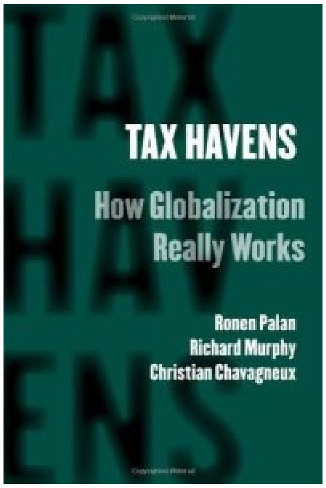

Book Tax Havens

How Globalization Really Works

Ronen Palan, Richard Murphy and Christian Chavagneux
Cornell UP, 2010

Recommendation

Some aspects of offshore finance take place in a murky world of sham transactions in exotic locales, yet many economists say tax havens play an important role in greasing the machinery of global capitalism and keeping tax-raising bureaucrats at bay. Authors Ronen Palan, Richard Murphy and Christian Chavagneux beg to differ. They see tax havens as fundamentally dishonest; these "fiscal paradises" favor the haves at the expense of the have-nots. While their opinions on the subject are clear, the authors also provide a thorough overview of what's going on in the world's tax havens and what the future might hold for them. Their writing style is a bit dry and disorganized, but they offer plenty of juicy details about the places and institutions that enable tax evasion. *BooksInShort* recommends this book to readers seeking an in-depth study of the rise of offshore financial centers and their place in global finance.

Take-Aways

- Tax havens enable rich individuals and corporations to save money on taxes.
- These offshore financial centers handle trillions of dollars; by some estimates, half the money in the world passes through tax havens.
- Some 56 nations – including the UK, Monaco, Switzerland, the Cayman Islands, Liechtenstein and Dubai – operate as tax havens.
- Firms and the affluent use tax havens; wage earners have little chance to hide income.
- Corporations use a variety of complex tactics and entities, such as "redomiciliation" and protected cell companies, to avoid taxes, creditors and scrutiny.
- The Enron, Bear Stearns and Bernie Madoff debacles all involved tax havens.
- Despite protests and calls for their regulation, tax havens prove endlessly agile, exceptionally creative and geographically savvy.
- The US government's prosecution of UBS drove a stake into Switzerland's longstanding policy of inviolate financial secrecy.
- Tax havens face heightened scrutiny because of money laundering concerns.
- Accountants, bankers and other tax specialists guide policy in tax havens.

Summary

Going Offshore to Avoid the Tax Man's Grabby Mitts

Tax havens are at the center of the murky world of offshore finance, where the wealthy, the paranoid and sometimes the downright shady can shelter their income and assets from the grabby hands of tax collectors. Taxpayers are drawn to tax havens for a variety of reasons. By setting up shop in the Cayman Islands, the Isle of Man, Liechtenstein or Dubai – to name just a few tax havens – rich individuals and corporations can lower their tax burdens. Because of their secrecy, tax havens tend to attract shadowy characters who hope to accomplish more than simply skirting the tax man. Tax havens also offer an escape from regulation; they can be hotbeds for laundering money and for stashing cash away from nosy spouses and prying partners. Countries that set up tax havens, for their part, use their sovereign status as a way to lure in the elite's capital. Yet the existence of these centers exacerbates the uneven fiscal responsibilities globalization has magnified: When corporations and the affluent don't pay their fair share of taxes, the rest of the world suffers the inequity.

> "The world of tax havens is opaque, confusing and secretive. It is a world that is saturated with stories, rumors and anecdotes."

Tax havens can create some surreal scenarios: One law firm in Georgetown, Grand Cayman, acts as the registered office for 18,857 entities. Landlocked Luxembourg has become a shipping center: Shipping companies set up their headquarters there to take advantage of Luxembourg's favorable tax climate. A full 12,000 of the British island of Jersey's 87,000 residents work in the offshore financial sector. And the Bahamas, hardly a famous banking bastion, has issued licenses to 4,300 banks; the world's financial institutions flock to do business in well-known tax havens. Don't underestimate these offshore centers: They are a major force in global markets. Whenever a big-name player implodes, whether it's Long Term Capital Management, Enron, Northern Rock, Bear Stearns or Bernie Madoff, tax havens invariably play a role.

"Fiscal Paradise"

Only a sliver of the world's population can make use of tax havens. Middle- and working-class taxpayers see their taxes deducted from their paychecks, so they have little opportunity for avoidance or evasion. The rich are the prime patrons of tax havens; they pay bigger tax bills and thus have more to gain by avoiding taxes. A cottage industry of offshore financial center, or OFC, professionals helps these wealthy taxpayers navigate the complex web of international tax law. The Big Four accounting firms – Deloitte Touche Tohmatsu, PricewaterhouseCoopers, Ernst & Young and KPMG – are major drivers in the tax havens, as are cadres of lawyers, bankers, tax experts and trust services companies. Any time a tax haven's legislature enacts new rules, these professionals are closely involved – they lobby for new loopholes, argue against stricter regulation and insist that tax havens are perfectly legitimate.

> "The truth is that nobody knows how much money is laundered through tax havens."

Intriguingly, tax haven countries aren't tax free, at least for their own citizens: Residents of Jersey, Guernsey and Switzerland pay taxes on all their income, including income earned abroad, yet nonresidents pay no taxes. Tax havens make money by collecting fees from tax exiles; for example, in the Isle of Man, nonresident firms must pay £320 a year to keep their shell companies in business.

> "Because of the proliferation in the number of tax havens, competition is intense."

In addition to low tax rates, tax havens offer two other benefits: secrecy and easy incorporation. Switzerland and Liechtenstein long have attracted capital by refusing to share financial information with authorities in other nations. Pressure from the US and other countries is changing that attitude, but Panama, Singapore, Dubai and Andorra still serve up confidentiality for those who want to shield their financial affairs from their own governments. The quick, convenient establishment of shell companies is another tax haven selling point. Foreign entities easily can register trusts and corporations in the tax havens, without setting up any physical operations within their borders. For instance, Northern Rock's special purpose vehicle in Jersey managed £49 billion, yet not a single Northern Rock employee worked in Jersey; Northern Rock employees in the UK ran the entity.

> "Statistics about tax havens are notoriously confusing."

No standard definition of a tax haven exists, but as of 2009 some 56 nations could claim the title. In general these locales take steps to facilitate tax avoidance, ensure confidentiality and ease incorporation. Even major nations can be tax havens; for instance, the UK qualifies, thanks in part to its "exceedingly" loose rules for incorporation. Amid fierce competition, these countries have carved out niches for themselves:

- Montserrat and Anguilla are more than "incorporation locations" for shell companies.
- Investors use "registration centers" such as Panama, Jersey and Vanuatu for their tax-advantaged investment vehicles.
- The Turks and Caicos Islands, Dubai and Singapore rigorously protect privacy to ensure their status as "secrecy locations."
- Some havens are "specialist service providers"; they target specific industries. Bermuda, for instance, has a niche in reinsurance.

Trillions of Dollars Move Offshore

No one knows the exact amount of cash funneled into tax havens, but most official estimates are in the trillions of dollars, including $1.5 trillion in offshore deposits in the Caymans, $2.3 trillion in Luxembourg and $4 trillion in Switzerland. Others believe that half of all the money in the world transits through tax havens and offshore financial centers. Secrecy laws prevent public disclosure of assets held; some tax havens even engage in puffery to make themselves seem like big players in the offshore financial game. Whatever the true numbers are, US corporations clearly have taken advantage of offshore tax havens. A report by Citizens for Tax Justice looked at the leading 275 US companies and found that 82 paid no taxes from 2001 to 2003, despite reporting $102 billion in pretax profits. An analysis by the US Government Accountability Office reached similar conclusions. When President George W. Bush announced a one-year tax amnesty in 2004 on overseas profits repatriated to the US, some $310 billion returned home, a sum equivalent to roughly 40% of the nation's external deficit.

> "The reality is that, however small or efficient a tax haven may be (or claims to be), none has been able to perform the miracle of running a properly functioning state without raising revenues through taxation."

In addition to tax evasion, an individual might want to hide money from a spouse, while a corporation might aim to skirt antitrust laws. Money laundering and embezzlement are other murky corners of offshore finance. A number of tax havens – such as the Cayman Islands, Guernsey, Liechtenstein, Luxembourg and Switzerland – also function as money-laundering hubs. Dictators and state officials who plunder their nations' coffers usually funnel their ill-gotten gains to tax havens. In the 1990s, Nigerian dictator Sani Abacha stole $2.5 billion of his country's funds and handed them over to international banks such as Credit Suisse, Credit Agricole Indosuez and BNP to manage.

> "The Big Four seem less interested in ensuring the safety of global capitalism by verifying that business practices are sound than in protecting private wealth at all costs."

Moving money offshore for the rich can be endlessly complex, with many different methods and legal structures, but its simplest goal is to financially disconnect the taxpayer from his or her home country. The UK, Monaco and San Marino, among other countries, offer "real or virtual residence" to the wealthy elite, including sports stars and entertainers, who want to lower their tax burden. German tennis star Boris Becker took up residence in Monaco, and Switzerland is home to musicians David Bowie, Phil Collins and Tina Turner. Formula 1 driver Michael Schumacher received an especially sweet deal from the Swiss: He pays taxes on his expenses rather than on his income.

"The battle against tax avoidance and evasion, which began in earnest in the late 1990s, has so far provoked ever more obscure, complex and sophisticated instruments of avoidance."

When a corporation wants to shift offshore for tax avoidance, the mechanics are easier: It establishes an international business corporation, or IBC, in the tax haven. "The perfect instrument" from the perspective of the corporation, the IBC allows a company based in a high-tax country to report its profits in low-tax locales. A limited liability company, the IBC can issue bonds, sell shares and own property, but it requires no disclosure, offers cut-rate incorporation costs and provides ironclad protection from creditors.

An Innovative Industry

Amid calls for greater scrutiny and more regulation, tax havens prove endlessly agile and creative. Consider the invention of "redomiciliation": Assume a company is registered in Gibraltar and its home-country authorities begin to question its tax status. By redomiciling to the Isle of Man, for instance, the company no longer exists in Gibraltar. That switch compels the home agencies to restart their investigations, which are costly and time-consuming. If the authorities relaunch their inquiry in the Isle of Man, the company simply redomiciles again to another tax haven.

"In the EU and in the United States under President Obama...the pendulum has swung very clearly against tax havens."

Another innovation, the limited liability partnership (LLP), "allows the separation of legal ownership of assets from the location of income arising from them." The protected cell company (PCC) is even craftier: It permits a corporation to form a network of entities that legally are independent and safe from creditors. If one cell faces lawsuits or bankruptcy, the other cells remain unaffected.

"Without the deliberate veil of secrecy that tax havens create, those using tax havens for the purpose of tax and regulatory avoidance would be readily identifiable."

Tax shelters aren't just changing their tactics; they're also geographically savvy. With secrecy practices in Switzerland under scrutiny, Swiss banks UBS and Credit Suisse have beefed up their private banking operations in Singapore.

The Big Four accounting firms and their industry cohorts are major enablers of all this financial dodging and weaving, by proposing and guiding legislation in tax havens. The companies draw a distinction between tax evasion, which is against the law, and tax avoidance, which is a legal and purportedly logical way for wealthy individuals or corporations to lower their tax expenses. The Big Four face accusations of conflicts of interest, in that they often audit the financial statements of corporations for whom they devise tax-reducing schemes meant to muddy corporate fiscal responsibility.

"The golden years of tax havens are over."

Free-market purists say tax havens play an important role in reining in the growth of ever-greedy government bureaucracies. However, since the late 1990s, tax havens have come under greater regulatory attack. US President Barack Obama has singled out the Cayman Islands' tax shelters as "a tax scam." In 2008, US authorities arrested UBS private banker Martin Liechti on charges of helping billionaire Igor Olenicoff create tax shelters in Switzerland and Liechtenstein to hide $200 million from US tax authorities. Another UBS employee, Bradley Birkenfeld, in plea-bargaining testimony, asserted that the Swiss bank channeled some $20 billion into sham offshore trusts to help wealthy clients skirt US taxes. The UBS cases have forced both Switzerland and Liechtenstein to relax their once crypt-like confidentiality standards and begin cooperating with US authorities.

A Brief History of Tax Havens

Tax avoidance and evasion are as old as taxes themselves. Examples of how some tax havens rose to prominence include:

- **Delaware** – Ironically, this US state pioneered lax corporate regulation. In 1898, Delaware passed a law creating a favorable incorporation climate that has attracted thousands of firms, and today it is home to 60% of US *Fortune* 500 companies.
- **Switzerland** – The canton of Zug followed Delaware's lead; in the early 1920s it began dangling cheap-and-easy incorporation and low taxes to attract companies.
- **Liechtenstein** – In 1924, this speck on the map took the Swiss franc as its currency and created a new type of corporation that blended secrecy with reduced taxes.
- **Bermuda** – Bermuda let the US-based manufacturer of LifeSavers candy shelter its overseas earnings in 1936. That sparked a rush to the island, with taxpayers as diverse as Shell, playwright Noel Coward and Greek shipping magnates setting up shop.
- **The Bahamas** – This chain of islands became a tax haven in the 1930s and gained notoriety in the 1960s when Mafia banker Meyer Lansky moved in. But the criminal connection sullied this "tax paradise," and other Caribbean nations stole its thunder.

About the Authors

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