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Tax havens. States complicities

Jacques Fontanel

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Université Grenoble-Alpes, CESICE, Grenoble
ILERI, Institut Libre des Relations Internationales, Paris

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Résumé : Depuis 40 ans, ces paradis fiscaux se sont multipliés, les entreprises ont fait appel à leurs services, par le canal de sociétés de service parmi les plus importantes au monde et les banques ont favorisé à la fois le blanchiment de l'argent et l'évitement fiscal. Il existe différents types de paradis fiscaux, ils ne se situent pas toujours dans les petites îles. L'OCDE et le GAFI sont chargés d'agir pour réduire les effets néfastes de ces opérations fiscales et criminelles, mais les intérêts des grandes firmes conduisent certains Etats à ne pas refuser l'application des politiques de type beggar-thy-neighbour. Les firmes multinationales, particulièrement dans l'économie digitale et de l'information, sont particulièrement efficaces pour échapper aux impôts, en jouant sur les divergences profondes de fiscalité et de réglementation bancaire des pays. Cette situation accroît l'injustice économique et les inégalités sociales nationales et internationales.

Over the past 40 years, these tax havens have multiplied, businesses have used their services, through some of the world's largest service companies, and banks have facilitated both money laundering and tax avoidance. There are different types of tax havens, they are not always located in small islands. The OECD and the FATF are charged with taking action to reduce the harmful effects of these tax and criminal operations, but the interests of large firms lead some states not to reject the application of beggar-thy-neighbour policies. Multinational firms, especially in digital economy, are particularly effective at evading taxes by playing on the profound differences in taxation and banking regulations between countries. This increases national and international economic injustice and social inequality.

Tax havens, beggar-thy-neighbour, injustice, social inequalities
Paradis fiscal, injustice, inégalités sociales

Tax havens have existed for a long time. They seemed to be reserved for people with high incomes who wanted to avoid taxes or who wanted to hide precautionary savings in the face of conflicts throughout the world's history. It was known that "dirty" money was placed there, the object of all drug trafficking, prostitution or dirty business not legally identified. Over the past 40 years, these tax havens have multiplied, companies have used their services, through some of the world's largest service companies, and banks have facilitated both money laundering and tax avoidance. Some states, often declared virtuous, such as Switzerland, Ireland or Luxembourg, have also engaged in this adventure, with great profit. For more than a thousand years, the City of London has not paid taxes and has been a financial centre for all these small-scale transactions, which have gradually been the subject of considerable transfers, directly and indirectly impacting global economic development. The world tour of tax havens makes one dizzy. Although it is very difficult to know exactly how much money is hidden under real or false names, estimates today put the amount of deposits at the low end of the range at over 40,000 billion dollars, mainly diverted from public resources or the result of money laundering procedures.

The issue should be addressed politically, as public expenditure is usually used for collective purposes¹. Social or national conflicts can arise from too much inequality, which then appears as injustice. The OECD and the European Union are rushing as slowly as possible to find a solution, as if they were afraid that some of its member states or government officials might be involved². The Panama Papers have highlighted the importance of these transfers among the world's top leaders³. No one knows what Donald Trump pays in taxes and even the Queen of England has been directly implicated in secret investments outside the UK's jurisdiction.

What are the criteria that define a tax haven?

The country must have recognised political stability, regardless of the constitutional system in place, a good brand image and a willingness to embrace international financial transactions as part of its competence and "know-how". As a result, it can benefit from the support of a major financial centre, have particularly well adapted information technology and be

¹ Fontanel, J. (1995), *Organisations économiques internationales*, Masson, Paris.

Fontanel, J., Arrow K., Klein, L., Sen, A. (2003), *Civilisations, globalisation et guerre*, PUG, Grenoble.

² Commission européenne (2016), Paquet de mesures contre l'évasion fiscale, http://europa.eu/rapid/press-release_MEMO-16-160_fr.htm

³ Commission européenne (2016), Paquet de mesures contre l'évasion fiscale, http://europa.eu/rapid/press-release_MEMO-16-160_fr.htm

located at the heart of an important network of bilateral agreements, allowing for tax evasion. The procedures for registering companies are easy and quick, and the information required is minimal. The formalism for the establishment of companies is reduced and the law concerning foreign trusts is, to say the least, unrestrictive and very liberal. The total freedom of capital movements is announced, even claimed. In this context, banking secrecy is institutional and taxation for non-residents is very low, if not zero. The confidentiality of financial transactions is an immutable rule, and national regulations are strict on these obligations. The country has legislative provisions or administrative practices limiting and even preventing an exchange of information on their taxpayers from other countries. Obtaining information from institutions located in tax havens is particularly difficult, usually even prohibited by law, because in addition to banking secrecy, there is also business secrecy, a provision claimed by large companies and widely respected by financial institutions and trusts. The opacity of finances passing through offshore centres is increased by the complexity of the arrangements put in place. Trusts or shell companies reduce the legibility of accounts, to their sole benefit. The search for the source of financial commitments located in tax havens comes up against silence and legislation⁴.

States are sovereign and it is impossible to dictate to them rules that they do not wish to follow in view of their sovereign power. Tax havens have particularly interesting tax exemption legislation. International judicial cooperation is then deliberately limited. Yet the WTO establishes specific trade rules, supposedly binding on member states, and the FATF (Financial Action Task Force on Money Laundering) fights money laundering at international level. However, compliance with these rules, which are ultimately not very binding with regard to the sovereignty of each State, does not make it possible to really combat these two scourges, which are reinforced by acts of corruption and secret agreements, often with the assistance or blessing of the public authorities of the countries concerned.

Since 2010, these offshore centres have been one of the main problems of the international financial system⁵. Public resources have been

⁴ Transparency International France (2014), *Agir contre la corruption*, TI France, Paris.

Zucman, G. (2015), *The Hidden Wealth of Nations ; The Scourge of Tax Havens*, University of Chicago Press.

⁵ Chavagneux, C. (2011), *A quoi servent les paradis fiscaux ?* Les Amis de l'École de Paris, 2011. Coulomb, F., Fontanel, J. (2006), *Spéculation et instabilité financière internationale* (avec Fanny Coulomb), in « Des flux et des territoires. Vers un monde sans Etats ? Presses de l'Université du Québec, Montréal, 2006. Fontanel, J. (2005), *Spéculation internationale et géopolitique*, AFRI, *Annuaire Français des Relations Internationales*, Vol. VI. 2006.

used by those who have never wished to contribute to the realisation of the democratic demand voted by the parliaments of the countries concerned. The activity of tax havens is considerable, estimated at 20% of the world's private wealth and 22% of external assets, with illicit activities accounting for a quarter of these amounts. More than 4,000 banks and nearly 3 million shell companies are involved. Half of international trade and a third of financial flows pass through tax havens. Start-ups know all the financial twists and turns to avoid taxes in every country in the world, except in those with no or very low taxation. Wealthy taxpayers can thus hide their fortunes under the shelter of banking secrecy. Tax evasion has reached such proportions that it now threatens the stability of states. Large multinational companies making billions of euros in profits can substantially reduce their taxes, thanks to complex financial networks that make them low contributors to public services. They develop complex financial arrangements or accounting operations in the "value chain" of production and trade within or outside the company, which favour the reduction of their taxes. In this way, they benefit from the weak fiscal coherence of independent public institutions on issues concerning national public budgets. The big consultancies actively participate in this wealth plundering, as the bankruptcy of Andersen demonstrated. Banks are not above helping their rich clients, even when they have been bailed out by public money. But states are now heavily indebted. Greece went bankrupt because of its inability to levy taxes, especially on wealthy shipowners and the clergy.

Real tax evasion businesses have been set up. Tax havens have normally committed themselves to the 40 recommendations of the OECD and FATF, with a view to redemption or avoidance of potential international sanctions. In various ways, there are just under a hundred tax havens. Several countries are not really willing to cooperate, including Egypt, Indonesia, Ukraine, Guatemala, Nigeria, Hungary, Bahamas, Cayman Islands, Cook Islands, Santo Domingo, Israel, Lebanon, Liechtenstein, Marshall Islands, Niue, Panama, Philippines, Russia, Saint Kitts and Nevis, Saint Vincent and the Grenadines, Anguilla, Barbados, Bahrain, Belize, Samoa, Montserrat, Seychelles, Vanuatu. The Financial Stability Forum's (FSF) offshore centres are slightly more open and include Ireland, Luxembourg, Switzerland, Andorra, San Marino, Barbados, Bermuda, Gibraltar, Aruba, Hong Kong, Isle of Man, Bahamas, Anguilla, Nauru, Netherlands Antilles, Turks and Caicos Islands. The FSF has been in existence since 1999 and manages foreign exchange reserves on behalf of developing countries (list not exhaustive). One should not forget the Offshore Financial Centres (OFC) which allow non-residents to borrow in a third national currency (such as the dollar) from non-residents in order to

benefit from favourable tax conditions. OFCs can be found in London, New York (U.S. International Banking Facilities, IBFs), Tokyo (Japanese Offshore Market, JOM), Hong Kong and Singapore.

As part of the government's policy to crack down on international tax evasion, France updated its list of uncooperative states and territories (ETNCs) in April 2012. The list includes Botswana, Brunei, Guatemala, Marshall Islands, British Virgin Islands, Montserrat, Nauru and Niue. Anguilla, Belize, Costa Rica, Cook Islands, Dominica, Grenadines, Liberia, Oman, Panama, St. Vincent and Turks and Caicos Islands have been removed from the list of tax havens, even though financial transactions are often questionable. This list rather highlights Luxury Yacht registrations, as other territories are not always suitable for business activity. In 2016, for Forbes magazine, the best tax havens suitable for commercial activities were first, Delaware, followed by Luxembourg, Switzerland, the Cayman Islands, the City of London, Ireland, Bermuda, Singapore, Belgium and Hong Kong. This list highlights the fact that not all tax havens are located on small islands. Europe, which is often so accustomed to making accusations against tax havens, forgets to mention some of its members or allies, who are often the main players in large-scale cases. However, today, EU countries are more risky for European residents. The best tax haven obviously depends on its specific location. Until 2010, the UK (as a commercial agent), Switzerland (for holding companies), Seychelles, Hong Kong, Singapore, Panama and Costa Rica were highly recommended by banks, but today investments in Europe are increasingly risky for Europeans themselves.

All the current mechanisms for combating tax evasion and money laundering require the cooperation of the country where the money was invested or laundered. A Financial Action Task Force on Money Laundering, the FATF, has been set up. The development of standards and the promotion of effective implementation of legislative, regulatory and operational measures to combat money laundering, terrorist financing and other related threats to the integrity of the international financial system are among its main objectives. The FATF has established a list of 40 measures to effectively combat money laundering, and all members are called upon to include these measures in their legislation. Its effectiveness is limited, however, as it has no executive powers. While it lists countries whose legislation is particularly conducive to money laundering, it cannot take any measures to compel them to comply with the transparency and "ad hoc" rules necessary for good international competition. The FATF monitors the progress of its members in implementing the required measures, examines money laundering and terrorist financing techniques and measures to combat them, and promotes the adoption and

implementation of appropriate measures at the global level. Among its members are Luxembourg, the United Kingdom, Switzerland, Singapore, Ireland and the United States, which are among the main producers and actors of these tax havens.

Designing accounting lines for tax optimisation

International transfers are not always governed by the simple exchange of products. Companies are concerned about their tax liabilities, and they use the cross-border trading scheme to declare the maximum value added to a product in the country with the lowest taxes. This policy is singularly changing the rules of global competition. What interest can a government of one country have in reducing its corporate tax rates from 50% to 30%, if nearby countries accept tax levels below 10%? Within the European Union, Ireland's strategy of tax competition to attract large multinational companies, notably through the system of free trade zones, is infuriating multilateral trade specialists who can no longer defend the idea of fair and normal competition between all members of international organisations designed to regulate free trade (WTO), the financial system (IMF) or support for specific operations in developing countries (World Bank). Moreover, by depriving states of valuable tax revenues, this phenomenon weakens both the capacity for public sector intervention and the independence of all countries in the world, especially those in the South, which suffer from increased dependence on foreign financial flows (aid, investment, debt), thus seriously limiting their political autonomy.

Statistical analyses of financial and commercial transactions do not fail to challenge specialists. The Virgin Islands have sometimes invested more in China than Japan or the United States. Russia seems to favour agreements and economic exchanges with Cyprus, a state belonging to the European Union. Mauritius is the largest investor in India. Multinational companies set up subsidiaries in these states, which invest worldwide and often develop their own subsidiaries. In this context, the registration of profits in internal trade is carried out in the territory that offers the lowest tax rate, both for the activities of the parent company and for their own subsidiaries. This phenomenon exists equally in developed countries. For example, the loss of revenue for the US government is estimated at more than 300 billion dollars, hidden in part in Delaware, a state adjacent to New Jersey. In other words, the US government admits this particular zone to favour US exports and imports, for a "special" aid of \$300 billion for the competitiveness of US companies and subsidiaries, which is not mentioned by the WTO. 60% of US imports concern intra-company trade, without

knowing the importance of the financial networks belonging to US economic actors in the complex arrangements of trusts and holdings.

The transfer prices of enterprises in the same group are supposed to follow a well-defined set of rules, established by each country or at the multilateral level. The general principle is that prices for trade between two companies in the same group should not be different from those of two independent companies. However, these prices are widely manipulated by companies. Transfer pricing strategies are central to the tax optimisation of financial groups and multinationals. More than two thirds of multinational companies use transfer pricing manipulation to reduce their final costs, thereby increasing their overall profit. Legal services for tax optimisation studies have become recognised profit centres, designed to create value for the company. Finally, large audit firms receive remuneration based largely on the results obtained in terms of tax avoidance. Multinational companies are taking advantage of this situation, without the Western states, even though they are members of the FATF, reacting to this state of affairs in a concerted manner. Governments show little courage to fight such evasion of potential revenues; sometimes, supported by these companies, they even tolerate this barely concealed tax evasion.

US law encourages complex arrangements to ensure the international commercial competitiveness of multinational companies operating in the US. It formalises this form of tax exemption for companies that domicile profits from international contracts in subsidiaries in offshore locations. Most of the large American companies, thanks to these arrangements, no longer pay corporate tax, to the detriment of other taxpayers. In this context, it is difficult to know the added value of each country, and therefore its real GDP. In France, given the presence of many countries practising tax competition, it is likely that the real value of its GDP is higher than its official figure. By the standards obtained for the United States, this discrepancy could be in the order of 10 to 15% of the GDP calculated by INSEE. In fact, this state of affairs poses a major problem in terms of the readability of statistics and their interpretation. If the value added declared at France's customs gateway means that this country does not have sufficient productivity and that, as a result, salaries are too high and should be reduced to improve the competitiveness of companies. In reality, this is nothing more than an accounting manipulation with considerable social consequences on wages and employment.

Article 238 A of the General Tax Code institutes a presumption of "abnormality" on certain financial transfers or payments made to low-tax areas. Article 209 B of the General Tax Code provides for the taxation of French parent companies of profits generated in subsidiaries located in countries with privileged tax regimes. However, it is always easy to use

another partner. For example, a company can sell milk produced in France at a near-loss, and export it to Germany for a simple operation, always with low added value. The finished product is then sold to Luxembourg, where, without any industrial operation being undertaken, a high added value is declared, with a correspondingly low tax. The product can then be returned to France to be sold at a price that will have been significantly higher than its original cost. In this case, it is very difficult to use these items. It would be necessary to be able to follow the whole production from country to country to see the real evolution of the declared added value. Luxembourg then uses the impoverishment policy of its neighbour, without any restriction, which may explain the size of its per capita income that its real activities in the value chain make very difficult to justify.

Criminal activities

Some criminal activities are particularly difficult to quantify economically. The secrecy of these transactions, which lead to money laundering, is particularly severe, and international legislation, generally lacking specific instruments, is unable to control them. The estimates proposed are random and often only show the tip of the iceberg. Analysts are well aware of the organisation of these criminal activities, but the estimation of their real size remains questionable. In the framework of the studies undertaken on the subject, it is necessary to report on drug trafficking (with the difficulty of highlighting whether, at the international level, certain substances are recognised as drugs, such as hashish or marijuana), the growing traffic in human beings (transport of illegal immigrants, sex industry, form of slavery), smuggling (concerning price differences due to heterogeneous taxes from one country to another), counterfeiting, or the arms trade. We should also mention slush funds, false invoices, clandestine work, insurance fraud, computer manipulation (impossible to estimate), financial crime, VAT fraud through the so-called "VAT carousel" system, but also balance sheet fiddling (Enron, Andersen, etc.) or swindling (Madoff), which benefits, at least in part, tax havens.

Corruption is undoubtedly the sector that is most beneficial to the development of tax havens, given the secrecy of operations. In fact, the importance of the phenomena that are classified under the relatively imprecise term "corruption" is largely underestimated today. And this underestimation, maintained by the media, is officially encouraged. The complicity of the political class and economic leaders in certain forms of corruption, in particular tax evasion, as evidenced by the acceptance of the use of 'tax havens', seems normal to many people of influence.

The public is not properly informed about the various forms of financial crime, the extent of such practices, their consequences for public finances and for the smooth running of the economy, and of course the financial amounts involved. There is no link between financial crime and wealth and income inequality, which is a fundamental issue. Criminal legislation in this area remains insufficient to punish all irregularities, and above all it remains very diverse from one country to another, thus allowing fraudsters and offenders to easily find refuge from prosecution.

Prosecutions are often politically sensitive and technically complex to carry out on an international scale. This can be explained by the lack of harmonisation of national legal systems and the absence or inadequacy of communication between countries normally belonging to the same networks. However, in cases of tax evasion, judges call on the help of judges in the country receiving the funds. This often results in very lengthy procedures, which constantly get bogged down in technical or legislative details, which in the end favour the money laundering exercise. For example, the Montebourg report on Liechtenstein highlighted the poor treatment of international letters rogatory by the Liechtenstein authorities. Requests for information from magistrates are completely ignored by their counterparts, which is both never punished and not subject to any information on the country's procedures for protecting fraudsters.

The abolition of tax havens has often been mentioned. President George Bush Jr. even included it in his plan to fight terrorism. In a simple version, it would be enough to progressively block the financial exchanges concerned. Immediate freezing or control seems difficult in view of the size of the transactions and the strategies put in place by multinational firms that are reluctant to carry out a "one-two punch" operation in low-tax financial centres. On the other hand, strict regulations could be put in place to ensure that reasonable taxation is accepted under well-defined conditions. This simple solution is rejected by governments, which have a special relationship with large firms that provide jobs for their nationals, improve their balance of trade in the very short term and carry significant political weight in the country.

Today, the current fight against money laundering and the excesses of tax havens is reduced to a legislative fight, with regard to the rules defined by the FATF. States that are reluctant to provide information on the nature and origin of funds deposited are not subject to any international retaliatory measures. However, the effectiveness of proceedings against national regulations could be considerably increased, but it remains difficult to oppose Delaware and the City of London, behind which lie all other tax havens. However, the United States has obtained the lifting of Swiss banking secrecy for certain operations deemed important by its

government, without itself giving up operations in Delaware. There is no real will to fight against the financial ins and outs of criminal abuses. The idea that these "offshore" centres are necessary for the functioning of capitalism and the market economy is anchored in the collective information. Financial crime has no visible or understandable effect on analysts, let alone citizens. Corruption is secretive, 'dubious' funds escape the scrutiny of national jurisdictions and multinational firms are happy to use country-to-country transfers to maximise their profits. This "white collar" crime is located in the rich strata of society, surrounded by legal and economic advisors in charge of finding all the gaps in the law to enhance their assets, to the detriment of the already unfair rules of income distribution produced by the market economy.

Overall, public indebtedness has increased considerably, particularly as a result of tax avoidance. In billions of dollars, France (2500, 99% of GDP), Germany (2800, 85% of GDP), Japan (12200, 250% of GDP), the United Kingdom (2680, 100% of GDP) or the United States (14700, 88% of GDP) are heavily indebted, but the magnitude of the negative effects depends on the maturity, interest rates and the domestic or foreign nature of their debtors. They are more or less affected by tax evasion and optimization⁶, it is very difficult to make comparisons.

The lack of financial resources is one of the leitmotifs of all political speeches of all governments. In this context, public education and research, health care and protection of the weakest, adequate remuneration for civil servants, support for farmers and financial support for young companies, all these activities that are essential for a country, are subject to cuts in funding that prevent them from achieving their republican objectives. The state is robbed of a share of its revenues and the prevailing view remains that taxes are already too high. They are too high for all but the heads of large corporations, whose tax rates are much lower than those of the middle classes. Direct taxes reduce personal incomes, indirect taxes increase the price of goods and payroll taxes increase the cost of labour.

However, if the government of France could charge all the tax revenues voted in parliament, it could reduce the tax burden on all taxpayers by more than 60 billion per year. There are 36 million tax households, but only 19 million pay income tax. In fact, on average, tax evasion robs taxpayers of 3,000 euros per year and probably more than 6,000 euros for households taxed in the 30% bracket. Obviously, not all of these sums go through tax havens, but it is likely that other hidden payments exist that reduce taxes through the transfer system, which makes

⁶ Fontanel, J. (2017), *Société offshore, paradis fiscaux, les nouveaux refuges de l'argent sale, La criminalité financière en Afrique. Formes, expressions et perspectives*, CREDIJ, Centre pour le Renforcement de l'Etat de Droit et des Institutions Judiciaires, Dakar, 2017.

the figures presented credible as a whole. This type of calculation could also be done for Russia, but it loses its acuteness, on the one hand because the public debt is low, and on the other hand the tax rate on income is much lower in this country than in France.

Economics is first and foremost political. The analysis of tax havens bears witness to this.

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