Tax Avoidance and Offshore Finance

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Taxation and the redistribution of wealth looks set to dominate the economic and political agenda in the twenty-first century. Inequality is currently the buzzword amongst academics, politicians and business leaders around the world, and the redistribution of wealth is the logical and most efficient means of addressing the problem. Tax avoidance and offshore finance are the primary obstacles to a coherent redistribution of wealth. Without a re-evaluation of taxation in the modern global economy, we will have to endure a future of poverty, state failure and conflict.

Tax avoidance through offshore finance enjoys some of economics' most horrific and shocking statistics. Half of the world's cross border trade is via tax havens; wealthy individuals (not including companies) are estimated to hold up to $32 trillion offshore; and, $1.3 trillion of illicit finance flowed from developing countries in 2008 alone.

This paper seeks to address the current failure of the international taxation system, its effect on the world, and the role of the labour movement. The key questions that will be covered are:

- Why is taxation so important for the global economy and people around the world?
- What is offshore finance and how do they avoid tax?
- How is this affecting the global economy?
- What does this mean for trade unions and their campaigns?

Why is tax so important?

Taxation was an important civilising leap for society with economic, social and democratic consequences that define much of the modern world. Tax has four core roles in our global society:

1. Redistributes wealth and income

Without the redistribution of wealth and income, capitalism could not function. Capitalism is by its very nature a dysfunctional economic system, requiring state intervention to share the gains of growth and guarantee the welfare of those that create the growth, who are often the poorest members of society.

2. Strengthens and protects channels of political representation

Alongside the ballot box, taxation serves as a supplementary source of government accountability. Public money, rather than private interests, provides the majority of state spending, ensuring that government serves the interests of its citizens. The global decline in taxation, and the increase in tax avoidance, has led to vested interests and wealthy elites having more influence over government.

3. Provides revenue for public services

Universal healthcare, free education, emergency services, professional policing and the majority of public services stem from the principle that state funds gathered from taxation should be returned to the tax-payer in the form of public services, creating and sustaining a healthy labour force, and therefore a healthy economy.

4. Reprices goods and services

Capitalism is unable to effectively set prices for goods and services. State-intervention, in the form of taxation, ensures that the environmental, social and indirect costs involved in the production and distribution of goods and services are factored into their pricing.

What is offshore finance and how do companies avoid tax?

When goods or services are sold from one country to another, the money instead flows through a tangled network of offshore financial centres, with commission charged in each jurisdiction by shadowy companies on trade they never see and are not practically involved in. Empty offices in tax havens charge millions for 'management services' or 'consultancy agreements', ensuring that their subsidiaries, located in 'tax-heavy' jurisdictions, remain loss-making and unencumbered by tax.

In the late-twentieth century, globalisation eliminated exchange and capital controls, reduced trade tariffs and taxes, expanded cross-border trade and investment, increased state income from foreign sources, and ultimately allowed capital to move virtually unimpeded. This has led to a new type of economic competition: 'tax wars'. Countries compete with one another to offer the lowest tax, highest levels of secrecy and least state oversight. The only beneficiaries are transnational corporations and billionaires, at the expense of billions of working people and their governments. Tax wars have produced a network of interconnected tax havens used by companies and the wealthy to avoid paying tax.

Tax havens also offer a number of other benefits, or even 'services', to its clients. Havens allow individuals and companies to escape financial regulation, transparency, social obligations, and even criminal law. Illicit arms trading, sports match fixing, bribery, fraudulent invoicing, trade mispricing, illegal political donations, insider trading and market rigging are all conducted in these offshore holdings.

In places like Cayman or Jersey more than fifty per cent of the economy is dependent upon the financial services industry, giving these microstates a vested interest in maintaining the current system of tax injustice. Secrecy jurisdictions such as Austria, Luxembourg and Switzerland lack the political will to challenge or end the system. The OECD and European Union have tried and failed to take action against the states involved.

There are multiple actors involved in this network including banks, transnational corporations, accountancy firms, offshore law firms, trustees, company formation agents and nominees, and lobbying groups.

The 'big four' accountancy firms (PWC, Deloitte, KPMG, Ernst & Young) have played the largest part in promoting tax injustice. Involved in promoting secrecy jurisdiction activities, the firms were strongly criticised by the US Senate for promoting the sale of so-called 'tax products' in 2003. The US Senate Permanent Subcommittee on Investigation found that some of these products were almost certainly illegal, with KPMG estimated to have made $180 million from selling schemes which cost the US Treasury up to $85 billion. In 2005, the European Court of Justice criticised KPMG's promoted scheme to avoid British sales tax, and the firm admitted that they knew the scheme amounted to 'unacceptable tax avoidance'. In 2011, a UK tax tribunal ruled that one of Deloitte's schemes, operated through a Cayman Islands-registered investment vehicle, was "created and coordinated purely for tax avoidance purposes".

> "Abusive tax shelters are usually tough to prosecute. Crimes such as terrorism, murder, and fraud produce instant recognition of the immorality involved. Abusive tax shelters, by contrast, are often 'MEGOs', meaning 'My Eyes Glaze Over'. Those who cook up these connections count on their complexity to escape scrutiny and public ire"
>
> *Senator Carl Levin, current chairman of the U.S. Senate Sub-Committee*

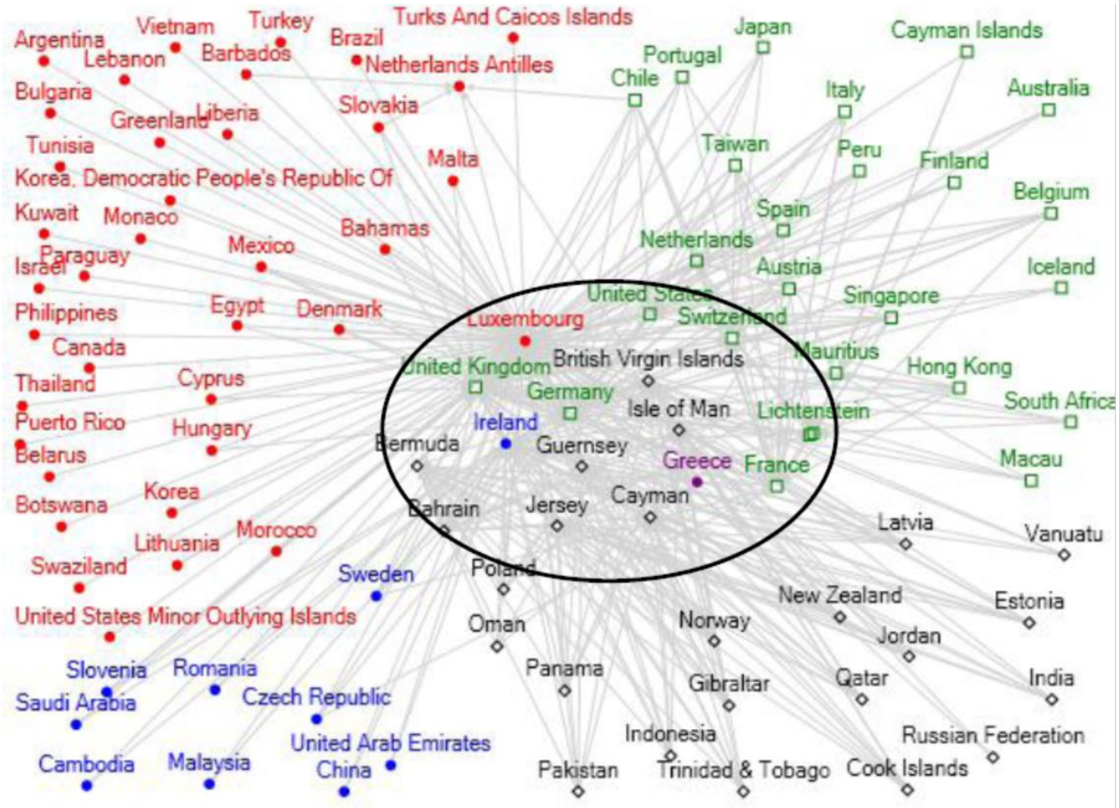
The ‘big four’ have a particular responsibility to bear for a number of reasons. Their size means they dominate accountancy worldwide and another major collective failure could collapse the international audit market, meaning they are ‘too big to fail’ and can plead special privileges for themselves.

Banks also play a key role in tax injustice. The world’s top 50 international private banks managed over $12.1 trillion of cross-border invested assets on behalf of private clients in 2010. The banks tend to cluster in havens that are geographically located close to the regions in which they operate. The Cayman Islands attract South American banks, Bermuda and the Bahamas have a large presence of US banks, and the Channel Islands have strong British and European representation. Mainstream banks also provide funding to facilitate abusive tax schemes and products sold by accountancy firms. Deutsche Bank was found to have knowingly financed tax products produced by KPMG. Morgan Chase and Citigroup were also criticised in various ways for their role in the Enron scandal, including providing finance through offshore vehicles.

How is this affecting the global economy?

Inequality is the primary consequence of offshore finance and tax injustice. The erosion of national tax sovereignty and the growth of regressive taxation stem from the ability of large multinationals, accountancy firms, banks and tax havens to forge their own taxation system. There has been a global policy shift away from taxing business towards taxing consumption and labour, through VAT, payroll and income taxes, also promoted by the IMF and World Bank. In many cases these substitute taxes have not raised as much revenue as the taxes they replaced. This has led to less spending on education, health, and other public services, which has increased unemployment and inequality.

The 2007 financial crisis owes a lot to global tax injustice. Aside from the widespread inequality it has caused, the secrecy of financial activity has increased the volatility of markets around the world, and disguised the fragility of companies and banks until it was too late.



The above diagram illustrates the movement of finance between state jurisdictions. Countries in the centre of the diagram are those most integrated into the system of offshore finance. Many of these countries will be unsurprising. The Cayman Islands, Jersey, the British Virgin Islands, Lichtenstein, Bermuda and Luxembourg are all familiar tax havens that have operated as such for decades. However, there are a few significant countries worth mentioning.

The United Kingdom is now the biggest tax haven in the world. Over the past four or five years the UK has redesigned itself as the principle tax haven at the centre of the illicit finance network. It is not a coincidence that the London property market has become an over-inflated bubble, with millionaires and billionaires around the world buying property in the capital to stash their cash overseas and avoid tax in their own countries. Similarly, companies which would have once chosen Ireland, Bermuda or Lichtenstein to base their taxable operations are beginning to relocate to London. London is also linked to Britain's dependencies and overseas territories, such as the British Virgin Islands, Jersey, Gibraltar, Bermuda, and the Cayman Islands, all age-old favourites for tax avoidance.

Britain is now beginning to suffer from a twenty-first century version of the 'Dutch Disease'. The Dutch Disease or 'resource curse' was the crowding-out of other industries because of an over-dependence on a single sector, previously the extraction and processing of natural resources. Today, countries such as the UK suffer from a similar over-dependence on finance, or more specifically illicit finance. The British pound has been over-strengthened, resulting in its non-financial exports becoming too expensive, and imports becoming cheaper, pushing the manufacturing sector into almost terminal decline. The British economy is being hollowed out by politicians, accountants, lawyers and businessmen colluding to artificially undercut rival tax jurisdictions at the expense of the British tax payer and the rest of the economy.

In 2012, George Papandreou, then Prime Minister of Greece, announced that his country could have avoided a bailout if the economy had not been robbed by funds being funnelled to tax havens. Although the financial crisis in Europe has been portrayed as a debt crisis, it is perhaps more accurate to describe it as a tax crisis. Without sufficient tax revenue, governments across Europe are being cornered into accepting fiscal austerity, increased inequality, and enduring stagnation.

Africa has effectively been embezzled by those involved in tax injustice. Net losses from illicit outflows between 1970 and 2008 from 33 sub-Saharan countries totalled $944 billion, whilst combined external debts for those countries at the end of 2008 was $177 billion. Almost all these outflows went via secrecy jurisdiction linked to OECD countries, with UK dependencies playing a prominent role.

Why is tax injustice and illicit finance important for the labour movement?

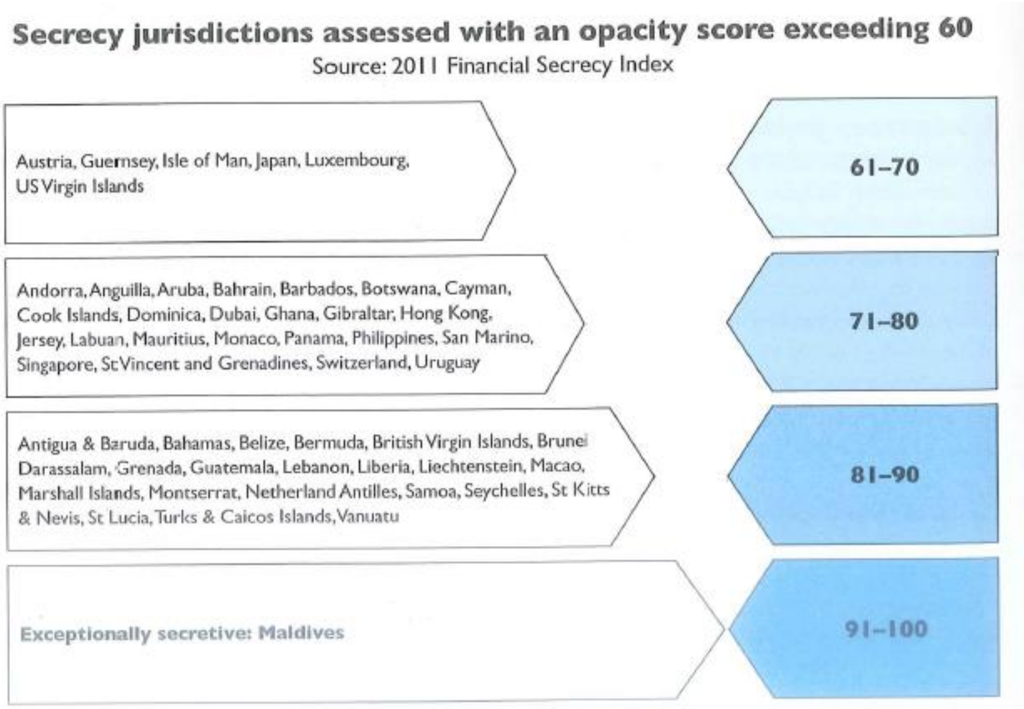
Inequality is the most serious threat to the lives of working people around the world, and tax injustice is one of the principle reasons that inequality is rising. NGOs, think tanks, international organisations and the press are leading the fight against tax injustice, and the labour movement must join them.

The campaign for tax justice is positioned within the wider campaign waged by the global south to challenge the economic system geared around the developed north. In China, India, Brazil and various African states, politicians and courts are beginning to demand the right to tax the commercial and financial activity that occurs within their economic jurisdiction. In 2012, the Indian government made retrospective changes to tax rules to ensure that the sale of Vodafone earlier in the same year was taxed properly by the state. Although the tax dispute is still ongoing, it demonstrates the new-found activism of governments in the global South in reclaiming the tax revenue they are rightfully entitled.

Good leverage campaigns are based on thorough research which examines every aspect of a company. The majority of transnational corporations are involved in offshore and illicit finance, opening up new avenues for research and campaigns. Although training should enable researchers to examine the geographical movement of finance and their legal implications, alliances must be forged with organisations that have the experience and capacity to shine light on tax avoidance:

The Tax Justice Network has expressed its interest in working more closely with the labour movement. Unlike the other international organisations and institutions already involved, trade unions are the eyes and ears on the ground in workplaces around the world. Our ability to monitor the real transactions that occur within transnational trade is invaluable when looking at the parallel movement of finance. The Tax Justice Network can offer the labour movement their analytical experience and resources in return for cooperation over the monitoring of transnational corporations.

The Tax Justice Network has developed a useful tool for assessing the involvement of companies in illicit finance. The Financial Secrecy Index (FSI) ranks tax havens according to their contribution to opacity in international finance, combining qualitative and quantitative data. When investigating companies, researchers can look at the locations of registered subsidiaries and recipients of financial transactions, and highlight cases where finance is being moved into secretive tax havens.



The OECD is an active, albeit conservative, participant in the campaign for tax justice. As the labour movement begins to work with the OECD over specific violations of labour and human rights, there is an opportunity to cooperate over the issue of offshore and illicit finance. In 1998, the OECD issued the Harmful Tax Competition report, which identified harmful tax policies, many of which were associated with tax havens, and made a series of recommendations. Despite the Bush presidency's intransigence over tackling tax havens, during the 2000s the OECD concentrated on promoting the Global Forum on Transparency and Exchange of Information for Tax Purposes. Many have criticised the weakness of the bilateral tax information exchange agreements (TIEAs) that the OECD has promoted, as information exchanges are not automatic and there are difficulties surrounding the request-making process. Since 2009, the OECD has tried to enforce an inspection regime to ensure compliance with double tax agreements and TIEAs. However, under pressure from major corporations and financial institutions, the OECD has rejected the concept of Country-by-Country reporting.

Since the late 1990s, the European Union has made two major attempts to tackle tax abuse. Firstly, it demanded member states to end preferential tax regimes. This increased the transparency of tax structures in Ireland and Benelux countries in particular. Guernsey, the Isle of Man and Jersey were also pressured into offering the same tax rates to companies owned by their citizens are those owned by non-residents. Relative compliance has had a significant impact on the tax systems of the three islands. Secondly, the EU has promoted the European Union Savings Tax Directive. This promoted the automatic exchange of information between member states on bank and other deposit holdings. However, Austria, Luxembourg, Liechtenstein, Switzerland and some of the UK's dependencies opted for a two-track scheme, making non-resident account holders exempt. Twelve EU member states currently support, in principle, the adoption of a Financial Transaction Tax. EU countries linked to tax haven activities, most notably Ireland and the UK, are vehemently opposed to the proposal.

Civil society is increasingly engaging with the issues of capital flight, tax avoidance, tax evasion and tax competition. Oxfam has produced a number of international reports on the issue and national organisations such as the US Citizens for Tax Justice have elevated the issue.

Transnational corporations spread their millions across tax havens around the world, report huge profits as minor losses, do not pay tax, and still tell workers that they cannot afford to pay them a decent living wage. The labour movement must adapt its strategies to the new dynamics of the global economy if it is to continue to fight for workers' rights.