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Mythbusters

from **nef** and the Tax Justice Network

"There's nothing we can do about tax havens"

Richard Murphy and Dan Hind

Tax avoidance by corporations and rich individuals has been high up the political agenda for a few years now. Tax havens play a key role in facilitating avoidance, yet so far, few serious measures have been taken to prevent their operation.

In this Mythbuster, economist Richard Murphy and author Dan Hind expose the myths around tax havens and explain there's plenty we could be doing to stop public money leaking offshore.

The myth (and its subsidiaries)

Tax havens are really just giant accounting functions, and as we'll see, the central claim that there's nothing we can do about them is false. Appropriately enough, this myth is surrounded by a number of subsidiary fairy tales and fantastical claims. Let's roll these up before we return to the core misunderstanding that the offshore sector promotes.

"There's No Such Thing As A Tax Haven"

Here's the first one: there's no such thing as a tax haven because no one can define what a tax haven is and therefore no one can be accused of being one. It's a claim often made by tax havens. So, for example, in April 2013 Maria Fekter, the Austrian Finance Minister then under fire for

Austria's tax haven status, denied Austria was a tax haven. Rather, she said that 'Austria is sticking to bank secrecy. We fight tax evasion and money laundering.' She was at the same time more than willing to suggest that others were tax havens, unlike her country, saying 'Great Britain has many money laundering centres and tax havens in its immediate legal remit - the Channel Islands Gibraltar, the Cayman Islands, Virgin Islands. These are all hot spots for tax evasion and money laundering.' The point is clear: whoever is accused of being a tax haven never agrees, because they can always suggest that the lack of definition lets them off whilst suggesting its someone else who should be the focus of attention, who then also deny the accusation made of them, in turn (as Cayman did, vigorously, on this occasion)[1].

"Sovereignty! Sovereignty!"

If and when the friends of tax havens realise that their audience aren't buying this first myth they

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then put forward what might be called the sovereign state myth. This says that since tax havens are independent jurisdictions they're free to establish their own tax and accounting laws and there's nothing anyone else can do about it. To do otherwise would be to challenge the sovereign rights of another state to self-determination within its own domain and that's just not allowed. Like many good fairy tales it has a hero with a German name, in this case, the Treaty of Westphalia[2].

"Financial Secrecy is a Basic Human Right"

The self-determination argument also comes in another form. Tax havens are keen to promote the myth that all people should be at liberty to organise their affairs however they want - and if that means a person deciding they want to put all or part of their wealth in a tax haven then that's their right and no one should stop them. If this right to use a tax haven can be equated with protecting core human rights then that's all the better. As Dan Mitchell of the Cato Institute argues, "there is even a moral case for tax havens. They play a critical role in protecting people who are subject to religious, ethnic, sexual, political or racial persecution."

"There's Nothing To Do. The Offshore Sector Has Already Reformed Itself"

The righteous indignation myth comes next: this says that tax havens have done everything that's been asked of them to end offshore abuse, and as a result there are none left. This is usually backed by a claim that 'former' tax havens are now totally open and compliant so there can be nothing left to worry about. For example, Anthony Travers of the Cayman Island's Stock Exchange, and a lead spokesperson for that jurisdiction on tax haven issues said in April 2013: [3] "The Overseas Territories already demonstrate full tax transparency. Given that the UK tax authority HM Revenue and Customs has full treaty access to Cayman accounts for UK tax purposes, the provisions of FATCA are simply duplicative, wholly unnecessary and will raise no additional revenue." That almost certainly came as news to HM Revenue & Customs, amongst others.

"Leave Us Alone, Or Else"

But of all the myths the last is perhaps the most desperate. It's says that if anyone seeks to interfere with tax havens, then they'll come to regret it - so it's best not to do so. The threat comes in various forms, usually subtle, but the point isn't difficult to grasp. For example, in evidence submitted by Jersey to the UK Parliament it said:[4] "The Foot Review commissioned by the former Chancellor of the Exchequer in 2008 … highlighted the value that Jersey had provided to the UK throughout the banking crisis, as the largest provider of net deposits, in the region of $218.3 billion, to UK banks in the second quarter of 2009 alone." The implication was clear: don't mess with Jersey, or you'll cut off your cash supply.

The reality

Three immediate things are worth noting about these myths. The first is that they move from the 'there's no problem' myth to the 'we've got the power to hurt you' myth with all shades in between. That does, of course, mean the myths are inconsistent one with another, but if you're also selling the myth that real things happen in tax havens, then a little inconsistency may not worry you too much.

Second, note how keen tax havens are to imply that all they do is legal: there's a real whiff about most of these myths that suggests that in all this tax haven debate it's the tax havens who uphold the law and everyone else who is pushing acceptability to its limits.

Last, there's not a little anger. The claims are trenchantly made. Tax haven proponents are on the side of reason, sweetness and light. Their critics must be wilfully ignorant or worse. Sensible people know that we just have leave things as they are and we'll all live happily ever after.

The myths that the users and friends of tax havens promote are exercises in sophistry. The arguments all look superficially plausible. Actually, they're just false.

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There Is Such A Thing As A Tax Haven

Let's start from the top, with the problem of definitions. It's true that it isn't easy to give a precise definition of a tax haven because they don't all do the same thing. But the problem is made much worse by the fact that organisations like the OECD find it politically expedient to turn a blind eye to them. This explains why its tax haven black list currently has no one on it. Meanwhile, the UN's Office on Drugs and Crime (UNODC) estimates that criminal gangs grab somewhere 2.3% and 5.5% of global GDP every year. Without the services of the offshore sector organized crime would drown in cash it could not launder.

There are lists of tax havens available, and have been for decades. What's more, the same countries turn up with startling regularity.[5] The Tax Justice Network has produced the Financial Secrecy Index that uses a raft of data from a wide variety of official sources to rank tax havens. Not only do tax havens exist, they can be compared and contrasted with considerable precision[6].

Sovereignty is a Fancy Way of Saying 'Red Herring'

Whilst it is obviously true that some tax havens are sovereign states - Cyprus is, for example - many are not. The UK is internationally responsible for its Crown Dependencies and Overseas Territories, for example, as the Dutch are responsible for a number of havens and the USA responsible for the US Virgin Islands. It's simply not true to say that these jurisdictions have a right of self-determination in all cases, as they don't. The UK, for example can, and does, quite regularly impose its will on its territories when it sees fit, as it is now doing with new kinds of information exchange agreements. In that case it's very obviously not true that tax havens cannot be interfered with.

But we can go further. It is flat out wrong to claim that states have no right to interfere with sovereign tax havens as all they're doing is managing their own domestic affairs. Tax havens intentionally create regulation for the primary benefit and use of those not resident in their geographical domain and then create a deliberate, legally backed veil of secrecy that ensures that those from outside the tax haven who use its regulation cannot be identified by their own jurisdictions to be doing so. That's a process solely intended to undermine the regulation and taxes of other states. As such tax havens whole purpose is to interfere in the domestic affairs of other countries. In that case those states have a complete and legitimate right to respond. The myth is just wrong.

Financial Secrecy is not a Basic Human Right

Let's also knock on the head the idea that tax havens defend human rights. No one in the history of humankind has been defended from abuse by a tax haven. Just because someone puts their wealth in a tax haven does not stop them being discriminated against because they're gay or on religious or gender grounds, or for any other reason. Instead their property rights may be protected, if only because they are hidden, but the abuse of their human as opposed to property rights does not end as a result of hiding their cash. It's nonsense to claim they do. At the same time it's important to note that human rights do not matter in a tax haven; only property rights do. That's what they exist to serve, and more often than not those property rights have been used to abuse. Christian Aid has estimated $160 billion a year is lost to the developing world as a result of tax havens helping illicit flows of cash out of the that continent. That is real abuse, and humans suffer a as result.

The Offshore Sector Has Not Reformed

So have tax havens done all they can to meet the demands made of them? And are they now transparent as they claim? The answer is a straightforward no. First of all, it has to be said that this is in part because the demands made have been too limited. For example, in 2009 the OECD asked them to sign just 12 tax information exchange agreements each - which could even be with other tax havens - to be considered 'internationally compliant'. This is some indication of how low the bar has been set for this standard of supposed cooperation. Second, even with such minimal standards demanded, for the benefit of so few other states (almost no developing countries have information exchange agreements with tax havens) the information they have supplied in what they claim to be a new era of transparency has been pitifully poor. As Christian Chavagneux noted on the OECD's own blog in March 2012: "France made 230 requests for information to 18 countries in the first 8 months of 2011. The reply rate was only 30% and the quality of the information supplied wasn't always of the highest quality." But perhaps the most telling point is that if tax havens had really done all that could be asked of them the USA would not have felt it necessary to impose the Foreign Accounts Tax Compliance Act on them in 2010 (more on that later). Neither would the UK seek to impose similar conditions to the US FATCA on its own tax havens in 2012. Action speaks louder than the tax havens' myth.

The Threats Are Empty

And last we come to the 'you'll regret it if you interfere' myth. This is the threat, made often and always encouraged by tax havens, that if measures are taken against them by any state then the wealthy people and large corporations located in that country will up sticks and leave permanently, taking the tax they currently pay with them so that the country imposing the measures will regret the action taken.

What is more, it is said, the measure can't work anyway because if sanctions were taken against one haven people would just move to another.

Neither variant on the myth is true. Let's deal with the first. Most people simply can't leave the place where they live. Even for the rich (maybe especially for the rich) social ties, their place in the social hierarchy, the status symbols of association like the houses they won, the clubs they belong to, the schools their children attend and their social networks powerfully root them in a place. Most people move because these various social arrangements, or their means of funding them, are not working. Few would wish to suffer the social upheaval of moving to simply save some tax, and there is very often good reason for that. More than that though, most entrepreneurs know that that it is by staying put and using all the facilities that the state gives them to make profit – from freely trained staff, the right to limited liability, law to defend their property rights, the state assumption of the responsibility for paying their staff in retirement and so much more besides, that they can really make their money.

As for corporations, they do not really move when they say they are going to do so and in a world of territorial taxation - where the UK only taxes profits arising in the UK this threat has now become completely hollow: companies are located in this country because there are profits to be made here. They will not turn their back on those profits to save tax and as such the threat cannot work.

As for the second variant, people choose the tax haven they go to for social reasons. It could be because it is sunny but it is much more likely to be the one that is closest; the idea that people roam the world to save tax is just not true. Tax havens secure business by developing networks of trust. A tax-avoiding dentist in Milwaukee or a crooked lawyer in Surrey won't entrust their ill-gotten gains to a Panamanian company formation agent they've never met if Bermuda or Jersey starts to look dicey. We already know that they want to hang on to their money.

The myths are just that, as are all the claims made by those who say there is nothing that can be done about tax havens. But that does not mean that there is nothing that should be done. It is to that subject that we turn next.

An End to the Havens

Tax havens can create myths if they wish. We do not need to believe them. But it's up to us to set out why and how we can end the abuse that tax havens facilitate. That's what this section is about.

Most importantly, it must be remembered that nothing really happens in tax havens. They just record transactions that take place elsewhere, and do so in a way that is often deeply hidden from view. Low or no tax rates may be the reason some use tax havens, but for most, the central appeal is secrecy. Tax haven secrecy means that those taking advantage of havens cannot be identified, and the full financial benefit they secure as a result is unknown. Our focus, then, should be on shattering this secrecy.

That we *can* shatter tax haven secrecy has been proven time and again. The OECD initiative of 1998 failed to achieve this goal, but the European Union initiatives of the same era had much greater success. The European Union Savings Tax Directive was imposed on the UK and Dutch tax havens, and was extended to some non-EU locations, covering 43 jurisdictions in all. Many agreed reluctantly, but the principle of information exchange between tax havens and other countries was established by this process.

More recently, the US has been persuaded that the principle of information exchange on request is too slow and cumbersome to provide an adequate deterrent effect. The **US Foreign Accounts Tax Compliance Act (FATCA)** of 2010 is the result. This demands that any financial institution anywhere in the world dealing with US taxpayers must *automatically* declare the income they pay to those persons and their account balances to the US either direct or through the government of the jurisdiction where they are operating. Many tax havens are signing up to FATCA deals, including Cayman, Jersey and Switzerland. In the circumstances the claim that nothing can be done about tax havens begins to look very hollow.

Others have noted the US precedent and are acting on it. In the UK, which is internationally responsible for so many tax havens, the reaction has been to say that if the US can demand this data then so can we, since we have to act as guarantor to the US for the supply of information from our tax havens. The result is that in the space of a few months the Isle of Man, Guernsey, Jersey and Cayman have all agreed to UK demands to sign agreements that are equivalent to FATCA with the UK.

Of course, it is not just individuals who abuse tax havens; major corporations do too. For them information exchange is not so much an issue as is accountability and transparency as to what they do where, not least so that the investor, stakeholder and tax authority can easily see if they are shifting profits to avoid tax. To address this we need to establish **country-by-country reporting**. This is an accounting standard that would simply demand that a company publish a profit and loss account, balance sheet and some cash flow data for each and every country where it operates, so that tax haven activity will be revealed. Ten years ago this was a pipe dream. Now it is to some extent being demanded in the USA and EU for extractive industries companies, and more importantly, the EU is now demanding it in full for banks. This is a massive step forward: if banks can deliver this data then any company can. In other words, the intellectual case for country-by-country reporting as a tool to report risk based on geography has been won. And that means that when it is extended, as many campaigners, NGOs and politicians now demand, we will be able to see what multinational corporations do in every jurisdiction where they operate. Tax authorities will have the knowledge they need to secure an equitable slice of profits generated within their national borders.

In summary

Even a casual glance at the arguments that the offshore lobby use to defend tax havens reveals the glaring inconsistencies between them. They want us to believe that these 'non-existent' jurisdictions are both the helpless victims of bullying by large economies, and capable of bringing these same economies to a standstill at the first sign of effective regulation. It's no wonder that the havens are in trouble.

Tax havens say there is nothing that can be done about them. But that's not true. A great deal has been done already. And a tipping point seems to have been reached where the US FATCA now requires tax havens to maintain all the information needed for full automatic information exchange on all individuals and the schemes they operate. Meanwhile, the EU's new rules for banks have set a precedent for all companies that operate internationally.

The signs are that ordinary people who make their way in the onshore world have had enough. They pay their taxes. And there's no reason why the rich can't be made to do the same.

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Endnotes

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2

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3

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