ACCUMULATION BY TAXPLOITATION

A WORLD-SYSTEMS ANALYSIS OF OFFSHORE TAX DODGING AND THE MOUNTING RESISTANCE AGAINST IT

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1. BACKGROUND

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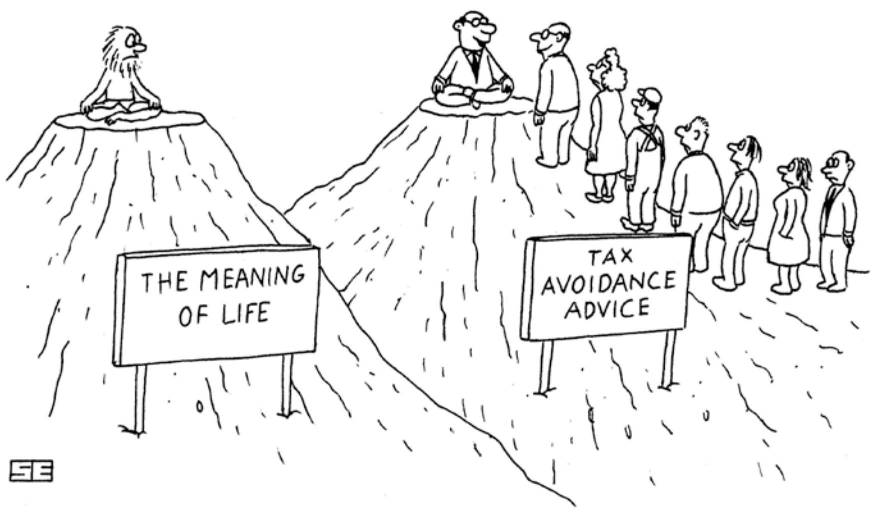
1.1 Offshore Tax Dodging (1/2)

Offshore tax dodging

- Umbrella term for **tax evasion** and **tax avoidance** using **offshore** structures.

- Demand: **high net worth individuals** (HNWIs) and **multinational enterprises** (MNEs).
- Supply: **tax havens** (also known as secrecy jurisdictions) and various **intermediaries**, mostly from the **accounting**, **law**, **banking**, and **finance** sectors. (Cousins et al. 2004; Palan et al. 2010; De Groen 2017; Schumann 2017)



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1.1 Offshore Tax Dodging (2/2)

- The term "**offshore**" generally connotes a geographical category, but in the context of tax dodging, it is a legal one.

- Offshore tax havens are essentially "**legal spaces that decouple the real location of the economic transactions from the legal location, and hence remove the tax liability of the transaction from the place where it actually occurred**". (Palan, 2009)

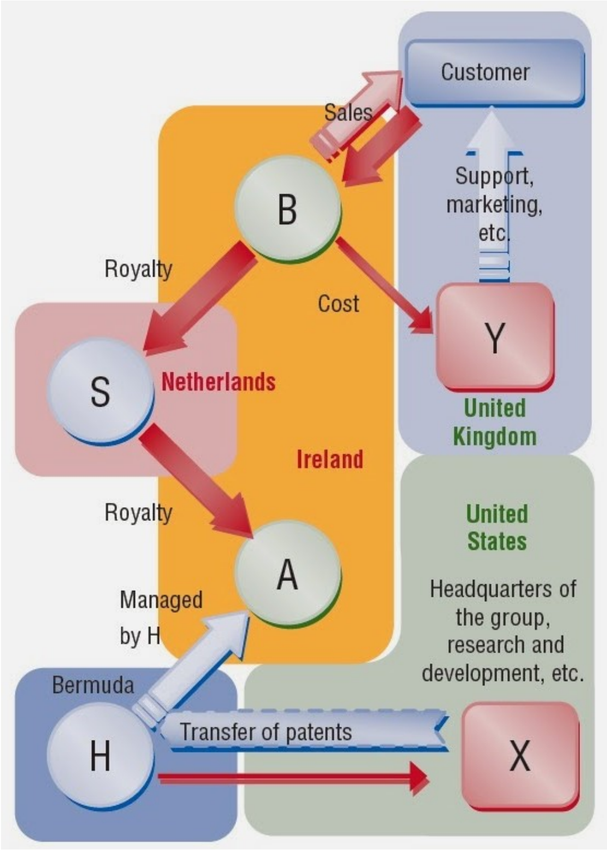
- They are highly specialized jurisdictions that offer a variety of services to help HNWIs and MNEs dodge taxes, with most offshore tax dodging schemes requiring the interplay of several specializations from several jurisdictions.

- Typically, offshore tax havens offer their clientele one, or a combination of, the following:

  - **very low or zero tax rates**;
  - **secrecy provisions**;
  - **light and flexible incorporation**. (Palan et al. 2010)

- Generally, the aim of corporate offshore tax dodging schemes is to **artificially shift profits to tax havens**, and **costs to regular jurisdictions** where the products are actually sold.

"Double Irish with a Dutch Sandwich" offshore tax dodging scheme (simplified)



Source: (IMF 2013, p. 47-48)

1.2 Size of Offshore Tax Dodging

- According to conservative estimates, as of 2015, somewhere between **US$7.6 to US$36 trillion** of untaxed financial wealth has been parked offshore, growing by somewhere between **US$200 to US$850 billion** annually, in relative terms **disproportionately affecting developing countries**. (Henry 2012; 2016; Zucman 2015; Crivelli et al. 2015; OECD 2015)

- This stash represents **8 to 38%** of the **US$95 trillion** total global financial wealth, and **3 to 14%** of the **US$250 trillion** total global financial and non-financial wealth that had been historically amassed up to that point. (Zucman 2015; Kersley and Stierli 2015)

  - Total official development assistance (ODA) by the OECD DAC in 2019: **US$153 bn**.
  - Total sovereign debt in 2019: USA – **US$21 tn**; EU-28 – **US$13 tn**; Japan – **US$11.8 tn**; China – **US$6.8 tn**; Latin Am. – **US$2.6 tn**; Africa – **US$1.3 tn**.

- According to voluntary disclosures, **73% (366)** of MNEs from the Fortune 500, **98% (98)** from the FTSE 100, and **57% (113)** from the ASX 200 reported that they operate tax haven subsidiaries, and numerous studies have shown that this strongly correlates with their lower effective tax rates. (Phillips et al. 2017; ActionAid 2011; TJN-Aus and United Voice 2014; OECD 2015)

- According to research published by the IMF, an estimated "**US$12 trillion – almost 40 percent of all foreign direct investment positions globally – is completely artificial**", consisting of "**financial investment passing through empty corporate shells with no real activity**", likely for tax purposes, and this "**phantom FDI keeps soaring, outpacing the growth of genuine FDI**". (Damgaard, Elkjaer and Johannesen 2018; 2019)

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1.3 Impact of Offshore Tax Dodging

- **Ravages tax revenues** – fewer resources for the funding or expansion of vital public services (e.g. education, healthcare, social security, mass transportation, research and development, etc.) and infrastructure projects, for faster and more effective responses to disasters and epidemics, as well as for focusing on key priorities like transitioning to a more environmentally sustainable economic model, among many others.

- **Exacerbates income and wealth inequality** – around **50%** of all wealth in tax havens is owned by the **0.01%**, and around **77%** by the **0.1%**. (Alstadsæter, Johannesen and Zucman 2017)

- **Perverts market competition** – grants an unfair competitive advantage to the wealthiest MNEs, the tax rates of which are conservatively estimated to be **4 to 8.5%** lower than those of similar domestic-only operations, SMEs, and startups, stifling innovation. (OECD 2015)

- **Undermines macroprudential and microprudential supervision** – most of the risky financial instruments (e.g. SPEs, SIVs, CDOs, hedge funds, etc.) that contributed to the global financial crisis in 2008 were registered in tax havens, far from any serious regulatory oversight, and offshore structures played a role in every major financial crisis since at least the 1982 default of Mexico. (Helleiner 1996; Errico and Musalem 1999; U.S. Senate Permanent Subcommittee on Investigations 2001; Rixen 2013)

- Ultimate result – **financial, macroeconomic, and societal instability**.

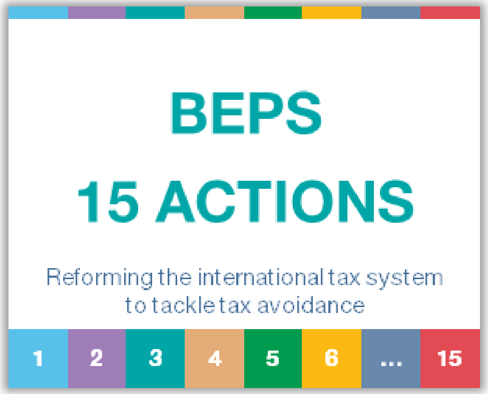
1.4 Historic Reform Momentum

- 11/2011 – G20 mandates the OECD to create the **Common Reporting Standard (CRS) for Automatic Exchange of Financial Account Information in Tax Matters** to tackle tax evasion by HNWIs and MNEs.

  09/2014 – CRS delivered and endorsed by the G20.
  - A milestone in financial account and tax transparency.

- 06/2012 – G20 mandates the OECD with undertaking the **Base Erosion and Profit Shifting (BEPS) Project** to tackle tax avoidance by MNEs.

  11/2015 – BEPS Project delivered and endorsed by the G20.
  - A milestone in corporate tax transparency, and the most far reaching reform of the international corporate tax system since its creation in the 1920s.



- 03/2017 – G20 mandates the OECD to continue its work on the **Tax Challenges Arising from Digitalisation (BEPS 2.0)** to effectively tax MNEs with highly digitalised business models.

  03/2018 – Interim Report (work ongoing)
  02/2019 – Public Consultation Document (work ongoing)

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2. OUTLINE OF THE PUZZLE

2.1 Problem of Limited Scope

- Aside from a handful of notable exceptions (Picciotto 1992; Hampton 1996; Palan 2006; Palan et al. 2010; Shaxson 2012), international taxation and offshore tax dodging almost nonexistent as areas of serious inquiry in either mainstream or radical international relations and political economy, and their systemic importance either unacknowledged, downplayed, or misunderstood.

- Explanations limited to largely ahistorical narratives focusing on proximate causes mostly related to the global financial crisis:

  - recession and bailouts resulting in greater need for tax revenue;
  - political elites needing to appear tough to placate furious publics.

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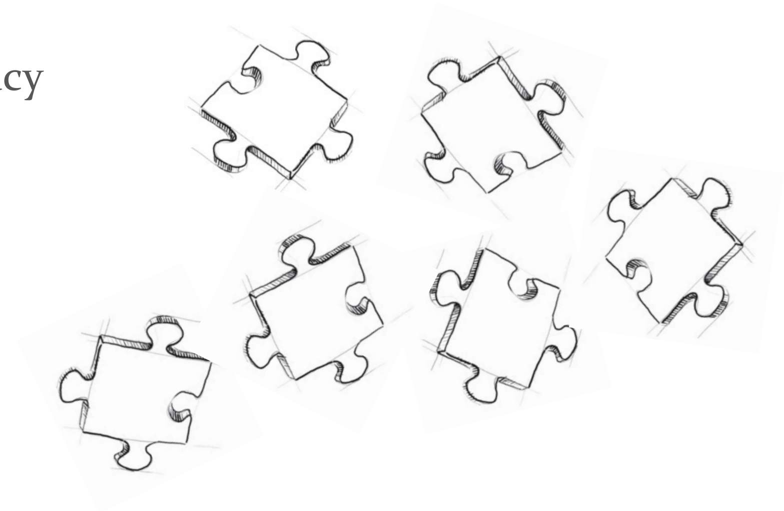
2.2 Puzzle Pieces & Research Questions

- **Puzzle pieces**:

  - Capitalism and its crisis of legitimacy
  - Dominant ideas and ideologies
  - International tax system
  - State interests
  - Class interests
  - Past regulatory attempts

  (Interests, Institutions, and Ideas)



- **Research questions**:

  How did the historic reform momentum against offshore tax dodging emerge, and why at this particular point in time?

3. WORLD-SYSTEMS ANALYSIS

3.1 Unit of Analysis & Key Structural Features

- Unit of analysis: **world-system = capitalist world-economy**. (Wallerstein 1974; 2006)

- 1) **Axial division of labor** – the capitalist logic of endless accumulation resulting in a system-wide exploitative hierarchy between core, semiperiphery, and periphery.

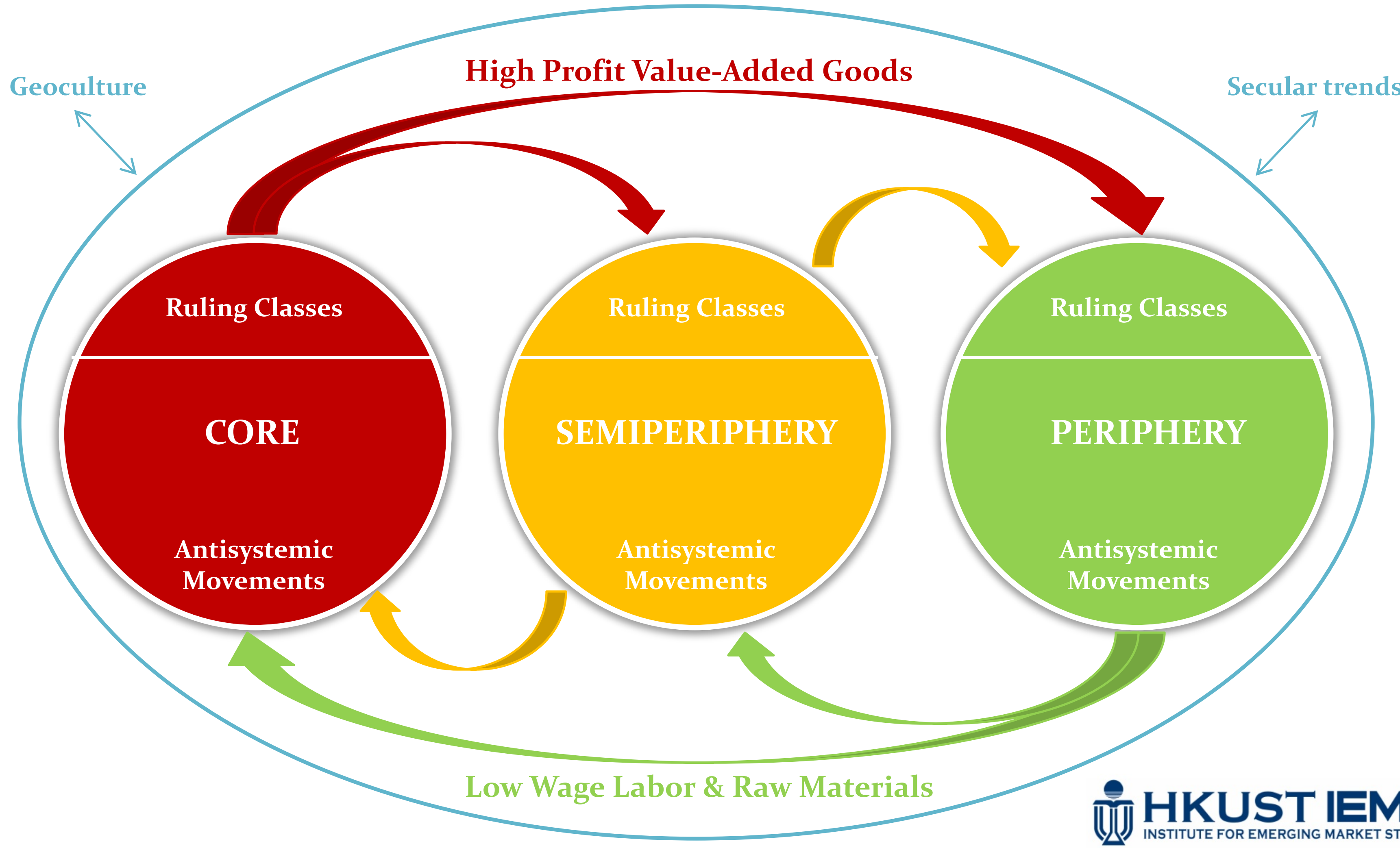
- 2) **Interstate system** – interstate competition between states resulting in a winner, a hegemon, which for a period of time establishes a stable dominant order (e.g. 19th century Great Britain, and 20th century United States).

- 3) **Geoculture** – the dominant understanding of the world, an ideological paradigm, or a global "common sense", resulting from a struggle between ideologies and antisystemic movements, as well as from a struggle over the control of the social sciences.

- 4) **Secular trends** – the numerous motions that keep the systemic edifice moving and evolving along a certain path (politicization, democratization, bureaucratization, transparency, technological progress).

- 5) **Crisis context** – the ultimately terminal crisis towards which every world-system marches and eventually reaches through the workings of the previous four features, resulting in systemic change.

3.2 Functioning of the Capitalist World-Economy



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4. OFFSHORE TAX DODGING AND THE MOUNTING RESISTANCE AGAINST IT

G20

OECD

GROUP OF 77 & CHINA

European Commission

European Parliament

TRANSPARENCY INTERNATIONAL
the global coalition against corruption

APMDD
ASIAN PEOPLES' MOVEMENT ON DEBT AND DEVELOPMENT

Latindadd
Red Latinoamericana por Justicia Económica y Social

EPSU
EUROPEAN PUBLIC SERVICE UNION

eurodad
european network on debt and development

CBGA
Centre for Budget and Governance Accountability

TUAC

actionaid

tax justice network

christian aid

GLOBAL ALLIANCE FOR TAX JUSTICE

PSI PUBLIC SERVICES INTERNATIONAL

ICRICT
Independent Commission for the Reform of International Corporate Taxation

Oxfam

TAX JUSTICE NETWORK AFRICA

GLOBAL FINANCIAL INTEGRITY

global witness

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4.1 Systemic Underpinnings of Offshore Tax Dodging (1/3)

- **Architecture of the international tax system**
- Created in the late 1920s by the Western colonial powers and their business elites, and designed to serve their interests at the expense of the semiperiphery and the periphery. (Picciotto 1992)
- 1) Skewed allocation of taxing rights benefitting capital-exporting economies (countries of "**residence**") at the expense of capital-importing economies (countries of "**source**"), and enshrined in a system of bilateral tax treaties, giving rise to the "**source-residence conflict**".
- 2) Reliance on two legal fictions:
  - **Separate entity principle** – for tax purposes, each subsidiary of an MNE group is to be treated as if it was a separate entity.
  - **Arm's length principle** - any transaction between related entities within an MNE group has to be priced as if it was undertaken between unrelated entities operating at arm's length, which is to say by using market prices.
- Two key takeaways:
  - **1) emerging powers and developing countries highly motivated to reform the international tax system**;
  - **2) the architecture of the international tax system unintentionally facilitates offshore tax dodging**.

4.1 Systemic Underpinnings of Offshore Tax Dodging (2/3)

- **Modern proliferation of tax havens and offshore tax dodging**

- Some of the oldest legislative tax haven acts trace back to **1869** (Monaco), **1875** (New Jersey), **1898** (Delaware), **1926** (Liechtenstein), **1929** (Luxembourg), and **1934** (Switzerland), but their modern proliferation is tied to three phenomena:

  - 1) **A 1957 Bank of England ruling**, which decreed "that transactions undertaken by UK banks on behalf of a lender and borrower who themselves were not located in the UK were not to be officially viewed as having taken place in the UK for regulatory purposes even though the transaction was only ever recorded as taking place in London" – such transactions thus became effectively unregulated, in other words "offshore". (Palan 2009)

  - 2) **Decolonization** in the 1960s (new countries looking for niches in the global market).

  - 3) **Globalization** and the advances in transportation and communication technologies.

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4.1 Systemic Underpinnings of Offshore Tax Dodging (3/3)

- **Rise of neoliberalism and the golden era of tax havens and offshore tax dodging**

- The establishment of an unregulated offshore financial market undermined the Bretton Woods system of capital controls by enabling massive capital flight, setting off a chain reaction which precipitated both the fall of the until then dominant centrist liberal ideological paradigm of Keynesianism, and the consequent rise to dominance of neoliberalism, the ideological paradigm based on competition, liberalization, privatization, deregulation, and low tax rates.

- The ascendance of neoliberalism to ideological dominance in the late 1970s marked the beginning of the golden era of tax havens and offshore tax dodging.

- The mutualistic symbiosis between neoliberalism and the offshore world increasingly led to crises, due to:

    - several rounds of financial deregulation;
    - capital flight;
    - growing public debt;
    - proliferation of risky financial instruments.

- Crises led to the loss of legitimacy of the system, which in turn led to growing resistance against the offshore world.

4.2 Rise of the Global Tax Justice Movement (1/3)

- Some pre-history of the global tax justice movement dating back to the late 1970s, the 1980s and the 1990s in the UK and the USA, along with some academic work (Picciotto 1992; Hampton 1996), but its modern rise can be traced to the activities of **John Christensen**.

- Born and raised in Jersey, worked at Deloitte in the mid-1980s and as Jersey's chief economic adviser in the 1990s.

- In 2003, he founds the **Tax Justice Network**, the first global NGO focusing specifically on tax justice.

- Various tactics: berserking, [Financial Secrecy Index](), [TaxCast]().

Rank	Jurisdiction	FSI - Value[6]	FSI Share[7]	Secrecy Score[4]	Global Scale Weight[5]
1	Cayman Islands[2]	1,575.19	4.63%	76	4.58%
2	United States[2]	1,486.96	4.37%	63	21.37%
3	Switzerland[2]	1,402.10	4.12%	74	4.12%
4	Hong Kong[2]	1,035.29	3.04%	66	4.44%
5	Singapore[2]	1,022.12	3.00%	65	5.17%
6	Luxembourg[2]	849.36	2.49%	55	12.36%
7	Japan	695.59	2.04%	63	2.20%
8	Netherlands[2]	682.20	2.00%	67	1.11%
9	British Virgin Islands[2]	619.14	1.82%	71	0.50%
10	United Arab Emirates[2]	605.20	1.78%	78	0.21%
11	Guernsey[2]	564.56	1.66%	71	0.41%
12	United Kingdom[2]	534.65	1.57%	46	15.94%

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4.2 Rise of the Global Tax Justice Movement (2/3)

- **List of tax justice solutions** (TJN 2020):
  - **1) Automatic exchange of financial and tax information**

  - **2) Beneficial ownership registers (public)**

  - **3) Country-by-country reporting (public)**

  - **4) Unitary taxation**

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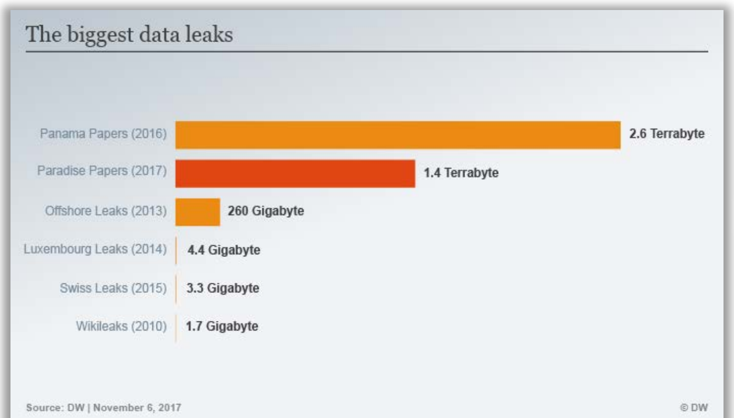
4.2 Rise of the Global Tax Justice Movement (3/3)

- The **tax justice** cause and the list of solutions gradually attract the attention and favor of an ever-expanding set of actors: **academics**; **NGOs**; **investigative journalists**; **trade unions**; **feminist**, **racial justice**, **and environmental movements**; **institutional investors**; **SMEs**; and increasingly **whistleblowers**.

  - A steady stream of **leaks** and **hacks** (ICIJ 2020): Offshore Leaks (2013); China Leaks (2014); Luxembourg Leaks (2014); Swiss Leaks (2015); Panama Papers (2016); Bahamas Leaks (2016); Paradise Papers (2017); West Africa Leaks (2018); Mauritius Leaks (2019); Luanda Leaks (2020).



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4.3 A Century of Regulatory Laxity (1/2)

- Offshore tax dodging widely reported in the media as a significant problem as early as the 1920s, eventually leading to a serious inquiry as part of the New Deal reforms in 1937.
- 1961 – President John F. Kennedy recommends the "**elimination of the 'tax haven' device anywhere in the world, even in the underdeveloped countries, through the elimination of tax deferral privileges for those forms of activities, such as trading, licensing, insurance and others, that typically seek out tax haven methods of operation**." (Kennedy 1961)
  - Republican and big business opposition succeeds in significantly weakening the legislation.
- 1981 – The Carter administration commissions the Gordon Report, which finds that:
  - investment into tax haven-based subsidiaries rose from US$4.7 bn in 1968 to US$23 bn in 1978; earnings of tax haven entities increased from US$0.5 bn in 1968 to US$4.4 bn in 1978; and deposits in tax haven banks have grown from US$11 bn in 1968 to US$385 bn in 1978.
  - The problem is identified as "**lack of meaningful exchange of information**", and the proposed solution is to conduct "**a coordinated multilateral attack on tax havens**". (Gordon 1981)
  - Opposition led by the Chase Manhattan Bank succeeds in defeating the proposal, claiming it would make U.S. businesses **uncompetitive**.

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4.3 A Century of Regulatory Laxity (2/2)

- 1990s – in what is later referred to as "**the attack of the alphabet**", the G7 tasks the FATF, the FSF, and the OECD to look into tax havens, with the Clinton administration being a strong proponent of the effort.
- 1998 – the OECD launches the first serious multilateral campaign against tax havens, the so called "**Harmful Tax Competition Initiative**", and its landmark report not only finds that "**tax schemes aimed at attracting financial and other geographically mobile activities can create harmful tax competition between States, carrying risks of distorting trade and investment and could lead to the erosion of national tax bases**", but also threatens tax havens with "**defensive measures**". (OECD 1998)
- OECD tax haven members Switzerland and Luxembourg publicly denounce the report and refuse to be bound by any of its provisions.
- Non-OECD tax havens argue on the grounds of **competitiveness**, leading to the Isle of Man clause.
- Intense lobbying effort by neoliberal/libertarian think tanks, banks and financial institutions gains support of 86 Republican Congressmen and several high ranking officials in the new Bush administration.
- May 2001 – the new U.S. Secretary of the Treasury Paul O'Neill lambasts the OECD and derails the campaign. "**The United States simply has no interest in stifling the competition that forces governments – like businesses – to create efficiencies.**" (Sharman 2006)

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4.4 Tangible Progress (1/2)

- 2005 – **EU's Savings Directive** mandates an annual **automatic exchange of information** on interest paid between EU Member States, their dependent and associated territories, as well as third parties like Andorra, Liechtenstein, Monaco, San Marino, and Switzerland.

- May 2008 – eruption of the **UBS tax evasion scandal** sets off an avalanche in the Swiss banking community, with the U.S. Department of Justice subsequently launching criminal investigations into 15 other Swiss banks aside from UBS, accusing them of conspiring to help their American clients evade taxes, and getting guilty pleas from most of them.

- 2010 – The Obama administration enacts the **Foreign Account Tax Compliance Act (FATCA)**, a unilateral game-changer in tax transparency.

    - FATCA asks all foreign financial institutions (FFIs) anywhere in the world to register with the IRS and report the relevant account information of all their U.S. clients.

    - Joining FATCA is voluntary, BUT, non-participation is treated with an automatic **30% withholding tax** on certain payments of U.S.-sourced income (e.g. dividends, interest, insurance premiums).

    - Participating FFIs are **required to withhold 30%** on these payments to non-participating FFIs, widening the coverage significantly.

    - FATCA is a direct influence on the CRS (which is also colloquially known as GATCA, as in Global Account Tax Compliance Act).

4.4 Tangible Progress (2/2)

- 1) **Automatic exchange of financial and tax information**
  - USA – Foreign Account Tax Compliance Act (passed 2010, effective from 2015) X
  - OECD – Common Reporting Standard (passed 2014, effective from 2017) X

- 2) **Beneficial ownership registers (public)**
  - EU – 4th/5th Anti-Money Laundering Directive (passed 2015, effective from 2017) X/X

- 3) **Country-by-country reporting (public)**
  - OECD – Base Erosion and Profit Shifting (passed in 2015, effective from 2016) X/X
  - EU – Proposed at the EU level in 2016 (results uncertain)

- 4) **Unitary Taxation**
  - EU – Common Consolidated Corporate Tax Base (discussed since 2001, launched and failed in 2011, re-launched in 2016, results uncertain) X
  - OECD – BEPS 2.0 (movement in some areas, results uncertain) X

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5. SYNTHESIS


tax haven
tax shelter
money
offshore bank
evasion
low tax
Cayman Islands
Bermuda
shell subsidiary
Isle of Man
tax competition
secrecy
nominal taxes
income tax
underground economy
reduction
territory
taxation level
wealth
asset
capital
advantage
avoidance
account
money laundering
jurisdiction
tax revenue
tax law
taxation
fraud
evasion
offshore bank
income tax
nominal taxes
Isle of Man
account
low tax
tax revenue
Bermuda
tax haven
reduction
tax shelter
advantage
asset
capital
Cayman Islands
underground economy
territory
tax haven
taxation
wealth
account
tax shelter
Isle of Man
taxation
capital
tax law
wealth
taxation level
reduction
secrecy
money
tax revenue
shell subsidiary
offshore bank
secrecy
underground economy
fraud
money laundering
avoidance
jurisdiction
tax revenue
tax competition
money
tax law
Bermuda
fraud
tax competition
shell subsidiary
Cayman Islands
capital
territory
underground economy
avoidance
asset
money laundering
taxation level
avoidance

5.1 Summary of the Main Findings

- The historic reform momentum against offshore tax dodging emerged at this particular point in time as a result of several historical factors and processes, including:

  1) the gradual loss of legitimacy of the dominant neoliberal ideological paradigm;

  2) the relative weakening of the United States vis-à-vis several emerging market powers;

  3) the steady growth and successes of the global tax justice movement;

  4) the unique challenges arising out of the digital economy; and

  5) several secular trends, such as of politicization, democratization, bureaucratization, transparency, and technological progress.

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THANK YOU FOR YOUR ATTENTION !

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