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WHY DO TAX HAVENS EXIST ?

by

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Overview

Tax havens play a central role in globalisation : more than half of the financial flows pass through tax havens, and 85 % of hedge funds are registered in tax havens. Not only do tax havens deprive countries of considerable revenues, but they are at the heart of global financial instability. In the nineteenth century, tax havens originated in the American states of New Jersey and Delaware (the location of the headquarters of most of the important US companies), because they provided exceptional tax conditions for companies. The number of tax havens grew in the 1960s from the London financial markets when multinationals began making various governments compete against each other to optimise their fiscal situation. Following the latest economic crisis, the OECD (Organisation for economic cooperation and development), the European Union, the American government and the G20 countries decided to intervene in order to provide regulatory control. At present, most of the action taken concerns individual tax evaders although multinationals largely profit from tax evasion. The battle has only just begun...

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TALK : Christian Chavagneux

It was only in the mid 1970s that international institutions became aware of the existence of tax havens and the specific role they play in the global economy. They first appeared at the end of the nineteenth century, and were not the result of deliberate planning but the consequence of various initiatives.

The three characteristics of tax havens

Tax havens have three characteristics.

Location in geographical areas which are not subject to stringent financial monitoring and are not heavily taxed

At the end of the nineteenth century, two American states, New Jersey and Delaware, were experiencing financial difficulties. Their state governors were advised by New York lawyers to solve their budgetary problems by increasing their tax revenues. Companies were encouraged to set up their headquarters in these states for which they were compensated by fewer financial controls and paid less tax than elsewhere. This state of affairs still applies today: Delaware is the state where most companies quoted on the New York Stock Exchange have registered their headquarters.

Fictitious residency

At the same time, two British companies, whose main area of activity was in Italy and India, challenged the fact that their profits were taxed in Great Britain. The judge ruled that inasmuch as all strategic decisions were taken in London, it was normal to tax the companies and their foreign activities in London.

In 1929, the Egyptian Delta Land and Investment company, a British property development company operating in Egypt, created a fictitious board of directors in Cairo with a dummy CEO. The judge ruled that insofar as the board was not located in Great Britain, it was not possible to tax the company in Great Britain for its foreign activities. This was the beginning for all subsequent practices of fictitious residency.

Bank secrecy

In 1932, Édouard Herriot's French government attempted to combat tax evasion, and carried out an investigation of the Parisian offices of the Commercial Bank of Bale. They unearthed two large notebooks containing the names of all the bank's French customers. The Socialist MP Fabien Albertin obtained a copy, and read out the names at a parliamentary sitting. They included Félix Potin (founder of a supermarket chain), the owner of the Lévitane furniture company, the owner of the Figaro newspaper, the owner of the Matin de Paris newspaper, three senators, about twelve generals, some judges, and two bishops. Two bank administrators were summoned to Paris. They refused to allow government officials to examine the accounts at the bank's headquarters and were sent to prison. Many foreign customers of other Swiss banks panicked and emptied their accounts which subsequently led to the collapse of two other establishments. As a result of this incident, Switzerland decided to establish a policy of bank secrecy. Article 47 of the 1934 Bank Law states that all bank employees who provide even the slightest piece of personal information regarding their clients to the Swiss tax department or any other government's tax department will be subject to a fine or a prison sentence.

In the middle of the 1960s, when the United States was investigating the Mafia, it quickly became apparent that a large amount of the Mafia's money passed through Switzerland. Swiss bankers were called to testify in front of the US Congress. They claimed that the practice of

bank secrecy dated back to the rise of Nazism in the 1930s, and that its aim was to protect Jewish assets. This was pure fiction as all current historical Swiss records show. Swiss bank secrecy is simply intended to help the Swiss financial sector grow by feeding off and to the detriment of its neighbours' tax systems.

The boom in offshore finance

These three characteristics (lax financial monitoring and low taxation levels, the possibility of fictitious residency, and banking secrecy) paved the way for the boom in offshore finance.

In 1957, the Bank of England claimed that England was no longer the leading world power and had been overtaken by the United States whose currency dominated transactions. Rather than attempting to make the British pound regain global supremacy, the Bank of England decided to organize the market in dollars which had been deposited and loaned from outside the United States (called 'Eurodollars') from London markets.

A few years later, Sir George Bolton, a senior official at the Bank of England, 'crossed over to the enemy', as unfortunately happens quite often. He became head of a private Latin American bank located in London, specialising in Eurodollar speculation. The American Treasury had not realised the existence of an organised Eurodollar market which had completely 'passed under its radar' until the end of the 1960s.

Slow on the up-take

In 1976, for the first time, an international institution, the Bank for International Settlements, noted in its annual report that a high volume of international capital passed through regions considered 'bizarre' and which had started to be called 'financial offshore centres'. Capital passing through these centres was not subject to any sort of financial monitoring. At this period, the areas in question were mostly in the Caribbean.

Until the mid 1990s, people continued to believe that these operations were unimportant and marginal. Like money laundering, the existence of tax havens was considered to be a 'crime without victims', in other words, it was deemed to involve just a few rich individuals or heads of multinational companies using the back doors of banks, and being economic with the truth on their tax returns, and a few members of the mafia laundering money. It was not really a problem.

At the end of the 1990s, tax departments realised that the use of tax havens had become more widespread. It was no longer just captains of industry or other very rich people who used them, but also executives of multinationals and even heads of SMEs (small and medium sized industries) who had sold their companies to finance their retirement. Additionally, corporate fraud - discreetly called 'tax optimisation' had expanded

Fraud by private individuals

The Tax Justice Network (TJN) estimates that individual tax fraud globally represents between 12,000 and 13,000 billion dollars each year. In France, the SNUI (Syndicat national unifié des impôts) estimated that fraud in 2007 accounted for 50 billion Euros per year, in other words 10 % of French tax revenues, a considerable amount.

There are some factors which allow us to assess the actual scale of individual tax fraud. During the UBS affair in 2008-2009, the American Internal Revenue Service (IRS) made Switzerland provide the names of 4,450 Swiss bank account holders. While waiting for these names, the IRS announced that people who wanted to 'turn themselves in' could do so in exchange for charges against them being dropped, and that they only have to pay the taxes they owed and the interest accrued. The operation was a success : 15,000 people admitted that they had benefitted from the services of UBS and other banks such as HSCB in order to defraud the IRS.

Fraud by multinationals

At the end of 2009, the Banque de France published statistics which showed direct foreign investments in France and direct investments by French multinationals abroad. The study showed that if one takes into account purely direct investments made in countries not considered to be tax havens, the global volume of investments from France to foreign countries decreases by 30 %, and Luxemburg drops from first to 19th place. Worse still, this calculation shows that the first foreign investor in France is none other than France itself (via its foreign subsidiaries). The conclusion is obvious: subsidiaries of French multinationals use tax havens for tax optimisation purposes before the money is reinvested in France.

Numbered indexes

Robert Lipsey, an American economist, compared the total number of assets held by American subsidiaries located in foreign countries with the number of employees in these subsidiaries in order to highlight the fictitious character of the activities of these subsidiaries in certain areas. The average ratio of all the subsidiaries of American multinationals based abroad is 1 million dollars of assets per employee. In Ireland, the Netherlands and Switzerland, this ratio increases to between 4 and 5 million. In Barbados, it is 22 million, and in Bermuda, 45 million. Robert Lipsey also calculated the ratio between the wage bill and post-tax profits. On average, in all foreign subsidiaries of American multinationals, post-tax profits represented 84 % of the wage bill. In Switzerland, the ratio is 160 % ; in Ireland, 660 % ; and in Bermuda, 3,500 %.

In 2009, a trainee helped me to carry out a study of companies quoted on the French stock exchange which used tax havens for the monthly magazine 'Alternatives économiques'. We looked into the appendices of company reports and noted down each time the list of establishments which we cross-referenced with those of tax havens. We realised that all the companies quoted on the French stock exchange existed in tax havens. There were more financial institutions there than any other sort of institution, and among these, BNP Paribas was prominent. However, this is not a very viable measure because some companies have justifiable reasons for their location. For example, it is normal for a luxury company such as Hermès to locate some of its organisations in tax havens where very wealthy people live.

Methods of tax optimisation

One of the preferred methods of tax optimisation is the improper use of transfer prices. The principle was updated by two American researchers who, with help from a senator, analysed data from American customs. They realised that considerable volumes of plastic buckets manufactured in Czechoslovakia had passed through a tax haven and then been imported to the United States for 2,500 dollars each. The subsidiary bought the buckets for 50 cents and sold them for 2,500 dollars each thus making huge profits. It came as no surprise to learn that this subsidiary was located in a region where profits were not taxed. This improper operation of transfer price was quite easy for the tax department to discover. However, the same method is now being used in areas where fraud is much more difficult to detect, notably that of intellectual property rights.

For example, a French company which advertises itself on Google France receives a bill from Google Ireland : Google's subsidiary which manages European advertising revenues is located in Ireland where the tax rate is 12.5 % (compared with 33 % in France). These revenues are not even taxed in Ireland : they are instantly transferred to Bermuda to pay for the rights to use the Google logo which is held by Google Bermuda, one imagines. How much is this right really worth ? There is no world market for the Google image which enables one to fix the price as one would for an ordinary commodity. It is therefore very difficult for the tax department to establish the financial bill for cheating, and the potential recovery plan to redress the situation can only take place in the form of negotiation.

Another method of tax optimisation is loan assignments between subsidiaries of the same company. The subsidiary located in a tax haven can grant a loan to a subsidiary located in France, and the fact that the French subsidiary has to reimburse this loan enables one to deduct the interest and therefore to eliminate part of the profits.

Financial intermediation

Currently, half of international financial intermediation, both in terms of financial investments and loans, passes through tax havens. Tax havens played a dominant role in the subprime crisis.

The first bank to have encountered difficulties in this crisis was Northern Rock, a British building society. Its accounts in London appeared to be clean, but all of its short-term debt had been concealed in a subsidiary registered as a charity in Jersey. The bank was only able to function because of an extremely rapid circulation of its short-term debt. When the subprime crisis started and bankers no longer granted mutual loans, Northern Rock found itself without any short-term financing, almost went bankrupt and had to be almost nationalised.

Analysis of the American accounts at Bear Stearns bank, the first American bank to declare bankruptcy, did not reveal any abnormalities. Several of its subsidiaries took extremely dangerous risks using hedge funds, half of which were in the Cayman Islands, and the other half in Ireland. These risks did not come off and resulted in the bank's collapse. It is said that in Dublin, if one wants to open a hedge fund and one submits the dossier two hours before office closing time, the fund can be operational the following day. In the rest of Europe, the creation of a hedge fund requires submitting documents with hundreds of pages and is subject to very strict and detailed checks.

When the subprime crisis took place, Peer Steinbrück, a former German finance minister, wrote a tongue-in-cheek article in the Financial Times about Anglo-Saxon capitalism. A week later, a German building society, Hypo Real Estate, was caught red-handed: its Irish subsidiary had tried to hide excessive risk-taking and had gone bankrupt.

A report from the US Government Accountability Office published in the summer of 2008 showed that half the toxic assets linked to the subprimes in American banks were managed from the Cayman Islands. One must not forget the roles played by the British Virgin Islands, Switzerland, Austria and Luxemburg as feeder funds in the Madoff case.

Tax havens are not responsible for the subprime crisis and this crisis would have taken place without them. However, they are present at all the important stages of this crisis and they can therefore be considered to be at the heart of financial globalisation.

Institutions attempt to hit back

In the 1920s, the League of Nations created a financial committee. However, the International Chamber of Commerce and Switzerland blocked the project: the Swiss delegate stated that 'regarding this subject, one must hurry to advance slowly with caution'.

It was only in the 1990s that inter-governmental institutions really started to take notice and to react. In 2000, three lists of 'suspicious' countries were drawn up. The FATF (Financial action task force) published the list of countries which facilitated money-laundering. The FSF (Financial stability forum which became the Financial stability board) distributed a list of countries which encouraged the evasion of prudential rules, in other words countries which enabled banks to take risks without the regulators' knowledge. Finally, the OECD (Organisation for economic co-operation and development) provided a list of countries encouraging tax evasion.

However, this initiative misfired. Countries merely had to agree to make an effort and to respect the law for their names to be taken off these lists. Having been taken off the lists, there was no subsequent verification which made it even easier for the countries concerned. Today, the FATF and OECD lists only have one or two names. Regulators had to wait until the 2007-2008 subprime crisis for progress to be made in this area.

New OECD initiative

In 2008, the German government obtained a file with the names of serious tax evaders. The finance minister wanted to make an example in this case and organised a press leak about the details resulting in the arrest of one of the tax evaders who was none other than the director of the German post office. When the police made a dawn raid at his home one morning, the entire press corps was there to capture the moment.

Germany passed part of this file to the French government in which a number of French taxpayers were named. The French and German finance ministers, Peer Steinbrück and Éric Woerth, organised an important conference on tax havens in Paris in November 2008. Seventeen countries took part. They asked the OECD to update the list of 'uncooperative' tax havens : Berlin wanted to add Switzerland to this list. Switzerland refused to take part in the conference.

The G20 meeting in London in 2009

The G20 meeting in London in April 2009 was the starting point of an attempt to regulate international finance. The OECD also took this opportunity to publish new classifications. As well as the 'white' list of countries which 'substantially' apply international rules (such as France, Russia, the United States and China), there is a 'black' list of countries which have never made any such commitment (including Costa Rica, Malaysia, the Philippines and Uruguay), and a 'grey' list of countries which agreed to conform to OECD rules, but have never actually applied them (Monaco, Liechtenstein, Switzerland, Luxemburg and Belgium).

Article 26 of the OECD Model Tax Convention

In Article 26, the OECD model tax convention establishes the obligation of tax havens to sign treaties of information exchange with the tax departments of the important industrialised countries and to answer their requests for information. If they want to be taken off the grey list, they have to sign treaties with at least twelve different countries.

Some countries play the game. Others try to prevaricate. Monaco signed treaties with San Marino, the Cayman Islands, Barbados and Switzerland, in other words with other tax havens, but not with Italy which is its main 'client'. Switzerland also tried to dodge the situation. Article 26 requires that the country making a request for information has to 'identify the taxpayer concerned'. Switzerland considers that the term 'identify' forces them not only to supply the name and address of the taxpayer, but also the name of the bank involved. Yet there are occasions when a tax department is convinced a taxpayer is guilty without knowing precisely which bank he uses. The tax department may also have noted the existence of shady transactions between a French account and a Swiss account, but without knowing to whom the accounts belong. A meeting took place between Éric Woerth and Swiss ministers : in the end, Woerth gave in, and accepted Switzerland's interpretation that the tax department should provide both the identity of the person and the name of the bank in order to obtain information.

The role of the peer review group

Countries which have signed at least twelve treaties start by being taken off the grey list. However, as a result of their experience in the first decade of the new millennium, the OECD decided to set up a peer review group. This was part of the global forum on transparency and

exchange of information for tax purposes (shortened to the Global forum on transparency) and is led by François d'Aubert. The peer review group undertakes two series of controls. Firstly, it checks to see if the commitment made by a country to sign exchange of information treaties with at least twelve countries is signed into law ; and secondly, it makes sure that if tax departments of countries signing the treaties asked for information, they would indeed receive it.

The peer review group regularly publishes reports on countries which have been investigated. The report on Switzerland was published in June 2011. The finger was pointed at Switzerland for its restrictive interpretation of Article 26 of the OECD model tax convention. The director in charge of the administration responsible for signing treaties was suspended and a vote in the Swiss parliament is due to take place very soon to make the conditions for tax assistance between countries more flexible.

Unfortunately, the power of the peer review group is limited to the publication of reports. Based on known results, in two or three years' time it could also establish a sort of global ranking of tax havens. But this would be the only sanction unless Global Forum members decided otherwise. Many emerging, developing countries such as India, China, Brazil and South Korea are determined to fight against tax havens. Consequently there is hope that with pressure from them, as well as the efforts made by Germany and France, the OECD will decide to take sanctions if necessary.

An agreement allowing new ways of getting around the restrictions ?

Switzerland is about to sign an agreement with the United Kingdom and Germany which is a cause for some discussion. According to the terms of this agreement, Switzerland would agree to estimate the volume of illegal investments made by British and German residents, charge them a tax, collect the tax and pay it to the British and German tax departments. In exchange, Switzerland would keep the identity of the people involved secret.

This measure may be interpreted as a means of avoiding the exchange of information, a measure which the OECD is trying to put in place. At the OECD, some people believe that the two schemes will not be mutually exclusive. British and German tax departments will still be able to request the identity of tax evaders *and* to make Switzerland tax the tax evaders in question and to make them pay this tax. NGOs (Non-governmental organisations) are more difficult, but if this were the case, Switzerland would be at the top of the list of co-operative tax havens. The conditions for signing this agreement between the three countries should have been known by the summer of 2011¹.

Action taken by the European Union

The European Union has also started tackling the problem of tax havens.

New jurisprudence at the CURIA

Until 2005, when there was a dispute between a tax payer (either a private individual or a company) and a State, the Court of Justice of the European Union (CURIA) favoured the tax payer. Since 2005, the Court has radically changed its legal opinion and now increasingly favours States. It considers that the free circulation of capital does not authorise a company to establish a subsidiary in a tax haven if the sole aim is not to pay tax. Fraudulent companies often have only addresses in tax havens, without having any working structure whatsoever.

To help in making its decisions, the CURIA can draw on a report written in 1999 by Dawn Primarolo (the paymaster general of the United Kingdom at that time). This report is like a code of good conduct, and points out the taxation measures of EU member-countries which

¹ A blog featuring remarks made about these agreements, signed after this talk, can be found on <http://alternatives-economiques.fr/blogs/chavagneux/>

are likely to bias the localisation of economic activities by granting non-residents more advantageous tax conditions than those which are normally applied. For example, it criticises the taxation system which was established in Jersey, Guernsey and the Isle of Man whereby local companies have to pay a corporate tax of 10 %, whereas subsidiaries of foreign multinationals are exempt.

The EU savings directive

The European directive on taxation of savings (referred to as the savings directive) which came into force in 2005 was subject to lengthy negotiation. As a result, when a Frenchman, for example, makes an investment in Germany, the bank where this transaction takes place must inform the German tax department which then transfers the information to the French tax department. Contrary to the OECD scheme which works according to demand, these exchanges of information are automatic. This law is applied in many countries: it was also negotiated with the Cayman Islands, Singapore, Barbados, Bermuda, Switzerland, and others. Some countries preferred applying tax deduction at source rather than implementing this system of automatic exchange of information. This deduction was 15 % in the beginning but it has progressively increased and is now 35 %. For the time being, however, the amounts paid by Switzerland to the French tax department in accordance with this directive remain greatly inferior to the French tax department's estimates.

The determination of the United States

The American administration proposed the Foreign Account Tax Compliance Act (FATCA) which should be a cause of concern for Swiss bankers. This act (which should come into force in 2013) states that foreign financial institutes such as banks, hedge funds or unit trusts which have been set up in the United States must reveal their bank dealings with American taxpayers to the US Inland Revenue Service. In this act, exchange of information is automatic. The Swiss are vigorously opposed to this law which effectively completes the measures taken by the OECD and the European Union. Clients can preserve their identity if they pay a 30 % tax. Despite this, the American government is currently exerting pressure on banks to supply them with the names of those in question.

Furthermore, whereas in France half the number of civil servants, including those in the tax department who take retirement are not replaced, the American administration has just hired 800 new people whose sole function is to combat tax evasion by private individuals and companies.

A new indicator : the FSI

In 2009, the Tax Justice Network (TJN), an NGO, created the Financial Secrecy Index (FSI), a new index which is both qualitative and quantitative. The qualitative measure takes into account laws and regulations of regions, and their international treaties. Based on this information, it assesses the quality of the secret they have in the form of an opacity score. The quantitative measure assesses the score according to the size of the region and its overall importance in world financial markets.

Regions such as the City of London or Delaware have the highest FSI value, whereas Great Britain and the United States do not appear on the OECD blacklists because British and American citizens pay their taxes. One must not forget that a tax haven is never for use by its own citizens, but by foreigners.

Conclusion

When a shareholder invests money in a company, no CEO would dream of denying him his profit-share. Why then, when a State provides its taxpayers with an education system, a job market and a working infrastructure, do some people refuse to pay the appropriate dividends,

in other words, taxes ? As Henry Morgenthau (Roosevelt's secretary of the treasury) in 1937 stated 'taxes are the price we pay for a civilised society ; too many of our citizens want a cut-price civilisation.'

Despite huge attempts which have been made over the past few years to combat tax havens, it is a shame that the OECD's action is aimed essentially at tax evasion by individuals and not corporate tax evasion. A work group put forward a proposition requesting that multinationals be subject not only to accountancy practices of the company headquarters, but also subject to a country by country reporting. This would show their turnover, the number of employees, the wage bill, any profit made and the amount of taxes paid in each of the foreign countries where the company has subsidiaries. This information, which multinationals clearly possess, never appears in their accounts. Its publication would help analysts to appreciate the amount of finance which is exchanged between subsidiaries of the same company. However, whereas it was easy to obtain a political agreement on measures concerning private individuals, this proposition was immediately blocked.

Likewise, when the G20 met in London in April 2009, they all acknowledged that tax havens presented an increased risk to international finance. The G20 countries asked the Financial stability board and the IMF (International Monetary Fund) to work together to draw up a list of these 'prudential' tax havens, but still nothing has been done.

The fight against tax havens has only just begun. John Christensen, the founder of TJN, thinks that we are exactly at the same point as the battle against climate change was in 1992, in other words, at a point when people are starting to realise that there is a problem and are taking initial action. At least now, the subject figures on the international agenda and this is already a sign of enormous progress.

DISCUSSION

Exchange of information

Question : *Article 26 of the OECD model tax convention obliges tax havens to provide information which in fact is held by private individuals who themselves are hiding information from the Administration. How can banks be forced to provide this information, presuming that they have it ?*

Christian Chavagneux : This is an important question because for a long time tax havens have refused to provide the information requested on the pretext that they did not possess the information. Article 26 refuses to allow them to plead this case. Switzerland, like Monaco, the Cayman Islands and any other tax haven now has to find the information, even if it involves a trust fund in Switzerland the owner of which is unknown. The administration must ask the trust's managers to reveal the name of the owner and give this information to the tax office making the request. It is the role of the peer review group to make sure that the requested information is obtained and passed on.

Personally, I am expecting something else. I would like to know whether the important industrialised countries will actually ask for information. Monaco has been criticised for not having signed a treaty with Great Britain but it is possible that Great Britain has never asked Monaco to sign such an agreement. It takes two to sign an agreement... On this basis, I would really like to see a centre set up in France in order to monitor French tax practices and for a debate to take place in parliament each year when the budget is presented to discover how many questions France asks and which countries it asks.

Handling information

Q. : *Even if tax offices receive all the information they request, would they be able to handle such information in view of the complexity of the financial framework ?*

C. C. : The same is true of information received by Customs and Excise, all of which is not necessarily used straightaway. Excel files can be set up to check certain factors when there is doubt. Another solution used by the Chinese administration which wanted to discover what type of operation to choose in order to save time was to poach consultants from KPMG who spent their time explaining to multinationals how to avoid paying tax. To do so, they still have to be paid salaries which are in line with the market.

Q. : *Are these consultants not sworn to secrecy ?*

C. C. : Not once they become civil servants. It is only fair because transfers can also take place in the opposite direction.

Unfortunately in France, tax officials lack the material means and are assessed according to quantitative criteria which encourage them to inspect a few thousand bakers or butchers who have cheated on their VAT payments rather than spend a year getting to the bottom of the financial embezzlement of one or two multinationals.

Sanctions ?

Q. : *If the result of the compilation of the OECD lists is not the imposition of sanctions, the risk is that the opposite will take place: countries on the black list are more likely to attract institutions or individuals who want to avoid paying their taxes.*

C. C. : At the moment, the OECD is making do just publishing the results. If, despite being called to order, Panama continues not to apply the rules, it is likely that the international community will end up by taking sanctions against Panama. But would this happen if the guilty country were Switzerland or even the City of London ?

The first type of sanction would be that each state would declare that if a country or territory is not transparent, then any financial transaction to or from this country is illegal. Of course, this would not stop the mafia from continuing to resort to the services of the financial establishments in question, but for a bank such as BNP Paribas it would become more difficult because its stock market value could suffer. Without going as far as banning transactions, these could also be taxed by as much as 30 %, 50 %, 80 % or more until the country or region in question agrees to make an effort.

It is also possible to take action against private companies. Recently Glencore (a commodities trading company) wanted to be floated simultaneously on the London and the Hong Kong stock exchanges. Unfortunately for Glencore, since last July, the Hong Kong stock exchange forces companies in the extractive industrial sector to publish accounts, country by country. This measure, as a result of various scandals linked to Glencore in China and Zambia, exacerbated the fall in the company's share price.

Likewise, when the American Administration realised that UBS was helping some of its clients to defraud the IRS, it gave the company the choice between revealing the names of the clients in question or losing its license in the United States. As no company can afford not to be present in the American market, UBS began providing names, and numerous fraudulent taxpayers spontaneously admitted their guilt.

It is therefore possible to impose sanctions as long as one has the political desire to do so.

Tax havens and tax competition

Q. : *What is the difference between tax havens which are illegal and simple tax competition which is legal ?*

C. C. : The former British Prime Minister, Edward Heath, explained that the difference between the two was the thickness of a prison door.

In the European Union there is discussion about establishing a common, consolidated tax base to tax multinationals. This is thought to discourage certain improper transfer practices. However, this would necessarily be translated by an increase in taxes for some countries which are strongly opposed to this. When Ireland asked for Europe's help, France replied 'with a tax of 12 % on companies compared to 30 % in France, you are a parasite. Start by increasing your taxes !' Ireland hides behind the right to competition and considers that it is France which has fixed its taxes too high.

In fact, the problem does not only come from the difference in taxation levels, but the culture of secrecy and the lack of monitoring which means that in some countries huge risks may be taken with impunity.

Waiving taxes on profits ?

Q. : *Many government financiers emphasize that it is much more difficult to defraud on indirect taxes (such as VAT) than on direct taxes. Should we not replace all direct taxes with taxes on consumption ?*

C. C. : I suggest you run for President on this ticket and see how many people will vote for you !

Q. : *This is what is happening currently. The social welfare system was created after the war at a time when everyone worked and when there were few imported products. Today, there is massive unemployment and very strong competition from abroad. We cannot continue to allow one quarter of the population to pay all the taxes.*

Dirty money

Q. : *Is the amount of money generated by drugs, prostitution and terrorism not significantly greater than that from tax evasion ?*

C. C. : All attempts to assess the respective amounts of money are very dangerous because they are, by definition, hidden. Nevertheless, every time I have discussed them unofficially with American, British or French bankers, I am told that flows of dirty money are significantly smaller than those related to tax evasion.

Susan Strange, a researcher known for being provocative, remarked that 'a member of the mafia who earns money from prostitution or drugs will send his son to Harvard and make him marry the heir to IBM. As a result, this money will then be laundered and will be quickly recirculated into society. Money from tax evasion never comes back. This is the money you need to concentrate on.'

Vice and virtue

Q. : *In his book entitled 'Profession : civil servant', François Bloch-Lainé, a former Treasury director, writes that to be able to pay civil servants at the end of the month, he sometimes had to carry out a certain number of financial manoeuvres such as drawing from the treasury of postal cheques. However, he did so in the name of a 'sacred' mission. It is likely that tax fraud is often carried out with very 'virtuous' motives.*

C. C. : It is certain that if one drew up a list of all the people or institutions resorting to tax havens there would be a few surprises. For example, Italy's Central Bank would be on the list ! During the 1990s, instead of placing its money in treasury bonds, it put money into a tax haven entrusted to the Long-Term Capital Management (LTCM) speculative hedge fund which promised returns of 40 %. It is also a well-known fact that the secret services are big fans of tax havens which allow them to organise their operations with the utmost confidentiality.

I can understand the argument whereby in the interests of the nation one can resort to using tax havens in the morning and in the same afternoon make speeches calling for their abolition. Nevertheless, today we have reached a stage where the phenomenon has grown from being a

cottage industry to a well-oiled machine, and where potential customers are now aggressively canvassed by telephone in order to reduce their tax payments. Tax evasion is a major source of inequality in growth because taxes weigh increasingly heavily on an increasingly small number of tax payers. At the end of the day, it is social cohesion and even democracy in our countries which are threatened by this phenomenon, not to mention the fact that poor countries are being deprived of tax revenues which would enable them to develop economically. I think it is time for urgent action to be taken.

Presentation of the speaker :

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