Tax havens report

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Executive summary

This report is the first that PCS has produced on the subject of tax havens. It has prepared it for four reasons.

First, PCS is committed to a fair, progressive tax system. It sees tax havens (or secrecy jurisdictions as we prefer to call them) as a threat to the establishment of such a system. This report notes that the UK might lose up to £18 billion a year as a result of the use of tax havens. This loss contributes significantly to the overall UK tax gap that PCS believes currently amounts to at least £120 billion.

Second, it believes that all initiatives to tackle tax haven abuse to date have failed, and wishes to contribute to debate on how that record can be corrected.

Third, PCS wishes to draw attention to the massively worrying trends in UK taxation, all put in place since 2009, which mean that far from tackling tax haven activity, the UK Government is now actively encouraging such activity on the part of multinational corporations based in the UK. Furthermore, because of the international tax agreements it has reached with them, it is also actively promoting the use of the financial services industry in both Switzerland and Liechtenstein for tax avoidance and evasion purposes.

Fourth, and of particular concern as it appears to have been almost entirely ignored elsewhere, PCS has concern that whilst eliminating tax haven abuse is the right thing to do, such a policy must take into consideration the local populations of those places that have been tax havens, many of whom have worked in the financial services sector as it has been the only source of employment available to them. It is PCS' opinion that these people should not suffer as a result of required changes in policy and as such we argue very strongly that those locations willing to reform their tax haven practices should be given support to protect jobs and livelihoods as they pass through a period of transition in their economies.

In support of these arguments, and as the report makes clear, the key service that tax havens supply is not low tax or light regulation, but secrecy. For this reason the report refers to the locations about which it has concern as secrecy jurisdictions in addition to the more common term 'tax haven'. PCS has accepted the opinion of the Tax Justice Network in defining secrecy jurisdictions as places that intentionally create regulation for the primary benefit and use of those not resident in their geographical domain. This regulation, this report argues, is designed to undermine the legislation or regulation of another jurisdiction by creating a deliberate, legally backed veil of secrecy that ensures those making use of a haven's services cannot be identified.

It is behind this veil of secrecy that tax evasion and avoidance by individuals and companies takes place. The same veil of secrecy permits the proceeds of crime and corruption to be hidden. Tax evasion, tax avoidance, crime and corruption cannot be differentiated: if one is to be tackled then all must be because this report argues that it is the same secrecy that facilitates them all.

That secrecy has had an enormous impact upon the world. If, as noted in this report, the UK loses at least £18 billion a year in tax revenue as a result of tax haven related activity then that is a sum four times bigger than the cost of eliminating child poverty in the UK.

Secrecy jurisdictions cost the developing world much more. It is clear that corporate tax abuse alone, aided and abetted by current rules of corporate accounting, cost the developing world more in tax lost than the entire annual world aid budget, and at least three times more than it would cost to meet the Millennium Development Goals.

These two examples demonstrate PCS' concern: as a result of tax haven activity the poorest nations and the poorest members of our society are being denied a standard of living which society could afford to provide.

That said, PCS recognises that reform will take time and that there are a variety of pathways available. Much of this report is concerned with identifying those pathways. The report does not suggest that all these pathways are necessary. Indeed, governments and multilateral bodies can achieve the goal of ending the damage done by tax havens by selecting the most appropriate approaches from the list. The report identifies five broad approaches:

1. The direct approach – tackling the havens head-on;
2. The domestic approach – tackling the domestic consequences of secrecy jurisdictions;
3. The UK dependencies approach – what the UK does about the locations for which it has particular responsibility;
4. The EU approach – how the most effective opponent of tax havens takes its initiatives forward;
5. The 'work round' approach – regulatory and other approaches that would have substantial impact on tax havens but do so tangentially.

It suggests there is substantial action to be taken under each heading, providing no excuse in future for those who say we are powerless to address this issue. Most particularly it calls for a series of reforms, which are grouped into broad categories as follows:

International reforms

1. The UK should now demand Tax Information Exchange Agreements with all identified secrecy jurisdictions so that they are forced to raise their standards of information exchange;
2. Improved standards of information exchange should be developed, including multilateral agreements between countries so that complex enquiries can be raised simultaneously in all countries involved;
3. Automatic information exchange should be put in place so that each country has to report to the country where a person really lives any source of income arising which they might have that is located outside their normal country of residence. As a result, for example, all tax haven bank accounts would have to be notified to the countries where their owners live. Nothing could be more effective in stopping tax evasion by individuals.

UK domestic law

4. The UK's domicile rule, that helps make this country a tax haven, should be abolished;
5. The UK's tax residence laws should be reformed to make it harder for people to leave the UK and claim tax haven residence;
6. Introduce general anti-avoidance principles into UK tax law to tackle artificial use of tax haven structures;
7. UK law should require significantly better disclosure from UK companies and trusts so that we set the international standard for transparency by which others can then be judged;
8. H M Revenue & Customs should promote a Code of Conduct for all involved in tax management that requires tax compliance, which this report defines as seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes. There should be greater scrutiny for those who refuse to participate, including professional advisers;

Investing in tackling abuse

9. Increased resources to be made available to HM Revenue & Customs to tackle tax haven / secrecy jurisdiction abuse as well as tax avoidance and evasion in general;

Reform in the UK's tax havens

10. The UK must demand an increase in the level of corporate transparency in the UK's Crown Dependencies and Overseas Territories to match that now found in the UK;
11. The UK must create a Registers of Trusts, equivalent to the current Register of Companies, and demand that its related territories do the same since trusts are still commonly used for tax avoidance;

European reform

12. The UK must support reform of the EU Savings Tax Directive so that all affected jurisdictions must offer automatic information exchange in full and this must be extended to companies and trusts and not just be applied to individuals;
13. The UK must promote geographic extension of the European Union Savings Tax Directive to as many countries as possible, including those outside the European Union;

14. The UK should support the introduction of a Common Consolidated Corporate Tax Base within Europe to tackle the problem of transfer pricing and tax avoidance between member states and should demand its extension beyond the European Union to ensure that tax haven abuse is eliminated by the use of this form of tax computation;

Accounting reform

15. The UK must actively demand that the European Union, the International Accounting Standards Board, the Organisation for Economic Cooperation and Development and stock exchanges must all require that multinational corporations prepare their accounts on a 'country-by-country' basis so we would know how much profit and tax was paid in each country in which they have operations. This would tackle the biggest single cause of corporate tax avoidance through what is called transfer pricing, would highlight the tax haven activities of companies, and would provide data on comparative labour conditions worldwide;

Financial services regulation

16. Credit card companies should be held to account for the use of their cards from offshore jurisdictions and be required to provide information on the beneficial ownership of those cards on demand, irrespective of their place of issue;
17. The tax profession should clarify their approach to tax haven activity and make clear the limits to professional good conduct in such places;
18. Secrecy jurisdiction banks and financial services institutions should be regulated from major financial centres such as London if that is where their parent company headquarters are located.

This is an ambitious package of reform. PCS is proposing it because it believes that the cost of inaction is now much higher than the cost of action. This report suggests that whilst the current economic crisis did, inevitably, have its causes in the major world economies, those secrecy jurisdictions that played an extensive role in repackaging sub-prime debt (Cayman and Jersey being of significance in this respect amongst British jurisdictions) played a major part in creating the climate of mistrust that precipitated the global financial failure which is now imposing an enormous burden on ordinary people throughout the world. This cost cannot be ignored, nor can the risk that it might recur be taken.

The demand for the reform of tax havens / secrecy jurisdictions in the global economy has never been greater. As this report shows, that has not as yet always been translated into the political will for change, but some reform is occurring nonetheless and that change already suggests that reform will have a profound impact on the operation of tax havens.

This though creates a new problem of the impact reform will have on the jobs and livelihoods of people working in the Crown Dependencies, British Overseas Territories and other tax havens. The loss of business to the financial services in these jurisdictions and the potential for a downturn in the local economy could lead to unemployment and hardship for those who have had no role in the undermining of other nation's tax arrangements. It is therefore vital that the UK Government, other governments and the multilateral authorities accompany any programme of change with plans to provide adequate transition and support arrangements for those territories affected.

That said, the case against tax havens is, we argue, uncontestable. Reform must, therefore, follow. The programme outlined in this report is one of the most innovative and ambitious outlined anywhere to date, and seeks to take into account all the developments at the London G20 summit in April 2009 and in the period thereafter. As such it lays out an agenda for change that demands close scrutiny from all who believe in fair taxation, transparent markets, proper regulation, the rule of law and preservation of our democratic way of life.

1 The tax haven issue

The UK is facing an enormous economic crisis. The economic failure caused by the recklessness of its banks has left it with a deficit in public finances that everyone agrees needs to be addressed.

The Government has decided to address this deficit by cutting public spending. PCS challenges the logic behind that approach which is ruining public services, undermining the income of the vulnerable in our communities and threatening the jobs of millions, including PCS members.

PCS has suggested that there is another way to tackle our budget deficit. That is by tackling the tax gap.

The tax gap has three components. It is made up of tax avoidance where people seek to get round the law to reduce their tax bill, even if legitimately. PCS estimates that tax avoidance might amount to £25 billion a year.[1] The second component is tax evasion. This happens when a person deliberately fails to declare income to a tax authority that has a legal right to know about it. PCS estimates that tax evasion costs the UK £70 billion a year. Finally there is unpaid tax, and in recent announcements this sum has amounted to about £25 billion at any point in time. In combination this creates a tax gap of £120 billion which, if tackled, could make a massive contribution to reducing the Government's deficit without any need for cuts in public services.

Of this total sum it has been estimated[2] that offshore activity in tax havens costs the UK not less than £18 billion a year. This is part of the tax gap, noted above. If that tax gap is to be closed then the issue of offshore activity and tax havens has to be addressed.

PCS is not alone in thinking this, of course. In 2009 the issue was high on the political agenda. In its communiqué issued in London on 2 April the G20 said:[3]

We agree … to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over.

It was an extraordinary statement, especially as the supporting statement on strengthening the financial system said[4] (in edited form):

It is essential to protect public finances and international standards against the risks posed by non-cooperative jurisdictions.

We call on countries to adopt the international standard for information exchange. We note that the OECD has today published a list of countries assessed by the Global Forum against the international standard for exchange of information.

We stand ready to take agreed action against those jurisdictions which do not meet international standards in relation to tax transparency. To this end we have agreed to develop a toolbox of effective counter measures for countries to consider.

We are also committed to strengthened adherence to international prudential regulatory and supervisory standards.

Some doubted whether this meant the beginning of the end of tax havens, as Gordon Brown claimed for the G20 process.[5] If they had doubt, he did his very best to dispel it in a series of remarkable letters issued at the time of the G20 meeting and in the week afterwards. As the G20 met he told the OECD:[6]

I think it is vital that we now build on this progress to make further advances in the fight against harmful tax practices.

I see two key priorities. First, we need to address urgently the issue of tax avoidance. Second, we need to broaden the scope of the work to ensure that developing countries can benefit from the greater transparency we are now achieving.

His message to the UK's Crown Dependencies, all of which met the initial standards set by the OECD was that this was insufficient. In a letter dated 9th April to the Chief Minister of Jersey he said:[7]

I welcome the progress which has already been made by the Crown Dependencies in meeting the OECD target of 12 TIEAs (Tax Information Exchange Agreements).

This standard should be seen as an indicator of commitment to the principle of tax transparency. I think it is particularly important that the Crown Dependencies continue to set the pace in this process and put clear water between themselves and those jurisdictions which only just meet the international standard. If genuine progress in agreeing, implementing and abiding by these agreements does not continue to be made I will encourage the G20 to look at this issue again until all abide by the highest standards.

Similarly, as international efforts on harmful tax practices start to really focus on the issue of tax avoidance, it will be vital to the interests of the Crown Dependencies that they can readily meet any new international standards which emerge.

The.... Ministry of Justice will be able to provide support to the Crown Dependencies on these matters over the coming months.

The message was unambiguous: Jersey, Guernsey and the Isle of Man had to reform, and reform rapidly or the UK would take action.

This was even more apparent in the letter sent on the same day by Gordon Brown to the Premiers of each of the British Overseas Territories that are considered to be tax havens, in which he said:[8]

Given the developments at G20 and, in particular, the identification of the toolbox of sanctions which will be applied against those who do not meet the international standard, I urge you to achieve the standard of 12 TIEAs or equivalent arrangements before the UN General Assembly in September.

The threat was clear: comply with the demands made or sanctions would be imposed. What was more, minimal compliance was not enough.

Read together the message from the G20 and from these letters was robust: it would seem that for the first time ever the political will had been created to tackle the problems that tax havens cause.

That was the good news in 2009. Unfortunately, however, for all the posturing at the time things have not progressed as well as those with concern about this issue would have wished. The backlash from the financial sector, which has been seen right across the spectrum of its activities has been just as strong with regard to tax havens, or secrecy jurisdictions as we prefer to call them, as it has been on banking reform, bankers' bonus payments, hedge fund regulation and a range of other issues.

The consequence is that the tax haven issue remains on the agenda for international action. It must be stressed that at least it remains there. For example, President Nicolas Sarkozy of France has said[9] that this issue is a high priority for him during his presidency of the G20 in 2011. The fact that he still has to say this, almost two years after Gordon Brown's strident comments is however clear indication that matters have not progressed as many hoped. The reality has been that if the London G20 meeting in April 2009 was the beginning of the end of tax havens, as Gordon Brown claimed, then the end of tax havens is clearly going to be some way in the future and that tax havens are not going to fade away without a fight, even though it is very obvious that the harm they cause has now been internationally recognised.

This report recognises these facts and in the light of them seeks to do three things.

Firstly, it seeks to explain why the tax haven issue is of such significance. In the process it seeks to define what the issue is, what its impact is and why, in brief outline, efforts to tackle it to date have not worked.

Secondly, it uses this evidence to suggest ways in which new regulation should be couched.

Thirdly, it reviews progress since the G20 and as a result highlights how policy should be changed to address the new issues that have arisen.

In doing so it is hoped that this report informs the debate and process of change that started with Gordon Brown's letters quoted above. What we know is that debate has a long way to go, and that if only it were pursued the benefit to the ordinary people of the UK and the world at large would be enormous. As Jon Snow, the lead journalist at Channel 4 News wrote[10] on 27 January 2011:

There is no one who intersects with the UK's current deficit related woes who does not know that if war were declared on these tax havens our financial position could be fast transformed. So why is nothing done? Why is it still permissible for British Citizens to avoid taxes by living, or locating funds in the Caymans, Liechtenstein, or indeed much closer to home in Channel Islands for 'tax purposes'? As the World Economic Forum opens in Davos, might it be a relevant question for the great brains assembled there? Don't hold your breath!

We aren't, but we believe that it is right to challenge this inaction precisely because Jon Snow is right: we do know our financial position could be transformed if the issue of tax havens was tackled, now.

Which is why we are seeking to do just that.

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1 All estimates are explained here http://www.taxresearch.org.uk/Documents/PCSTaxGap.pdf
2 See http://www.taxresearch.org.uk/Documents/TaxHavenCostTRLLP.pdf, research undertaken in 2009
3 http://www.g20.org/Documents/final-communique.pdf
4 http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf
5 http://www.ft.com/cms/s/0/5d39b10a-0fff-11de-a8ae-0000779fd2ac.html accessed 13-4-09
6 Letter from Gordon Brown to Angel Gurria of the OECD dated 30 March 2009 in the possession of the author of this report
7 http://www.taxjustice.net/cms/upload/pdf/Brown_090408_Letter_to_jersey.pdf accessed 13-4-09
8 http://www.taxjustice.net/cms/upload/pdf/Brown_090408_Letter_to_BVI.pdf accessed 13-4-09
9 http://www.guardian.co.uk/world/2010/dec/30/nicolas-sarkozy-g8-presidency-ratings-france
10 http://blogs.channel4.com/snowblog/hey-davos-tax-havens/14521 accessed 28-1-11

2 PCS' tax concerns

PCS has a number of concerns about tax havens, all of which justify its intervention in this debate.

Firstly PCS wants a just and equitable taxation system in the UK. PCS believes that there are five reasons for taxation. Tax is used to:

1. Raise revenue;
2. Reprice goods and services in pursuit of social objectives (tobacco, alcohol, carbon emissions, etc.);
3. Redistribute income and wealth;
4. Raise representation within the democratic process because tax is the consideration in the social contract between those governed and the government and it has been shown that democracy flourishes when people believe they can use their vote to influence the use of the tax they pay; and finally to;
5. Reorganise the economy through the use of fiscal policy.

These are all, in PCS' opinion, positive attributes. This reflects PCS' belief that taxation revenue raised at appropriate levels to fund judiciously managed state expenditure is of benefit to society as a whole.

This outcome is not possible in PCS' opinion without an efficient tax system. PCS believes that an efficient taxation system has nine attributes with one overriding characteristic to which they all contribute. These attributes require that an efficient tax system is:

1. Comprehensive – in other words, it is broad-based;
2. Complete – with as few loopholes as possible;
3. Comprehensible – it is as certain as is reasonably possible;
4. Compassionate – it takes into account the capacity to pay;
5. Compact – it is written as straightforwardly as possible;
6. Compliant with human rights;
7. Compensatory – it is perceived as fair and redistributes income and wealth as necessary to achieve this aim;
8. Complementary to social objectives;
9. Computable – the liability can be calculated with reasonable accuracy;

All of which facilitate the chance that it will be:

10. Competently managed.

In combination these are key attributes that PCS' tax justice campaign seeks to promote. This campaign is based on the belief that tax justice can be defined as a six stage process to:

1. **Define** the tax base. This is the first essential step in creating progressive taxation and in promoting the better use of resources within society.
2. **Find** what is to be taxed. If the tax base cannot be accurately located then there is no point in trying to tax it.
3. **Count** the tax base. Unless the tax base can be quantified it cannot be taxed.
4. **Tax** the tax base at the right rates of tax, in the process making sure the inter-relationship between the various tax bases is properly managed to ensure that the essential revenue raising, repricing and redistributive qualities of a just tax system is created.
5. **Allocate** the resulting revenues efficiently and to best social effect.
6. **Report** – governments must be accountable for what they do with tax revenues or the democratic principle fails.

It is PCS' suggestion that the existence of tax havens is a blockage to the fulfilment of many of the principles outlined here. This prevents the creation of a just and equitable tax system and undermines the efficiency of our tax system at cost to society at large.

Tax havens do more than that though. Successive campaigns on tax justice have highlighted abuse within the UK economy perpetrated by tax haven companies, whether they be private equity employers seeking to undermine employee rights, PFI operators dependent upon the tax breaks these places provide, straightforward corruption that has been hidden in these jurisdictions, or the more recent banking scandals within the 'shadow banking system' which they have facilitated and which has already imposed enormous cost on honest taxpayers in the UK. All of these activities have, of course, cost jobs in the UK.

Even this tally of abuse is not the limit of the damage that tax havens cause. There is unambiguous evidence that tax havens also harm developing countries.[11] There can also be no doubt that they massively distort the terms of world trade, favouring developed countries over developing nations, large companies over small enterprises and multinational concerns over local ones. All of these create imbalance within the world economy and all of these facts, in combination with the imbalances that tax havens create in the taxation system, increase the gap between the world's wealthiest people and the vast majority of people on this planet.

This report is written against the background of these beliefs, assumptions and concerns, all of which give us, we think, ample grounds for PCS to participate in this debate.

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11 http://www.christianaid.org.uk/images/deathandtaxes.pdf

3 PCS' concern about the UK's current tax haven strategy

The UK is currently facing the greatest economic crisis in living memory. The causes of that crisis could be, and probably will be, debated forever. Few at this point of time dispute that it is the consequence of the collapse in the banking sector in the UK and worldwide first seen in 2007 and which escalated in 2008. The cause of that banking crisis will again be the subject of much historical debate; from our perspective at this point of time they can easily be summarised under three headings.

The first is that there was lax regulation. Of course this was the fault of governments, as all governments of all countries from the 1980s onwards were captured by the dogma of neoliberal economics which said that the market would provide optimal solutions if left to its own devices. This was the dogma that gave rise to capital market liberalisation which also resulted in the boom in offshore tax haven activity from the 1980s onwards, promoted by Ronald Reagan and Margaret Thatcher. The blame for this whole culture can entirely appropriately be laid at their door, and as such it political responsibility can be clearly assigned.

Secondly, the responsibility can be laid at the door of the bankers themselves. Their considerable greed, and their willingness to exploit the assets of which they were meant to act as custodians for their own personal benefit, resulted in their promotion of abusive structures which inflated profits, reduced tax liabilities and generated the bonuses which have so undermined the stability of our banks and our society.

Thirdly, responsibility can be laid at the door of those who were meant to self-regulate these markets in accordance with the dogma of neoliberalism. The auditors of these banks, who failed to draw attention to their instability, should have carried a considerable burden of responsibility for all that followed from their failure. The ratings agencies that were meant to assess the risk inherent in financial products, and who so very obviously failed to do so, directly contributed to the abuse of markets that resulted from their actions, including the enormous loss to pension funds that has arisen as a consequence – a loss that would directly impact on many ordinary people and their prospects for retirement. And regulators, often standing at arms length from government, but always recruited from the private sector from whom they were not as a consequence independent, obviously failed in their duties. In combination it was this willingness to turn a blind eye that resulted in the failure of our banks, and it was the same willingness to turn a blind eye that led to the abuse that has arisen with regard to tax, banking, finance and general, regulatory abuse in tax havens. The two failures are similar, because they were made by the same dogma, by the same groups within society, and with the same consequence.

The first and most important point to note is that despite these very obvious failings there has been almost no reform of banking, auditing, credit agencies or the bringing forward of regulation of these activities so that they might be under direct state control in the United Kingdom. As a result Mervyn King, the Governor of the Bank of England was able to say in October 2010 that[12] "Of all the many ways of organising banking, the worst is the one we have today." In other words two years after the crisis really struck home nothing has changed. Shadow banking remains in place, offshore remains as significant as ever, and the risk is as big as it ever was.

As is noted elsewhere in this report, some specific actions have occurred to limit the impact of some of the UK's tax havens upon our economy. In particular, as a result of cooperation between the United Kingdom and the European Commission, Guernsey, Jersey and the Isle of Man have all been told that their tax systems are illegal under a ruling under the terms of the EU Code of Conduct on Business Taxation. Similarly, as a result of pressure brought to bear under the terms of the European Union Savings Tax Directive, both the Isle of Man and Guernsey have decided to exchange information on all interest paid on personal bank accounts maintained in their territories by citizens of the European Union. However, Jersey has refused to do so, and no sanction is being imposed as a result. The Isle of Man has had its VAT subsidy from the UK cut, giving rise to a saving to the UK of £140 million a year, making this territory much more dependent on the taxes it can raise itself, which will almost certainly force reform of its corporate tax system. And the UK has signed some tax information exchange agreements with other tax haven jurisdictions such as Liechtenstein.[13] However, the evidence of any significant additional tax revenues arising is as yet weak, and just two possible prosecutions are apparently planned so far as a result of the exceptional arrangement agreed with that Alpine jurisdiction, despite several thousand people apparently having made a declaration of tax-evaded funds. If that is the case then the attitude towards tax evasion by the wealthy appears not to have changed within HM Revenue & Customs, and that is also worrying.

This attitude of tolerance towards tax evasion by the wealthy is particularly notable in the arrangement negotiated between HM Revenue & Customs and Liechtenstein. This arrangement is quite unlike that agreed between the United Kingdom and any other country, and indeed is quite unlike any arrangement agreed between any other country and any other tax haven. As PricewaterhouseCoopers have noted on their UK website:[14]

The Liechtenstein Disclosure Facility (LDF) offers the most generous terms yet announced by HMRC for making a tax disclosure. The key points are:

- An agreement signed between the UK and Liechtenstein Governments requires 'financial intermediaries' in Liechtenstein to be satisfied that their UK customers have been declaring their Liechtenstein investments to HMRC.
- tax is only assessed from April 1999 onwards
- there is a guarantee of no prosecution for tax offences
- the penalty is fixed at 10%
- a composite rate option exists, which can give favourable results
- there is no 'name and shaming'
- there is an efficient disclosure process with no obligation to meet HMRC.

The LDF was created with the signing of an agreement of understanding between the UK and Liechtenstein in August 2009. It formally started on 1 September and will run until 2015.

The arrangement is quite extraordinary: a criminal (for that is what a tax evader is) is granted guaranteed immunity from prosecution for declaring their crime under this scheme. Unlike other tax evaders they can only be assessed for the tax evaded for a maximum of ten years, liabilities before then being ignored, although most tax evaders can be assessed for tax evaded for a period of up to twenty years. In addition, the maximum penalty that they can pay for having committed that crime is 10% of the tax owing. It should however be noted that a 10% tax penalty is the absolute minimum rate of penalty that a person pays in the United Kingdom if they make an entirely innocent error when submitting their tax return, with no intention being and shown of intent to defraud HM Revenue & Customs, but with it subsequently being revealed that the error has arisen. In other words, hardened offshore tax evaders are being treated more favourably than most taxpayers in the United Kingdom who make an innocent error when trying to comply with the complexities of the UK tax system. And, unlike those who make an innocent error, they are not subject to the immense stress of a personal tax investigation. Even more absurdly, those who have undertaken their criminal activities in another tax haven are allowed to move their illegally held criminal funds to Liechtenstein from that other tax haven and then take advantage of this extraordinary deal which puts them in a better position than any normal taxpayer in the United Kingdom. It is as if the UK tax authorities have gone out of their way to provide a Rolls Royce service to the UK's tax criminal class. At the same time, the UK could not have done more to encourage the financial services industry in Liechtenstein. In the light of the comments Gordon Brown made in April 2009 the paradox could not be more stark.

Perhaps most important of all, however, is the enormous change in attitude towards tax avoidance through tax evasions that has been built into the UK's corporation tax system since 2009. It is extraordinary that in April 2009 Gordon Brown said that the era of tax havens was over and yet at the same time his own government was beginning a process of change, now built upon and developed with potentially enormous consequences by the current Coalition government, that will make it very much easier for UK-based multinational corporations to hide their profits in tax havens, as far away as possible from HM Revenue & Customs.

The first such change was that in 2009 it was announced that many dividends from overseas would be exempt from UK tax. This means that if profits were sent back to the UK they would remain largely free of any additional tax charge, and consequently that those earned in a tax haven would enjoy the benefit of low or no tax arising in those places.[15] This was an immediate, and government-sponsored, boost to tax haven activity at exactly the same point in time that Gordon Brown was declaring it to be over.

Secondly, there is to be a significant relaxation of the Control Foreign Company (CFC) regime that will for many corporations probably make it easier to move profits out of the UK. Full details of the reform are not yet known, but the pronouncements made are worrying. This is especially true because the changes proposed in 2010 will exempt profits diverted into tax havens from third countries – a beggar-thy-neighbour policy with serious consequences for developing countries who will now not have the protection that the UK CFC legislation previously provided by preventing UK-based multinational corporations from stripping income from developing countries into tax havens safe in the knowledge this could not be challenged from the developing country, but that would in any event fail because the UK would then demand tax on the profit instead. That second demand will now not happen, making developing countries substantially more prone to transfer pricing abuse.

More importantly still, it was also proposed[16] in November 2010 that income recorded in tax haven subsidiaries of UK multinational corporations should be subject at most to an 8% tax charge under Controlled Foreign Company rules whilst the profits of foreign branches of UK companies, including branches in tax havens, are to be exempted from UK tax.

In combination these represent the most fundamental reforms of the UK residency basis of tax since it was first introduced at the time of the First World War. It does in effect mean the UK has shifted to a territorial basis of tax but has at the same time offered an effective tax rate of 8% to multinational corporations who hide their profits out of the UK, and that at the same time the UK has abandoned all obligation it might ever have accepted to stop UK-based multinational corporations exploiting developing countries. This is an extraordinary negation of responsibility.

The simple fact is that despite all the promises, the UK is not delivering on tax haven reform, and worse still, is actively encouraging large multinational corporations, including our banks, to use tax haven locations to hide their profits out of sight of HM Revenue & Customs, meaning that those companies will no longer make any form of significant contribution towards the cost of running our economy, or to the recovery from the crisis that they caused. Far from the UK making progress in its fight against accidents, it is ceding control of its tax system to them, and the major corporations that dominate regulation in those places.

As final evidence of the trend, in October 2010 the United Kingdom announced[17] that it was to sign an agreement with Switzerland with regards to future taxation arrangements on the funds held in that country by UK resident persons who have invaded their obligation to pay tax on those funds in the UK.

Astonishingly, this new arrangement does not necessarily require that all those funds be declared to the UK tax authorities. Instead, the anonymity and banking secrecy of Switzerland is recognised and upheld by the new agreement, with those holding accounts in that country, including those accounts that harbour tax evaded funds, having the right to preserve the anonymity into the future; this is all on condition that Switzerland deducts tax at an agreed sum from payments of interest, gains and maybe some other sources of income to the accounts in question before the amounts are made available to the account holders. The UK will then enjoy the benefit of some of that withheld tax, but since the tax in question will be charged at a rate (it is expected) of no more than 35%, which will then settle the full UK liability owing on the income question despite UK taxpayers having liability to pay tax at rates of up to 50% on their investment income, the agreement does in effect provide a massive subsidy to the Swiss banking industry by giving any higher rate taxpayer in the UK a tax advantage from relocating their accounts from a bank in the United Kingdom to Switzerland when they will as a result pay a lower overall rate of tax.

This is not just negligent on the part of UK tax authorities, it is a direct encouragement of tax haven activity in Switzerland by the UK tax authorities, and as a result represents complete abandonment of control of the UK tax system henceforth to a foreign government because we can never, effectively, again increase our higher rate of tax on investment income without the consent of the Swiss.

Far from tackling tax havens, since 2009 the UK government has effectively given in to them and those who use them.

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12 http://www.bankofengland.co.uk/publications/speeches/2010/speech455.pdf accessed 28-1-11

13 The full list of UK tax information exchange agreements at 28-1-11 is Antigua and Barbuda, Anguilla, Aruba, The Bahamas, Belize, Bermuda, British Virgin Islands, Dominica, Gibraltar, Grenada, Guernsey, Isle of Man, Jersey, Liberia, Liechtenstein, Netherlands Antilles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, San Marino, Turks and Caicos Source http://www.oecd.org/dataoecd/43/59/43775845.pdf. The real question is why it took so long to get cooperation from those jurisdictions when so many are under direct British responsibility.

14 http://www.pwc.co.uk/eng/issues/liechtenstein_disclosure_facility.html accessed 28-1-11 and

15 http://www.hmrc.gov.uk/budget2009/bn05.pdf accessed 27-1-11

16 http://www.guardian.co.uk/politics/2010/nov/29/corporation-tax-8percent-exodus-multinationals accessed 27-1-11

17 http://www.ft.com/cms/s/0/4394572a-e05d-11df-99a3-00144feabdc0.html#axzz1C7tgnJ3D accessed 28-1-11

4 PCS' employment concerns

This report analyses tax haven / secrecy jurisdiction activity and finds much of it to be harmful. It is, of course, not alone in doing so. The prevailing sentiment in society at large has moved against tax havens. There is, however, a dimension to this issue which few have not addressed that we do, explicitly.
Eliminating the harmful impact of tax havens will have benefit for the world at large, but in the process many people who actually live and work in such locations will suffer personal loss, whether it is as a result of losing their own job, or from the loss of economic well-being in their wider community. This is a special concern for PCS. PCS wants tax justice: it also has appropriate concern for the livelihoods of those people who are long-term residents of tax havens.

The Crown Dependencies have been the subject of special concern since the G20 meeting which focussed the world's attention on tax havens in April 2009. The Prime Minister picked them out for special attention in his letters sent after that summit, as noted already. They have also been subject to much comment, some of it notably complimentary in the Foot Review report issued in October 2009. And simultaneously they have been subject to particular attention from HM Treasury in London who in October 2009 made two apparently unrelated but very important announcements of consequence to the Crown Dependencies, both of which suggest an opinion quite different to that suggested by the Foot Review.

In the first announcement the Crown Dependencies were advised by the UK Treasury that their corporate tax regimes were unacceptable to the European Union.[18] This has led to confirmation from the European Union late in 2010 that they too hold this opinion.[19]

This means that in effect after almost a decade of planning for a 'zero-ten' corporate tax regime in the Crown Dependencies, around which they have built a considerable part of their other tax and financial strategies, they now have, at very short notice to revise their arrangements for taxing companies if they are to comply with the requirements of the EU Code of Conduct on Business Taxation. This will almost certainly mean that they will all have to introduce some form of universal tax on corporate profits, with Guernsey already suggesting a likely rate of 10% for all companies registered there. The impact of this move on their offshore business, which has traditionally been dependent on what the Crown Dependencies have termed 'tax neutrality' but which has in practice meant 'no tax', is hard to assess, but is bound to reduce the volume and value of financial services business they undertake in future.

In the case of the Isle of Man a second announcement was of even greater significance.[20] The UK and the Isle of Man have pooled indirect tax revenues (until 1973 principally purchase tax and some excise duties and since that date VAT and some excise duties). The intention was always that the UK would subsidise the Isle of Man, which was the poorer location. The so-called 'Common Purse Agreement' by which this pooling of revenues was managed was revised in 2007 when the subsidy was retained although by then, depending on the measure used income per head in the Isle of Man was as high as, or higher, than in the UK – the reverse of the situation at the time of all previous revisions. When public attention was drawn to this anomaly the UK Treasury decided, unilaterally and with very little notice being given, to renegotiate the terms of the Common Purse Agreement, giving notice in October 2009 of withdrawal of the subsidy over three years until at the end of that three year period the Isle of Man would see its government's income reduced by about 25% (approximately £140 million, all as a result of reduced VAT payments from the UK)[21] unless alternative tax raising measures were put in place.

These changes put the broadly favourable comments about the state of development in the Crown Dependencies in the UK government's Foot Review in sober perspective. As the Foot Review noted:[22]

the Crown Dependencies' decision to build up reserves in recent years during a period of rapid economic growth has served to increase their resilience. They had also invested effort in improving the quality of data they obtained, compiled medium-term economic forecasts and 'stress-tested' against economic shocks.

It is not clear that Foot anticipated this shock coming from HM Treasury. As was also noted in the report of that Review, it:

tentatively concluded that the Crown Dependencies and the Overseas Territories were distinguished within the developed world by differentiating themselves from the international consensus, sometimes through tax rates but more often through the absence or near absence of certain forms of taxation. Whilst there were other drivers for doing business in these jurisdictions (including, for example, a stable legal environment and authorities who were responsive to market developments), tax was an important motivating factor.

It is now apparent that at least part of this marketing base for the Crown Dependencies will be lost as a result of the necessary changes to the zero-ten tax regime that are required of the Crown Dependencies. In that case, whilst the Foot Review noted that:

the Crown Dependencies' industry bases were sufficiently diverse that they had the potential to raise worthwhile levels of revenue from a Corporate Tax system more aligned with international 'best practice' than the regimes currently in place.

The reality is that the introduction of such taxes, the general attack on tax havens and the Foot Review's suggestion that:

the Review has, therefore, concluded that the UK should take the lead internationally in encouraging improvements to .... the transparency of beneficial ownership of companies and trusts.

which it implies should apply within the Crown Dependencies as well, all suggesting there will be a significant down turn in business in the financial services sector in these locations, and with it employment and government revenue.

Such a move would in the opinion of PCS have a welcome and beneficial effect on tax revenues, and with it jobs and economic prospects in the UK and elsewhere in the world. It is however important to note that many local people in these jurisdictions, and maybe others under the control of the UK, are bound to suffer as a consequence of such changes. This is through no fault of their own: they did not choose the tax structures of their jurisdictions or have any meaningful choice about the dominance of the finance industry in their economies.

In that case though, whilst not changing the message that resolving the massive threat to economic stability that tax havens/secrecy jurisdictions pose is an issue of priority for the UK Government, PCS also believes that those governments, including that of the UK, who rightly want to eliminate tax haven abuse also have a responsibility to manage the consequent fall out of that process on the local populations who will be affected by that policy.

In this context it is important to note that in some tax haven locations associated with the UK, significant numbers of people, as a proportion of the local population, are employed in the financial services sector. The Interim Report of the Foot Commission, looking into the future of British Finance Centres notes, included this table:

Jurisdiction	GDP	Financial services GDP (% of total)	Financial services employment (% of total)
Anguilla	£104m	£12m (12%)	250 (4%)
Bermuda	£2,925m	£1,207m (41%)	7,600 (19%)
British Virgin Islands	£571m	£206m (36%)	2,100 (13%)
Cayman Islands	£1,283m	£465m (36%)	7,500 (21%)
Gibraltar	£740m	£145m (20%)	2,400 (12%)
Guernsey	£1,666m	£528m (32%)	7,500 (24%)
Jersey	£4,089m	£2,177m (53%)	13,300 (23%)
Isle of Man	£1,817m	£721m (40%)	8,000 (14%)
Turks & Caicos Islands	£414m	£44m (11%)	500 (3%)

The noted ratios for Guernsey and Jersey are, according to research undertaken by the Tax Justice Network, the highest for any locations in the world.[23]

The dependence of many of the communities on finance did not occur by chance. When reform is planned the UK Government should not forget that for very many years tax havens did not operate against the will of the international community but with its acquiescence and sometimes with its active support. This was particularly true for the UK which saw tax haven activity as a way of reducing the dependence of these locations on the UK taxpayer. That was a mistaken policy for which we have paid a high price, but for which the local population of those places should not suffer now.

What this means is that the UK Government, other governments and the international financial institutions have a very strong moral obligation to ensure that all tax havens are given all the practical and financial support necessary to ensure that they can make the transition away from their status as a secrecy jurisdiction, without unemployment and hardship for those who have lived and worked there for considerable periods of time. This obligation is particularly strong for the UK Government with regards to the future of the Crown Dependencies and the British Overseas Territories for which the UK has particular responsibility. Some revenues to support the necessary process of change that is required might come from within these jurisdictions themselves. Much will not.

A programme of external support might address the following issues:

1. Immediate technical and financial support should be given to ensure that necessary tax reforms can be introduced to ensure that the Crown Dependencies can meet their international obligations, including those to the European Union. This is essential if stability is to be restored to their economies.

2. The provision of practical support to help territories implement plans to replace economic activity lost with other less destructive forms of commerce is essential.

3. Transition funds should be made available to prevent hardship resulting from redundancies during the period in which territories are restructuring their economic activity. This may be a particular obligation for the UK Government given that it encouraged the development of finance centres in the Crown Dependencies.

4. Particular support will be required to assist those facing potential financial hardship as a result of likely falls in property prices in some or all of the places affected, where current valuations have been massively inflated by their low tax status and the influx of tax exiles and the presence of migrant workers from the financial services industry. If this population inflow reverses then property prices in the Crown Dependencies and British Overseas Territories are likely to fall, leaving many local people facing negative equity. Arrangements to relieve this problem will have to be agreed between the UK Government and the governments of the Overseas Territories and the Crown Dependencies as well as with the banks operating in these locations, who will have to share at least part of the loss that they have also helped create without creating financial instability, due to high levels of personal bankruptcy in these locations.

5. Support for the creation of new international networks to support the affected territories will be necessary. For example, the Crown Dependencies may want or need to negotiate new relationships with the European Union if they cease to promote their current form of financial services activity. The UK will have to actively support them in that process. This may well help them access a wider range of markets for the services they offer.

6. It is highly unlikely that the entire financial services sector will leave the Crown Dependencies. They have developed particular expertise in some areas that might be applied to good use in an open and competitive market despite the removal of secrecy as a means of creating competitive advantage. For example, there is little doubt that some reinsurance activity and trust administration can survive openly and accountably, whilst some forms of inter-bank activity might remain where secrecy has never been a matter of significance to the location of such activity. It is vital that if these activities can be identified and can be demonstrably proven to be viable and beneficial without secrecy being a component in their supply, then these sectors can be rebuilt without the distortion of artificial tax advantage being a factor in their use. The creation of new structures will require international support to ensure their acceptability, but given that many of the world's offshore suppliers are part of onshore organisations (for example, very few banks operate solely offshore, most being branches of well known

onshore operations) this process must be possible. In this way disruption can be minimised in these places.

7. A programme to create alternative employment must be promoted which for the reasons already noted should receive active UK support. Some might return to traditional activities e.g. tourism, which may benefit from a new green awareness, but which will need to diversify if it is to be successful. Of late, too much of the tourist trade has been focussed on servicing the needs of the visiting financial services executive in these locations; a wider audience needs to be appealed to. More likely, new activity will need to be attracted. The islands have developed considerable data processing and administration management capacity: this is, after all what much of the financial services sector does. That capacity and ability has to be re-focussed to earn new services-based business for the islands. The financial support noted above for those who might suffer financial hardship whilst the islands move from their current tax haven status is essential if this repositioning, which should guarantee work but maybe in different sectors from those the islands have traditionally engaged with to date is to be successful.

8. The islands should also, if more integrated into the international community, seek to manage services on behalf of that community. Their independence is what allowed them to develop as tax haven secrecy jurisdictions. If retained, that independence remains one of their key marketing attractions but it may be possible to use it in different ways. For example, this gives them a potential special status which is almost the exact reverse of what they enjoy now. They could take a lead in promoting accountability. In many transactions in the world, especially those that involve either what are called 'politically exposed people' or countries where there has been abuse and corruption, there is now an urgent need for financial transparency. The very expertise that the Crown Dependencies have had in promoting secrecy could be turned on its head: their financial institutions (almost all of which are owned by and part of multinational groups, whether of accountants, banks, insurance companies or more) could, within the stable but independent environment they enjoy become the centres through which sensitive transactions could be required to be undertaken precisely so that these transactions can be monitored and reviewed, whether by international agencies or by being put on public record. There is at present no location anywhere that has sought to develop this financial expertise. Acting in unison, maybe, the Crown Dependencies might do just that and turn their current negative status around to one where a positive attribute could be afforded to their financial services sector.

This would of course require considerable political leadership and a willingness to be open and accountable in a way currently unfamiliar to the Crown Dependencies, but there is almost certainly no location on earth outside the Crown Dependencies which has the opportunity to become the preferred conduit of choice for sensitive transactions requiring the highest degree of monitoring to ensure the lowest possible risk of corruption, and which has all the required skills already in place to achieve this goal at remarkably little cost to the international community.

Of course the demands this might impose would be significant, and yet the demand for high transparency, low risk states subject to significant regular international oversight within an independent environment must now exist. And if this is not the answer, then similarly creative thinking is now needed to find a way forward for the Crown Dependencies. That process is one PCS supports.

18 http://www.ft.com/cms/s/0/6228f1e4-b9c3-11de-a747-00144feab49a.html accessed 27-11-09

19 http://www.taxresearch.org.uk/Blog/2010/12/10/zero-ten-the-european-documents/ accessed 5-1-11

20 http://www.ft.com/cms/s/0/bc4fc872-bdd9-11de-9f6a-00144feab49a.html accessed 27-11-09

21 http://www2.iomtoday.co.uk/pdfs/CMrevsharestatementfinal.pdf accessed 27-1-11

22 http://www.hm-treasury.gov.uk/d/foot_review_main.pdf accessed 27-11-09

23 http://www.secrecyjurisdictions.com/PDF/FS_in_Workforce.pdf accessed 30-11-09

5 What is a tax haven?

One of the biggest problems anyone has when addressing issues relating to tax havens and offshore financial centres (OFCs) is in agreeing what these terms mean.

The Gordon Report[24] to the American Treasury in 1981 said 'There is no single, clear, objective test which permits the identification of a country as a tax haven'. Twenty-five years later, academic Jason Sharman[25] said 'The term "tax haven" … lacks a clear definition and its application is often controversial and contested'.

Both statements are true. They are even truer of the term 'offshore financial centre', the definition of which is itself confused by a dispute about the meaning of the term 'offshore'.

Offshore has been defined as a 'legal space that decouples the real and the legal location of a transaction with an aim to avoid some or all kinds of regulation.'[26] What this means in practice is that an offshore jurisdiction offers people resident in another jurisdiction the legal opportunity to record their transactions in that offshore jurisdiction even though the transaction itself does not really take place there, and the parties to the transaction are not resident in that offshore place. The parties to the transaction are therefore 'offshore' in the sense that they are located outside the country in which the transaction is recorded. It is important to note that offshore does not in this context have anything to do with small islands, palm lined beaches, or distant locations. Liechtenstein is one of only two double land-locked states in the world but is very definitely an 'offshore' jurisdiction.

The confusion caused by failing to define both tax havens and 'offshore' adequately has been a major factor in the failure to tackle tax haven issues to date. This is because it has resulted in much talk at cross-purposes, direct conflict between regulators and consequent gaps in the regulatory process. At its most basic level no one has, for example, known whether to describe places being targeted by regulations and policies as tax havens or offshore financial centres. These places have exploited that confusion by denying that they are either of these things. They, for example, say they are international finance centres, a term that appears without any justification bar the obfuscation it creates. This lack of definition has as a result played straight into the hands of the jurisdictions seeking to continue their trade, however it is described.

The reality is that tax havens are places. The Tax Justice Network[27] suggested in 2008 that:[28]

Tax havens are places that create legislation designed to assist persons – real or legal – to avoid the regulatory obligations imposed upon them in the place where they undertake the substance of their economic transactions.

They added with regard to tax havens:

There is a second characteristic that most tax havens share in common. They create an environment of secrecy that allows the user of the structures created using its law to do so either wholly anonymously, or largely so.

They went on to define offshore finance centres as something quite different. They said:[29]

Offshore financial centres are not the same as tax havens. OFCs are the commercial communities hosted by tax havens that exploit the structures that can be created using that tax haven's legislation for the benefit of those resident elsewhere. In other words, the offshore financial centre is made up of the accountants, lawyers, bankers and their associated trust companies that sell services to those who wish to exploit the mechanisms the tax haven has created.

This differentiation of tax havens from offshore financial centres is important. It makes clear that any process of change would require action not just against the states that are secrecy jurisdictions, but also against the bankers, lawyers and accountants who populate the offshore financial centres.

The thinking has now, however, been taken further. The Tax Justice Network has now stopped referring to either tax havens or OFCs. It does instead use the term 'secrecy jurisdiction'. A secrecy jurisdiction is defined by them as:[30]

a place that intentionally creates regulation for the primary benefit and use of those not resident in their geographical domain that is designed to undermine the legislation or regulation of another jurisdiction and that, in addition, creates a deliberate, legally backed veil of secrecy that ensures that those from outside the jurisdiction making use of its regulation cannot be identified to be doing so.

This definition is significantly different from those that have been used to date by the major international financial institutions tackling this issue. For example, the Organisation for Economic Cooperation and Development[31] defined a tax haven in 1998 as a place that offers low or no taxes, no effective information exchange for tax purposes, a lack of transparency and the absence of any substantial economic activity in the place where the transaction is recorded.[32] In so doing tax was clearly the focus of its concern.

The European Union also had a tax focus for its concerns when it defined harmful tax practices offered by tax havens in its Code of Conduct on Business Taxation. This said in 1998 that tax haven activity could be identified by: a) tax structures designed to make sure that local markets were taxable but international ones were not; b) low tax rates that were only available to individuals and companies not actually resident in a jurisdiction; c) the granting of tax advantages even in the absence of any real economic activity; d) the basis of profit determination for companies in a multinational group departs from internationally accepted rules, in particular those approved by the OECD; e) a general lack of transparency.

In contrast the International Monetary Fund in 2007 suggested in a working paper[33] that 'An OFC is a country or jurisdiction that provides financial services to non-residents on a scale that is incommensurate with the size and the financing of its domestic economy'. It is obvious that for the IMF regulation of the financial services sector is the focus of concern.

The Financial Task Force on Money Laundering (FATF) was established by the G7 summit held in Paris in 1989, in response to mounting concern over money laundering. The FATF decided to stay away from the definitional debate on the nature of tax havens and OFCs. Instead it concentrated on issues mainly relating to drugs money laundering, and since 2001, terrorist financing. As a result it created a list of 'non-cooperative countries and territories' (NCCTs), or countries that had detrimental rules that might facilitate money laundering. Their list of required actions to address money laundering initially contained 40 recommendations. Another nine were added after 9/11 to address terrorist financing issues.[34] In practice these, in combination, describe tax haven activities, but using another quite distinct criteria.

The result has become readily apparent: a patchwork of regulation, incomplete in its scope and without a theoretical foundation to explain the problem being tackled has resulted in massive opportunity for continued abuse by those places that are generally considered tax havens / secrecy jurisdictions whilst providing them with the opportunity to claim that they are 'well regulated' because they have met some or all of the standards demanded of them even though those standards, in combination, have in many cases required remarkably little regulatory change from the places they are meant to impact.

That confusion has not been helped at all by the G20 / OECD process announced in April 2009. The OECD has, quite extraordinarily in the opinion of many, for the purposes of that process defined a tax haven as a place that has signed fewer than 12 tax data sharing agreements with other jurisdictions, whether as part of a Double Tax Agreement or a Tax Information Exchange Agreement.[35] This has the advantage of being objective, and measurable, but there are many problems implicit in this definition, noted later in this report. These problems include the fact that this definition only relates to tax evasion, that the number of required agreements is very low given that there are at least 200 nation states with which information could be exchanged, and there are significant problems within the OECD-approved information exchange agreements which limit their use, as will again be noted later in this report. The problems these issues have given rise to have been a major cause of concern since the G20, and will continue to blight tax haven policy until they are resolved.

At this juncture, however, what this variety of definitions suggests is that a broader definition of a tax haven is required. For that reason this report uses the definition of a secrecy jurisdiction proposed by the Tax Justice Network as an appropriate test for future action in this area because it covers many more issues than tax, emphasises the international nature of the problem, and highlights the fact that secrecy is the most important corrosive issue that must be addressed if the abuse that those places traditionally called tax havens promote is to be prevented in the future.

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24 Gordon Report. 1981. Tax Havens and Their Use by United States Taxpayers—An Overview. U.S.Treasury, duplicated

25 Sharman J C, 2006, Havens in a storm: the struggle for global tax regulation, Cornell University Press.

26 Palan R, Murphy R & Chavagneux C, 2009, Tax Havens: At the Heart of Globalization, Cornell University Press (forthcoming)

27 www.taxjustice.net accessed 4-3-09

28 Murphy R, Creating Turmoil, Tax Justice Network submission to the Treasury Select Committee, June 2008

29 ibid

30 Murphy, R 'Finding the Secrecy World: Rethinking the language of offshore', Tax Research LLP, 2008

31 Organisation for Economic Cooperation and Development – an organisation of 31 of the richest nations

32 http://www.oecd.org/dataoecd/33/0/1904176.pdf accessed 4-3-09

33 Ahmed Zoromé International Monetary Fund (IMF) April 2007 IMF Working Paper No. 07/87 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=986815#

34 http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html accessed 2-6-08

35 See glossary for explanation of these and other technical terms.

6 Why tax havens are on the international agenda

Tax havens / secrecy jurisdictions have never been in the news as much as they have since the onset of the global financial crisis in 2008.

The world recession is of course the primary reason for this exposure. There has been widespread agreement that tax havens / secrecy jurisdictions have facilitated the current financial crisis, although those places have, of course, denied this. The governments of the USA, UK, France and Germany have, however, been agreed upon this point. Never before have they done so, at least with such clarity or vigour. The opinion that they share in common is that the opacity that tax havens/secrecy jurisdictions created, facilitated the whole structure of the shadow banking system, which contributed so spectacularly to the failure of the financial system in 2008.

This though is not a sufficient explanation in itself for the attention tax havens have received. There have been significant changes in attitudes towards tax havens over the last few years that suggest there are more significant issues at play, meaning that the recession has simply been the catalyst for the creation of an environment in which change can begin.

Perceptions have changed

As the definition of a secrecy jurisdiction noted above makes clear, they are places which create regulations designed to undermine the laws of other places. This means they are all, by definition, places that can create laws with international impact. This immediately suggests the first issue that the tax haven debate raises, which is that of tax sovereignty.

The issue of tax sovereignty has been a major obstacle to progress in past discussion of the tax haven issue. The OECD and EU definitions of tax havens as places offering low rates of tax were seen as an indication that they were undertaking their attack on these places because they wished to change these rates. This left both the OECD and EU subject to easy counter attack because it was easy to represent that their actions were a direct assault upon the tax sovereignty of the places in question. This was exploited by supporters of tax havens in the USA who suggested that this represented an assault on low tax rates in general and in June 2001 the then newly elected President George W Bush withdrew his support for the OECD process tackling tax haven abuse for precisely this reason.

The impact was significant. The assault on harmful tax competition was virtually halted outside the EU as a consequence. All the OECD could then do was promote the use of Tax Information Exchange Agreements, which, as is noted below, have had very little impact at all on tax haven / secrecy jurisdiction behaviour.

By, in our opinion both correctly and appropriately, redefining the tax haven issue as one relating to secrecy jurisdictions, this problem is removed. Tax is not referred to in the definition of a secrecy jurisdiction. It is just one of many potential regulations that could be created by one place to undermine the impact of law in another state. Any state that then takes action to prevent another undermining its regulation is, again appropriately in our opinion, not seen to be attacking low tax rates in tax havens, but is instead acting in its own self-defence. So, for example, if the UK takes action to stop tax haven abuse it is not by doing so attacking places with low tax rates. It is simply saying that any place with low tax rates should not allow them to be abused to undermine the tax revenue properly due to the UK. That means the UK would, if it took such action, not be seeking to undermine the tax system of the tax haven. What it would be doing is stopping the tax haven undermining the tax system of the UK. George Bush did not see things in this way in 2001, and put back the process of tackling tax haven abuse by years as a result.

This changed perception, which has only become prevalent since about 2009 has now, appropriately, emboldened those states wishing to tackle tax havens / secrecy jurisdiction abuse and has influenced the rhetoric used by many politicians when discussing this issue. For example, because it took this view Germany has been significantly more aggressive with Switzerland than it might otherwise have been when beginning to tackle organised tax abuse from within Swiss banks revealed from 2009 onwards, and the same spirit has underpinned the quite aggressive stance taken by the USA against Switzerland in the course of the USA's action to tackle abuse by UBS, a Swiss bank, inside the USA.

Without this change in approach it would have been much harder to raise the tax haven issue. The use of this new approach is imperative to progress, as is the term secrecy jurisdiction for this reason.

The economics are understood

On March 10 2009 the Financial Times published an editorial on the financial crisis in which they said:[36]

Every first-year economics student learns the conditions for an unregulated market, in theory, to function efficiently. The most important are full information, enforceable property rights and contracts, and the absence of "externalities" – effects of economic transactions on third parties. These conditions are never fulfilled, but many markets come close enough that participants' self-interested actions achieve good outcomes for all.

When these conditions are absent, markets malfunction; the way they do so is one of the great topics of economic theory. It tells those who care to listen that when a market is too opaque, or when the effects of market transactions are too inter-dependent, the pursuit of self-interest can make everyone worse off, or unfairly land some with the losses caused by others, or – in extremis – make markets disappear altogether.

These arguments are basic market economics: there is little doubt that they have substance. Tax havens disrupt these basic market processes because they are used to create opacity: that is the secrecy to which the definition noted above refers. In addition they promote law designed to undermine regulation elsewhere. That is an artificial externality which is intended to and does undermine the effective operation of markets, whilst the secrecy they provide about the true ownership, control and financial status of tax haven entities means that enforcing property rights against them is almost impossible.

The conclusion is obvious. The Financial Times argued that there was an intellectual and moral failure in tackling these economic issues which had resulted in the failure of the financial system. It is apparent that toleration of tax havens was an integral part of that intellectual and moral failure. Using the logic that the Financial Times has incorporated into its own argument on the causes of financial failure it is clear that tax havens / secrecy jurisdictions must be eliminated if an effective financial system is to be recreated.

This is an entirely new circumstance. The opportunity to present this argument has not existed before. The awareness of the issue is unprecedented. This has been a catalyst for change.

Civil society is involved

There has been another catalyst for change. Until 2000 civil society had virtually ignored tax haven issues. In that year Oxfam published a report suggesting that tax havens cost developing countries at least US$50 billion in lost revenues a year. So limited was the reaction at the time that no other development agency picked up the issue and Oxfam did not take it further. As a consequence in June 2001 there was no civil society reaction to President George W Bush's withdrawal of support for the OECD initiative on tax havens.

The Tax Justice Network,[37] which arose from meetings at the European Social Forum in the autumn of 2002, was formally launched in the United Kingdom in March 2003. Its International Secretariat has been based in the UK since that time. From small beginnings it has become a key player in terms of empowering many civil society organisations to raise issues relating to tax havens. The result is that most of the UK's major development agencies (Christian Aid, ActionAid, Oxfam, Save the Children, War on Want, CAFOD, the World Development Movement, and more besides) now have clear positions on tax havens / secrecy jurisdictions and many of them are running campaigns on tax justice.

In 2001 War on Want published a report[38] on the need for a Tobin Tax on currency speculation to prevent another Asian currency crisis and to generate valuable tax revenue to be used to fund sustainable development. There was massive resistance from the global financial sector at the time but with the recent global financial crisis and huge bank bailout the idea of financial transaction taxes being used to raise valuable tax revenues are now back on the political agenda.[39]

Crucially the Tax Justice Network (TJN) has been able to shine a spotlight on the murky world of tax havens. In particular, through the publication of its Financial Secrecy Index (FSI)[40] it has highlighted the problems with financial opacity within tax havens in places as far apart as the City of London to Delaware in the USA, and Vanuatu in the middle of the Pacific Ocean.[41] Alongside the FSI the expert research and analysis provided by TJN has enabled the media to expose the huge scale of tax dodging and its links to many well-known FTSE100 companies; most notably during the Guardian's tax gap investigation. This in turn has changed the media and public perceptions about tax havens.

The current wave of campaigning on tax justice which followed the global financial crisis in 2008 is focused on promoting transparency in tax reporting and recovering the billions in lost tax to pay for valuable public services and fight poverty. The involvement of trade unions such as PCS through the Hands Off Our Tax Offices campaign and ultimately the TUC, which focused on the impact of tax dodging on promoting inequality and poverty, helped make tax justice a key political issue for the previous Labour government. This has continued through the trade union-backed 'Tax Not Cuts' campaigns.

The involvement of civil society has transformed this debate. The active support of NGOs, in particular from international development agencies, and trade unions, has helped mobilise tens of thousands of supporters to take up the issue. This in turn has put pressure on MPs and ultimately government leaders in countries to act. In the lead up to the London Summit of the G20 in March 2009 tax justice campaigners had been lobbying key countries such as France, Germany, the US and the UK. This led to European-based campaigners targeting Jersey, a well-known UK tax haven, for a series of public actions prior to the London Summit which culminated in 'tax haven reform' becoming a key issue during the Summit.

The result is that the work of the TJN and other NGOs and campaigning groups active on this issue has, in combination with working with trade unions, largely created the opportunity for change that now exists, and to which this report contributes.

36 http://www.ft.com/cms/s/0/cbc4cfd8-0ce4-11de-a555-0000779fd2ac,dwp_uuid=ae1104cc-f82e-11dd-aae8-000077b07658.html accessed 24-3-09

37 http://www.taxjustice.net/cms/front_content.php?idcatart=2 accessed 13-1-11

38 http://www.neweconomics.org/sites/neweconomics.org/files/Robin_Hood_Tax.pdf

39 See Robin Hood Tax Campaign http://robinhoodtax.org

40 http://www.financialsecrecyindex.com/index.html accessed 28-1-11

41 See also http://www.secrecyjurisdictions.com/index.php accessed 28-1-11

7 What do tax havens do?

Tax havens / secrecy jurisdictions provide secrecy as their primary product. Secrecy is created in the following ways.

Banking secrecy

Firstly, many secrecy jurisdictions, such as Switzerland and the Cayman Islands, have banking secrecy created by law. This means that it is illegal for a person working for a bank in that location to disclose details of any information relating to a bank account maintained in that place to a third party without facing criminal prosecution.

Banking secrecy was pioneered by the Swiss in 1934. It was not created, as the Swiss are inclined to suggest, to protect the Jews and trade unionists from the Nazis. There was no such international concern on their behalf in 1934. It was actually created to prevent the French tax authorities repeating an exercise they undertook earlier that decade to secure the names of at least 2,000 prominent French citizens evading tax using Swiss bank accounts. As such the claim that banking secrecy was created to protect human rights is a myth. It was created to protect those evading their responsibility to pay tax by hiding their funds in jurisdictions in which they did not live and that remains its main purpose today.

It was noted in the Financial Times in March 2009 that some Swiss bankers have estimated that at least half of all Swiss bank deposits would leave that country if banking secrecy was to be abolished.[42] It is extraordinary that the fortune of a state has been built upon its handling of what is, in reality, stolen property since that is what tax evaded funds are, and it is tax evasion that banking secrecy is designed to facilitate.

Nondisclosure of corporate legal and financial data

Many secrecy jurisdictions, such as the UK's Crown Dependencies, do not have legally backed banking secrecy but do create an effective form of banking secrecy that is almost impregnable through the combination of legal structures and entities that they make available to clients of the financial services industry located within their domains. This is possible because the financial services sector in these locations designs their services to make sure that the identity of their client can remain hidden from view, a possibility that continues despite recent supposed reforms.

Whilst it is undoubtedly true that some people who make use of tax haven services do so in their own names this practice is largely the preserve of those who either do intend to declare the tax liabilities that arise on the income they earn in tax havens / secrecy jurisdictions in the place where they really live, or of the naive and ill-informed, many of whom will be petty tax evaders. Anyone with serious intent to hide money in a secrecy jurisdiction will do so by holding it through a combination of trusts and companies.

A trust is formed whenever a person (the 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 for their services. Most offshore trusts are what are called discretionary trusts. This means that the settlor does not have to say to whom the trust income and gains will be distributed when the trust is established. This is supposedly left to the discretion of the trustees.

A company is 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. A considerable range of companies are available for incorporation in offshore jurisdictions but most of them have some features in common. In particular, those owning the company (usually the shareholders) are legally distinct from those running the company (usually called directors) and both the shareholders and directors are considered quite legally distinct from the company itself, which is considered to be a person in its own right even though, of course, this is a legal fiction. The result of this fiction is, though, that neither the directors nor shareholders are liable for the actions of the company.

With regard to companies, but not trusts, UK law requires some compensatory actions to ensure that the advantages which limited liability and a legal structure provide are not abused. In particular, a company is required to place on public record its constitution, the names and addresses of its shareholders, directors and company secretary (a now almost redundant role in law), the address of the place at which it may be contacted and its annual accounts, although these need not include a profit and loss account and need not be audited if the company is considered to be ‘small’, which over 90% are.

The reason for requiring this public documentation is simple: if the shareholders and directors are not liable for the actions of the company then those trading with it should at the very least have the opportunity to identify them, and to have access to accounting information to provide them with the assurance that they will not lose as a result of trading with this entity which, ultimately, can renege on its debt if it becomes insolvent.

It is unfortunate (at the very least) that similar disclosure is not required with regard to trusts in the UK even though these have been extensively used as artificial legal constructions to ensure that tax and other obligations are avoided by the people that create them.

Offshore none of this information is required on public record. For example, some secrecy jurisdictions do not have a list of the companies incorporated in their domain. Almost none require a constitution to be filed, none require accounts on public record meaning that those who trade with offshore companies are always exposed to substantial risk, and if information is required on the ownership of shareholders or the names and addresses of directors then nominees can be used to fill these roles. A nominee is usually a local lawyer or accountant, but can sometimes be another offshore company, who simply lends their name to be recorded as a shareholder or director, but who always agrees to undertake this role on behalf of another person whose identity is as a consequence completely hidden from public view.

Any person who is seeking offshore secrecy can still achieve it with ease by managing their affairs in a secrecy jurisdiction through a combination of a trust and a company. Local professional firms in these places will establish trusts on behalf of non-resident people at modest cost. These trusts do not always record the name of the person who has created them. They also rarely note the names of the people who are intended to benefit from them. Of course, the local professional person should know that information, and must do so to operate the trust, but in the absence of any public register of this data, and in the absence of any of these trusts having to submit tax returns to local tax authorities because they are, invariably, considered not taxable in these places (meaning as a consequence that no public authority in the secrecy jurisdiction will have any awareness of the existence of such a trust) this record is often of limited use in tracking tax abuse.

These trusts almost always then own shares in secrecy jurisdiction limited companies. The trusts almost never undertake any activities themselves. When creating this secrecy jurisdiction companies’ nominees will be used as directors and shareholders so that no public record linking the company with the trust will be in existence. Another level of secrecy is, therefore, created.

Because few such companies are required to submit tax returns to local tax authorities because they are almost invariably considered to be outside the local tax regime, it is once again almost irrelevant that the local lawyers or accountants managing these arrangements know who beneficially owns the company. The local authorities do not, and as there is no way of linking the company as a consequence to the trust that legally owns it, or in turn with the person who created it, or with the people who benefit from the company’s operation – no effective audit trail for tackling abuse exists in most cases in a form that can be readily accessed by secrecy jurisdiction authorities.

It is the company that then has a bank account with an offshore bank, which may, however, have a very familiar high street name. It is that bank account, which is now several stages removed from the person for whose benefits it is really operated, that will handle the offshore funds. Of course, the bank is also required to know the ultimate beneficial owner of the account, but their doing so has no consequence for the tracking of tax evasion. Because the bank will now be paying interest to a local registered company that is not considered taxable in the state in which the account is operated, they have no obligation to report any suspected tax offence with regard to the account.

The whole structure is terribly convenient to all involved, providing as it does enormous secrecy and opportunity for those who facilitate it to do so with immunity. The reality is that such structures also provide an enormous barrier to progress in identifying those undertaking tax evasion, at least as insurmountable as that presented by those states that have legal bank secrecy. It is stressed that this does not take place in far away and remote locations: this happens in places like Jersey, Guernsey and the Isle of Man.

All this, though, still leaves a problem for the person setting up such a structure for the purposes of tax evasion. They will need to get their hands on the money in the offshore account or the exercise will, from their point of view, have been in vain. This problem is conveniently overcome in a simple way, especially if the structure has been created for the benefit of an individual. A corporate credit or debit card can easily be issued on the account maintained by the offshore company. The beneficial owner, living in a state where they should be taxed on the income credited the company, uses that corporate credit cards to pay their bills. The card may be anonymous, such accounts being available from a number of jurisdictions, and of course no name is now required to authorise payment – a PIN number is all that is needed. As such anonymity is guaranteed.

Refusal to exchange information on a taxpayer's affairs

The secrecy that the above arrangements provides would not be so important if the tax havens did not go out of their way to make it difficult for the countries that are defrauded of tax owed to them to find out who is committing this crime.

Whilst there is now clear evidence that at least some secrecy jurisdictions do cooperate on investigations concerning criminal matters, very few consider tax evasion to be a criminal issue, largely because they have no domestic interest in the tax lost as a result of the operation of the financial services industry in their jurisdiction. This is precisely because it is deliberately structured to make sure that no tax will be due locally. As a result no tax returns will be due locally in the secrecy jurisdiction from those using its services to evade tax in their home jurisdictions and the tax havens providing services to these people can therefore rightly claim they have no interest in the tax affairs of these people as a consequence. They might as a result say that they undertake all necessary regulation of the affairs of these people within their own jurisdictions but the truth is that such a claim is hollow: no regulation is intended to apply to them and compliance is therefore automatic.

Beyond assistance with criminal enquiries there are two additional types of information exchange arrangement in which tax havens can participate. The first is the exchange of tax information exchange as a result of a request made by another jurisdiction. This, in the language of offshore is called 'information exchange on request'. This comes in two forms. The first, which is almost never relevant in the case of a tax haven, is made as a result of there being a double tax agreement between the tax haven and the jurisdiction requesting information from it. Double tax agreements are rarely signed with tax havens because they usually grant some tax privileges to those who are at least notionally resident in tax havens which no major nation state would ever wish them to have. Where a secrecy jurisdiction has a double tax agreement it will be because it is a country of some size. Switzerland and Belgium are examples of places considered tax havens / secrecy jurisdictions which do enjoy the benefit of double tax agreements for this reason. However, because both refused to include appropriate information exchange clauses in their double tax agreements to protect banking secrecy within their domains they were added to the OECD grey list[43] of states subject to potential tax sanctions in 2009. As a result both have been obliged to reform their practices since then to meet international expectations on norms of behaviour appropriate when exchanging information for tax purposes. This small step towards enhanced information exchange has been one of the small benefits that has resulted from the focus on tax haven abuse at the London G20 Summit in 2009.

The second type of information exchange agreement on request is called a Tax Information Exchange Agreement (TIEA). TIEAs are problematic, because they are, in effect, mini double tax agreements that relate only to information exchange and grant no other privileges to either party to the agreement.

TIEAs are based on an OECD Model Agreement which was published in 2002 by the Global Forum on Taxation, a loose institution formed in 2001 as a result of the OECD's Harmful Tax Practices Project. This Forum includes many tax havens and secrecy jurisdictions such as Bermuda, the Cayman Islands, Cyprus, the Isle of Man, Malta, Mauritius, and the Netherlands Antilles.

TIEAs have several fundamental flaws. First, by the end of April 2009 just 62 of them had been signed. The G20 process changed this. By November 2009 there was the appearance of significant progress: a total of 180 Tax Information Exchange Agreements had been signed by then. However, of these 24 were between states where both parties were on the OECD grey list. All of Austria's and Belgium's were of this type at that time. 62.5% of Andorra's were of the same type, as were 75% of Monaco's, whilst 57% of San Marino's fell within this category, as did 40% of Liechtenstein's and 60% of St Vincent & the Grenadine's. It was already obvious that the system was being seriously gamed by those jurisdictions under pressure to ensure that they could sign as many agreements as possible with the least likelihood of actually partaking in any effective information exchange. There has to be considerable doubt as to what real benefit arises from agreements such as that between Monaco and Andorra when neither has any tax data of any consequence to exchange with the other; a fact that must be known to all involved. It is extraordinary that such an agreement contributes towards the twelve agreements each such place must have to meet what are called 'international standards of compliance'.

By the close of 2010 the number of Tax Information Exchange Agreements had increased to over 440. In January 2011, using the criteria that signing just 12 agreements was sufficient progress to substantially meet internationally acceptable standards for information exchange, the OECD was able to say[44] that there were just nine jurisdictions that had not met that standard – the exceptions being Liberia, Montserrat, Nauru, Niue, Panama, Vanuatu, Costa Rica, Guatemala and Uruguay. However, because all had committed to signing 12 agreements they were satisfied that the matter was moving towards international resolution.

This however ignores remaining issues of enormous significance within the agreements signed. For example, 87 of the agreements signed are with either the Faroe Islands (population[45] 49,057), Greenland (population[46] 57,637) or Iceland (population[47] 308,910). In combination therefore 19.7% of international compliance is assured by signing agreements with states with just 0.006% of the world's population.[48] The ludicrous nature of the standard is consequently very obvious.

It is also obvious that there is a problem when it is noted that[49] Spain has just four agreements with tax havens, India has one, South Africa none, Brazil has none and Italy has none. There is a very obvious bias in the agreements made available – with far too many still being between tax haven states that are never going to make use of them but which count nonetheless towards the ludicrously small total of 12 such agreements that is required for international acceptability (Andorra has, for example, included in its total agreements with the Faroe Islands, Greenland, Iceland, Liechtenstein, Monaco and San Marino, none of which are ever likely to give rise to any information exchange request) whilst the real needs of real states for information are being almost entirely ignored.

It is clear that this Tax Information Exchange Agreement process has a long way to go if it is to be in any way meaningful. The prospect of that is also very low: the number of agreements required to create any meaningful information exchange under this process would, given that there are at least 40 significant secrecy jurisdictions and at least 100 states that would benefit from information exchange, requires at a minimum 4,000 TIEAs for the system to be anything like effective (the two classes being largely mutually exclusive), and there is no indication that this is at all likely to happen.

Even if it were, there is also the very obvious problem to be addressed, which those pinning their hopes on the arrangements ignore, that TIEAs are notoriously difficult to use. For example, although the USA and Jersey signed their TIEA in 2002 it had by 2009 been used just five times according to Jersey.[50] This is a matter of such embarrassment to Jersey that the USA asked that such information no longer be published by Jersey in early 2011. However, at the time that Jersey acknowledged this, it also noted all the information exchange requests it had received in total since its TIEAS had been in operation, were as follows:[51]

[F]or the period from 1 January 2007 until the 31 December 2009 there were 12 requests and for the year 2010 there were 27 requests. Over the period as whole requests have been received from Australia, Denmark, Germany, Iceland, the Netherlands, Norway, Sweden and the USA.

These suggest pitifully small amounts of information were being exchanged despite the novelty of the system and the desire that many states must have had to use it for the first time. The reasons for this need explanation. Although it has been claimed, by the OECD in particular, that Tax Information Exchange Agreements will end banking secrecy this claim is hard to substantiate. As the OECD standard TIEA[52] makes clear, a request for information must:

(a) identify the person under examination or investigation;
(b) state the precise information sought;
(c) specify the tax purpose for which the information is sought;
(d) state the grounds for believing that the information requested is held in the place of which enquiry is being made;
(e) state to the extent known, the name and address of any person believed to be in possession of the requested information.

These conditions are immensely difficult to meet. Suppose, for example, a UK person set up a trust in the British Virgin Islands, which in turn owned a company in the Cayman Islands which had a bank account in Bermuda on which a credit card was issued that was used by a UK resident person to bring the proceeds of tax evasion back into the UK, and that information about this structure was sought by HM Revenue & Customs. This is an entirely plausible structure that a person with serious intent to commit tax fraud (or another crime) might construct without exceptional cost being incurred. The first and obvious question is to which of these jurisdictions should the request for information be sent? All TIEAs are at present bilateral, not multilateral, so a claim would have to be sent to each of these places in turn. The time consuming nature of this process, and the likelihood of failure of process arising as a result of resulting difficulties in proving the trail of data from one location to another immediately becomes apparent.

Second, if this problem could be overcome the UK tax authorities would, to prove they had a valid request for information need to prove that:

a. The UK resident person had set up the trust about which the enquiry was made, even though there will be absolutely no public documentation to prove this point;
b. The trust in question owns the company about which enquiry is being made, even though again there will be absolutely no public documentation to prove this point and the company registries in the secrecy jurisdiction of which the enquiry is being made will have been designed to make this information almost impossible to prove;
c. That the company in question has a bank account, probably with the number being required to be stated, at a particular branch of a particular bank in the jurisdiction in which enquiry is being made.

What this does, in fact, mean is that the UK tax authorities have to know almost everything about which they are making enquiry before a valid request for information can be made under a TIEA. Unsurprisingly this means that they have extremely limited use in practice, and when multiple jurisdictions are involved they are almost impossible to use in any circumstance. The most that they can provide in that circumstance is a deterrent effect or the opportunity to verify data that a tax evading person has, in effect, either inadvertently or deliberately already made available to his or her domestic tax authorities in the course of an investigation of their affairs.

The conclusion is obvious: tax information exchange agreements of this sort are never likely to yield any serious information exchange of value and are never likely to act as a serious deterrent to those intent on undertaking serious tax fraud or other serious crime. They are, regrettably of largely cosmetic benefit to make it appear as if progress is being made when the reality is that the opacity of the jurisdictions supposedly targeted by the OECD will remain almost entirely intact for all practical purposes.

The alternative to information exchange on request is automatic exchange of information. Ideally this would be an exchange of information on the amount of each specified type of income that a taxpayer from one jurisdiction might benefit from in another jurisdiction in which they are not resident. There is, in practice, nothing surprising about information exchange between financial institutions and tax authorities of this sort. What very few people in the UK appreciate is that every bank in this country sends a report to HM Revenue & Customs every year detailing every penny of interest they pay to their UK resident taxpayer customers. This is a practical example of automatic information exchange working to provide information on income earned to H M Revenue & Customs so they might use it to check tax compliance by UK taxpayers.

24 of the 27 member states within the European Union operate similar arrangements between themselves to share information of this sort if interest is paid by a bank within their domain to a taxpayer in one of those other states. This arrangement operates under the terms of what is called the European Union Savings Tax Directive.

Three EU member states (Austria, Belgium and Luxembourg) plus most of the tax havens associated with the UK and the Netherlands (Cayman Islands being an exception) have operated under a different arrangement, although Belgium is now moving to join the majority arrangement. These states offer the customers of their banks who are not resident in their countries a choice if they are resident in an EU member state. The customer can either have details of the income they receive exchanged with their domestic tax authority or they can have tax (currently at the rate of 20%, but rising to 35% in June 2011)[53] deducted from the interest they receive. Data from Jersey suggested about 50% of those holding accounts to which this arrangement might apply in that place opt for information exchange.[54] The rest do not. The only reasonable explanation for this is that they are tax evading or avoiding. The Isle of Man and Guernsey are moving to automatic information exchange in 2011 to coincide with the increase in the tax-withholding rate to 35%.[55]

The importance of automatic information exchange is that research in the USA has shown that when there is automatic reporting of income to governments, compliance rates on tax returns, i.e. correct reporting of income received, exceeds 90%. When there is no such disclosure compliance rates fall below 70%.[56] This research was, however, done within the USA. Across borders, and where tax haven secrecy is involved the rate may be much lower, as the data from Jersey noted above suggests likely. In this case automatic information exchange is vital between states to ensure tax is paid in the right place at the right time – which is the basis of tax compliance. Tax havens by their behaviour undermine the prospects of tax compliance, and that is one of the key complaints that may justifiably still be laid at their door.

There is an alternative and easier method of information exchange to that used by the European Union Savings Tax Directive which might achieve the desired deterrent effect with regard to offshore structures, and would do so at much lower cost than exchanging full data on income received by a taxpayer. The cost saving would obviously be an advantage in this respect, but so too would the fact that the simpler any system is the easier it is to implement, and so the more likely it is to both happen and soon. In this alternative arrangement[57] all regulated financial services business in a jurisdiction that is required to keep data on their clients for money laundering purposes would have to advise their government annually of the structures that they operated for the benefit (as defined for money laundering purposes) of a person resident in another state. This is a powerful definition: under money laundering rules the real ultimate beneficial owner of any financial structure has already to be identified by the financial services company operating it on their behalf, however many steps that beneficial owner puts into a transaction to hide that ownership. A structure could be defined for this purpose as an interest in a bank account, trust, company, foundation, partnership or other entity receiving or managing income.

In this arrangement, data on beneficial ownership that should already be known to the financial services industry in a tax haven / secrecy jurisdiction would have to be information-exchanged with the state where the beneficial owners of the structures they operate actually live. The cost would be small, which is important, and no income data would be provided: the mere existence of the arrangement would be reported, that is all. That makes the arrangement simple to operate.

The impact of automatic information exchange of this sort would be two-fold and highly significant. First, those holding accounts in these places would almost certainly declare them in the countries in which they live. They would know that if they did not there would be a very high risk of them being discovered anyway. Second, Tax Information Exchange Agreements will suddenly become meaningful because the data exchanged under automatic arrangements could become the basis for follow up data requests using Tax Information Exchange Agreements if clarification were needed on the amount of income received. This would mean that all the effort expended to date on TIEAs would not, after all, be wasted and that too has to be welcome.

The current state of play

As this section has made very clear, banking secrecy, corporate secrecy and taxpayer secrecy are the core offerings of tax havens / secrecy jurisdictions. Secrecy is much more important to them than low tax rates. Without secrecy a great many of those taking advantage of their low tax rates could not do so; they rely on that secrecy to prevent their tax evasion from being discovered.

Secrecy jurisdictions like to suggest that the tax haven debate is about tax rates. It is not. This debate is about the right of a state to collect taxes from those persons who are resident within it. It is about the right of a state to enforce the rule of law in their state without that right being interfered with by legislation passed by another state with the deliberate intention of underlining the rule of law in another country's domain. It is about the right to expect one state to cooperate with another in enforcing law that ultimately is to the benefit of both. It is about stopping rogue states deliberately undermining the law of other places through the provision of secrecy.

Seen in this way the states that are attacking tax haven practices are not in any way challenging the sovereignty of the tax havens; they are acting in defence of their own right to enforce their laws. That is why it is right and proper for the states threatened by tax haven activity to take action against it, not least because that tax haven activity is in far too many cases an assault on the right of a government to fulfil its democratic mandate. And that is a threat to all of us.

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42 http://www.ft.com/cms/s/0/2ed5ef86-17e3-11de-8c9d-0000779fd2ac.html accessed 24-3-09
43 http://www.oecd.org/document/57/0,3343,en_2649_37427_42496569_1_1_1_1,00.html accessed 13-4-09
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49 All data from http://www.oecd.org/dataoecd/43/59/43775845.pdf accessed 21-1-11
50 This was noted on the web site of Jersey Finance http://www.jerseyfinance.je/ until the Spring of 2009. When it became widely reported the page was removed from public view.
51 Official answer in the States of Jersey quoted in http://www.taxresearch.org.uk/Blog/2011/01/18/jersey-claims-this-is-tax-information-exchange/ accessed 20-1-11
52 http://www.oecd.org/dataoecd/15/43/2082215.pdf accessed 16-4-09
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54 http://www.investorsoffshore.com/html/specials/july06_std.html accessed 17-4-09
55 http://www.gov.im/iomfinance/banking/eusavingsdirective.xml accessed 20-1-11
56 Henry J. Aaron and Joel Slemrod (eds.), The Crisis in Tax Administration. Washington, DC: The Brookings Institution (2004).
57 Explained in more detail here http://www.taxresearch.org.uk/Documents/InfoEx0609.pdf accessed 20-1-11

8 What are the consequences of tax haven secrecy?

Tax havens / secrecy jurisdictions provide secrecy as their primary product.

There are six main consequences of that secrecy:

1. Increased tax evasion and tax avoidance;
2. Redistribution of wealth from the poorest in the world to the richest in the world;
3. Increased opportunity for corruption;
4. Financial instability;
5. Inefficiency within markets;
6. Weaker democracies.

Each will be explored in turn.

Tax evasion and avoidance

In March 2009 a Swiss banker quoted in the Financial Times[58] said he believed that half of all funds deposited in that country would leave if bank secrecy was abolished – implying they must be tainted by tax evasion – and that the bankers know it.

That case is not isolated. Switzerland, Belgium (to 2010), Luxembourg, Austria and a number of British-related tax havens refuse to automatically exchange information on all interest paid on bank accounts held in their domain by people who live in other EU territories under the terms of the EU Savings Tax Directive. That Directive has only one stated purpose, which is to curtail tax evasion. These places deliberately subvert that purpose and in the process must know they facilitate tax evasion.

Data published in Hansard[59] in February 2009 showed that the UK was suffering considerable losses to tax havens. Those losses, when extrapolated, showed much of that loss was caused by Jersey, Switzerland, the Isle of Man and Guernsey. An estimate from the same month suggested total losses to tax havens to the UK each year amounted to £18.5 billion per annum.[60] The figure was made up of £8.5 billion from UK resident high net worth individuals (HNWIs), £3 billion by large UK companies and £7 billion as a result of tax evasion and related activities, or a total of not less than £18.5 billion per annum. The figure for HNWIs includes a loss of more than £4 billion attributable to the UK domicile rule that is exploited by tax haven operations. The figure for corporate losses seems modest in view of subsequent revelations in the Guardian and Sunday Times newspapers[61] that Barclays alone may be saving £1 billion a year through aggressive tax avoidance through tax havens, and that Google manages to avoid paying almost any UK corporation tax at all on its UK sales of £1.25 billion, giving rise to a possible saving by Google, as noted by the Sunday Times, of £100 million of UK tax.[62] This loss of £18.5 billion was enough at the time to pay for the entire industry, agriculture, employment and training budgets of the UK government. There is no reason to think the scale of loss has changed significantly since. Indeed, because the UK has failed to reform its laws on tax residence although these are in a state of confusion due to recent court decisions the losses may be increasing, and not decreasing. Urgent reform of the residence laws is now needed.[63]

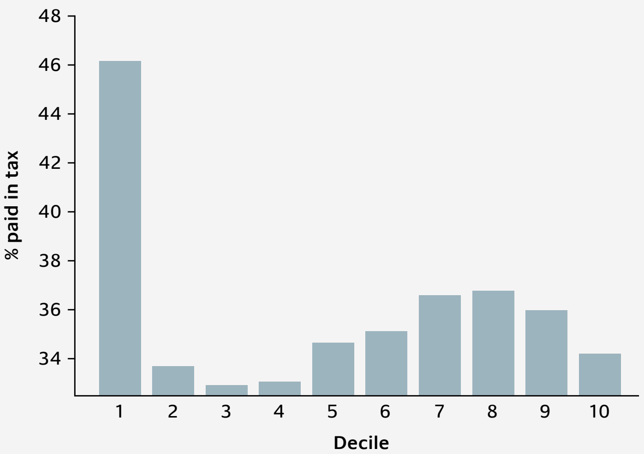
Redistributing wealth from the world's poorest people to the world's richest people

Secrecy jurisdictions deliberately and successfully redistribute wealth from the poorest in society to the richest. They do this in many ways.

First, the facilities they offer to those who want to avoid and evade their tax liabilities are only available to those who can afford the services of the offshore financial community who work within them – and they come at a significant price. This ensures that it is only the wealthiest people and the largest companies, in turn owned by those wealthiest people, who can have access to them – especially if they wish to use these places with any degree of legitimacy. The consequence is simple: the richest people and largest companies often pay a lower proportion of their income in tax than the poorest in society.

The evidence in support of this is clear. In the Trade Union Congress's publication The Missing Billions published in 2008, based on 2006 data, it was reported that the largest companies in the UK paid tax in the UK at an average rate of about 22% – with the rate having fallen by 0.5% a year over the previous seven years. At the same time small companies were paying tax at 21%; their effective rates were higher in almost all cases. The use of tax havens has unambiguously shifted the burden of corporate tax onto small companies, and as further work for the TUC in 2010 has shown, the trend has been maintained.[64]

The same is true of individuals where in the UK the lowest decile of taxpayers grouped by gross income have a much higher effective tax rate than the top decile – and many in the top 1% of 'income' earners pay little or no tax, as the following graph shows:[65]



This, however, is just the domestic effect on redistribution that is exacerbated by access to tax havens. Internationally it is worse. It has been suggested that tax havens facilitate the flow of up to $800 billion of illicit funds a year from developing countries to the developed world.[66]

Included in this sum is an estimate of transfer mispricing that they facilitate costs developing countries $160 billion a year.[67]

Tax evasion they facilitate might deny governments at least $250 billion a year in tax revenues from high net worth individuals.[68]

Of course the numbers are estimates, and there are parameters for error within them, as their authors admit. However viewed though, they are massively bigger than the total annual world-wide aid budget of a little over $100 billion a year, and of course tax havens massively undermine the effectiveness of that aid by providing the services that ensures that corruption can occur.

No wonder more than a billion people – a sixth of the world's population – live in absolute poverty.

Increased opportunity for corruption

In March 2009 John Kay said in the Financial Times:[69]

If you operate in the penumbra of legality, as havens do, it is easy to slip outside the bonds of legality altogether. Where there is legal avoidance of tax and regulation, illegal avoidance of tax and regulation is rarely far behind, and often hard to distinguish: where there is secrecy the motive is frequently impropriety; where there is impropriety, criminality is rarely far behind, and hard to distinguish. To turn a blind eye to avoidance of the law is to undermine all law.

This is what happens in tax havens.

The abuse is obvious, whether it be of the sort Enron did, the sort perpetrated by those in power in so many countries in the world and targeted by Transparency International, or tax evasion.

Global Financial Integrity estimates the illicit financial flow out of developing countries, almost all through tax havens / secrecy jurisdictions, is not less than $800 billion a year.[70] Of that sum they estimate 3 – 5 per cent is corruption by government officials and the like, 30 per cent is criminality such as drug trafficking and the balance – some 65% or so – is by commercial organisations, most relating to tax-related issues. But all of it is corrupt. And it flows through tax havens because of the deliberate veil of secrecy they create.

Creating financial instability

Many in tax havens / secrecy jurisdictions argue that the current world economic crisis started 'onshore'. By that they mean in the UK, USA and similar states.

There are those who agree. Lord Turner said in a report on the future of regulation in the UK's financial services sector that:[71]

It is important to recognise that the role of offshore financial centres was not central in the origins of the current crisis. Some SIVs were registered in offshore locations; but regulation of banks could have required these to be brought on-balance sheet and captured within the ambit of group capital adequacy requirements. And many of the problems arose from the inadequate regulation of the trading activities of banks operating through onshore legal entities in major financial centres such as London or New York.

That argument is hard to sustain for long though, initially because as those in the more conventionally recognised tax havens / secrecy jurisdictions also often argue, London and New York are amongst the most significant tax havens. This is an opinion where, for once, those in the more conventionally recognised tax havens happen to agree with the Tax Justice Network who in its Financial Secrecy Index suggested that the USA was the most significant secrecy jurisdiction in the world and the UK the fifth.[72]

In addition, the argument is only logical if it is also recognised that in reality nothing really happens in tax havens / secrecy jurisdictions. This needs some explanation. It is important to recall that secrecy jurisdictions are places that intentionally create regulation for the primary benefit and use of those not resident in their geographical domain that is designed to undermine the legislation or regulation of another jurisdiction and that they, in addition, create a deliberate, legally backed veil of secrecy that ensures that those from outside the jurisdiction making use of its regulation cannot be identified to be doing so. There are therefore three parts to the equation:

a. The place that creates the abusive regulation / legislation – the secrecy jurisdiction.
b. The people who sell this abusive regulation – let's call them the Offshore Finance Centre (OFC) for ease. This is populated by accountants, lawyers and bankers in the main.
c. The clients of the OFC – who by definition will not be located in the place that creates the regulation and in which the lawyers, accountants and bankers are also situated.

As a result of course it can be argued that tax havens did not create the financial crisis. By definition secrecy jurisdictions serve a population that is not resident where they are. That means by definition what these people do is 'elsewhere' as far as the secrecy jurisdiction is concerned. And that means that whatever activities tax havens facilitate does not happen within them – so of course the financial crisis was not created offshore.

Except that is not the whole story. The financial crisis might have happened 'elsewhere' as far as the tax havens are concerned – but their activities had the effect of ensuring that whatever did happen 'elsewhere' was much more serious than might otherwise have been the case. They did this in a number of ways.

First, they offered what has been called a "get out of regulation free" card to businesses that use them. Whenever banks (in particular) were threatened by onshore regulation that might have reduced the impact (or even prevented) the speculative bubble that has created our current world recession, their response was that they would move offshore. They did not need to: they just needed tax havens / secrecy jurisdictions and their lax regulation to be there to ensure no-one properly regulated them anywhere. There is no doubt that this massively contributed to our current crisis.

Second, competition on regulation between tax havens, and between them and other jurisdictions has undoubtedly led to a steady degradation in regulation over the last decade. This has been especially true in regulation in areas such as trust law, the need to place data on public record and on hedge funds but also contributed to the UK's 'light touch' approach to banking regulation in general.

Third, the tax incentives and opportunities created by tax havens undoubtedly accelerated the build-up in debt and leverage across the global financial system. This was and is still especially true in the activities of private equity and hedge funds – where tax relief on their enormous borrowings was given onshore but their profits flowed tax free offshore – meaning that in effect they got a double benefit, which encouraged them to borrow more and more.

Fourth, "satellite" tax havens like some Caribbean islands have acted as conduits for illicit and other financial flows, often from developing countries into the wealthy financial centres like London and New York, and these flows have contributed to large scale macroeconomic imbalances. The entire mainstream economics profession has neglected to measure most of these vast flows but they did, for example, contribute to the significant over-valuation of sterling for many years which massively harmed the UK's export capacity, helped undermine our manufacturing capacity and left us with an over-reliance on financial services which all too obviously cannot now provide for our needs.

Fifth, one of the most important features of the crisis is that the financial system was frozen as a result of mutual mistrust and impenetrable complexity making it impossible for trading partners to understand each other's accounts. The secrecy jurisdictions, by giving companies incentives to festoon their financial affairs across multiple jurisdictions, and by covering these affairs in a veil of secrecy, have played a major part in this. As such they were the catalyst for the crisis that emerged in August 2007.

Sixth – subprime debts may have been created onshore, but they were sliced, diced and repackaged offshore. The securitisation industry played a substantial role in the growth of some locations, such as Jersey and the Cayman Islands.

Seventh – hedge funds have massively undermined the stability of the world's markets and significantly distorted rewards in them, as well as creating the idea that trading horizons might be of less than a minute's duration, so distorting concepts of value. Almost all are offshore – and unregulated. More hedge funds are registered in the Cayman Islands than anywhere else in the world even if the fund managers are actually in London and New York.

Eighth – private equity is very largely based offshore – meaning that their very many employees in the UK are much less secure than they once were. The ramifications are obvious.

Ninth, significant parts of the pensions industry are now relocating offshore to places like Guernsey – where regulation is inevitably lighter than onshore. This has exacerbated the crisis of confidence amongst ordinary people who, quite reasonably, have increased concern about their prospects for future security as a result.

The point is clear. The deliberate opacity that offshore creates might hide no real economic activity – but it also makes it impossible to tell what is happening 'elsewhere' – which may well be onshore – when that activity is recorded behind a veil of secrecy. The consequence has been a massive loss of trust – and much of the blame for that can be appropriately laid at the door of tax havens. As such they probably contributed more to the current financial crisis than anything else when that crisis is best represented as a breakdown in the trust which underpinned the financial system.

Tax havens create inefficiency within markets

Tax haven activity is entirely dependent upon secrecy. That secrecy is an entirely deliberate and artificial market distortion. It is only available to some businesses and people and not others: a premium is placed upon access to this ability to hide one's affairs.

One premium is imposed by cost: it is not cheap to set up offshore structures. As a result they are only available to larger businesses and wealthier individuals. As a result the wealth gap increases.

Another premium is imposed by age: those able to create structures before they are declared illegal are usually allowed to retain them after use by new market entrants is banned. This means older people, and most especially older companies, have opportunities not available to new businesses that cannot legally access these centres. This has created a bias against new enterprise.

Thirdly, there is a premium imposed by legality. Some will choose to act illegally and take the risk of doing so. Others will not. If insufficient resource is allocated to tackling the illegality there will be a positive and predictable return from that illegal behaviour which imposes a premium on those who choose to be law abiding.

Lastly there is a premium on those who work nationally: they cannot access offshore in a way those who work internationally can. They suffer as a result.

In each and every case the answer is not to open the tax haven market to all: for a start that is not possible. Second, it would only make the problem worse: there would be even less data available to markets than now, and as the FT notes, the result might be no markets at all.

The answer is to create a level playing field. This is what efficient markets require. That means all corporate and other entities created by law should place their data on public record; all should have their data exchanged with their domestic tax authorities; all should provide it to those who need it to appraise the risk of trading with them if they are a limited liability entity and then we remove a market distortion. That market distortion does at present support:

- monopoly power,
- the power of those already wealthy,
- the power of the large company over the small company, and
- the power of the existing market player over the new market entrant.

All of these result in the misallocation of economic resources because insufficient data is available as a result of these failures to allocate resources efficiently. There is no benefit from this for society as a whole. Far from it: wealth and resources are misallocated as a consequence of them; because of the secrecy implicit in offshore the cost of capital goes up (one reason why the bank bailout has been so expensive) and because of the activities of offshore agents a cost of tackling abuse is imposed on society at large.

None of these things need happen. Those who argue against tackling offshore argue for inefficient markets. Those who argue for tackling it argue for efficient markets where resources are as optimally allocated as possible, where risk is mitigated and capital has the lowest possible cost. Getting rid of tax havens would help achieve that.

Then we would have proper globalisation for the benefit of all, not globalisation to reinforce monopoly profit that is the tax haven-inspired variety that we have now.

Tax havens undermine democracy

Tax havens undermine democracy. They do this through their promotion of a process called tax competition. As one of the proponents of tax competition, Richard Teather, a lecturer at Bournemouth University has said:[73]

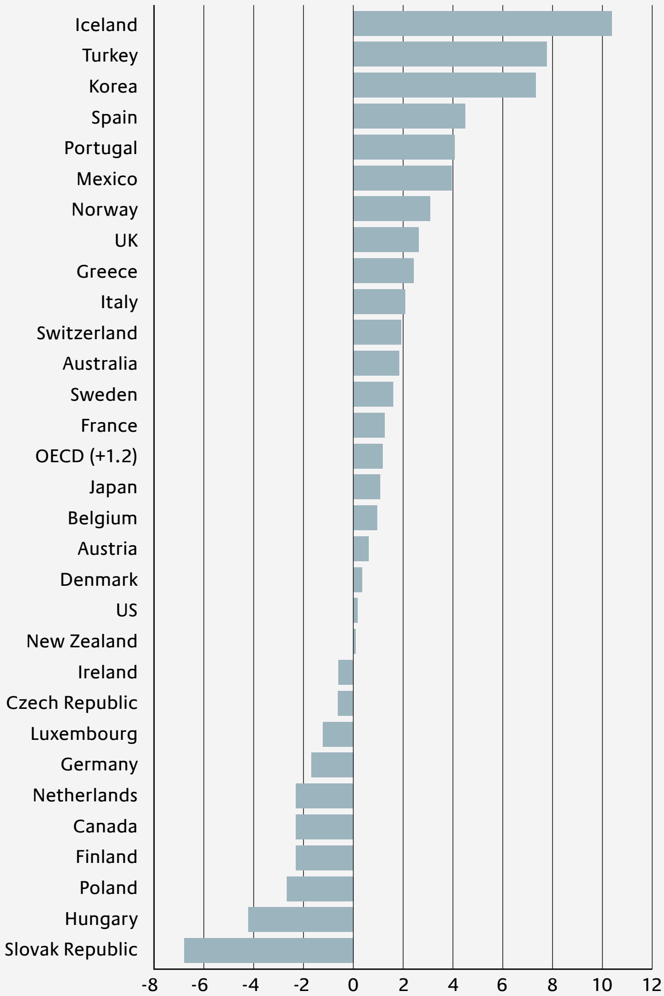
Tax competition acts as a check on governments' ability to raise taxes; it ensures that governments have more limited funds and thus provides incentives for governments to spend more wisely. By preventing taxes becoming too high, tax competition boosts economic welfare, productive investment and employment. Low-tax jurisdictions also make global capital markets more efficient.

Such arguments are commonplace amongst tax haven/secrecy jurisdiction proponents. There are a number of assumptions implicit in such statements; that:

1. It is appropriate for one government to deliberately set out to interfere in another government's ability to raise taxes.
2. Because a government does have a reduced capacity to raise taxation it is necessarily more efficient.
3. Taxation reduces economic welfare and well-being.
4. Flows of unregulated capital through tax havens without cost being incurred result in efficient financial markets.

Each of these has an extremely dubious foundation; perhaps of note is the fact that no group has protested more strongly that another state does not have the right to interfere in the setting of tax rates than the tax haven jurisdictions who have been subject to sanction in the past. By definition this undermines the legitimacy of their argument – that they serve a useful purpose in influencing the tax rates in other nations.

It could be argued that tax havens have not succeeded in their aim of reducing the role of the state. Over the last decade or so the average rate of government spending in OECD states has risen, as this table of changes in the tax to GDP ratio shows:[74]



States increasing spending as a proportion of GDP significantly outnumber those doing the opposite in the period before the financial crisis emerged, despite the rhetoric to the opposite that has dominated popular discourse. This might suggest tax competition is having little impact, especially when it is also widely recognised that the countries with the highest level of well-being in the world are the Nordic states, where levels of taxation are high. Few would also argue that the many African states that often have the lowest rates of overall taxation demonstrate high levels of well-being. In addition, the argument that flows of hot money through tax havens have produced economic well-being has already been dealt with, above.

However, each of these arguments ignores two more fundamental issues. The first is that tax rates, levels of spending and the allocation of reward within a society should be determined by the people of each state in free and democratic elections. If the people of a state wish to have a high rate of tax, and resulting high levels of public service, or even of income redistribution, then that is their choice. No one, most especially a small group of financiers who have taken effective possession and control of the legislature of a small jurisdiction, should be allowed to try to undermine that democratic process being undertaken elsewhere. Those who demand that these financiers have such power through such locations are in effect saying that the democratic process is one to which they do not subscribe.

Second, whilst overall levels of spending may have risen in many states, as shown by the OECD, the relative burdens of tax have shifted from capital to labour as under tax haven pressure corporation tax rates have fallen steadily and the proportion of tax raised from labour through such charges as VAT has risen steadily. This process is the consequence of tax competition and shifts the burden of tax from the best off in society to those least able to pay, contributing to the increase in the gap between the best off and poorest in society and to the unjust distribution of tax within society, where the wealthiest in the UK appear to have a lower overall tax burden than almost everyone else in society.

Any suggestion that tax competition can be ignored is, therefore, wrong. Governments have maintained spending in the face of it, but at cost to those least able to afford it. In that sense those promoting tax competition through tax havens are probably quite satisfied with their efforts. Those seeking justice in the tax system have every reason to maintain their opposition to it.

The message is simple: tax havens are being used to undermine democracy. They are a threat to a fundamental part of our way of life.

58 http://www.ft.com/cms/s/0/2ed5ef86-17e3-11de-8c9d-0000779fd2ac.html accessed 17-4-09

59 http://www.publications.parliament.uk/pa/cm200809/cmhansrd/cm090212/text/90212w0006.htm#09021316000432 accessed 21-1-11

60 http://www.taxresearch.org.uk/Blog/2009/02/01/tax-havens-cost-the-uk-185-billion-a-year/ accessed 21-1-11

61 http://www.timesonline.co.uk/tol/news/uk/article5908523.ece?token=null&offset=0&page=1 accessed 17-4-09

62 http://www.timesonline.co.uk/tol/news/uk/article6122329.ece accessed 7-5-09

63 Foir ore information on this issue see http://www.tuc.org.uk/extras/taxresidence.pdf accessed 31-1-11

64 http://www.tuc.org.uk/extras/corporatetaxgap.pdf accessed 21-1-11

65 Source: Can Labour be called the 'party of fairness?' David Byrne and Sally Ruane, Compass 2008.

66 http://www.gfip.org/storage/gfip/executive%20-%20final%20version%201-5-09.pdf accessed 17-4-09

67 http://www.gfip.org/storage/gfip/executive%20-%20final%20version%201-5-09.pdf accessed 17-4-09

68 http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore.pdf accessed 17-4-09

69 http://www.ft.com/cms/s/0/82b35220-1585-11de-b9a9-0000779fd2ac.html accessed 17-4-09

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71 http://www.fsa.gov.uk/pubs/other/turner_review.pdf accessed 21-1-11

72 http://www.financialsecrecyindex.com/2009results.html accessed 21-1-11

73 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=878438 accessed 21-1-11

74 http://www.oecd.org/document/4/0,3343,en_2649_34533_41407428_1_1_1_1,00.html accessed 20-4-09

9 What can be done about tax havens?

Awareness of the existence of a problem does not guarantee that solutions to tackle it are available. In the case of tax havens / secrecy jurisdictions this is not true; picking the best solutions from the range available may be a bigger problem. There are five broad approaches to tackling the issue:

1. The direct approach – tackling the havens head on;
2. The domestic approach – tackling the domestic consequences of the havens;
3. The UK dependencies approach – what the UK does about the locations for which it has particular responsibility;
4. The EU approach – how the most effective opponent of tax havens takes its initiatives forward;
5. The 'work round' approach – regulatory and other approaches that would have substantial impact on tax havens but do so tangentially.

The options for each approach need to be considered separately before the consequences of any action are then taken into account.

It is not being argued here that every approach and every one of the actions described below needs to be taken in order to resolve the tax haven problem. Rather these are presented as a series of options from which governments and multilateral organisations can choose the most appropriate combination. The important thing is that the choice made is truly effective in ending the damage done by havens.

The direct approach

As has been noted in this report, there are limitations in the G20 outcome. Given that is the case, there are, however, many courses of action open to the UK at this point of time to push forward the agenda on tax havens/ secrecy jurisdictions. Options available include:

Pushing for as many TIEAs as possible

The G20 has suggested that signing twelve TIEAs will be sufficient for a jurisdiction to be considered compliant with international disclosure standards. There is, however, no reason why the UK should be satisfied with having such agreements with the likely limited range of jurisdictions that this implies might offer such agreements to it. The UK should be demanding an information sharing agreement with every jurisdiction on the current OECD grey list, and should encourage every other country to do the same. If all countries demand these agreements then the international standard would become meaningless: much higher levels of cooperation would be required to ensure compliance with international standards. As such this programme should be aggressively pursued. The result would be:

1. That the UK would have a significant increase in the number of information sharing agreements it has available to it;
2. Tax havens would have to sign many more such agreements than are currently anticipated;
3. Pressure for improved standards of information sharing would increase as experience of TIEAs was obtained, and their weaknesses become apparent;
4. Pressure on tax havens to collect information for exchange would increase.

Push the OECD into creating better international standards

It is very obvious that the Tax Information Exchange Agreement approach promoted by the OECD has considerable problems inherent within it when used with tax haven administrations that promote secrecy to ensure that the 'smoking gun' which must exist to validate any enquiry made of them is extremely hard to find.

This was recognised by Gordon Brown who did in his letter to the OECD dated 30 March 2009 request that an alternative mechanism be created for use by developing countries so that they too might share in the benefits of information exchange. At present it is very unlikely that any of their tax administrations will have the resources required to mount an effective request for information exchange under a TIEA.

The first point for progress by the OECD must, therefore, be in creating this alternative model for developing countries. As yet it seems almost no progress has been made on this issue despite it being promised in 2009: action is now long overdue.

There is, however, no doubt that ultimately tax information exchange requests on demand will not deliver the tax haven reform that the world is demanding, particularly if the current veil of secrecy about the ownership and control of tax haven companies and trusts is maintained.

Two things can change this, and the OECD can assist with both. First, there needs to be a change from the currently favoured bilateral information exchange agreements to multilateral information exchange agreements. If a tax haven structure is, quite feasibly, created by a person living in the UK using a trust written under Jersey law owning a company in the Cayman Islands with directors in the British Virgin Islands operating a bank account in Bermuda, then it is very unlikely that a bilateral information request will yield the answers that the U.K.'s HM Revenue & Customs might require to correctly assess tax upon the creator of the whole arrangement. The opportunities for failure under the existing bilateral information exchange structure are simply too significant for it to even be worthwhile investing the effort required to make the requests for data. A multilateral information exchange structure where a request can be made simultaneously to several jurisdictions, each of which is required to cooperate in the provision of information, would overcome this obstacle to progress. It is essential that the OECD create and promote such agreements or these multijurisdictional tax haven structures will become significantly more common, and that much harder to attack.

Secondly, the OECD needs to embrace automatic information exchange. This occurs when a jurisdiction requires that banks and other financial services institutions operating within its domain report to it information on all income paid by them to persons resident in other jurisdictions with which it has automatic information exchange agreements. This is already happening under the terms of the European Union Savings Tax Directive, about which more is written below, but its model needs to be developed more widely, applied outside its geographical domain, and to be extended from interest, which is its sole current focus of attention, to other forms of financial income including dividends, pensions, life assurance payments, capital gains, trusts distributions and financial derivatives of all sorts.

In addition, if as the EU now proposes, the OECD were to suggest that information exchanges take place not just on the name of the recipient legal entity of the income streams referred to above, but also on the basis of the material beneficial owners of the entities in question, then the veil of secrecy created by tax havens would be shattered forever. This is entirely possible. Those banks and other institutions that pay income to offshore trusts and companies must know who their beneficial owners are under international anti-money laundering regulations. There would, as a result, be no additional administrative burden in disclosing information on this basis. All that is needed is the political will to do so.

The domestic approach

It is possible that the most effective mechanisms for tackling the tax haven problem will be created domestically. A number of options are available.

Demand reform of the U.K.'s domicile rule

The UK is a tax haven. For those who are not domiciled[75] in this country the UK provides an almost perfect base from which to use tax havens to minimise tax paid on their worldwide income. This is why the UK is so popular with international billionaires.

If the domicile law was abolished for taxation purposes then the UK could not be used as a tax haven by these people. This would increase the UK's moral authority when tackling other tax havens, many of whom are keen to point out this aspect of the U.K.'s tax affairs when criticised by authorities in London. Whilst action on this issue was taken by the last Labour Government, all it meant was that those non-domiciled who were in the country for more than seven years had to pay £30,000 a year to retain the privilege of using this rule. That did not abolish the domicile rule: it just meant the difference in the tax systems available to those of considerable wealth and those in the rest of the community widened still further, and that was the wrong direction of travel on this issue. It is abolition of the domicile that will resolve this matter whilst, in all likelihood raising significant additional tax revenue each year.

Demand reform of the UK corporate law

UK corporate law is not of the required standard if the UK is to beat both domestic tax abuse, use of the UK's corporate tax haven and secrecy jurisdiction, and if that law is to be used as a benchmark for international standards to be achieved by other jurisdictions.

There are a number of significant weaknesses which are highlighted here, but the range of issues to be addressed is broader than those noted:

- The names and addresses of all beneficial owners of UK companies should be declared on public record and in UK corporation tax returns (which might then be combined with corporate annual returns for tax, which would have the advantage of saving administrative burdens);

- Any person acting as a nominee director should declare that fact and on whose behalf they act;

- Full accounts should be on public record for all companies. The current abbreviated accounts filed by small companies offer no saving in accounting burden to small companies but do prevent meaningful information being available on public record to protect those trading with these companies from risk;

- At present more than 300,000 companies a year are struck from the Register of Companies without a liquidation taking place. Many of these will have overdue accounts; a significant number will have never filed accounts. There is the opportunity for substantial abuse in this process. An automatic penalty as a proxy for tax owing should be levied on the directors and shareholders of companies struck off without having filed up to date accounts as a disincentive to abuse UK corporate entities.

- At present there is no register of trusts in the UK and as such this area is subject to substantial risk of abuse. There should be a Registrar of Trusts for the UK. Details equivalent to those for companies should be recorded on public record to prevent the risk of abuse.

Increase the resources available to HMRC

HM Revenue & Customs is subject to a substantial office closure and redundancy programme, over the course of which more than 40,000 jobs will eventually be lost. Many of those who will leave the service will be trained tax officials of long experience whose expertise is needed to tackle the extensive tax avoidance and evasion within the UK economy. Evidence suggests, very strongly, that each tax official employed collects a very significant multiple of their cost of employment. It is essential that these trained and expert employees with local knowledge of the economy be retained at this time to ensure that the attack on tax avoidance is effectively managed.

General anti-avoidance principle

The logic of UK taxation, and that of many other places, has always been that tax is charged through the application of specific rules, and avoided by getting round those rules. Anti-avoidance legislation has traditionally worked by adding layer upon layer of rules designed to plug loopholes, but with the resulting risk that opportunity for new abuse is created at the same time.

A new approach to this has been proposed over the last decade. This suggests that a general anti-avoidance principle be written into taxation law. This promotes the idea of tax compliance where this means that a person or company seeks to pay the right amount of tax (but no more) in the right place at the right time, where 'right' means that the economic substance of the transactions undertaken coincides with the form in which they are reported for tax purposes. Broadly speaking as a consequence the approach states that if a step is placed into a transaction for the sole or main benefit of securing a tax benefit then that step is ignored in calculating the taxation due.

Many in the UK thought such a rule existed in the UK for a period of more than fifteen years as a result of House of Lords decisions in the early 1980s, which were reversed in the late 1990s.

The UK Government is now using an increasing number of 'principles based' anti-avoidance measures in new legislation to tackle complex abuse where as a consequence HM Revenue & Customs are allowed to argue that the form of a transaction does not comply with the spirit of the law and as such the approach noted above, where elements of the transaction are ignored for tax purposes, can be used. This is welcome but to really effectively tackle tax avoidance (in particular) a general anti-avoidance principle is needed in UK law, potentially applicable to any taxable transaction so that abuse can be curtailed.

A general anti-avoidance principle might read as follows:

1. If when determining the liability of a person to taxation, duty or similar charge due under statute in the United Kingdom it shall be established that a step or steps have been included in a transaction giving rise to that liability or to any claim for an allowance, deduction or relief, with such steps having been included for the sole or significant purpose of securing a reduction in that liability to taxation, duty or similar charge with no other material economic purpose for the inclusion of such a step being capable of demonstration by the taxpayer then subject to the sole exception that the step or steps in question are specifically permitted under the term of any legislation promoted for the specific purpose of permitting such use, such step or steps shall be ignored when calculating the resulting liability to taxation, duty or similar charge.
2. In the interpretation of this provision a construction that would promote the purpose or object underlying the provision shall be preferred to a construction that would not promote that purpose or object.

The government announced the creation of a committee[76] to consider the possible introduction of such a provision into UK law in 2010. This committee is expected to report in 2011. In the meantime political momentum for this change must be maintained.

Demand that companies file tax returns with country-by-country data included

As is noted below, there is an urgent need for country-by-country reporting by multi-national corporations to tackle some of the forms of transfer pricing abuse that are so prevalent and which are having such significant impact on both domestic tax revenues and on developing countries in particular.

To require this in statutory filed accounts would require action by the International Accounting Standards Board whose job it is to now set the accounting rules for most of the world's major economies.[77] However, the UK (and other major economies) could lead the way in creating this data if corporate tax returns for UK corporations were required to be supported not just by the accounts of the individual company for which the return was being submitted, but by consolidated accounts prepared on a country-by-country basis as well.

Given the international concern on tax avoidance, evidenced for example at the G20 London summit in April 2009 and at subsequent G20 meetings and from the OECD, European Union and International Accounting Standards Board, this approach appears a plausible way to deliver the first benefits of country-by-country reporting and to pave the way for its universal use.

The approach to the UK's tax havens

The UK's approach to its tax havens has been decidedly mixed since the London G20 meeting.

A number of stages can be noted. After the immediate reaction to the G20, where the messages delivered were robust and strong, as noted previously there then followed a review, undertaken at the behest of the Treasury chaired by Michael Foot. This review was announced in the pre-Budget report in November 2008, and was meant to "look at the immediate and long-term challenges facing British offshore financial centres in the current economic climate, including:

- financial supervision and transparency;
- taxation, in relation to financial stability, sustainability and future competitiveness;
- financial crisis management and resolution arrangements;
- international cooperation."

It was hampered from the outset by the choice of Foot, the Chairman of the UK Office of the Promontory Financial Group to undertake the work. As the Promontory Financial Group notes:[79]

A veteran of nearly four decades in financial services, Mr Foot joined Promontory from the Central Bank of The Bahamas, where he was Inspector of Banks & Trust Companies. From 1998 to 2004, Mr Foot was a Managing Director of the Financial Services Authority, the UK's centralized regulator of banks and investment companies (FSA). Prior to his services at the FSA, Mr Foot served at the Bank of England for 29 years, in a number of posts of increasing responsibility, including head of the European and Foreign Exchange Divisions.

Promontory says of itself:[80]

'Promontory is the consultant of choice for financial service companies, large and small. '

At a stroke all the previous experience Michael Foot had was clearly irrelevant: having made his position clear whilst working in Bermuda he also had an obvious conflict of interest in being Chair of a firm of advisers to companies located in the very territories his review was meant to critically appraise. The bias inherent in the review was apparent from the moment that it became clear that a large part of his budget and a significant part of his final review[81] was dedicated to seeking to discredit the work of the TUC on the issue of the Tax Gap, published in 'The Missing Billions'.[82] That work was undertaken on behalf of the review by international accountants Deloitte, a firm themselves represented in many of the world's major tax havens / secrecy jurisdictions, and therefore also clearly conflicted out of involvement – if objective standards of assessment for selection had been used.

Perhaps unsurprisingly, little use has ever been made of the resulting report, but its findings, subject to all the caveats on its objectivity already noted, should however be noted.

It[83] has suggested that "The Review has ...concluded that the UK should take the lead internationally in encouraging improvements to ... the transparency of beneficial ownership of companies and trusts." This was welcome. There is a real problem with this issue in the UK, but as the Foot Report noted, any such reform should extend to those tax havens for which the UK has responsibility.

PCS supports this improvement in transparency, wherever the recommendation may come from. Realistically PCS believes that the UK could demand that:

- Corporate transparency in the tax havens matches that in the UK, as amended as noted above in due course. This would have the following impact:
  - It would reduce the risk of corruption being routed through these places;
  - It would assist identification of the beneficial owners of corporate entities in these places;
  - It would reduce risk at all levels within marketplaces, and especially the financial markets, by placing on public record the accounts of banks and all other entities trading in these places. This would have the immediate impact of improving transparency and so reduce the risk of bad debt as well as reducing the cost of capital and enhancing the likelihood of markets allocating resources efficiently for best overall benefit for society;
  - It would assist the recovery of tax on income hidden in such entities at present.

- Demand trust transparency in the tax havens. At a minimum, and until a public register of trusts is created in the UK, there should be a requirement that all the Overseas Territories and Crown Dependencies require that all trusts operated from their territories, about which they know nothing in most cases at present since they are not taxable, should be recorded in a central government-held registry that has on file:
  - The name of the settlor;
  - The trust deed and all associated documents such as letters of wishes;
  - The names of the beneficiaries or those who actually have benefitted.

  This would mean that:
  - This sector was likely to be better regulated;
  - The prospect of effective information exchange would be greatly enhanced;
  - Abuse would be reduced by reason of even this level of disclosure.

  The measure is easily enforceable: if no claim on or by such a trust would be valid if the trust was not registered and if its property would be that of the Crown if unregistered then all settlors and beneficiaries would demand that their trusts be registered.

- Demand that the EU Savings Tax Directive withholding option be withdrawn in these places (see more, below). The Cayman Islands has always, it should be noted, cooperated in this way, and the Isle of Man and Guernsey will from July 2011 – but Jersey still holds out – so assisting those who wish to tax evade. If all UK tax havens fully information-exchanged under the European Union Savings Tax Directive and if, as is noted is planned for the future (below), this exchange was extended to the trusts and companies located within them owned or controlled by EU resident people, then the whole Tax Information Exchange Agreement process would also become meaningful and useful by providing the 'smoking gun' data on which a tax enquiry might be made. The failure of places like Jersey to cooperate in this process is a powerful indication of their lack of willing to eradicate tax evaders from the ranks of those using their facilities. As such this is a key demand if they are to indicate real change in their behaviour.

Further developments from the UK that can form the basis for progress are noted later, below.

The EU approach

The European Union Savings Tax Directive (EU STD)[84] has just one purpose, which is the eradication of tax evasion. As the European Commission says of it:

'The ultimate aim of this Directive is to enable savings income in the form of interest payments made in one Member State to beneficial owners who are individuals resident in another Member State to be made subject to effective taxation in accordance with the laws of the latter Member State.'

After many years of negotiation the EU Savings Tax Directive was brought into force on 1 July 2005. To date it only applies to accounts maintained in the names of individuals and it only applies to accounts held by persons resident in the EU member states. In those states where the Directive is in full operation information on interest paid to a bank account maintained by an EU resident person living in another state is sent by the tax authorities of the state where the payment is made, to the tax authorities of the place where the recipient is resident. This arrangement matches that in many places, including the United Kingdom, where banks are required to disclose information on all interest they pay to the local tax authorities to ensure that income is correctly declared.

Three member states of the EU (Austria, Belgium and Luxembourg – although Belgium is now joining the main arrangement leaving just Austria and Luxembourg in the recalcitrant camp) negotiated an alternative arrangement for use with the EU Savings Tax Directive. This was then copied by many of the other locations that agreed to comply with its terms, including Switzerland and Liechtenstein as well as all the British secrecy jurisdictions covered, excluding the Cayman Islands. Under this alternative arrangement a person from another state who has a bank account in these places is given a choice; they may either agree that the information on income paid to them is sent to their domestic tax authority, in which case no tax is deducted from that payment at source, or they can decline to have that information sent to their domestic tax authorities, in which case tax is deducted at source from the payment made to them. Initially tax was deducted at the rate of 15%, but the rate of 20% is now used and from 1 July 2011 the rate will be 35 per cent. The Isle of Man and Guernsey have announced that they will withdraw the withholding tax option from that date. It appeared Jersey did likewise in the summer of 2009 but then they clarified their position saying they would only do so if all other states operating the withholding tax option did likewise. Since this is unlikely Jersey appears to be opting for non-cooperation on this issue for some time to come.

Although the European Union Savings Tax Directive appears penal it is in practice easy to avoid its provisions, and many banks go out of their way to assist their customers to do so. In particular, by simply transferring a bank account into the ownership of either an offshore company or trust, all disclosure and withholding tax requirements are completely avoided at present. When the BBC Panorama programme investigated bailed out UK banks in September 2009 it discovered that Northern Rock in Guernsey was quite happy to recommend such an arrangement to a customer who explicitly asked how to avoid the withholding tax arrangements, but would only do so for a 'shell' corporation – that is a purely nominee arrangement set up purely for tax avoidance purposes – and not for a genuine trading company. Lloyds Bank in Jersey when interviewed for the same programme were happy to disclose that they had set up special arrangements so that their Channel Islands funds were paid via Hong Kong to get round this withholding tax arrangement.

This avoidance has been widely acknowledged to be taking place. As a result in November 2008 the European Commission suggested reform of the EU STD,[85] a move now supported by the European Parliament. The main proposed changes are to extend the range of income covered by the EU STD and to change the way in which arrangements in states operating the STD but who are not themselves EU members work. Both are significant, but the latter more so in the context of this report.

In effect the requirement under the revised STD will be that anyone paying interest or other qualifying income to an individual, trust or company in any of the relevant states (the UK Crown Dependencies, Overseas territories, Switzerland, etc.) has to ensure they can identify the true beneficial recipient of the money. That is not the trust or the company itself to which the money might be paid, but the real owners of that company or the settlor or beneficiaries of the trust as identified for anti-money laundering purposes by the banks and other people making the payment in question. Those people will then have to make the decision as to whether to have tax withheld or information exchanged, and if exchange takes place it will be in their names, not that of the company or trust. It is, in addition, envisaged that the withholding option will come to an end at some time in the future, as was always intended to be the case when the whole Directive was first implemented.

This is of enormous significance. What the European Commission is effectively proposing is an arrangement where offshore tax planning is ignored for tax purposes and that entire offshore tax planning structures are 'looked through' for tax purposes. The result is that the European Commission suggest it is assumed that these offshore structures are, in effect, artificial steps put in place for tax avoidance purposes which have no significance for tax liability calculation, as if a general anti-avoidance principle of the type noted above were in universal operation throughout the EU STD territory.

If this revised STD is approved there are likely to be major consequences in the UK's tax havens. First, the scale of their business will decline dramatically because much of it will become significantly more transparent and open to scrutiny than it is now. Second, tax recovery is likely to rise significantly in the UK and elsewhere. Third, pressure on the offshore finance industry to meet international regulatory obligations will increase significantly because there will be nowhere left for them to hide in the jurisdictions covered by the revised European Union Savings Tax Directive. Finally, if coupled with the end of tax withholding, the offshore sector in the UK's secrecy jurisdictions would be likely to come to a virtual end. Unsurprisingly there is talk of independence in Jersey as a result; those responsible no doubt seeing the writing on the wall for the finance industry if they remain associated with the UK and so with the European Union Savings Tax Directive, with which, despite their protestations they have no choice but comply.

In the light of this it is in our opinion the duty of the UK to now:

- Promote the revised EU STD;
- Require that the UK tax havens /secrecy jurisdictions fully cooperate and endorse this proposal;
- Promote taxation of 'offshore structures' on the 'look-through' basis the EU STD now proposes;
- Promote automatic multilateral information exchange of the type it incorporates, and has proven to work, more widely, and for use with developing countries in particular;
- Argue for geographical extension of the scope of the EU STD;

- Show that it is only in combination with these measures that the Tax Information Exchange Agreements promoted by the OECD can be effective tools for tackling international tax evasion.

The 'work round'

The above-noted measures all involve direct legislative or regulatory action. All are important but that is not the only approach that can be adopted to tackling the abuse that tax havens / secrecy jurisdictions facilitate. Going back to the consideration of definitions found at the start of this report it must be remembered it can be argued that a secrecy jurisdictions is comprised of two components. The first is the place – that is the tax haven. The second is the Offshore Finance Centre (OFC) made up of bankers, lawyers and accountants who populate that tax haven to sell the services that it facilitates. The measures so far described have been aimed at the tax haven. It is as important to tackle the OFC community of bankers, lawyers and accountants who actually make the abuse of these places possible.

There are a number of very effective ways in which this community could be tackled. These can be summarised as follows:

1. Demand country-by-country reporting by multinational corporations;
2. Demand that credit card companies be held to account for their offshore activities;
3. Put pressure on the tax profession – what is their attitude to tax havens?
4. Promote Codes of Conduct for taxation management;
5. Promote unitary taxation;
6. Promote measures by which offshore banks and other major financial services might be regulated from onshore.

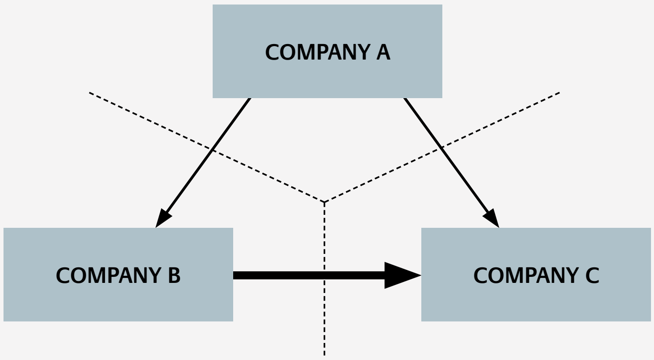
Each of these needs exploration in more detail.

Country-by-Country (CbyC) reporting

It is easy to forget that the biggest identified problem in tax haven abuse is not tax evasion by individuals but is transfer mispricing by major corporations. Christian Aid believes that this costs developing countries at least $160 billion a year.[86] At a more specific level, DSG plc (Dixons, as it is better known) lost a transfer pricing case with HM Revenue & Customs in April 2009 as a result of which it has been suggested it might pay 'hundreds of millions of pounds', which gives some indication of the scale of the issues involved.[87] The shifting of profits to tax havens has also been the subject of other, more recently resolved tax disputes of which the most notable is the settlement of a claim made by H M Revenue & Customs against Vodafone plc. Whilst there has been much debate as to the appropriateness of this settlement it is important to note that in excess of £1.2 billion of tax from an offshore location – Luxembourg – was retrieved as a result.[88]

It is therefore important to note that transfer pricing and other relocations of profit to tax havens / secrecy jurisdictions take place can do so whenever two legal entities are under common control and trade with each other. This might mean that one is controlled by the other because one owns the other, or it might mean that both are owned by another party who could be an individual, a trust, or another company.

For ease, see the following diagram:



Company A owns Company B and Company C (the narrow arrows). Each is in a separate country, indicated by the dashed line (although it is stressed, transfer pricing also applies within a country, it just tends not to be a matter of concern when that is the case).

Company B and Company C trade with each other (the broad arrow) and even though neither owns the other they do transfer price when doing so because they are both owned by Company A.

It is said that Company B and Company C transfer price because they could in theory sell goods and services between them at any price they choose because it would have no impact upon the reported results of the group of companies owned by the shareholders of Company A if the price they used were not the same as the market price. In saying this it is important to note that a group of companies only makes a profit under consolidated accounting rules when it actually deals with an independent third party customer.

Setting prices in this way might be absolutely fine for the shareholders but of course it is not for the taxation authorities of the countries in which Company B and Company C are located. If Company B is in a country with a low tax rate but Company C is in a country with a high tax rate, then there is a very strong incentive for Company B to overprice the goods or services that it supplies Company C. This would have the result of over-stating the profit in Company B but of understating the profit in Company C. The result would, of course, be that Company B overpaid tax (albeit at a low rate) compared to that due if a market price had been used whereas Company C would under-declare its profits and pay less tax as a result. This is, in outline, what the UK HM Revenue & Customs suggested DSG did by having its Irish subsidiary (tax rate 12.5%) overcharge for warranty insurance to the UK (tax rate 30% in the period in question).

As a consequence there is a rule countries can adopt, promoted by the Organisation for Economic Cooperation and Development (OECD), that market prices should be used on all intra-group trades undertaken on an international basis. However, this is an incredibly difficult rule to enforce for a great many reasons – not least due to the difficulty of proving what market prices might be – and only information on the trading of the group as a whole can indicate whether it is in operation or not. When it is not, transfer mispricing is said to be taking place.

The difficulty of identifying when transfer mispricing might be taking place is compounded by the nature of the accounts produced by major corporations. The single set of bound glossy accounts sent to shareholders actually represents just one possible view of the transactions undertaken by a group of companies. That view includes all the third party transactions of the group of companies to whom the accounts relate i.e. their trading with people who are unrelated to it. It is argued that this shows what the shareholders in the top company of a group want – which is how ‘their’ directors have managed ‘their’ money for them. But that one and only view of the group as a whole also eliminates from view some incredibly important information, including details of all intra-group trading i.e. that which takes place between the companies under common control. It is, of course, in these transactions, that are hidden from view in these accounts, that transfer mispricing takes place.

The OECD estimates that 60% (and maybe more) of world trade is undertaken on an intra-group basis.[89] The result of the chosen basis of accounting for the world’s largest multinational corporations is that none of this trade – which forms the majority of all world trade – ever appears in the published accounts of these companies. In fact, most is never seen in any accounts on public record anywhere because many of the companies through which trading takes place will be in tax havens and they do not require that the accounts notionally trading from those locations place accounts on public record.

For example, in research undertaken by the Tax Justice Network in 2009 it was noted[90] that of the 33 UK FTSE 100 companies who complied with the legal requirement to put on public record data on all their subsidiary companies, it was noted that they had, between 2,612 in the locations that the Tax Justice Network recognised as tax havens / secrecy jurisdictions at an average of 79 each – a ratio much higher than equivalent data for public companies in the Netherlands, France and the USA. Nothing is really known about the use of these companies. Of course that use may be entirely legitimate, and no transfer mispricing need ever arise. The question is however, how do we and how could we know when it is, of course, also entirely possible for a company to exploit this lack of transparency for its own ends.

To tackle this issue a number of NGO groupings, including Publish What You Pay, Global Witness, the Tax Justice Network, Christian Aid, ActionAid and Oxfam have backed the creation of a new approach to the preparation of group accounts created by Richard Murphy, the principle author of this report. This is called 'country-by-country reporting' (CbyC). These groups, and PCS, argue that if the International Accounting Standards Board (IASB) that is responsible for setting accounting standards used by most major countries and most major corporations around the world were to fulfil its mandate to promote accounting standards that meet the needs of 'participants in the world's capital markets and other users', then they would have to ensure that a multinational company provide users of its accounts with country-by-country information disclosing, as a minimum, details of:

1. The names of each jurisdiction in which it operates;
2. The name of each of its subsidiaries that operates in each and every jurisdiction in which it operates;
3. What its consolidated profit and loss account is in every jurisdiction in which it operates, identifying both third party and intra-group trade and profit both before and after tax as well as labour costs and head count;
4. How much tax it actually pays as a consequence.

This does not mean that the value of consolidated financial accounts is in question. Users need that data to form one objective view of the trading of the group in which they have invested, or might invest. However existing accounts prepared on this consolidated basis do not:

1. Disclose the extent of intra-group trading within the reporting entity;
2. Allocate the trading of the entity to specific geographic jurisdictions, and as such prevent risk assessment at this level (which might often be significant) being undertaken;
3. Show the sustainability of the profit allocations to enterprises and jurisdictions within the group, or the sustainability of the tax charge declared in a set of accounts because the location in which the payment is made is usually unknown;
4. Show vital information required by those trading locally with the entity. This means that suppliers, employees and customers located in a particular country do not have the information they need about trading with local group members, much of which is also not available to them locally because few countries require this information to be readily available on freely accessible public record to such persons although the International Accounting Standards Board has clearly recognised its obligations to these groups;
5. Provide tax authorities with the information they need to assess overall tax risk within the organisation.

This last data would become apparent because if, for example, a group reported that it had high profits in a tax haven location, almost all of which arose as a result of intra-group trading, but it had a small number of employees there and almost no tangible assets (perhaps because it was a 'brass plaque' company with no real physical presence). In that case it would be obvious that tax avoidance was taking place. This disclosure requirement would, by itself, be enough to stop much of this abuse arising, and that is likely to be one of its major benefits.

For these reasons this report suggests that another view of the trading of a multinational group of companies is required and for the reasons noted suggests that this would be best achieved if the data in consolidated financial statements were reconciled to reporting published on a country-by-country basis.[91]

Demand that credit card companies be held to account for their offshore activities

Most people are familiar with debit and credit cards and most people in the UK have one or more of them. There is no doubt that they have transformed the way in which payments are made.

They are also used in another way. As a US government[92] report has noted:

Bank regulators and credit card industry representatives we interviewed acknowledged that credit card accounts might be used in the layering or integration stages of money laundering. For example, by using illicit funds already placed in a bank account to pay a credit card bill for goods

purchased, a money launderer has integrated his (sic) illicit funds into the financial system. Most law enforcement officials we met with were unable to cite any specific cases of credit card–facilitated money laundering in US–based financial institutions. ...However, evidence from a congressional investigation showed that credit card accounts accessed through banks in certain offshore financial secrecy jurisdictions could be vulnerable to money laundering.

It is this last point that is key: it has been widely known within the tax profession for many years that credit cards provide one of the easiest ways to remit funds into a state without this remittance being identified. This happens when a credit card or debit card issued on an offshore bank account that is being used to hold tax-evaded funds is used to make payment for goods and services purchased by the beneficial owner of that account in the UK. The card can, of course, be automatically settled by direct debit or other charge from the offshore account without any transaction apparently appearing to be made from the UK.

A number of developments in credit card usage in recent years have made this process much easier. Chip and pin is one, because signatures are now rarely required to make a payment, so avoiding the need for physical identification of a card user. Second is the use of the Internet: distance selling facilitates this form of usage. Thirdly, pre-paid cards are now commonplace. These can be, and often are, anonymous. Such cards are readily available, albeit in modest amounts in the UK.[93] Each of these developments increases the degree of anonymity available to the users of offshore cards and so makes tax evasion and the resulting money laundering that arises from it easier to undertake.

This should be an issue of concern to all credit card issuers, whether it be the card franchisees such as Visa and MasterCard, or the card issuers such as banks, but because these networks have their foundations in banking their dedication to secrecy and client confidentiality appears to be paramount and as such it has proved very difficult for tax authorities such as HM Revenue & Customs to secure data on the beneficial ownership of cards to prevent abuse occurring.

There are, however, many occasions when a card can be linked to a particular individual. Firstly, this happens when an individual has to positively identify themselves to undertake a transaction. This happens, for example, when a flight is booked. Then a person has to provide a positive identity that will be used when the person booked presents themselves at an airport with their passport. Second, this happens when a hotel is booked; most hotels now require routine identification by way of a passport. Third, this happens when a credit card is used to make payment for a product or service to be supplied to a particular address within the UK.

In each of these cases it is likely that the credit card payment will be processed through a major UK credit card supplier via the merchant's own contract with that bank. It would be onerous to require that all credit card payment details be automatically supplied to tax authorities – and of remarkably little benefit – but it would seem to make complete sense that details of the following transaction types should be automatically supplied to the UK tax authorities:

1. Payment made using a credit / debit card issued on an offshore bank (from a list of locations to be determined) for an airline ticket for a person with a British passport;
2. Payment made using a credit / debit card issued on an offshore bank for a hotel room for a person with a British passport;
3. Payment made using a credit / debit card issued on an offshore bank for the supply of goods or services to a British address.

If card terminals were programmed to ensure that the necessary details were required at the time that a credit / debit card from such a bank was processed to ensure that the requisite data was supplied to the authorities as part of the transaction processing arrangement, then the degree of additional work would be limited.

The incentive to use credit cards for this purpose would then be massively reduced – so removing one of the key ways in which funds are laundered. Those that remain in use could be more easily captured as the basis for an investigation. Investigations of this sort are underway in some countries, such as the Nordic States. Importantly, this clearly proves such processes are technically feasible. The same is also indicated to be true in the USA where in April 2009 the Internal Revenue Service issued a subpoena against a credit card payment processing company with the intention of compelling the company in question:[94]

To identify American clients who, through credit cards, debit cards and other financial processing arrangements, "may have diverted unreported income offshore or received unreported income from undisclosed offshore sources or have taken improper deductions or credits or have failed to withhold tax on certain payments made offshore," all going back to 2002.

It is time the UK did likewise. Innovations of this sort make the use of tax haven accounts much harder.

Put pressure on the tax profession – what is their attitude to tax havens?

The offshore finance industry is not a myth. Nor is it an object. It is a service industry staffed by real people. Those who lead that industry are, in the main, lawyers, accountants and bankers.

Each of these professions is governed by Codes of Ethics. Indeed, it is the existence of standards that are proven to exist that sets professions apart.

The evidence within this report is clear: tax havens do impose a very real cost on society. We believe as a result that their existence, and the presence of members of these professions within them, and servicing them, is a challenge to those professional bodies that have been established for public benefit with legal privileges being granted to them, and which despite that appear to be acting in the best interests of a very small proportion of the public as a whole, and against the best interests of the governments that gave them their Charters. It would seem that the time has come to challenge these public bodies about where they stand on the issue of tax havens / secrecy jurisdictions and the use of those places by members of their profession as service providers, as advisers and as clients.

This challenge might be related to the issue of Codes of Conduct, which is the subject of the next section of this report. These however relate to the activities of individual tax payers and advisers: the challenge to the professional bodies is to establish guidelines on what they think is the acceptable use of tax havens / secrecy jurisdictions and to then create enforceable guidelines to be applied to their membership in pursuit of their Ethical Codes.

As yet there is no indication that any professional body governing the activity of finance professionals anywhere in the world has issued such guidelines. At a time when the issue of tax havens /secrecy jurisdictions is so significant this seems to be a matter where change is needed, and PCS strongly recommends that the UK legal, accountancy and banking professional bodies address this issue as one of urgency that has potential significant impact upon their standing and that of their members.

A Code of Conduct for Taxation

There has been much discussion about the need for a Code of Conduct for taxation in the UK.[95] A great deal of that discussion entirely misses the point that is of relevance here and relates solely to the service obligations that HM Revenue & Customs has to members of the public. Of course it is important that HM Revenue & Customs fulfil its obligations in a proper fashion. No one denies that, but to produce Codes of Conduct that look like the 'Charter Mark' proposed in the dying days of John Major's Conservative Government[96] is nothing more than a public relations exercise, as that process was widely recognised to be. What is needed is a Code that has bite within and beyond the UK that applies to the Government, tax payers and tax agents and advisers (whether accountants, lawyers or bankers) alike, with penalties on those who do not abide.

Such a Code has been proposed by the Association for Accountancy and Business Affairs in the UK. Their suggestion says:[97]

A Code of Conduct for Taxation

Objective

This Code of Conduct relates to the payment of taxes due to a State or other appropriate authority designated by it.

Scope

This Code applies to:

1. Governments and their agencies in their role as tax legislators, assessors and collectors;
2. Taxpayers, whether individuals, corporate bodies or otherwise;
3. Tax agents, whether they are undertaking tax planning or assisting with tax compliance.

Application

It is intended that this Code be voluntarily adopted by States and should be used to guide the conduct of taxpayers and their agents who choose to comply with it whether or not they reside in a State which has adopted the Code.

The Code

The Code is divided under six sections, each of which includes three statements of principle.

1. Government

a. The intention of legislation is clear and a General Anti-Avoidance Principle ('Gantip') is in use;
b. No incentives are offered to encourage the artificial relocation of international or interstate transactions;
c. Full support is given to other countries and taxation authorities to assist the collection of tax due to them.

2. Accounting

a. Transparent recording of the structure of all taxable entities is available on public record;
b. The accounts of all material entities are available on public record;
c. Taxable transactions are recorded where their economic benefit can be best determined to arise.

3. Planning

a. Tax planning seeks to comply with the spirit as well as the letter of the law;
b. Tax planning seeks to reflect the economic substance of the transactions undertaken;
c. No steps are put into a transaction solely or mainly to secure a tax advantage.

4. Reporting

a. Tax planning will be consistently disclosed to all tax authorities affected by it;
b. Data on a transaction will be consistently reported to all tax authorities affected by it;
c. Taxation reporting will reflect the whole economic substance and not just the form of transactions.

5. Management

a. Taxpayers shall not suffer discrimination for reason of their race, ethnicity, nationality, national origin, gender, sexual orientation, disability, legal s tructure or taxation residence; and nor shall discrimination occur for reason of income, age, marital or family status unless social policy shall suggest it appropriate;
b. All parties shall act in good faith at all times with regard to the management of taxation liabilities;
c. Taxpayers will settle all obligations due by them at the time they are due for payment.

6. Accountability

a. Governments shall publish budgets setting out their expenditure plans in advance of them being incurred, and they shall require parliamentary approval;
b. Governments shall account on a regular and timely basis for the taxation revenues it has raised;
c. Governments shall account for the expenditure of funds under its command on a regular and timely basis.

Enforcement

States seeking to comply with the Code will voluntarily submit themselves to annual appraisal of their Conduct. These appraisals will in turn be reviewed by a committee of independent experts appointed by participating States. Differences of opinion will be resolved by binding arbitration.
Any taxpayer or agent wishing to comply with the Code may do so. A State should presume that a person professing compliance with the Code has done so when dealing with any tax return they submit. In consequence the administrative burdens imposed upon that person should be reduced. In the event of evidence of non-compliance being found any consequential penalty imposed should be doubled.

No doubt other alternatives could be proposed, although it is notable that those from within the tax profession who have demanded such Codes seem to remain dedicated to the Charter Mark model.[98] The latest Charter issued by HM Revenue & Customs[99] is, unfortunately, far too close to this model as well, and appears without teeth as a result. As such whilst it says, for example, that the Revenue will "distinguish between legitimately trying to pay the lowest amount and bending the rules through tax avoidance" and in this context will "use our powers reasonably" this is a negative and service based test, not a positive statement of what is required of taxpayers, and as such conforms to a lowest common denominator aspiration rather than an indication of expectation. As such no statement is made that all taxpayers, and corporate taxpayers with corporate responsibilities in particular, must be tax compliant and demonstrate the resulting commitment to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the form in which they are reported for taxation purposes. The suggested Code noted above does do that.

The 'Code of Practice on Taxation for Banks' issued by HM Revenue & Customs in December 2009 gets much closer to addressing the appropriate issues,[100] saying as it does:

The Government expects that banking groups, their subsidiaries, and their branches operating in the UK, will comply with the spirit, as well as the letter, of tax law, discerning and following the intentions of Parliament.

This means that banks should:
- **adopt adequate governance to control the types of transactions they enter into;**
- **not undertake tax planning that aims to achieve a tax result that is contrary to the intentions of Parliament;**
- **comply fully with all their tax obligations; and**
- **maintain a transparent relationship with HM Revenue & Customs (HMRC).**

This is obviously close to the form suggested by civil society, noted above but with one important difference: there are no apparent sanctions for non-compliance with the new Code, which makes it little more than a public relations gesture.

In November 2010 it was announced that 15 banks had signed up to this Code.[101]

There is, given the lack of sanction within it, little hope that this Code will tackle tax avoidance of the type shown to be undertaken by Barclays Bank plc in the past.[102] In addition, the reaction of the tax profession is, broadly speaking, that it is unconstitutional to use Codes for this purpose; tax can only be applied by law, they argue. If that is the case, giving a Code legislative backing may be a necessary step, and support for a General Anti-Avoidance Principle may be essential. The right answer may well, of course, be to have both, widely applied, as PCS recommends.

Promote unitary taxation

The world's corporation tax systems fall into two basic types. There are 'residence-based' systems; these tax a company on its worldwide income in the country in which it is incorporated, with credit being given for any tax already paid on the same source of income in the country where it arose. The UK has, broadly speaking, had such a system to date.

The second type is the 'territorial-based' system; in such systems tax is only charged on earnings arising within the territory that is charging the tax. Earnings arising to a company from elsewhere are ignored and are not taxed in the territory where the company is resident. This arrangement is found in Europe. It is also widely used in tax havens. The US operates a compromise between the two arrangements with a territorial basis when income arises, but with income from overseas being charged to tax on receipt in the USA if remitted there.

Neither system makes much sense in a world where companies operate globally. Since capital market liberalisation in the early 1980s companies have had virtual free rein to decide where they will locate. As a result the power of the state to charge tax has been reduced substantially. This is particularly true when this corporate freedom has occurred at a time when a steadily reducing number of ever larger companies have come to dominate world trade, much of which, as has already been noted, they can hide from view within their group accounts. This is an issue highlighted, for example, by President Obama when in May 2009 he announced an attack on tax havens,[103] and highlighted abuse of the US tax system from three relatively unexpected sources – the Netherlands, Bermuda and Ireland – all of them extensively used for routing trades within groups of companies largely away from public view.

The problem with these systems is simple to identify; they try to tie profit to a place when that is always going to be hard to do in a genuinely multinational company. Locating profits in particular subsidiaries of multinational companies in particular locations only makes this doubly hard.

The problems within the UK tax system in addressing this issue only emphasise the difficulties. To ensure that tax is properly assessed on a residence basis the UK requires three anti-avoidance mechanisms. The first is its transfer pricing rules, which should prevent profit being shifted out of the UK and into low tax jurisdictions. That said, no system is perfect, so a second line of defence is required. That second mechanism is found in the tax charge levied on dividends from overseas subsidiaries when they are remitted to the UK, with credit being given for any tax paid in the country of origin from which they come. However, this assumes that the profits earned in overseas subsidiaries are remitted back to the UK, but with this becoming increasingly uncommon as the ratio of dividends to profits earned falls, with investors being increasingly content to realise their return from investments by way of capital gain and not from an income yield, a third control mechanism is necessary. That is the UK's Control Foreign Companies (CFC) rules. The UK is not alone in having these; many countries do. All have encountered difficulty with their operation, not least because of the European Union's presumption that capital must be allowed to flow freely within the world economy. The rules are as a consequence complex, and subject to frequent challenge over the last decade.

In essence what the CFC rules say is that if a UK-based company owns a subsidiary company that is located in a jurisdiction where the tax rate is significantly lower than that which would have been paid in the UK then the possibility exists that the subsidiary in the tax haven location might be deemed to be resident in the UK for taxation purposes and have to pay tax as if it was UK located, even though it is incorporated elsewhere. There are, however, exceptions to the rule. In particular, if it can be shown that the company operating in the low tax jurisdiction is undertaking a real trade where goods and services are bought from and sold to independent third parties, or where a real economic function is undertaken by a significant number of staff (for example) then it can be argued that the company is not subject to the CFC rules, and it can enjoy the low rate of tax that the location in which it is trading offers and it can retain its reserves in that location subject only to that low local rate of tax, unless and until those profits are remitted back to the UK, when UK tax rates would have applied.

The assumption inherent in the logic of the CFC rules is, once more, that the profits located in a low tax jurisdiction will flow back to the UK in due course to be paid to the members of a company as dividends. As noted, however, this logic can be seriously awry.

It is stressed however, that these three anti-avoidance measures do not exist independently of each other; to a very large degree they stand or fall together. So, for example, if dividends will not be taxed upon receipt in the UK then there would be little point in having CFC legislation and if profits were not subject to attack if artificially transferred out of the UK by transfer pricing legislation then clear indication would be given that there would be no concern about their subsequent return as dividends.

Despite this, the last Labour Government and the Coalition government elected in May 2010 have taken actions that have in combination undermined the whole credibility of this system designed to protect revenue in the UK from abuse from tax havens. Firstly, in 2009 it was announced that many dividends from overseas would be exempt from UK tax. This means that if profits are sent back to the UK they will remain largely free of any additional tax charge, meaning that those earned in a tax haven will enjoy the benefit of low or no tax arising.[104]

Secondly, there is to be significant relaxation of the CFC regime that will for many corporations probably make it easier to move profits out of the UK. Full details of the reform are not yet known, but the pronouncements made are worrying. This is especially true because the changes proposed in 2010 will exempt profits diverted into tax havens from third countries – a beggar-thy-neighbour policy with serious consequences for developing countries who will now not have the protection that the UK CFC legislation previously provided by preventing UK-based multinational corporations from stripping income from developing countries into tax havens safe in the knowledge this could not be challenged from the developing country, but would in any event fail because the UK would then demand tax on the profits instead. That second demand will now not happen, making developing countries substantially more prone to transfer pricing abuse.

More importantly it was also proposed[105] in November 2010 that income recorded in tax haven subsidiaries of UK multinational corporations should be subject at most to an 8% tax charge under CFC rules whilst the profits of foreign branches of UK companies, including branches in tax havens, are to be exempted from UK tax.

This is the most fundamental reform of the UK residency basis of tax since it was first introduced at the time of the First World War. It does in effect mean the UK has shifted to a territorial basis of tax but has at the same time offered an effective tax rate of 8% to multinational corporations who hide their profits out of the UK, and it has at the same time abandoned all obligation it might ever have accepted to stop UK-based multinational corporations exploiting developing countries. This is an extraordinary negation of responsibility.

Thankfully there is an alternative to the failed complexity of the residence basis of taxation and the wholly inappropriate territorial basis of taxation that is being used to replace it. That alternative is called unitary taxation. Under the rules of unitary taxation, which are widely used to allocate profits between companies operating in different states within the USA and have therefore been extensively tried and tested, the total group profit is allocated to locations on the basis of a formula. The classic formula is called the Massachusetts apportionment and it allocates the profit made by a group as a whole to countries on the basis of a formula that gives equal weighting to third party sales, employees and physical fixed assets made from or located in a jurisdiction. One of the reasons for requiring employee and fixed asset information to be disclosed under country-by-country reporting (noted above) is to ensure that sufficient data is available to allow a unitary apportionment formula allocation to be undertaken with regard to any group of companies to which country by-country-reporting would apply to determine whether its profit allocation looks reasonable or not on that basis. It should be noted that the European Commission is exploring the use of a unitary basis of tax apportionment in the EU, but this has been subject to significant objection, not least from the United Kingdom and Ireland.[106] However, work on this proposal, which is called the Common Consolidated Corporate Tax Base is resuming in 2011.[107]

Using a formula apportionment method means that artificial reallocations of activity within a group can be largely eliminated from consideration when deciding the likely profit arising within a group. This is especially so if third party sales are stated net of intra-group purchases to prevent their artificial reallocation to locations like Ireland. As a result the objectives of the 'arms length principle' or transfer pricing that the OECD promotes as the ideal solution to solving transfer pricing disputes is achieved but with much less effort and accounting being required than is the case under its chosen bilateral approach, which can in any event lead to more than or less than the whole of a group's profit being taxed.

It is important to note that disputes about appropriate formulas for allocation purposes are one of the problems within unitary taxation. Clearly a dispute mechanism is required to resolve such issues. A unitary approach would not be without its own difficulties. We do however believe that it is likely that unitary profit allocations between states will be:

- less arbitrary;
- more economically justifiable;
- easier to calculate;
- less prone to abuse, and
- easier to audit

than existing arrangements based on transfer pricing and CFC rules.

A unitary approach can in principle be adopted by a single state, although it would be desirable for there to be broad international agreement on at least the general principles of definition of the tax base, and especially on the allocation formula. The work done by the European Commission on the Common Consolidated Corporate Tax Base, mentioned above, already provides a good basis for the tax base definition.

Perhaps most importantly, we suggest the use of unitary taxation because we believe that the adoption of a unitary basis of taxation would enhance the freedom of choice for any government with regard to the taxation of mobile capital, of which the profits of multinational corporations are a part. At present governments have almost no tools available to them to respond to the pressure created by tax competition, a process that is leading to a steady reduction of rates in corporation tax and which is now resulting in real loss of revenues to governments around the world. A unitary basis of allocation of profit breaks this cycle. Once profits have been allocated a country is at liberty to tax them at whatever rate it pleases, thus restoring control of taxation revenues to sovereign governments, where we believe it belongs. This makes unitary taxation a vital component in any effective tax system for the 21st century.

Regulate offshore banks from their head office locations

At present the regulation of financial services is undertaken on a similar basis to taxation. It is undertaken nationally when the main entities that are regulated operate globally. It makes no sense to tax on this basis because the conflict in approach always leaves tax authorities on the back foot and it makes no sense to regulate in this way for exactly the same reason. This is especially true when it is realised that there really are very few ‘offshore banks’. There are also very few offshore accountants of any size either, although the same is not quite so true of lawyers. For the banks and accountants the major players offshore are all branches and associates of the major ‘onshore’ players who are simply using the tax havens /secrecy jurisdictions to further their global goals.

In that case it makes little or no sense to regulate these supposedly ‘offshore’ entities from within those jurisdictions for two reasons. First of all, they are under the direction and control of ‘onshore’ entities in places like London and New York. To pretend otherwise is to avoid the obvious truth. Secondly, it is very obviously the case that any form of regulation is much harder offshore in a tax haven / secrecy jurisdiction for two reasons. The first is that these locations have very little power over multinational entities who may come and go from such locations at whim, and who therefore as a result have enormous political influence within these locations that are dependent upon their staying. Second, local regulation is dependent upon the presence of local regulators who have, in what are very often very small locations, to live shoulder-by-shoulder with those who they seek to regulate. Quite clearly this is socially difficult, if not impossible. The possibility of effective regulation in the goldfish bowl communities of many of the tiny offshore financial services communities (when compared to mainstream centres such as London, for example) is very low indeed.

There is an obvious solution to the dilemmas that these issues present. This is that the major financial organisations within the world’s tax havens / secrecy jurisdictions should be regulated from outside these places, and ideally from that place which has responsibility for regulating the entity of which they are a part as a whole. So, for example, a British bank in a tax haven should be regulated from London; a German bank from Berlin, whilst a firm of accountants should be regulated from that domain with which the tax haven / secrecy jurisdiction has closest ties in which the firm in question also has an office. So, for example, a Jersey branch of the Big Four should be regulated from London but a Netherlands Antilles branch should be regulated from the Netherlands.

The advantage of this arrangement is obvious: in a globalised world where divisions in regulatory responsibility can be exploited by the financial services community this structure breaks down national boundaries in the way that corporations have already done. In so doing it would facilitate the appraisal of risk whilst bringing much of the shadow banking system under proper supervision. The benefits are obvious: many of the causes of the current failure are to be found in the shadow banking system and in the lack of trust that was created by the opacity of tax haven banking activities of the world's biggest financial corporations. This type of regulation would assist in bringing such structures into the open. That is why having offshore regulated from onshore makes so much sense.

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75 Domicile is a concept in taxation law used almost exclusively by the UK and Ireland, which inherited it upon independence. A person's domicile is their natural home. It is not related to their place of birth, or residence, or their nationality. It is their place of origin to which they plan to return one day. Proving his/her intention is of course very difficult but whilst a person has a domicile outside the UK they are able in certain circumstances to avoid the obligation imposed upon all people who are UK resident and domiciled to pay tax on their worldwide income and gains. Those not domiciled but resident in the UK can instead pay tax only on their UK source income and that part of their worldwide income and gains that they choose to bring to the UK. Any income or gains that they leave outside the UK is untaxed in the UK and if located by them in a tax haven will probably suffer no tax at all anywhere in the world.

76 http://www.hm-treasury.gov.uk/press_04_11.htm accessed 21-01-11

77 The USA and Japan are both partial exceptions at present but both are also on convergence paths.

78 http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/press_130_08.htm accessed 26-1-11

79 http://www.promontory.com/Offices/London.aspx accessed 26-1-11

80 http://www.promontory.com/ accessed 26-1-11

81 http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/foot_review_deloitte.pdf accessed 26-1-11

82 http://www.tuc.org.uk/touchstone/Missingbillions/1missingbillions.pdf accessed 26-1-1

83 http://www.hm-treasury.gov.uk/indreview_brit_offshore_fin_centres.htm accessed 20-11-09

84 http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/savings_directive_review/index_en.htm accessed 26-4-09

85 http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/savings_directive_review/index_en.htm accessed 27-4-09

86 http://www.christianaid.org.uk/images/deathandtaxes.pdf accessed 27-4-09

87 http://www.accountancyage.com/accountancyage/news/2240985/tax-tribunal-publishes-dixons accessed 27-4-09

88 http://www.guardian.co.uk/commentisfree/2010/oct/22/vodafone-tax-case-leaves-sour-taste accessed 26-1-11

89 http://www.oecdobserver.org/news/fullstory.php/aid/670/Transfer_pricing:_Keeping_it_at_arms_length.html accessed 27-4-09

90 http://www.taxresearch.org.uk/Documents/WoERevisedVersion.pdf accessed 26-1-11

91 Significantly more information on this issue is available in http://www.taxresearch.org.uk/Blog/2010/12/15/country-by-country-reporting-tjn-submission-to-the-european-union/ accessed 26-1-11

92 http://www.gao.gov/new.items/d02670.pdf accessed 30-4-09

93 http://www.what-prepaid-card.co.uk/non-reloadable/Anonymous-prepaid-cards.html accessed 1-5-09

94 http://www.nytimes.com/2009/04/16/business/16tax.html accessed 8-5-09

95 See for example http://www.accountancyage.com/accountancyage/news/2211377/ciot-releases-ideal-taxpayers accessed 8-5-09

96 http://www.independent.co.uk/news/uk/politics/people-ignorant-of-citizens-charter-the-cabinet-has-admitted-it-needs-to-do-more-to-push-john-majors-big-idea-patricia-wynn-davies-reports-1473720.html accessed 27-4-09

97 http://www.taxresearch.org.uk/Documents/TaxCodeofConductFinal.pdf accessed 26-1-11

98 See, for example http://www.politics.co.uk/opinion-formers/press-releases/economy-and-finance/charter-draft-inadequate-says-ciot-$1286511$469629.htm accessed 27-4-09

99 http://www.hmrc.gov.uk/charter/index.htm accessed 26-1-11

100 http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMCE_PROD1_030008 accessed 27-1-11

101 http://www.thegovmonitor.com/world_news/britain/banks-in-england-sign-code-of-practice-on-taxation-43478.html accessed 27-1-11

102 http://www.timesonline.co.uk/tol/news/uk/article5908523.ece?token=null&offset=0&page=1 accessed 27-4-09

103 http://www.hm-treasury.gov.uk/indreview_brit_offshore_fin_centres.htm accessed 5-5-09

104 http://www.hmrc.gov.uk/budget2009/bn05.pdf accessed 27-1-11

105 http://www.guardian.co.uk/politics/2010/nov/29/corporation-tax-8percent-exodus-multinationals accessed 27-1-11

106 See http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm for more information

107 http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/ccctb_en.htm accessed 27-1-11

10 Conclusion

This report has thrown down a dual challenge to the UK Government and the wider international community.

The first challenge is to live up to the statement made at the London Summit of the G20 that the world's most powerful and richest nations will take action to ensure that the "era of banking secrecy is over". Unfortunately, the procedures put in place to achieve this goal fall very far short of what is needed. This report seeks to outline a range of options available to the international community if they are really serious about ending the damaging secrecy provided by tax havens. In that way this is a solutions-focussed report.

The second challenge requires the UK Government and international community to protect the jobs and livelihoods of those living in tax havens who face heightened risks as a result of the more concerted multilateral action against tax haven secrecy. Many of those likely to be affected had no direct or leadership role in the secrecy activities of tax havens and it would be deeply unjust, given the historical acquiescence of the international community in the activities of tax havens, if they were to suffer hardship as a result of new measures. That is why this report has outlined a bold programme of financial and practical support on the part of the UK Government and other leading economies to provide extensive financial and practical support to ensure the continued operation of open and accountable financial services and of a viable local economy in tax havens, the British Overseas Territories and Crown Dependencies.

PCS believes that with these two goals in mind, the UK can take a lead in tackling the issues that still threaten the stability of the world financial system and which are related to the opacity created by the world's tax havens/secrecy jurisdictions – and urges it to do so.

Appendix 1

Tax havens in which the UK's largest banks are known to have subsidiary companies

Bank	Total	Lloyds TSB	Barclays	HSBC	RBS
Cayman Islands	240	17	143	14	66
Jersey	147	60	37	20	30
Guernsey	58	7	18	22	11
Isle of Man	44	2	29	7	6
British Virgin Islands	26	7	4	8	7
Bermuda	22	0	1	14	7
Gibraltar	10	4	3	0	3
Total	547	97	235	85	130

Note: 1) HBOS did not file data
2) HSBC filed incomplete data and figures may be understated
3) These banks appear to have no subsidiaries in Anguilla, Montserrat or the Turks & Caicos Islands

Based on research[108] by the TUC, January, 2009.

108 http://www.tuc.org.uk/economy/tuc-15906-f0.cfm accessed 27-1-11

Appendix 2

UK related tax havens in which the 'big four' accountancy firms have operations

Tax Havens	KPMG	Ernst & Young	PWC	Deloitte
British Virgin Islands	1		1	1
Cayman Islands	1	1	1	1
Guernsey	1	1	1	1
Isle of Man	1	1	1	1
Jersey	1	1	1	1
Bermuda	1	1	1	1
Gibraltar	1	-	1	1
Turks & Caicos Islands	1	-	1	-
Anguilla	1	-	-	-
Montserrat	-	-	-	-

Based on research by Tax Research LLP,[109] 2010

109 http://www.taxresearch.org.uk/Documents/Where4Art.pdf accessed 27-1-11

Appendix 3

Where are the world's tax havens?

The most rigorous assessment to date of the world's secrecy jurisdictions was undertaken by the Tax Justice Network when it was preparing its Financial Secrecy Index in 2009. The index is available in full at this web site: http://www.financialsecrecyindex.com/index.html

For data on where the world's secrecy jurisdictions are, and why the Tax Justice Network determined that they had this status, it is best to refer to the Tax Justice Network website dedicated to this research work at http://www.secrecyjurisdictions.com/ where a wealth of information on this issue is available.

As a result of a research programme, initially funded by the Ford Foundation, the Tax Justice Network published its financial secrecy index relating to data as at 31 December 2008 in November 2009. This ranked locations by both their opacity (measured by 12 indicators) weighted by their significance indicated by cash flowing through the location. The resulting rankings were as follows:

Financial Secrecy Index – Final Ranking

Secrecy Jurisdiction	Opacity score	Financial Secrecy Index Value	Financial Secrecy Index Rank
USA (Delaware)	92	1503.80	1
Luxembourg	87	1127.02	2
Switzerland	100	513.40	3
Cayman Islands	92	403.48	4
United Kingdom (City of London)	42	347.79	5
Ireland	62	143.73	6
Bermuda	92	122.30	7
Singapore	79	109.34	8
Belgium	73	78.60	9
Hong Kong	62	76.34	10
Jersey	87	76.22	11
Austria	91	42.32	12
Guernsey	79	36.20	13
Bahrain	92	23.53	14
Netherlands	58	23.18	15
British Virgin Islands	92	14.98	16
Portugal (Madeira)	92	12.36	17
Cyprus	75	11.59	18
Panama	92	10.83	19

Secrecy Jurisdiction	Opacity score	Financial Secrecy Index Value	Financial Secrecy Index Rank
Israel	90	10.37	20
Malta	83	8.68	21
Hungary	75	7.65	22
Malaysia (Labuan)	100	7.20	23
Isle of Man	83	5.79	24
Philippines	83	5.10	25
Latvia	75	4.11	26
Lebanon	91	2.65	27
Barbados	100	2.60	28
Macao	87	1.89	29
Uruguay	87	1.82	30
United Arab Emirates (Dubai)	92	1.52	31
Mauritius	96	1.20	32
Bahamas	100	1.10	33
Costa Rica	92	0.51	34
Vanuatu	100	0.50	35
Aruba	83	0.28	36
Belize	100	0.20	37
Netherlands Antilles	75	0.11	38
Brunei*	100	0.10	joint 39
Dominica*	100	0.10	joint 39
Samoa*	100	0.10	joint 39
Seychelles*	100	0.10	joint 39
St Lucia*	100	0.10	joint 39
St Vincent & Grenadines*	100	0.10	joint 39
Turks & Caicos Islands*	100	0.10	joint 39
Antigua & Barbuda*	92	0.08	joint 46
Cook Islands*	92	0.08	joint 46
Gibraltar*	92	0.08	joint 46
Grenada*	92	0.08	joint 46
Marshall Islands*	92	0.08	joint 46

Secrecy Jurisdiction	Opacity score	Financial Secrecy Index Value	Financial Secrecy Index Rank
Nauru*	92	0.08	joint 46
St Kitts & Nevis*	92	0.08	joint 46
US Virgin Islands*	92	0.08	joint 46
Liberia*	90	0.08	54
Liechtenstein*	87	0.08	joint 55
Anguilla*	87	0.08	joint 55
Andorra*	83	0.07	57
Maldives*	80	0.06	58
Montserrat*	79	0.06	59
Monaco*	67	0.04	60

*Jurisdictions marked with an asterix are ranked according to their opacity score.

Appendix 4

A very limited glossary of the terms used in this report is offered here. A full glossary is available on line at http://www.secrecyjurisdictions.com/glossary

Accounts	The annual published statements issued by a company in accordance with the legislation and regulation of the country in which it is incorporated for the benefit of shareholders and others (if they are permitted access under local law) who wish to appraise the financial performance of a limited liability company or other limited liability entities such as a limited liability partnership.
	If the company is registered on a stock exchange which requires compliance with the rules of the International Accounting Standards Board then the accounts will also have to comply with their rules. Otherwise they will comply with locally issued accounting standards.
	The report will normally include a statement from the directors of the company providing an overview of the trading of the entity for the year, a profit and loss account showing its income and expenditure during the period and its net profit plus an estimate of taxation liabilities that will arise from them, a cash flow statement showing how it used the net cash surplus or deficit that it generated during the course of the year, a balance sheet showing its total assets and liabilities at the year-end as represented by the total net investment by the shareholders, and notes to the accounts which explain each of the statements.
Accounting standards	Regulations which govern the way in which certain transactions are reported within the accounts of companies and other entities. Originally issued on a national basis, and usually by the professional bodies of accountants within each country, they are now being supplanted by International Financial Reporting Standards issued by the International Accounting Standards Board
Bilateral information exchange	Information exchange undertaken because an agreement to exchange data has been reached between two states, to which agreement no other state is a party. Compare with multilateral information exchange.
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.
Consolidated accounts	A group of companies is made up of two or more member companies with one company owning, directly or indirectly, more than 50% of each of the other members. When this happens the shareholders of the ultimate parent company can only appraise the return on their investment if they can see the combined result of the parent company in which they have invested and that of all the subsidiary companies that it controls. This outcome is achieved by preparing consolidated accounts. In consolidated accounts all the trading between members of the group of companies is eliminated because this cannot generate profit for the ultimate parent company shareholders, which can only be earned by trading with independent third parties. It is only a third party trading that is reflected in consolidated accounts. The balance sheet in a set of consolidated accounts only reflects liabilities owing to or from third parties, those between group companies being eliminated.

Controlled foreign corporation (CFC)	A tax definition to describe a situation in which a company which charges tax on the profits of corporations has a subsidiary registered in a tax haven or other territory where little or no tax is charged on the profit the subsidiary makes. The subsidiary is then called a CFC and its profits can in some cases be subject to tax in the country of residence of the parent company.
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.
Country-by-country reporting	A proposed form of accounting in which a multinational corporation will be required to report in its accounts in which countries it operates, what the names of its subsidiaries are in each and every jurisdiction in which it operates, and to publish a profit and loss account of each such jurisdiction, without exception, showing its sales and purchases, both from third parties and intra-group, the number of employees it has and the cost of employing them, its financing costs both third party and intra-group, its profit before tax, its tax charge split between current and deferred tax, and a summary of its assets and liabilities in the location.
Double tax relief	Tax relief given by the country in which the tax payer resides for tax paid in another country on a source of income arising in that other country.
Double tax agreement	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.
Financial reporting standards	The term now commonly used for accounting standards.
Financial statements	See accounts.
Holding companies	A company that either wholly owns or owns more than 50% 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.

International Accounting Standards Board	A privately owned company registered in Delaware in the USA but based in London in the United Kingdom which issues International Financial Reporting Standards. It is largely financed by the largest firms of accountants in the world and the financial services industry. It is self-regulating and resists government interference. Its status as an issuer of accounting standards was transformed when its standards were adopted by the European Union for use by all companies quoted on stock exchanges in that territory from 2005 onwards.
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.
International financial reporting standards	Accounting standards issued by the International Accounting Standards Board
Loophole	A technicality that allows a person or business to avoid the scope of a law without directly violating that law.
Multilateral information exchange	A tax information exchange agreement either between one state and multiple other states or to which multiple states are party. Compare with bilateral information exchange.
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.
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 use the term International Finance Centres.
Partnerships	Any arrangement where two or more people agree to work together and share the resulting profits or losses.
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.
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.

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.
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.
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.
Sanctions	Measures a country might take against a non-cooperative tax haven. Measures endorsed by the G20 include:[110] • increased disclosure requirements on the part of taxpayers and financial institutions to report transactions involving non-cooperative jurisdictions; • withholding taxes in respect of a wide variety of payments; • denying deductions in respect of expense payments to payees resident in a non-cooperative jurisdiction; • reviewing tax treaty policy; • asking international institutions and regional development banks to review their investment policies; and, • giving extra weight to the principles of tax transparency and information exchange when designing bilateral aid programmes.
Secrecy jurisdiction	Secrecy jurisdictions are places that intentionally create regulation for the primary benefit and use of those not resident in their geographical domain that is designed to undermine the legislation or regulation of another jurisdiction and that, in addition, create a deliberate, legally backed veil of secrecy that ensures that those from outside the jurisdiction making use of its regulation cannot be identified to be doing so.
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.

Subsidiary company	A company 50% or more owned by another company which is its parent company.
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 whilst attempting to comply with the letter of the law while 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 competition	This is 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	Tax compliance is seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.
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 Information Exchange Agreement	TIEAs are bilateral agreements under which territories agree to cooperate in tax matters through exchange of information. In practice the range of information that might be exchanged is quite limited. Tax information exchange agreements are a result invariably signed with tax havens and not with major states, where double tax agreements are used instead. Given that the burden of proof that the requesting state has to present before a request for data under a TIEA can be made they are being little used.
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.
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 which increase the cost or reduce the sales value in states which charge higher tax rates and increase the sales value or reduce the costs in states with lower tax rates. The difficulty for many corporations at a time when over 50% of world trade is within rather than between corporations is that there is no market price for many of the goods or services that they trade across national boundaries because they are never sold to third parties in the state 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 a company's supply chain, which process 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 (MNCs).
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.
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.

110 http://www.londonsummit.gov.uk/resources/en/PDF/annex-strengthening-fin-sysm accessed 7-5-09

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