to its customers in similar terms to the letter issued in the earlier investigation. By the deadline date of 16 January 2004, some 1,250 customers had paid Revenue over €45 million.

Following meetings between the Chairman of the Revenue Commissioners, Mr Frank Daly, and the CEOs of the ten major Irish financial institutions, the banks agreed to request their subsidiary or sister companies outside the State to inform their customers that an investigation by the OAG would commence on 29 March 2004, and that to avoid prosecution, publication and higher penalties, their account holders should submit a computation and full payment of liabilities. The OAG issued a booklet and tax computation sheets to assist calculations. Under this scheme some 11,500 taxpayers have made payments of over €600 million. The total received by OAG to date in its investigations is over €750 million.

Following the OAG’s initiative, it was reported that Ireland was “the only territory in the world whose residents have run down their individual deposits in the Isle of Man”.

The OAG’s next move is to pursue those who failed to come forward under these disclosure programmes. The group has obtained the names of Irish residents who did not come forward in the first investigation. These cases are currently being investigated with a view to collecting outstanding liabilities and prosecution. OAG will also seek further High Court orders to require financial institutions to provide details about money transferred offshore by Irish residents.

This innovative approach used by the Irish Revenue to track transfers from domestic to offshore bank accounts could be replicated in many countries. Ireland is a fairly small country, with its own set of tax haven policies. However, to have raised €720 million from tackling tax avoidance has made a significant contribution to its exchequer and made clear that cheats are not acceptable within its economy. This is an action that other governments around the world are urged to follow.

5.1 Corporate social responsibility

The Publish What You Pay campaign has begun to achieve success in calling on companies working in the oil, gas and mining sectors to publish what taxes and other revenues they pay to the governments of developing countries. They have made notable progress, but their work serves to highlight the need for further action. Whilst there have been particular problems of corruption in these sectors and the countries in which they operate, the problem of corporate taxation abuse is universal. Companies are not paying the taxes they owe to countries around the world.

Despite this the corporate world has a particular duty to lead the way in setting an example in paying the tax that is due by them to the governments of the countries in which they operate. Nothing better reflects the corporate responsibility of any company than its payment of taxes that are due. Tax payments are a major component of a company's economic footprint in the country or countries in which it operates.

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Records of tax payments are not being made available at present. The US probably leads the way in disclosing information on tax payments, with the UK close behind and other leading developed countries following in their trail. But in almost no case is it possible to find out with ease:

- The names of all countries in which a transnational company operates.
- The names of the subsidiaries through which it operates in those countries.
- What sales they make in those countries, both to people other than themselves (third parties) and to other group companies (inter-group sales).
- How much they spend on labour costs in each country.
- How much they spend on other goods and services within each country, both purchased from third parties and on an inter-group basis.
- What profit they make in each country in which they operate.
- What tax they pay there.
- What level of assets they employ in each country.

Yet it is the case that every transnational company has this information available for internal accounting and management purposes. This information should be published because:

- A transparent company should be prepared to acknowledge where and how it operates.
- Crucially, if this information is

published it will be clearwho is, and who is not, shifting profits for tax advantage. For example, if the profit rates declared in developing countries were significantly below the average for the company as a whole this would suggest that profit was being transferred out of these countries. And if profits were being declared in tax havens but most of the sales and purchases that took place there were undertaken on an inter-group basis and few people were employed then it would be very likely that transfer pricing activities were taking place.

This information would enable shareholders, employees, suppliers and governments

Box 4. Transparency works – The Cofina case

In early 2004, the Swiss development advocacy group Berne Declaration received documents showing how the coffee trading firm Volcafé (now part of the ED&F Man group) used a postbox company on Jersey to book profits tax free.

The leaked *Instructions to the Offshore Invoicing* at Volcafé illustrated how the Jersey subsidiary Cofina (COF) was used for profits laundering purposes. Cofina was simply a postbox company. Coffee was delivered straight from the producer countries to the end customers, yet Cofina was apparently the seller.

The *Instructions to the Offshore Invoicing* reminded managers of Volcafé's subsidiaries in exporting countries: 'Please take care that all communication with the final buyer is made in the name of COF and mention clearly towards your customers that they receive all documents in the name of COF.'

Subsidiaries in producer countries were given instructions on how to give Cofina the appearance of real company. It started with the fax machine: 'You should program your fax machine in a way that your name does not appear on faxes dispatched in the name of COF. If it is cost wise justifiable you should install another fax machine for the dispatch of "COF Faxes".'

On Jersey there was only one person who signed important documents on behalf of Cofina. Cofina also kept the document files. The instructions who have relationships with TNCs to assess the risks involved in dealing with them as well as to let governments understand where and how profits are being declared in the group as a whole. The issue of accounting transparency is a vital element of tax justice, and TJN has published a draft International Accounting Standard to promote this idea which is available from the website.

Box 4 presents the case of international coffee trading firm Volcafé which went to considerable lengths to avoid disclosing how it used an off-shore subsidiary to launder its profits in a tax haven.

reminded export country managers: ‘During the handling of the contracts you may keep documents for easy reference and information with you, but they should be kept separately and strictly confidential. The complete filing and documentation has to stay with COF.’

The Cofina case gained public attention with a report on Swiss Television which was based on the material received by Berne Declaration. Only three months later Volcafé /ED&F Man dismantled Cofina Jersey. In August 2004, the company confirmed that they no longer conduct ‘any business through so-called tax havens’. The Cofina transactions are now booked through Volcafé International Ltd, based in Winterthur. Volcafé stated that ‘any such profits arising from that business will consequently be taxable in Switzerland’.

Berne Declaration remains concerned that earnings from the international commodities trade are distributed fairly. The offshore structure of Volcafé was just one example of the use tax havens by firms in the sector. Despite the dissolving of their offshore structure, Volcafé’s profits are still taxed at headquarters rather than in the producing country.

Clearly, a change in international standards on the use of offshore companies in commodity trading is essential. A first step could be the agreement of voluntary guidelines by companies operating in the coffee sector. Berne Declaration has produced concrete proposals for the inclusion of the issue of tax in codes of conduct.

5.2 Automatic information exchange

Information exchange between countries would go a long way towards tackling the culture of tax evasion and tax avoidance. The European Union has made some progress with the European Savings Tax Directive, but this is restricted in scope and needs to be extended to cover all countries. It is therefore proposed that:

- All banks and other financial institutions should be required to disclose as a matter of legal duty all interest, dividends, royalties, licence fees and other income (including that from employment) that they pay to citizens of another country each year, with sufficient information being provided to ensure that the recipient can be identified.
- This information should be automatically exchanged between countries so that each country has access to data on the income paid to its citizens in other countries to ensure that it is properly taxed.
- If a country refuses to do this then it should be denied economic favours until compliance is forthcoming. These favours might be access to markets without tariffs, the right to receive tax information in exchange, the right for its citizens to receive income without being taxed, or the right to enjoy the benefits of double tax relief. In combination these measures would be sufficient to encourage most countries to comply.

These requests are not unreasonable. The principle of automatic information exchange is being established in the EU, albeit that it has a long way to go yet, and bilateral treaties to allow more limited information exchange are now becoming more commonplace, even with some tax havens.

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. This is both desirable and practicable, and such measures will also assist in tackling organised crime, corruption, terrorism and money laundering.

5.3 Citizenship and personal taxation

High earners who travel frequently with their jobs can easily avoid paying tax. This is often possible because in most countries someone who is neither a citizen nor long-term

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.

resident is typically only charged tax on that part of their income which is earned there, which means that income received elsewhere in the world will not be taxed unless it is sent to that country. This opens up the opportunity for such people to divert large parts of their income to tax havens where it is held untaxed. There are several problems with this:

- It means that the world's wealthiest people, including rock stars, set a poor example by appearing to spend much of their time endorsing the process of tax avoidance.
- It means that the people most able to pay tax in the world often pay little or no tax.
- It establishes a wholly parasitical industry of lawyers, accountants and bankers who service the desires of these people who act as economic free-riders.
- It undermines the ability of any country to charge progressive rates of income tax because the wealthy threaten to leave.

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. Travel has become easier. Capital movements are virtually unrestricted. Access to offshore financial services has been extended to a far wider range of wealthy individuals. The sums of money lost to governments, particularly those of developing countries, are too large to be ignored.

There is an answer, and it is provided by the US. This is that every country should require its citizens to pay taxes on their world-wide incomes whether they are resident in the country of which they are a citizen, or not. This is discussed in more detail in section 5.5 below.

5.4 Corporate taxation

A new basis for taxing corporations is also required. A national basis for corporate taxation makes no sense when companies can operate in 150 or more states simultaneously. It is inevitable that taxation problems will arise in circumstances where the company acts globally but taxation is imposed locally.

Of course, local taxation works quite acceptably for local companies. In their case no change is needed to the way in which they are taxed, and that means around 95 per cent of the world's firms will remain unaffected by any changes. In the case of TNCs, however, further research is necessary to identify a viable basis for establishing a common definition of taxable profits and a common basis for agreeing how much profit is attributable to each country in which the corporation operates.

This basis for taxation will be complex, but so are the activities of major corporations. It is likely that:

- Trading profits will need to be taxed on a unitary basis.
- Interest and other investment income will initially have to be taxed on a source basis.
- There will need to be a fallback of a residence basis for investment income and gains.

Of course this will require a high degree of international cooperation on tax, which will take time to achieve, not least because this basis of tax will mean that tax haven activity will cease to be attractive to most companies. The achievement of this objective would mean that:

- Corporations would pay tax on all their profits.
- Those profits will be allocated to the countries in which they are earned.
- Each country will then be able to set its own tax rates to determine how much tax they wish to collect – so this suggestion does not in any way undermine the autonomy of individual governments.

5.5 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. There are many such rules at present but the following are likely to give the fairest result:
  - All people who are citizens of the country should be considered resident within it, whether they are physically present or not, and should be subject to its taxes whether present or not. This is not a common rule, but is used by the US, for example, at present. Exception could be made if the person were resident in another 'acceptable' country.
  - Of course, credit should be given for taxes paid overseas. Additionally, it should be possible for a person to apply to be a citizen of another state if the move is a genuine one.
  - All people who spend more than 183 days in any country in a tax year should be considered to be taxable by that country, whether they are citizens or not.

Using these rules it quickly becomes apparent that:

  - Becoming a tax exile is quite difficult because in many cases it would mean giving up citizenship, and many people would be reluctant to do that because this may deny them the right to return to their country of origin, to which however they do not want to pay tax.
  - It is possible for a person to be tax resident in more than one country at a time. This is already a reality for many people in the world, and gives rise to the need for other provisions to ensure tax justice referred to below.

- Tax all 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.
- 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.
- Have strong arrangements for international cooperation on tax which as a minimum would require that:
  - Information is automatically exchanged between tax authorities so that income earned in one territory and which belongs to a person resident in another territory is automatically reported by the first country to the second.
  - Credit is always given for tax paid in a country in which an income arises when calculating the tax due on it in the country in which it is received. This would mean that income is only taxed once at the maximum of the higher of the two rates.
  - Full cooperation is provided by each tax authority to ensure that tax evasion and tax avoidance are detected and prevented.
  - Each country helps the other to collect any tax due to it.

5.6 General anti-avoidance principle

Aggressive tax avoidance can be countered through the creation of what are called general anti-avoidance principles within taxation law. 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 less likely they are to work since a rigid provision looks more like a rule and merely creates its own set of new loopholes that the tax planning industry seeks to exploit.

A general anti-avoidance principle is based on the following logic:

- if any transaction is undertaken primarily to secure a tax advantage, or
- any step in a transaction is added for that purpose
- then the benefit that transaction gives for taxation purposes can be ignored, and
- tax can be charged as if it had not taken place.

Such a legal principle should be a vital part of the law in every country if the struggle on tax evasion and avoidance is to be won. 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, eventually rules are not enough to make the system comprehensive. Principles have to be built-in to ensure that the rules do not create their own problems.

This suggestion is exceptionally 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.

It is to tackle this sort of abuse by professionally qualified people that we suggest a major extension of professional ethics to make clear that many current practices are considered unacceptable professional conduct in the future.

5.7 World Tax Authority

There is a clear need for a World Tax Authority (WTA) to monitor the impacts of fiscal policies on trade and investment patterns, and to protect national tax policies from harmful practices.

The idea of a general anti-avoidance principle is exceptionally 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.

Despite evidence of the failure of the international tax policies to tackle transfer mis-pricing, thin capitalisation, tax competition and tax avoidance, none of the existing multilateral organisations such as the World Trade Organisation, the World Bank or the International Monetary Fund have intervened to prevent market distortions. This has been recognised at the highest of levels. 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'.

One organisation that has attempted to remedy the situation is the OECD, which has a considerable expertise in this area, but this poses problems because the OECD only represents the rich nations of the world and many nations are consequently excluded from its decision-making process.

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.
- 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 not undermine the autonomy of the state, an autonomy which is in any case being threatened to a much greater degree by 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 many 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.

Despite evidence of the failure of the international tax policies to tackle transfer mis-pricing, thin capitalisation, tax competition and tax avoidance, none of the existing multilateral organisations such as the World Trade Organisation, the World Bank or the International Monetary Fund have intervened to prevent market distortions.

For a WTA to be successful, it would need to establish policies in the areas referred to above. In many of these areas more research into best practice is needed. This is because these are areas that have been substantially ignored by the academic world to date. There is, therefore, an immediate need for more research into what would constitute a just international tax system.

5.8 Tax assistance for developing countries

Developing countries rarely have the resources to implement appropriate taxation policies. This is because these take time to develop, require well paid personnel who can feel secure in their employment, and need legal backing to ensure that when demands are made of international taxpayers these are met. Unfortunately these resources are not available at present because:

- cash resources have to be used for other, more immediate, priorities
- tax officials are often lured away from their posts by offers of higher paid employment in the private sector, frequently with international firms of accountants
- local tax officials feel unable to challenge international companies for fear they will remove their investment

For these reasons there is a pressing need for international assistance to be provided to developing countries to ensure they can establish:

- sound taxation systems
- good tax administrations
- rigorous procedures that require international companies to account for what they do (which would be greatly assisted by our proposed international accounting standard)
- international enforcement procedures that ensure international corporations pay what they owe
- sound career paths for key personnel so that they can afford to stay in their jobs

5.9 Holding governments to account

It is not sufficient to ensure that countries can raise the taxation 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.

Many states defend the lack of disclosure of accounting information by saying that the corporations in question are privately owned and therefore entitled to privacy. This proposition is not acceptable in a modern world that needs to protect itself from capital flight, money-laundering and the entire range of illicit commercial activity

This means governments have to account openly and transparently for their actions. Many initiatives, in part headed by the International Monetary Fund and supported by the Extractive Industries Transparency Initiative are driving this process. These initiatives are indicative of action needed in an essential area of international tax reform that does, however, have a national focus.

5.10 Publish who you are

It is incredibly difficult to tax people without knowing who they are, what they do, and what their financial situation is. Most tax havens and a great many other countries do not require the limited liability corporations they allow to operate under their laws to file the following information on public record:

- the constitution of the organisation
- names of the real members (not the nominees)
- the names of those really running the corporation (not the nominees)
- the annual accounts of the organisation prepared in accordance with internationally accepted standards and audited if activity exceeds internationally agreed levels

Many states defend this lack of disclosure by saying that the corporations in question are privately owned and therefore entitled to privacy. This proposition is not acceptable in a modern world that needs to protect itself from capital flight, money laundering and the entire range of illicit commercial activity. Any corporation that is given rights and privileges in law that allows them to impose a burden on others has a duty to account for how it exercises those rights. Limited liability is a massive privilege to enjoy, and it can impose a cost on anyone who deals with the entity. As such the obligation to account transparently always arises when a limited liability entity of any form is registered. For this reason the above information should be disclosed.

5.11 Trusts

Trusts are a principal vehicle of tax injustice:

- They are used to hide wealth from tax.
- Discretionary trusts hidden behind nominee trustees create a secrecy space that is hard to regulate.

- In common law countries, trusts are equivalent to secret bank accounts. This is a valid complaint of those countries that are being asked to remove their banking secrecy laws.
- Incredibly, charitable trusts own many of the offshore 'special purpose vehicles' that are used by so many companies as part of their international tax planning. This is an abuse of the concept of charity.

Trusts have been widely abused and they clearly need to be better regulated. They serve useful functions in such areas as:

- The promotion of genuine charities.
- The protection of children and the disabled who are unable to look after their own affairs.

There is no reason why every trust should not be required to disclose on public record the following:

- who created it
- what the trust deed says
- who the trustees are
- who the beneficiaries are, and in the case of discretionary trusts any potential beneficiaries listed in the settlement
- trust accounts

Trusts are given rights and privileges similar in many respects to those of limited liability companies. These rights and privileges should be balanced by a requirement for transparency and social responsibility.

5.12 The national agenda

The international agenda is important, but tax reform has to be national (and even local on occasion) if tax justice is to be ensured. This publication does not offer suggested reform of any individual tax system. Decisions regarding such issues will be decided by campaigns at a national level. However, there are a set of issues which should not be overlooked:

- Does the country have a comprehensive system of taxes?
- Does it have appropriate tax rates that 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?
- Is any sales tax fair and are essential items free of 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 (source or residence, arising or remittance) 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 within the country? Are they held to account for their actions?
- 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 all this information available at modest cost at most?
- 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?
- Is the country on our list of tax havens? If so, how can it remove itself from the list?

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.

GLOSSARY

Affiliate	A related company or subsidiary.
Aggressive tax avoidance	The use of complex schemes of uncertain legality to exploit taxation loopholes.
Arising basis	Treating income earned outside the country of residence as liable to tax in the year in which the income is earned, even if it is not remitted to the country where the tax is payable. *Compare with the remittance basis.*
Banking secrecy	Banking secrecy laws strengthen the normal contractual obligation of confidentiality between a bank and its customer by providing criminal penalties to prohibit banks from revealing the existence of an account or disclosing account information without the owner's consent. Can be used to block requests for information from foreign tax authorities.
Capital gains tax	A tax on the profits from the sale of capital assets such as stocks and shares, land and buildings, businesses and valuable assets such as works of art.
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 income are not declared in the country in which a person resides.
Charitable trust	A trust established for purposes accepted by law as charitable.
Citizenship basis of taxation	Tax is charged on the worldwide income of all citizens of the state irrespective of whether they are resident or not in the territory during the period for which the taxes are levied. The most obvious example is the USA.
Company or corporation	An entity treated as a separate legal person from those who set it up, established under the rules of the country in which it is registered.
Controlled foreign corporation (CFC)	A subsidiary company or corporation registered in a tax haven or other territory where little or no tax is charged on the profit the subsidiary makes. Profits declared by the subsidiary can in some cases be subject to tax in the country of residence of the parent company if it has the appropriate controlled foreign company legislation to enable it to do so.

Coordination centres	A special form of company with taxation advantages, often used to attract corporate headquarters to a country. Most notably found in Belgium, the Netherlands and Ireland.
Corporation tax	A tax on the profits made by limited liability companies and other similar entities in some countries, but otherwise usually being similar in application to income tax.
Currency transaction tax	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. Considered the most likely form of the Tobin Tax to be effective in practice.
Deferred tax	A fictional tax which only exists in company accounts and is never paid. Deferred tax does not, as such, exist. But 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 with 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. 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.
Discretionary trusts	Most offshore trusts permit payments to be made at the discretion of the trustees, which means that the identity of beneficiaries can remain a secret. In practice, trustees normally follow a 'letter of wishes', provided by the settler, instructing them whom they are to pay money to, when and how.
Domicile	The country identified as a person's natural home, even if that person has not been resident there for extensive periods of time.
Double tax relief	Tax relief given by the country in which the taxpayer resides for tax paid in another country on a source of income arising in that other country.

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.
Effective tax rate	The percentage of tax actually paid in relation to the total income of the person paying the tax.
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.
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.
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.*
General anti-avoidance principle	A legal principle that seeks to prevent a tax payer 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, for which reason the concept of tax compliance is important. If the person was seeking to be tax compliant then they should probably keep the benefit they obtained from the transaction. If they were tax non-compliant then they should not. *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 downs ways of interpreting series of events to determine whether the benefit of tax legislation can be given to the tax payer. Rules are invariably open to interpretation, however, 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.

Hedging	A strategy intended to reduce investment risk using call options, put options, short selling or futures contracts. Often refers to taking a futures position that is equal and opposite from a position in the cash market. A hedge can be used to lock in existing profits. It is often claimed that hedging is best done offshore, but there is no evidence to support this assertion and most hedging expertise is onshore.
High net-worth individuals	Otherwise known as HNWIs (pronounced hin-wees). Generally categorised as individuals with more than US$1 million of liquid financial assets available for investment.
Holding companies	A company that either wholly owns or owns more than 50 per cent of another company, the latter being called a subsidiary. An intermediate holding company is a holding company which has one or more subsidiaries but is itself owned by another company. The term ‘ultimate holding company’ refers to the one that is finally not controlled by another company.
Income tax	A tax charged upon the income of individuals. It can also be extended to companies. The tax is usually charged upon both earned income from employment and self employment and unearned income e.g. from investments and property.
Inheritance tax	A form of gift tax charged upon the estates of people upon their death.
International Business Corporations (IBC)	A type of company offered by many offshore finance centres and tax havens, usually one which 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.
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. Mainly occurring in the USA.
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 property is transferred to a holding company located in a tax haven, the licence fee income paid to the licensor may be exempt from tax, as well as reducing the taxable profits of the operating company (often a subsidiary) which is the licensee.
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.
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.*
Offshore	Offshore relates to any jurisdiction (regardless of whether they are islands) which provides tax and regulatory privileges or advantages, generally to companies, trusts and bank account holders on condition that they do not conduct active business affairs within that jurisdiction. The term is very broad and normally includes 'onshore' tax havens such as Andorra, Lichtenstein, etc.
Offshore financial centre	Although most tax havens are Offshore Finance Centres (OFCs) the terms are not synonymous. Tax havens are defined by their offering low or minimal rates of tax to non-residents but may or may not host a range of financial services providers. An OFC actually hosts a functional financial services centre, including branches or subsidiaries of major international banks. States and microstates that host tax havens and OFCs dislike both terms, preferring to call themselves International Finance Centres.
Partnerships	Any arrangement where two or more people agree to work together and share the resulting profits or losses.
Payroll taxes	*See social security contributions.*
Permanent establishment	An office, factory, or branch of a company or other non-resident. Under double tax treaties business profits

	are taxable at source if attributable to a permanent establishment. May include construction sites or oil platforms in place for over six months.
Poll tax	A tax that levies the same sum on each person irrespective of their means to make payment.
Preferential tax treatment	A situation in which individuals or companies can negotiate their 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 not quoted on a stock exchange. Shares cannot usually be sold without the consent of the company or its owners; 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 and inversions.
Progressive taxes	A tax system in which as 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 quoted 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 public company.*
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.
Regressive taxes	A tax system in which as a person's income from all sources rises, 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 transfer-pricing.
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.
Remittance basis	Concerns income earned outside the country of residence. The remittance basis says that tax is only due in the year when income is remitted to the country in which the tax payer is resident and not when it arises. Enables a person to avoid tax indefinitely in their country of residence provided it is kept and spent abroad. *Compare with the arising basis.* Both have relevance within the context of the residence basis of taxation.
Residence	For an individual, the person's 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.
Residence basis	Taxation of residents of a territory on all their worldwide income wherever it arises, usually with a credit 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 residence country rate if it is higher. *Compare with source and unitary basis.*

Ring-fencing	Different and preferential tax and regulatory treatment given by tax havens to companies and trusts owned by non-residents as contrasted to companies and trusts owned by residents.
Sales tax	Taxes on sales can be levied in two ways. Firstly, as a general sales tax (GST) added to the value of all sales with no allowance for claiming a rebate on tax paid. Secondly, as a value added tax (VAT) charged by businesses on sales and services but which allows businesses to claim credit from the government for any tax they are charged by other businesses. 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 the better off. VAT is the most widely used form of sales tax.
Social security contributions	Payments made towards a fund maintained by 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.
Source basis	Taxation of income in the territory where it is earned. Under 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). *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 per cent or more owned by another company which is its parent company.
Tax arbitrage	The process by which a sophisticated tax payer plays off the tax systems of two different countries to obtain a tax benefit as a result.

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 term is sometimes used to describe the practice of claiming allowances and reliefs clearly provided for in national tax law. It is, however, now generally agreed that this is not tax avoidance. 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 seen as being tax compliance. So what the term tax avoidance now usually refers to is the practice of seeking to not pay tax contrary to the spirit of the law. This is also called aggressive tax avoidance.

Aggressive tax avoidance is the practice of seeking to minimise a tax bill by attempting to comply with the letter of the law whilst avoiding its purpose or spirit. It 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.

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

The pressure 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. Applies mainly to mobile activities or business, 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 an increased burden on individuals.

Tax compliance	A term that is acquiring a new use. It can mean 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 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 break that law, the onus of proof otherwise falling upon them. This test is then 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'.
Tax efficiency	A term used by tax professionals to suggest getting away with paying as little tax as possible.
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 haven	Any country or territory whose laws may be used to avoid or evade taxes which may be due in another country under that country's laws. The Organisation for Economic Cooperation and Development defines tax havens as jurisdictions where: • non-residents undertaking activities pay little or no tax • there is no effective exchange of taxation information with other countries • a lack of transparency is legally guaranteed to the organisations based there • 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 mitigation	A phrase used by tax professionals when describing the desire to pay as little tax as possible.
Tax non-compliant	A person who is not seeking to be tax compliant.
Tax planning	A term used in two ways. It can be used as another term for tax mitigation. 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.
Tax shelter	An arrangement protecting part or all of a person's income from taxation. May result from pressures on government or a desire to encourage some types of behaviour or activity, or may be a commercial or legal ruse, often artificial in nature, used to assist tax planning.
Thin capitalisation	Financing a company with a high proportion of loans rather than shares. Used by transnational corporations to reduce the business profits of a subsidiary, since the interest on loans is usually allowed as a deduction, but 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	The Tobin Tax or Currency Transaction Tax (CTT) is a proposed tax on the foreign exchange market named after the late James Tobin, the Nobel Prize winning economist, who proposed the idea.
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 saving. If a transfer price can be shown to be the same as the market price then it is always acceptable for tax. 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 per cent of world trade is within rather than between corporations is that there is no market price for many of the goods or services that they trade across national boundaries. This situation arises because they are never sold to third parties in the form in which they are transferred across national boundaries within the corporation. This gives rise to complex models in which attempts are made to allocate value to various stages within the supply chain within a company, a process which is 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 corporations (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.
Trustee	A person who holds the legal title to assets held in a trust and administers it.
Trust beneficiary	Anyone who may obtain a benefit from a trust. A person who has the right to a benefit has an ‘interest in possession’; a discretionary beneficiary can get income or benefits only when and if the trustees decide to pay it to them.
Trust settlor	The person who establishes a trust by gifting assets to it.
Unitary basis	Treating the income of related entities within a single firm or corporate group on a combined or consolidated basis, and applying a formula to apportion it for taxation by the

different countries or territories from which it derives. Each may apply the rate of tax it wishes. An alternative to the residence and source bases of taxation. It has been used in federal countries such as the USA, applying an allocation formula based on a ratio of sales, employment costs and assets employed within each state. It has been opposed by tax authorities (and TNCs) because they consider that it would be too difficult to reach international agreement especially on the formula. However, taxation of highly integrated TNCs may in practice entail a formula-based allocation of profits, due to the difficulty of finding appropriate arm's length transfer prices.

Value Added Tax	Known as VAT. *See sales tax.*
Wealth tax	A tax on a person's declared wealth, typically imposed annually at a very low rate. Once commonplace in Europe these are now rarely used since they are thought to encourage people to hide assets offshore.
Withholding tax	Tax deducted from a payment made to a person outside the country. Generally applied to investment income, such as interest, dividends, royalties and licence fees.

ENDNOTES

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" Tax havens cause poverty "

THE ASSOCIATION FOR ACCOUNTANCY & BUSINESS AFFAIRS

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

The one per cent of the world's population who hold more than 57 per cent of total global wealth use these havens to escape taxation. The sheer scale of the lost tax revenue this implies for governments around the world - some US$255 billion per year - beggars belief. This figure would more than plug the financing gap to achieve the Millennium Development Goal of halving world poverty by 2015.

At the same time, free-riding transnational 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, particularly in developing countries, to lower tax rates and provide tax incentives to attract investment. This has resulted in a shift of the tax burden to workers and low-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 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 professionals profit from abusive tax practices. It also outlines the numerous policy failures that have encouraged the creation of the shadow economy of tax havens and proposes a range of practical solutions to this global crisis.

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