

Tax Havens and Tax Competition: One Rule for the Poor, No Rules for the Rich

“Only the little people pay taxes,” (Billionaire hotel owner Leona Helmsley at her trial for tax evasion in 1989).

Introduction

Development is closely linked to tax revenue, to provide public goods and services such as transport infrastructure, health services and education, vital for reducing poverty in developing countries. Today, the world faces a growing problem in collecting the revenue to fund such public goods and services: tax competition is providing more and more opportunities for the wealthy to escape their tax obligations. As a result, the burden of taxation is shifting – wealthy individuals and transnational corporations (TNCs) benefit from tax havens and low-tax regimes throughout the world, whilst ordinary citizens and smaller domestic businesses bear the cost. Governments pursue increased taxes on consumption and smaller business, and policies such as privatisation and cuts in public services; responses that prevent the benefits of economic growth from reaching the poor. If left unchecked, these trends will be disastrous for development.

Tax Havens: The New Shadow Economy

Twenty years ago there were only a few tax haven jurisdictions, serviced by a handful of offshore professionals, and impractical for many businesses and individuals. That was before the worldwide dismantling of controls on the international flow of capital, and before the electronic communications revolution. Today, the offshore industry is a major global business, the home of an enormous shadow economy.

- Half of all world trade appears to pass through tax havens,¹ even though they account for only 3% of world GDP.² This anomaly arises because transnational corporations record many transactions in tax haven jurisdictions solely to avoid tax, with little or no basis in the economic reality of their operations.
- The value of assets held offshore, either tax-free or subject to minimal tax, is at least \$11 trillion; over one-third of the world’s annual GDP.³
- Total funds passing annually through tax havens’ financial services sectors are broadly equivalent to the world’s total trade in goods and services (some \$7 trillion).⁴
- The offshore industry as a whole is involved in about half of the world’s financial transactions by value.⁵
- Revenue losses to developing countries are at least \$50 billion – around the same magnitude as annual aid flows.⁶
- The UK alone loses at least £20 billion a year from tax havens.⁷
- Companies formed for offshore purposes are now being formed at over 150,000 per year – there are well over 1 million worldwide.⁸

Tax Competition: a Global Problem

TNCs and wealthy individuals can shift their income into any of some forty or fifty tax havens that span the globe. Such jurisdictions compete with each other, and with the rest of the world, to attract mobile capital by offering low-tax or no-tax environments, as well as other dubious 'benefits' such as secret ownership. Tax havens are one extreme outcome of this process, but all countries are affected: we see the UK and US awarding new tax breaks for the wealthy,⁹ whilst developing countries offer tax-free export processing zones and tax holidays for TNCs. London is arguably the single largest tax haven of all time, providing a tax-free offshore environment for massive flows of eurodollars from the 1970s onwards.

Economists have modelled tax competition to try and assess its effects, but such attempts are open to considerable criticism. Based on abstract assumptions that do not hold in the real world, economic models give conflicting results depending on which assumptions are used. Such models ignore the reality of globalisation, especially the persistence of mass poverty.

There are two important conclusions to draw from the economists' work. Firstly, the overriding dynamic of tax competition acts against the interests of the poor: benefits flow to mobile tax bases (TNCs and wealthy individuals) to the detriment of the less mobile (ordinary people and smaller businesses). Secondly, despite this overriding dynamic, there are some circumstances in which developing countries or regions may *potentially* use tax competition to reduce poverty. A great deal of research is needed, particularly from an anti-poverty perspective, in order to establish practical solutions.

Development and Democracy: under assault

The scale and importance of what is happening is not widely recognised, but this is changing. Networks of academics, researchers, professionals and campaigners are joining forces to expose the threat to development and democracy that tax competition and tax havens present.

- States are losing sovereignty over taxation policy, as they are effectively forced to compete to attract mobile capital. Democratic control – the influence of the majority of citizens over tax policy - is fading, to be replaced by a race to the bottom in the taxation of capital over which we have no say.
- Taxing the rich at higher rates than the poor (progressive taxation) is rapidly becoming problematic. This not only undermines ethical tax policy - it is also economically inefficient. Mainstream theories of taxation all recommend progressive taxation as a practical and effective way to finance public goods and services.
- Despite economic growth, the tax revenue raised from capital is shrinking in comparison to that raised from ordinary citizens. In other words, the tax burden is shifting from the rich towards the poor.
- This shifting tax burden threatens to be particularly disastrous for the developing world. It may prevent the growth of domestic demand and internal markets; it creates unfair tax disadvantages for local businesses, encourages capital flight rather than domestic investment, stunts economic growth, and generally skews economic development towards an unsustainable reliance on foreign capital and markets. (This list of problems is not exhaustive; research from developing countries is currently being collated by the Tax Justice Network (see 'What you can do,' further below)).
- Tax competition and tax havens reduce tax revenues that could otherwise contribute to public services, development, and the reduction of poverty: an increased annual return of just 0.5% on assets held offshore could finance entirely the UN Millennium Development Goals for 2015.

War on Want's View

Tax competition needs restricting. Global treaties must establish parameters that prevent extreme outcomes of tax competition such as tax havens, and ensure that limited forms of tax competition contribute to the reduction of poverty – not to the further enrichment of the wealthy.

The practical steps to tackle this are open to debate. OECD governments are already tackling certain aspects, but their approach reflects OECD concerns and not the need to tackle global poverty. This approach has been criticised for paying little regard to the concerns of citizens, NGOs, trade unions, other social movements, or non-OECD governments. In particular, this OECD initiative is regarded with great scepticism in many developing countries.

The views from developing countries are particularly important, because tax competition can be a useful tool for attracting investment that otherwise would not occur. It may be difficult to weigh up the local benefits of such investment against the local and global costs of such competitive tax practices. At War on Want, we consider research in this area to be an important aspect of the fight against world poverty.

War on Want therefore supports all efforts to research this issue and to bring it to the attention of all sections of society, particularly to people and organisations that work to reduce global poverty. We oppose unrestricted tax competition. We argue for the democratic participation of citizens, NGOs, trade unions and social movements, throughout the world but particularly from developing countries, in negotiations with the express agenda to:

- severely curtail the role of tax havens in the world economy;
- ensure that tax competition only continues where it helps reduce poverty.

What you can do

- Large corporations who use tax havens to pay low effective rates of tax should be exposed as socially irresponsible. If you have investments such as a pension fund, keep track of which companies your money is invested in. If they are identified as tax avoiders then write to them expressing your concern. As an investor they will listen to what you say.
- Write to your MP expressing your concern that the UK loses £20 billion a year to tax havens. Ask who is benefiting from these tax breaks, and how many schools or hospitals could be built if this revenue loss were stemmed.
- The global Tax Justice Network is a focal point both for research and for campaign activity. This is a new initiative that seeks to promote debate, and aims to establish a worldwide coalition to highlight and resist the threat to democracy and development presented by unrestricted tax competition. **www.taxjustice.net**.
- In the UK, the Association for Accountancy and Business Affairs (AABA) publicises this problem and lobbies for reform, and provides an excellent starting point for news and for research at **<http://visar.csustan.edu/aaba/aaba.htm>** (the site operates from the USA to benefit from freedom of information laws). AABA's 'Offshore Watch' page will keep you informed of current news articles and developments that can form the basis of short letters to MPs or to the media.
- Throughout Europe, the ATTAC network can direct you to news and campaign activities around this and other financial globalisation issues. Start at **www.attac.org**.
- In the USA, Citizens for Tax Justice is a well-established group that focuses mainly on US issues; see **www.ctj.org**.
- **www.waronwant.org**

Box 1: How do tax havens work?

Secrecy

Laws permit non-disclosure of information widely considered essential to democratic society - such as business accounts, and ownership of assets, trusts and companies. Such secrecy provides protection for criminal, corrupt and terrorist fortunes, and encourages the illegal evasion of tax.

Lack of Regulation

Financial services and banking are often subject to minimal regulation, providing suitable environments for money laundering. Where governance codes and laws exist, there is often neither the political will nor the resources to implement them effectively.

Tax Avoidance

Many tax havens offer non-residents complete exemption from tax for many forms of corporate or personal income. Where tax is payable, this is often at minimal rates, or negotiated in secret with the authorities with little reference to tax law.

Box 2: Nauru – who’s cleaning up?

In just one year, \$70 billion of foreign currency funds from Russia passed through banks in the tiny Pacific island of Nauru (population: 11,146).¹⁰ That year was 1998, the year the rouble collapsed and kept falling until by April 1999 the Russian Central Bank had only \$11 billion foreign currency reserves left.¹¹ Nauru’s secretive banking practices and its links with Russia clearly contributed to massive capital flight, and are therefore implicated in the hardship that the currency collapse brought to millions of ordinary Russians.

Unlike the traditional image of tax haven islands, Nauru is a bleak landscape with no natural harbour, mostly uninhabitable from years of surface phosphate mining. When a journalist visited the island in 2000, the country’s entire banking system appeared to be contained within a shack stuffed full of computers and air-conditioners. “I knocked on the door, and it opened slightly to reveal a woman holding a broom. The cleaning lady of the new global economy. She wasn’t particularly hostile when I asked if there was someone inside I could talk to. But she said that there wasn’t and that I should telephone. When I asked her for the number, she said she didn’t know it and closed the door.”¹² In fact, this black hole in the world economy is regulated by a Ms Urhle, and her two registrar assistants. According to press reports, Ms Urhle has only recently asked her government to fund an accountant and a lawyer to help her.¹³

Box 3: How do transnational corporations benefit?

For payment of a fee, a company can be formed which is then subject to the laws – or absence of laws - within the tax haven jurisdiction. Anybody who can afford it can transact business through tax havens, simply by establishing such a company and creating some paperwork showing ownership of goods passing through its books. By manipulating the apparent prices of goods passing in and out of the tax haven company (‘transfer prices’), transnational corporations can falsely shift taxable profits out of the higher-tax economies where the real business is taking place, and into tax havens where little or no tax is payable. This is a favourite trick of large transnational corporations (TNCs) trading between subsidiaries. Of course, such a scam risks exposure as illegal tax evasion, and many businesses go to great lengths to stay inside the law and still retain the tax benefits. However, all the evidence shows that transfer price manipulation remains very common.

Notes:

¹ French finance minister D Strauss-Kahn, in a speech to the Paris Group of Experts in March 1999, quoted in J Christensen and M Hampton, "All Good Things Come to an End," *The World Today* vol 55, no. 8/9, 1999 (Royal Institute of International Affairs).

² Oxfam GB Policy Paper, "Tax Havens: Releasing the hidden billions for poverty eradication", 2000 (Oxfam GB).

³ Estimated by J Christensen of AABA, quoted in "Tax Avoiders Rob Wealth of Nations," 17/11/02, *The Observer*.

⁴ Oxfam GB, 2000, op cit.

⁵ offshoresimple.com (offshore professionals) at http://www.offshoresimple.com/tax_havens_history.htm

⁶ Oxfam GB, 2000, op cit.

⁷ "Big Business Still Dodging the Tax Issue", 12/01/03, *The Observer*.

⁸ Finor (offshore professionals) at http://www.finor.com/en/tax_havens_history.htm

⁹ Eg tax exemptions for profit on sale of substantial shareholdings, UK, 2002 budget; tax cuts on share dividends, US, 2003.

¹⁰ <http://populations.com/country.asp?ID=119>

¹¹ "Rouble at Record Low," 5/4/99, BBC, at http://news.bbc.co.uk/1/hi/business/the_economy/312000.stm

¹² J Hitt, "The Billion-Dollar Shack," *New York Times Magazine*, Dec. 10, 2000, at <http://www.nytimes.com/library/magazine/home/20001210mag-moneylaundering.html>

¹³ "South Pacific islands hit by regulations after 9/11," Joe Leahy, *Financial Times*, 8/1/03