Presentation to EU Parliament Special Committee on Tax Rulings (TAXE)

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Many thanks for asking me to speak to you this afternoon. I will try to keep my comments brief: your questions will, I am sure, be at least as important.

I am aware that you are now some way into your investigation of issues relating to the exchange of information on tax rulings and have heard, or will hear, evidence from a number of witnesses. In that case what I want to do in the time I have available is to explain what has been happening in the theoretical context that I and others have developed to explain the behaviour of multinational corporations when making use of such arrangements.

This theoretical framework is partly explained in the book I co-authored on tax havens (Tax Havens: How Globalization Really Works, Ronen Palan, Richard Murphy, Christian Chavagneux, Cornell University Press, 2010). That In turn was influenced by a paper I wrote in 2009 that laid out the theoretical foundations for the Tax Justice Network's Financial Secrecy Index (Defining the Secrecy World: Rethinking the language of 'offshore', Richard Murphy, TJN, 2009). These ideas were popularised in Nick Shaxson's excellent book 'Treasure Islands'.

The theories in question suggest that tax haven behaviour has a number of characteristics not recognised before we wrote. These are that:

1. Tax havens create economic opportunities for themselves by exploiting their power to legislate;
2. The legislation that tax havens create is not primarily intended for the benefit of those resident in their jurisdiction;

3. The legislation in question is designed to help those using it avoid some aspect of the regulation of the state where they have the substance of their residence i.e. where they are in common sense terms really located;
4. To assist those making use of these laws that tax havens create those tax havens also put in place a deliberate veil of secrecy that makes it harder for the users of their tax haven laws to be identified.

It is the veil of secrecy in part four of this process that has been vital to the success of the first three parts: without secrecy the attractiveness of tax haven legislation is greatly diminished as its use carries reputational risk. Until we wrote this was not appreciated and it is precisely because of the importance of secrecy that we began to use the term 'secrecy jurisdiction' in preference to 'tax haven'. No one, me included, could accurately define a tax haven but I have just defined a secrecy jurisdiction.

The idea that secrecy was key, coupled to this definition of the secrecy jurisdiction, let us then propose a number of other ideas. The first of these related to the effectiveness of the process of financial regulation. This, we suggested was dependent upon the proximity of the regulated person or transaction and its regulator. There were four concepts we suggested that might describe where regulation took place:

1. 'Here'. This happens when an entity transacts in the location where it is regulated;
2. 'Somewhere': the entity transacts in one location but is regulated somewhere else that can, however, be identified;
3. 'Elsewhere': the entity is registered in a location (a secrecy jurisdiction) that deliberately only seeks to regulate the transactions recorded in that jurisdiction knowing that the sole purpose of many of the entities that they register is to transact 'elsewhere' i.e. in another jurisdiction, about which they ask no questions, creating the deliberate and foreseeable possibility that much of what an entity does and the transactions it undertakes may not be regulated at all;
4. 'Nowhere': the entity may or may not transact, but where it does and where it might be regulated cannot be identified.

Knowingly, or unknowingly, these ideas have had a significant influence: the idea of automatic information exchange is, for example, intended to tackle the issues arising from

both categories two and three (with category three, which best describes many secrecy jurisdictions being a particular target). It has to be admitted though that category four is unlikely to be addressed by automatic information exchange.

What these categories of regulation also helped create is the concept of the 'secrecy space'. This is a virtual location whose existence is effectively created by the deliberate blind eye turned to regulation outside their domain by secrecy jurisdictions that means that the location, nature, value and beneficial participants to many transactions are hard to identify. The more remote regulation is from the secrecy jurisdiction that notionally regulates an entity the more opaque is the secrecy space.

In this case the successful use of the secrecy space to avoid regulation, including that on tax, is dependent upon a number of factors successfully coexisting. These are:

1. The existence of secrecy jurisdictions, and the legislation, regulations and rulings that they promote;
2. The availability of financial services providers in those locations to service the transactions that are recorded within them, but which actually have economic consequence elsewhere;
3. An attitude of what I call 'constructive non-compliance' on the part of the regulatory authorities within the secrecy jurisdiction;
4. The availability of opacity that the secrecy jurisdiction user can use to help prevent their identification.

There are, of course, three types of financial services provider who aid and abet those seeking to use secrecy jurisdictions. They are:

1. Banks;
2. Lawyers;
3. Accountants and auditors.

In this context it is important to note that it is likely that all the major banks both make use of secrecy jurisdictions to distort the location of their own profits. In 2013 Barclays reported

76% of their profits before tax in Luxembourg or Jersey although just 0.2% of their staff were, for example, located within them.

There are, of course, specialist offshore lawyers, but all major firms of lawyers will have contacts with such places.

However, the most persistent and important participants in this activity are the Big Four firms of accountants - PricewaterhouseCoopers, KPMG, Deloitte and EY. As my research has shown, they are present between in all the major tax havens in the world. Unless this was the case it would, of course, be impossible for multinational companies to make use of these places because there would be no one in that location to manage their transactions or audit the affairs of the companies that they register in those places, even if those entities really trade elsewhere.

It is not, however, these financial services providers who are most likely to be engaged in the process of 'constructive non-compliance'. I suggest that this is most commonplace amongst the governments of the secrecy jurisdictions themselves, many of which are, I stress, EU member states.

Constructive non-compliance is a process of appearing to work with and for international cooperation on information exchange and other matters relating to tax abuse whilst using every opportunity for engagement to put obstacles in the way of achieving such a result. So, for example, Jersey has been actively involved in OECD committees aimed at improving the regulation of the offshore environment whilst at the same time proactively promoting innovations in the offshore products it supplies. It has at the same time, for example, also opposed the demand that the beneficial ownership of the companies that are recorded in the island be put on public record. That is precisely what I call constructive non-compliance. There is an appearance of one thing happening whilst another is actually occurring.

I have also heard much anecdotal evidence that considerable obstacles are being put in the way of effective information exchange. For example, data that has obviously been produced from computers is supplied in printed format, or alternatively turned into PDFs that cannot be scanned so that re-keying of all information is required before the data has any useful purpose. The effect is to completely destroy that data's value in use.

I would suggest that such efforts to constructively non-comply are widespread. The best current example is on the issue of the beneficial ownership of companies. Although many countries are supposedly complying with new requirements on this issue, including many EU members, the refusal of any country, including the UK, to put in place properly regulated registries of beneficial ownership with the matching investment needed to enforce such disclosure and verify its accuracy shows that there is a widespread culture of constructive non-compliance on issues relating to tax enforcement that permeates the culture of most EU governments and that must change if tax collection is to become effective.

I stress that constructive non-compliance also involves turning a blind eye to all the consequences of the activities of a company or person outside the jurisdiction in which it is supposedly regulated – in other words deliberately creating the concept of 'elsewhere' noted with regard to the secrecy space earlier in this talk by consciously refusing to ask anything about what an entity does in countries other than that in which it is supposedly regulated.

The UK is, for example, guilty of this with regard to what it considers to be non-resident companies, from whom it does not demand tax returns meaning that it has no information to exchange with the countries where the companies it permits to be incorporated actually trade. This is a standard tax haven trick that has been adopted by the UK in recent years. The consequence is that tax regulation can be avoided throughout Europe with considerable ease, aided and betted by many willing governments.

Let me turn though to another – the availability of secrecy – before addressing what can be done on these issues. When we are looking, in particular, at issues relating to exchanging data on tax agreements then it is the corporate world that is of interest. Secrecy in this part of the tax environment is especially easy to create by combining two forms of opacity. The first opacity is created by the use of secrecy jurisdiction subsidiaries of multinational companies. These, of course, do not have to file their accounts on public record, so nothing is known about what they do. This problem is compounded by the fact that many multinational companies fail to publish lists of all their subsidiaries. The law in this area is often very poorly applied, as has been found in a number of studies in the UK, for example.

The second type of opacity is that provided to multinational companies by the requirement that they only present consolidated financial statements on public record. There is, of course, a benefit to many users of accounts from the preparation of consolidated financial statements: I do not dispute that. Investors do, in particular, require such information. But, contrary to the opinion of the International Financial Reporting Standards Foundation, investors are not the only users of such financial statements and it is time that the European Union reminded them of that fact. Precisely because consolidated financial statements do, deliberately and by design, remove from view and account all the transactions that take place between the companies that make up a multinational enterprise they do also remove from view about 60% of all of the world's trade, which is undertaken on an intra-group basis, and 100% of the transactions that give rise to tax rulings between members of multinational entities. And, precisely because we do not have country-by-country reporting on public record as yet for multinational companies it is still the case that we have no idea to what extent most multinational groups use tax haven subsidiaries to re-locate profits, or to what extent their profit margins vary from country to country and nor do we, as a result, have the opportunity to check whether there might be correlation between profit margins and tax rates in the jurisdictions in question.

I am, of course, aware that the OECD is seeking change on this issue and is suggesting that multinational companies should file country-by-country reports on their trading to the jurisdiction in which their head office is located but it is also readily apparent that this procedure will be open to substantial constructive non-compliance. For example, whilst the OECD has said that this information should be automatically shared by the recipient state with all jurisdictions that have interest in it there are, it would seem, already moves in the USA to make sure that application for the data must be made under the terms of double tax agreements which are not, as they are designed at present, suitable for this purpose.

In that case, we presently face a situation where finding out where a multinational corporation trades, and in what amount, with what tax impact is for all practical purposes very largely impossible. It is against this environment that you are now wanting to look at how to improve the exchange of information on what might represent illegal state aid through the creation of advance tax clearances that are, in themselves, a potential form of secrecy jurisdiction regulation intended, by their very nature, to solely benefit a company in a jurisdiction other than that which provides the clearance (where the actual transactions

undertaken will be nominal, at best) and which have, to date, enjoyed a considerable veil of secrecy, putting them firmly into the theoretical framework of abuse that I have explained to you.

So, how can these problems be addressed? Thankfully, there are solutions. The tax justice movement has always designed solutions to solve the problems it has identified.

Firstly, and most importantly, you have to identify the existence of the problem that you want to address. At present you have no real mechanism to do that. Unless it can be guaranteed that the potential existence of tax abusive arrangement within a multinational corporation can be readily identified by the tax authority who is suffering as a consequence then there is no chance of creating effective information exchange. Effective information exchange from jurisdictions where a culture of constructive non-compliance exists, as is common place throughout low tax jurisdictions and many EU member states, can only be enforced when the abuser can be sure that they have information that proves they are likely to have been abused. Mandatory country-by-country reporting to every tax authority in Europe is the only way to ensure that this will happen, and the only way to ensure that this takes place on a timely basis is to require that this data is put on public record. If you do not do that then your chance of success in the mission you have set yourself is very low indeed.

Secondly, the most effective way to eliminate tax abuse is not to regulate it out of existence, but to change the behaviour of the tax abuser. All tax systems do eventually work on the basis of the voluntary compliance of taxpayers with not only the letter but also the spirit of the law of the jurisdiction in which they operate. Again, this is highly unlikely to happen unless the opacity that presently permits the abuse of low tax jurisdictions by multinational corporations is lifted and, once more, I suggest that public country-by-country reporting is the best way in which public pressure to comply with tax law can be created with regard to multinational corporations.

Thirdly, it is always possible that companies will seek to hide some part of their transactions through apparently unrelated entities or orphan companies over which they do in reality have effective management and control but where they might want to represent otherwise. In that case unless European countries are willing to invest in effective registers of beneficial ownership, and their enforcement, any attempt at solving the problem of opacity within

some types of corporate structure cannot be solved. Opacity is a gift to the corporate tax abuser, and it is within your power to ensure that it is banished for good.

Fourth, it is quite clear that many of the arrangements that give rise to corporate tax abuse would be considered abusive if the EU Code of Conduct on Business Taxation was to still be effective. This soft law had considerable impact in the late 1990s, and continued to do so on, for example, the UK's tax havens, for sometime thereafter. There is real value to soft law precisely because it focuses upon the spirit and not the letter of the law. This Code is overdue to be revisited, revised and then enforced. This will however require that throughout Europe governments accept that there is a conflict between their desire to have transactions artificially relocated to within their jurisdictions when they rightfully belong elsewhere and the proper payment of tax. Without that willingness to accept a necessary compromise on this issue the prospect of a successful outcome for your current project is low.

You then need to ask a question about whether the abuse that you are tackling is systemic or not, and whether systems need to change as a result. I suggest to you that the problem is systemic and arises precisely because of the OECD's arms length pricing principle which presumes that every single company within a multinational entity is independent of each other and must be taxed as such even though this is a very obvious nonsense that, I am sure, any ten-year-old could identify as such. Multinational corporations think as single entities, act as single entities, report their affairs as single entities, and should therefore be taxed as single entities, and it is precisely because of the failure to tax on this basis of what they really are that so many opportunities for tax arbitrage exist within the current EU and worldwide tax system.

It is absurd that we have a tax system that effectively says that however a multinational company wants to contract with itself this must be respected. So, for example, if such a company claims that a loan has been made through Luxembourg then the tax authority does not have the right to ignore that claim, all it can do is seek to reprice the interest paid to what might be considered an arms length value. This places all the opportunities for abuse with the corporation because the only weapon, given the weakness of most controlled foreign company rules, that a tax authority has in this situation is to suggest that such transactions are mispriced, when they should actually have the opportunity to say that the

transaction as a whole should be totally ignored because the structure adopted is itself abusive. Adoption of the Common Consolidated Corporate Tax Base is the obvious solution to this problem. I would however stress that without the creation of common accounting standards for all countries at the same time, and their mandatory use, the opportunities for multinational corporations to arbitrage even within the CCCTB are also substantial, and should not be ignored. There is no point in trying to solve one problem by simply creating another.

This, however, highlights a further systemic crisis. Under successive EU treaties the freedom to incorporate wherever the owners of a company choose has been granted whatever the disadvantageous tax consequences for the country where they might really reside. I am in favour of the free movement people. I might even be in favour of the free movement of capital. But what I am definitely not in favour of is the artificial relocation of capital to secure a tax advantage at cost to society at large making use, or rather abuse, of EU treaties so that tax is not paid in the right place, at the right rate and at the right time. That though is precisely what the freedom to incorporate wherever a person so chooses provides.

This is important. The notion of free markets is entirely dependent upon the ability of states to provide an appropriate regulatory structure that prevents abuse occurring and yet what is readily apparent is that the EU treaties provide the exact opposite: just because it is possible to incorporate wherever a person so wishes free markets are necessarily and always undermined by those who are willing to free ride the system through the use of secrecy jurisdictions, constructive non-compliance, regulatory arbitrage, the opacity of corporate accounting and the systemically flawed corporate tax systems in use in Europe at present that collectively provide enormous opportunity to those who wish to abuse the principle of free markets to undermine collective prosperity.

I welcome the moves you are making to improve information exchange on tax agreements but unless you understand the problem is of the nature and extent that I have outlined in this presentation, and the fundamental difficulties that the current structure of the international tax system when combined with EU regulation poses for effective corporate taxation throughout the EU then I'm afraid to say that your project will only rearrange the deckchairs on the deck of the EU corporate tax system. That, at this point of time, is not enough to deliver the tax justice that the people and the honest companies of Europe who

are suffering at the hands of tax abusing corporations demand. I hope, therefore, you can tackle these broader issues within the remit you have set yourselves.

Thank you.