

## Documentation

# „(Um)Steuern! Steuerbetrug, Geldwäsche und Korruption“ (The fight against tax crime, money laundering and corruption)

June 4, 2013 - AK-Bildungszentrum, Wien



©Patrizia Gapp

*Dokumentation: Julia Hüpfel, editiert von Martina Neuwirth.*

gefördert durch die

 **Österreichische  
Entwicklungszusammenarbeit**

## Introduction

**Martina Neuwirth:** Good evening, I am working on tax issues at the VIDC and I have planned and organized this panel. A warm welcome from me and also from the organizers, the VIDC-Vienna Institute as well as the Austrian Chamber of Labour. Now let me first introduce my three distinguished guests.

*Brigitte Unger* is director of the Institute for Economic and Social Research in Düsseldorf and chair of Public Sector Economics at the Utrecht University School of Economics. She has worked extensively on corporatism, economic policy, tax competition and money laundering. Brigitte Unger has measured money laundering for the Netherlands in 2006 and published three book and several academic articles on the topic. Furthermore, she is a consultant on money laundering issues for the Dutch Ministry of Finance, the United Nations and Eurostat.

*James S. Henry* is the author of a worldwide cited Tax Justice Network (TJN) study that was published in 2012, titled “The Price of Offshore Revisited”. He is an economist, lawyer and investigative journalist and former chief economist at McKinsey. James S. Henry has published numerous articles in the New York Times, The Wall Street Journal, The Nation and more. He is one of the founders of the Tax Justice Network and, since March 2013, he is Chair of the Global Alliance for Tax Justice which comprises 81 different organizations in 37 nations. James S. Henry had already been working on issues such as tax or debt and the link to the underground economy before the global economic crisis. His books include “The Blood Bankers”, published in 2003 and “The Pirate Bankers”, published in 2006.

*Gubad Ibadoglu* is associate professor of economics at the Azerbaijan State Economic University and Senior Analyst at the Economic Research Centre in Azerbaijan. He works and publishes extensively on energy and oil revenue management in Azerbaijan and the South Caucasus, as well as on public finance issues. He is a member of the international board of the Extractive Industries Transparency Initiative – an international multi-stakeholder initiative that aims to improve transparency and accountability in the extractive sector. As a multi-stakeholder initiative it includes governments, companies, civil society groups, investors and international organisations. At the regional and national level, Gubad Ibadoglu is part of the National Budget Group and the Steering Committee of the Black Sea NGO forum. Mr. Ibadoglu was invited not only because he is an expert in revenue management and public finance-but also because there is an increasing interest in Austria on Azerbaijan and the Black Sea region as a whole.

## Background

**Martina Neuwirth:** Looking at today’s main issues of tax crime and money laundering, we see that due to the effects of the global financial crisis debt level soar worldwide. At the same time, as James Henry has shown with his study, twenty-one to thirty-two trillion dollars of private financial wealth are hidden in offshore accounts and seven to ten trillion alone stem from developing countries.

According to the U.S. think tank Global Financial Integrity, illicit flows from developing countries have increased since 2001. Most illicit flows come from trade mispricing, meaning they stem from overvalued or undervalued import or export prices.

What offshore leaks has shown us is that wealthy individuals, tax evaders, drug traders and alike often use the same means and channels to hide money. They make use of banking secrecy, shell companies or corporate structures that do not conceal the real beneficiary owners. Tax crimes, money laundering and corruption are closely interlinked and connected. This is what the discussion tonight will be about.

International tax rules were designed in the 1920s and 1930s or, in the case of transfer pricing regulations, in the 1980s and 1990s. That was a time when the economy was not as globalised as it is today and when no highly integrated multi-national companies existed. These rules are outdated, new international rules are needed. Additionally, competition between countries is getting tougher. East African countries alone lose nearly three billion U.S. dollars a year just because of tax incentives. That means that not only international tax rules need revision, it also means that there needs to be more cooperation than competition between countries. The current crisis has increased the political pressure to clamp down on tax evasion, money laundering and corruption. The question remains how effective these regional, national and international measures are when, at the same time, inequality and illicit flows are still on the rise.

## **The Global Haven Industry: Enabling Tax Crimes, Money Laundering, and Corruption**

**James Henry:** Guten Abend. A serious problem worldwide is that we have a Global Haven Industry, not just an Archipelago of seventy-five or eighty secrecy jurisdictions, but a very profitable business that has become out of control since the 1970s, when it took off first. Back when I started studying this problem as a graduate student, we had about fifteen secrecy jurisdictions in places where people would go to hide money and corporations could park their profits to lower their incomes taxes. Now, there are about eighty secrecy jurisdictions - that is one third of all sovereign nations - that have decided to go into the business of selling their sovereignty to offshore companies and individuals. Some of the wealthiest people on the planet and some of the wealthiest companies are taking advantage of this situation. This is really a structural problem. It shouldn't merely be viewed as a moral issue. We need to do something to fix the problem because the existing nation state system lends itself - in an era of globalization - to this kind of cross border game play.

There are four different pathologies as a result of this global haven industry. One is odious finance, the second is so-called pirate banking, the third comprises multi-national companies gaming the system and, finally, the big problem we are all facing is the tax competition among wealthy and poor countries alike. There are some African countries that actually have negative corporate income tax rates once you take into account all the subsidies they are giving to multi-nationals.

The main conclusion is that this is a big global industry, it is not a case of treasure islands, it is not a case of indigenous corruption - it is much more a system that has been developed to enable corruption across borders. When we quantify the abuses, we find that on the pirate banking site there are three hundred billion U.S. dollars a year of lost tax revenue to the world. Pirate banking refers to the business of moving money of wealthy individuals offshore and hiding it from tax authorities, or secreting the money that public officials steal which is a big problem amongst all countries (recently France and Spain). The global stock of wealth that is missing off the books amounts to twenty one to thirty two trillion dollars by our estimates. This is owned by a tiny share of the population - the top ten million people on the planet. Next to all this missing financial wealth, there is also non-financial wealth that is not included in these numbers, so we think these are conservative estimates. The top zero point one four per cent of the population is basically the owner of this. This system is enabled by the world's largest banks. The top fifteen international private banks now manage more than twelve trillion assets. The top ten alone handle more than six to seven trillion of assets under management, cross-border deposits and unmanaged brokerage assets that are invested by wealthy foreigners. That crowd is exactly the same set of players who were responsible for the 1980s lending to the developing world that got so many countries into trouble. The same private banks were involved in the financial crisis and all of them got bailed out. With their behavior they are facilitating tax dodging by the wealthiest few.

Inequality has been on the rise but our existing data on wealth inequality does not include tax evasion which would make it even worse. Tax haven abuses by multinationals we just saw last week with Apple, a big American success story, parking sixty four per cent of its global profits in Ireland. In Ireland, Apple has only one per cent of its total employment and it paid very little tax for three years, sheltering more than hundred billion dollars of profits from any taxation anywhere. There are lots of companies doing exactly the same thing: They offshore digital property, brands, and intellectual property, they take advantage of the haven system and they also use transfer mispricing – a method that Martina referred to. Then there are lots of bogus intra-company services and loans that many companies use to reduce their domestic tax burdens. That is worth two hundred billion dollars a year of lost tax revenue.

Combined, at least for the United States, numbers are substantial enough to potentially allow us to really solve what we call our sequestration problem - finding eighty five to a hundred billion dollars a year of increased tax revenue by going after these two kinds of abuse. Speaking with a key advisor to President Obama last Friday, she doesn't believe there is any money gathered offshore and I think they are just flat wrong about that.

We have a lot of specific solutions to propose and this issue has just come on top of the agenda at the OECD, the G8, the G20, the EU Parliament, the Council of Europe - all of the major policy making institutions that are finally waking up across the board and considering remedy is not only on the individual side. Global automatic information exchange was just adopted by the G20 as its strategic direction and in Europe country by country reporting is now being widely discussed next to beneficial ownership registration and mandatory declarations of offshore wealth by public officials. For the corporate world, we are moving towards proposals to have something more like what the United

States has domestically, with respect to formula apportionment of corporate profits for the world. Corporate taxation should be based not on bogus entities that are set up in treasure islands around the planet with no real economic substance, but should be based on sales, assets, research or other kinds of real activities that the companies are involved with. That kind of formula apportionment system, unitary taxation, is a system that we at the Tax Justice Network (TJN) are lobbying hard for.

TJN was founded in 2002 by a tiny group of individuals, mostly in the UK. At that time, it was an impossible mission to clean up our offshore havens. By now, we have a global movement on our hands. We have eighty one NGOs in thirty seven countries, we have done pioneering research in the area of measuring offshore activity, the impact of corporate tax dodging and revenue losses and in the area of so-called global pirate banking where you have all these very large banks that are specializing essentially in facilitating tax dodging. Why is a little organization like largely volunteer organization like TJN with a budget of less than two million dollars a year (coming mainly from development organizations) doing this research? Why is neither the IMF, nor the UN or the World Bank with its three thousand economists doing it? According to the former IMF Deputy Director, key tax havens are members of these organizations and they prevent the study of these issues. It has been left to groups like TJN and researchers to do the kind of estimates that were done recently. The TJN wrote a report in July 2012 that was widely regarded as a strong piece of research, has been critically reviewed by lots of economists and gained general acceptance when it was put on the cover of the Economist. We gathered lots of key partners in the development community and they are beginning to understand that taxation is fundamental to development, even though this is not traditionally a key issue for them. The top twenty developing countries have about seven trillion dollars offshore, low and middle income countries have nine to ten trillion dollars of financial wealth owned by their residents that has been parked offshore. At the same time they own about six point five trillion of official reserves. On the other hand, they have about four point five trillion dollars of debt. If you net that out, all this flight wealth and the official reserves that have been invested abroad in first world assets, the developing world as a whole is a net creditor to the first world. This is just bizarre from the standpoint of development economics. What it says to us is that they are net creditors to such an extent that their problem is not a debt problem anymore but a tax problem. The problem is to reach these offshore assets that have moved beyond the realm of their own tax authorities. As a result of that, developing countries are forced to rely on regressive taxes: Value added tax, excise taxes and sales taxes. In Brazil, the top ten per cent of the population pays a lower share of the cost of government, than the bottom fifty per cent because they have been forced to rely on these regressive taxes.

In this era, the biggest players have turned their global presence and abilities into mining these loopholes as a business opportunity, trying to drive down their competitive tax rates. They do that by saying they work in the name of their shareholders. The fact is though, that someone has to pay the tax bill. If, as John Rawls said, taxation is about a fair system of cooperation that is what we are aiming at here. It is not a question of a tax rate, it is about whether you are going to pay taxes at all, whether there is going to be justice for all or whether we are going to have a system where the richest players on the planet, with the aid of the biggest banks, the biggest law firms and the biggest accounting firms can game this system and pick and choose what laws they respect. That is the real

issue here – not the issue of a tax rate or tax competition. We have had thirty years of tax competition, now we have lower corporate and individual rates than we had in the 1980s across the board. So it is not tax rates that are driving people offshore. Rather, it is the offshore system that is driving tax rates to a point where average corporations in the United States, for example, were used to pay twenty to twenty five per cent of the total federal tax burden and today they pay around six per cent with a declining trend. Corporations have asked for a five per cent tax rate if they bring the two trillion dollars they have offshore back to the United States, because they do not have to pay corporate taxes as long as it is held there. However, they should not get away with that a second time, after they got a deal in 2004 with the argument they were creating jobs by bringing the funds back which did not happen. So we should not try that kind of approach of reforming the system.

## **Money Laundering and Tax Evasion – Analysis of Recent Developments**

**Brigitte Unger:** A couple of years ago money laundering and tax evasion would have been two completely different topics. In the last three to four years, these two topics have increasingly merged.

Money laundering means trying to hide the illegal part of your proceeds and bring it back into legal circuits. After lots of projects, gravity models, dynamic macro-economic two sector models etc the conclusion about the scope of money laundering is, that it lies somewhere in the area of about five per cent of World GDP, that is about three to three point five trillion U.S. dollars. These are laundered proceeds from criminal activities.

Originally, money laundering referred to criminal activities, starting with drugs. In 1986, Bill Clinton had the idea of focusing on fighting drug money and thus reducing the incentive for people to engage in the drug business instead of unsuccessfully trying to lock down on drug dealers. Then, after 9/11 terrorist activities and finally tax crimes were added to the list of predicate crimes. Recently, the proliferation of weapons came in. Eventually, money laundering are the proceeds of all kind of crimes which are defined by a list of crimes or the seriousness of the crimes. Not only the understanding of money laundering and its definition have changed over time, also the ways criminals find to launder money. One example is the buying of untraceable Bit Coins that have been used by the mafia to launder billions of U.S. dollars. In this context, criminals are always ahead and authorities are running behind.

Was anti money laundering policy successful with its original goal of reducing drug production and sales by closing down on drug financing? Looking at heroin and cocaine production, which is the biggest drug problem in the United States, the UN estimates that the numbers are at the same level as before the start of the campaign. The only visible change is a shift from hard drugs to soft drugs. With regards to money laundering, over the last years an increase took place in the United States, while in Europe the figures remained constant or decreased slightly.

In a forthcoming study for the European Union (for DG Home), we analyzed anti money laundering policy in twenty seven EU countries. We wanted to find out more about the threat of money-laundering to European countries, how international standards – especially the EU Directive against money laundering – are implemented nationally, how the financial intelligence units (FIUs), the reporting units etc. are set up, what public prosecutors do for enforcement etc.

Our threat analysis, done in cooperation with institutions like the IMF, is that this threat is really a problem of rich, large, Western countries, as indicated in the graph. The public debate normally circles around small countries like Cyprus or Estonia. And indeed, as a percentage of GDP, much more money is laundered in these countries than in to countries like Germany or France. The small countries are overwhelmed by sums of laundered money that are too big compared to their size. But to focus on them is problematic because in absolute terms, much more money is laundered in big states. The United States is the country with the largest sum of laundered money. Fifty per cent of the money that is being laundered worldwide, stems from the United States. But we never hear about this.

Money laundering is a very recent topic on the international agenda. It was invented in 1986 when the United States passed the first anti money laundering law. In 1989, the Financial Action Task Force (FATF) was founded and since then topic has spread around the world in an enormous speed. Today, there are only four countries worldwide that are not covered by international standards of money laundering – Iran, North Korea, Ethiopia and Angola. This increased coverage has been accomplished mainly through blacklisting of countries that do not fulfill the FATF standards (the FATF forty plus nine recommendations). This can mean, for example, that no U.S. bank would do business with these countries anymore. This can be very harmful and therefore, also through diplomatic intervention, these lists tend to empty very quickly. At the moment, only two countries are non-cooperative, namely Iran and North-Korea, and fifteen others have major deficiencies. Especially in Europe, this way of blacklisting countries is a strange political instrument. We normally look for cooperation with and compliance of the private sector. We prefer the ‘carrot’ approach.

Today the understanding of money laundering varies greatly across European countries - in some it is considered as fighting drugs, in some as fighting tax evasion and in others, such as Greece, it is considered as fighting corruption. If we try to group all these countries, we see that countries with a high GDP and a lower percentage of shadow economy consider money laundering more as tax evasion, while countries with a lower GDP and higher percentage of shadow economy think this is about fighting drugs. Suppressed economies with a low GDP and a low percentage of shadow economy do not face this problem.

The merging of money laundering with tax evasion started in 2000, when the OECD published the first non-cooperative tax haven list. First, next to Liechtenstein, it included mainly islands and thus led to the general assumption that all tax havens are islands. This changed only when the European Union saw that tax revenues of its member states were declining. When expenditures had to be cut and tax evasion increased because of the financial crisis, the topic was taken more seriously by politicians. Offshore leaks helped enormously, when it became obvious for the first time that this is not a small-scale problem but that there are large amounts of money hidden from tax authorities.

Partly, this evasion took place legally by tax avoidance - by shifting activities offshore - and partly it took place by illegal means. In the UK, for the first time, the parliament started a public naming and shaming of individual companies that avoid taxes. The parliament openly named and shamed companies like Starbucks (a company who buys all its coffee beans in Switzerland for tax reasons), saying that it is not illegal what they did but immoral. Companies such as Google created daughters in Ireland and the Netherlands to use existing loopholes and then shifted their profits to a Caribbean island. These constructions include a lot of almost criminal energy of lawyers and tax advisors. The naming and shaming of companies and persons (like Uli Höneß in Germany) seems to help much more than what had been achieved via politics before. It increases pressure by focusing public attention on them.

In the European Union, the fourth directive on anti-money laundering will be signed soon in parliament. It will include 'tax crime' as a predicate crime for money laundering. This is problematic as the definition of 'tax crime' varies widely in every European country. In some countries, like Austria, only very serious crimes fall under this category. The new directive should therefore include 'tax evasion', instead of 'tax crime', to increase its usefulness.

In our study we divided Europe in four different groups of anti-money laundering policy. In the first group of countries (Austria, Denmark, Finland, Germany, Ireland and Sweden), the "American" anti-money laundering law with double punishment for the predicate crime *and* for laundering fits very badly. Thus, they have big problems following the recommendations of the FATF of criminalizing self-laundering. The second group (Belgium, France, Greece, Italy, Portugal, Spain and the UK) has internal problems with the anti-money laundering law – cleavages, how to set it up, and internal struggles. The countries of the third group (Cyprus, Luxembourg and the Netherlands) are very similar in their anti-money laundering laws. There we do not find a lot of crime but large sums of criminal money from abroad are channeled through them. The last group comprises the Eastern European countries (Bulgaria, Hungary, Romania, Czech Republic, Malta, Poland, Slovakia, Slovenia, Latvia, Estonia and Lithuania) that joined the European Union recently. They do not see anti-money laundering as their first priority. The European Union thus varies greatly, not only in its understanding of tax crime, but also in its anti-money laundering regulations.

## **The Fight Against Tax Crimes, Money Laundering and Corruption: Case of Azerbaijan**

**Gubad Ibadoglu:** Good evening. Azerbaijan is a very interesting country - there are lots of differences between the poor and the rich, between urban and rural areas or between the presidential administration and the power of the civil society. This year in mid-October, the next presidential elections will take place. Azerbaijan is one of the richest countries in the South Caucasus, even though twenty per cent of its territory has been occupied by the Armenian forces. Its high GDP is mainly due to the oil occurrence and the special role of Azerbaijan as a transit zone in the South

Caucasus. Since independence, the GDP growth rates have been remarkable, being the highest in the world with thirty four point five per cent in 2006.

Looking at the non-oil GDP growth and the non-oil GDP taxes, it becomes clear that they are not directly correlated. While the non-oil GDP growth has increased up to sixteen per cent in 2008, sharply dropped to under four per cent in 2009 and slowly increased again after that, the non-oil taxes to non-oil GDP has remained fairly constant. Unofficially, it is mostly the oil sector that is paying taxes.

The oil production in Azerbaijan peaked in 2010 with fifty point eight million tons, and has decreased to forty three million tons in 2012. After 2015, Azerbaijan's role as an exporter of gas will increase and it can contribute to the European market. According to the Production Sharing Agreement production sharing agreement, the government of Azerbaijan receives a seventy five per cent share of the total revenue of oil production. This is a lot of money for our government as the country is one of the smaller countries in the region. In 2011, the oil revenue was twenty nine point six billion U.S. dollars. This is very high compared to the annual state budget. It means that Azerbaijan sends five thousand barrels oil daily to the world market additionally to six point four billion cubic meters of gas per year. Due to the large oil and gas revenues, in 2011 eighty seven per cent of the government budget came from this source. In total, the State Oil Fund (SOFAZ) received more than sixty seven billion AZN in revenue; thirty four point two billion remained at the end of the last year. This means that forty per cent of the total oil revenue was saved.

The oil revenue is mostly spent through the state budget after being transferred from SOFAZ. It is spent mainly on infrastructure and on investment projects, etc. In the future, the oil revenue is going to increase even further, depending on the oil price. If it will be at eighty U.S. dollars a barrel, the total revenue will be at more than one hundred and twenty billion U.S. dollars in next 10 years. In another scenario with a high price of oil of hundred U.S. dollars a barrel, the gain will be about one hundred and sixty billion U.S. dollars. In comparison, the gas revenue will not be as large and thus it is mostly used for the constantly increasing domestic demand. This poses a challenge for the Azerbaijan government, as there will be a deficit between the revenue and the oil money that is being spent in the next ten years. In 2013, the State Oil Fund transferred fourteen billion U.S. dollars to the state budget. If the stable oil spending that resulted in a small deficit this year continues, the deficit will grow as well. In the future there will also be more demand for foreign debit because there are not many alternatives. Furthermore, the government spending will rise. One reason for this is that Azerbaijan will host the European Olympic Games in 2015 and it is thus required to invest in its sport facilities and infrastructure. There are currently also two projects, White City and Dream Island, that both require increased public spending.

Azerbaijan signed EITI in 2003 as a pilot country and became the first complying country in 2009. Even though there is some experience in working with EITI, it is not possible to find a correlation between developments in Azerbaijan and the work of EITI. There is no direct link between corruption index as well as between the good governance index and EITI.

The state budget of Azerbaijan strongly depends on oil revenue. In 2010, it received nineteen point two billion U.S. dollars and fourteen billion out of this came directly from oil revenue. It is quite problematic for civil society to access information on the state budget and government expenditures. According to the Research National Budget Group, more than sixty per cent of the state budget is not disclosed to the public, including the construction budget, the defense budget, law enforcement and more. There is no information and this is an example of the deficiency of the public spending of Azerbaijan. In 2011 and 2012, the public spending was much higher in December compared to the other months (around 30% of the total annual budget). This is an example of the existing corruption in Azerbaijan as it is not possible that actual expenses increased so drastically in one month. It seems more likely that at the end of the year the numbers in the book were adjusted due to corruption.

In 2010, according to my calculations, the share of the shadow economy was sixty six point two per cent of total GDP which amounts to twenty seven point five billion AZN. This money mostly goes into offshore deposits. When looking at trade figures, a discrepancy between numbers registered by the exporting country and the amount that is registered as imports in Azerbaijan occur. For example, Turkey exported goods valuing eight billion U.S. dollars to Azerbaijan between 2003 and 2009, in Azerbaijan only goods valuing six point three billion U.S. dollars were registered as imports from Turkey. This indicates a lot of unregistered operations. In the trade with sixteen countries, there is a total discrepancy of ten point six billion U.S. dollars, which accounts for forty three per cent of the total imports from these countries.

The causes for this high percentage of the shadow economy include: legal institutional problems due to the country being a transition economy; the high level of taxes and allowances for social safety in the regulated sphere of the economy; social-cultural and educational discrepancies; degradation of social ethics and traditions of devotion to the state; the intensification of urbanization and migration processes; a disbelief in state authorities; the widespread habit of using cash money; and the control of state authorities that often try to interfere with private companies that are often under the control of oligarchs. This also creates many barriers for FDI and results in its low share of twenty two per cent of all investments in Azerbaijan.

Tax crimes have similar causes and problems. Amongst the most important causes are the changing of parameters for tax objects; the creation of special conditions for tax payers (full or partial freeing from VAT); secrecy of turnover and lowering payments; double accounting; overestimation of special technological needs and expenses as well as changing the payment date of taxes.

We can conclude that the tax base in Azerbaijan is decreasing through the increase of production and service costs. Also, there is no implementation of the law of income declarations by civil servants despite the passing of a new law in 2005. All this results in individuals and companies avoiding tax payments by decreasing their income and increasing their liabilities, artificially decreasing the amount of VAT, expanding cash calculations to distract from tax duties and establishing offshore companies or suspending activities within Azerbaijan. It also happened that 'foreign' oil and gas companies that participated in the Production Sharing Agreement belonged to family members of the president, as came out due to the EITI's transparency initiative. In 2009, a gold field contract over three billion contract was signed.

**Martina Neuwirth:** Summing up, on the one hand on national, regional and international level, there is the issue of transparency including the lifting of banking secrecy. On the other hand, there is a gap between the existing law and its implementation on the ground.

As said before, there is also a large grey area between legal and illegal tax practices. How to deal with that? The head of the tax policy unit of Deloitte in the UK said in a parliamentary hearing: “Our advice is that one is only allowed to file a tax position if one has a more than fifty per cent view that it will succeed“. This shows us that Deloitte proposes schemes to its clients with a fifty per cent chance that they might be illegal. What does that tell us? And Jim, how do you see the role of the US? On the one hand, they are pushing transparency while on the other hand, parts of the USA, like Delaware, are tax havens themselves?

**James S. Henry:** On the role of the United States – every country has its things to be proud of and things to be ashamed of and the United States is no exception there. We have led the world in anti-bribery legislation, pressing for corruption and foreign bribery to be a crime. We have led the world in prosecuting these crimes. In the area of tax havens though, it is true that the United States has designed its tax laws in a way that if you are a non-resident alien, we don’t tax you on your U.S. income from assets you hold. And we don’t share the information with the authorities of your country. In March 2009, the Mexican finance minister wrote a letter to the then Treasury Secretary, Timothy Geithner, asking to share the same information with Mexico on its residents that it shares with Canada under the automatic information exchange agreement. The United States didn’t respond to that letter, but last November an agreement was signed with Mexico under FATCA (Foreign Account Tax Compliance Act). However, it leaves a lot of discretion to the U.S. Treasury about how much information to actually sign up for to share with Mexican authorities.

We are also going to prosecute Swiss banks for example for regressive violations of U.S. tax law, coming to the United States and helping wealthy Americans take their money to Switzerland. Just last week, the justice department told Switzerland that it was not going to do a global settlement with all of its banks, it was not going to take the offer of ten billion U.S. dollars. There are now more than ninety banks in Switzerland that are on the verge of investigation, out of three hundred and twelve Swiss banks. In that area, the United States is doing the exact right thing, because some of this behavior can only be stopped if you have serious criminal investigations. But in the area of its own banks, taking money from wealthy Latin Americans for example and not sharing information on the tax proceeds, the US shows double standard.

One example of the difference between a law and legal evasion is the banana case, based on a study by TJN UK in 2008. This is the kind of information you would like to have on a country by country basis for every industry, but right now it is secret as multi-nationals don’t have an obligation to tell you where they are paying taxes. So they park a lot of their income offshore and they don’t pay taxes on it.

Bananas are mostly exported from Central America and South America – a handful of countries and a handful of producers, members of the so-called banana cartel. If you start in Ecuador, you have labor costs of one and a half pence, production costs about ten and a half pence and one pence of taxable profits in the home country. The export price total is about thirteen pence. Then they have a Cayman island subsidiary that they have set up for the purchasing network and that charges the parent company eight pence for the use of that network. Then we go on to Luxembourg, they charge eight pence to the parent for the financial services associated with that banana. Then on to Ireland, where they charge four pence for the use of the brand. Then to the Isle of Man, where they have a separate subsidiary, charging four pence for insurance services. All these are captive companies, there is no real arm-length pricing because there is no competitive market for any of these intra-company transfers. Remember, about fifty per cent of international trade nowadays is intra-company trade. So in many cases there is by definition no competitive market. Six pence are charged for management services in Jersey and finally in Bermuda seventeen pence for the use of the distribution network. By the time the banana gets to London, the import price is sixty pence, a thirty nine pence retail mark-up and how much tax do they pay on this whole banana? About one pence of taxable profits is left. That is legal tax evasion!

The system is designed to facilitate this kind of avoidance. No-one sat down and cooked it up but major multi-nationals, tax accounting firms, law firms are experts that are using the transfer pricing system to facilitate this kind of funny business. They are basically gaming the system. On the other side, the tax authorities are trying to keep up. Imagine trying to audit this kind of value chain. It is almost impossible for the tax authorities, even though they are trying very hard to get to audit this transfer pricing regime. Developing countries can't even afford to have transfer pricing regimes. It is just too expensive, as it is very costly to come up with competitive information or with a competitive pricing system. At TJN we argue that the law, the following of rules, is not good enough. That is like the garment industry saying they can go to Bangladesh and not pay attention to fire insurance or safety conditions workers are living with. We have to reinstall some principles. One of these principles is that the companies need to pay fair tax rates across the world and not just one pence out of 60 pence of retail profit. That is the same game that is being played in variations by Starbucks, by Google and by other American and some major European companies.

**Martina Neuwirth:** In Austria, there is a very strict banking secrecy which might be lifted, at least partially, by the end of the year. Do you think lifting banking secrecy is important for anti-money laundering efforts or is it just one unimportant measure amongst others?

**Brigitte Unger:** If the banking secrecy would be lifted, it would clearly be much easier to identify tax evasion and illegal money laundering. For example, at the moment I pay my taxes in the Netherlands. If I declare in my tax declaration that I do not hold any bonds or equities, a pop-up opens saying that other information is registered. The tax authority thus knows that my mortgage was covered by a bond, which I did not even know until then. And the system is automatic which makes it very hard to evade tax. As Austria has a banking secrecy, no information about my account here is visible in the Netherlands. If the information on foreign bank accounts would be known and exchanged, it would become nearly impossible, at least for individuals, to evade taxes, because all the information would

be known. In Austria and Germany, due to our history, we do not trust the state enough and thus do not want it to know everything about us. But what you can clearly see is that if you collect and concentrate information, it becomes easier to identify discrepancies. Therefore, lifting banking secrecy would immediately erase and minimize many of the problems we face in this area.

**Martina Neuwirth:** That was clear. Gubad, you mentioned problems between the civil society and the intransparency of the system in Azerbaijan. Do you think the Extractive Industry Transparency Initiative has helped to bring in more transparency or would it be better to have another system? Civil society is part of the initiative, but in your country it cannot act completely free, as there are cases of harassment and activists are put to jail.

**Gubad Ibadoglu:** The Extractive Industry Transparency Initiative has a very narrow mandate. It only covers the revenue side of the extractive industry, including the mining sector. There are some obligations to involve civil society organizations, but it depends on the level of development of these organizations. In Azerbaijan, the current state of the civil society is not good, because there are many restrictions and limitations to the access of information. One example is that according to local legislation, civil society cannot access information on the founders of companies, or other commercial information, like how much tax is paid by companies etc. Another problem is that civil society itself is divided into several groups - some of them being Government Orientated Non-Government Organizations (GONGOs). In Azerbaijan, if a civil society organization receives funds from the government, it means that it is in some ways obliged to do something for them. If the international branch of the Human Rights Watch (HRW) makes a negative statement on human rights in Azerbaijan, all civil society organizations in that field that receive funds are called together and asked to sign a contra-statement. EITI gives some opportunity to access information through their reports but information is only disclosed in an aggregated form and not on a company by company basis. Furthermore, some companies in the oil and gas sector joined EITI automatically to seem more transparent to the outside but, as I said, after some months of investigations it was shown that they were offshore operations of family members of the president. Since Azerbaijan joined EITI in 2009, there was no significant process towards transparency visible. According to the rules, complying countries should pass the audit and validation in five years during which the EITI is established as a routine process. It publishes a report only once a year and involves some civil society organizations.

## Discussion

*My question concerns the remark of Mr. Henry that every country has its own version of double standards. How do you see the FATCA initiative in this context? If I understand it correctly, the US has little to reciprocate, it does not even have a legal base for it, but some initiatives are under way. What is the exact version in the UK at the moment? Is it serious about the offshore destinations on its own territory? What is the most likely scenario of the OECD, G20 initiatives in this respect?*

**James S. Henry:** I am very proud of the FATCA law. For all of its limitations and the fact that it is somehow one-sided, it gives activists in the EU a model what they should be asking for with respect to U.S. financial institutions. It gives Mexican, Brazilian and Argentinian activists that are dealing with

that every day a model what they should be demanding that their governments ask for with respect to the U.S. banks that want to do business there. So the law is a first step, even if there are many loopholes in the existing FATCA requirement. It is a requirement that foreign financial institutions that want to do business in the United States must report their U.S. clients' income to the U.S. treasury to be taxed. It is a first step towards automatic information exchange. But the Swiss agreement on FATCA that was negotiated in February left the entire insurance industry out of the reporting. We all know that the Swiss insurance industry is widely used by wealth managers. You can get a 100 m<sup>2</sup> safety deposit box at Geneva airport, none of the wealth and assets that are stashed in there need to be reported under FATCA. Banks have been working since 2009 to set up anonymous accounts for Swiss wealth managers. But these problems are not going to be solved overnight. I have been working on this for forty years; my first article was about how much cash the United States had offshore. There are lots of things we can do about all this and I think FATCA is a good first step.

*I would like to raise two issues. First, back in the 1970s, I was chairman of an airline in Africa. After an appointment, a Boeing representative came to my office and asked me to buy aircrafts from their company. He was actively trying to bribe me to buy aircrafts from his company. In the 1990s, Airbus made a big deal in the Middle East over aircrafts worth five billion U.S. dollars for the coming five years. Boeing was not happy with this deal, because they were intending to sell to the same buyer. Then, they found out that Airbus bribed the chairman of the buying company and thus, through public pressure managed to council the deal. However, in the end they agreed on a compromise. This is corruption. In developing countries, we are very keen to stop this corruption, but nobody took any action against Boeing or Airbus. For them, this is a normal practice. What can legally be done? Second, a president in Africa side-lined public funds and put them into a Swiss bank account under his name, while he was in office. Years later, he went back to transfer the money to another account, but was told he does not have access anymore as he opened the account as a president – a position he no longer held. However, the money was not transferred back to the state either, but remained in the Swiss bank. How can you explain the occurrence of such a situation? How can laws and the international understanding deal with them?*

**Martina Neuwirth:** This touches two important issues that we have not touched so far – corruption and the recovery of stolen assets.

**James S. Henry:** There is the Foreign Corrupt Practices Act in the United States and if you provide some information to the Justice Department, they would go even after Boeing. In general, the problem that you described, about the dictator not getting his money back from Switzerland, is a common problem. The general problem of kleptocracy, of how public officials are behaving and their access to pay-offs and bribes, is something the TJN is worried about. You need active NGOs, active civil society, the press, the investigative journalists of the world - the ones that were bringing this to public light. They don't care whether it's the United States or France or a Swedish Arms Company bribing people. They will go after them, they genuinely are interested in doing the right thing. On the issue of asset recovery, I have personally been involved in tracking the assets of General Alfredo Stroessner from Paraguay and those of Ferdinand Marcos from the Philippines. We found that the Central Bank of the Philippines had been a piggy bank for the Marcos family. They had borrowed seven billion U.S. dollars from mainly U.S. banks and then transferred much of that offshore to Switzerland. The Philippine government until today still services these loans. The Swiss have coughed up a grand total of five hundred and eighty five million U.S. dollars out of the four billion U.S. dollars that were parked. That is what we call 'odious debt' in the United States. It's a doctrine that dates

back to the Spanish civil war, when we first evoked it with respect to the loans that Cuba had been forced to borrow by Spain. With regimes like Marcos though, we have not applied this principle of odious debt. The asset recovery problem is tricky, it is kind of too late once the money gets abroad. We have to find ways of preventing this in advance. One way is to go after public officials worldwide and require them to declare their assets worldwide upfront. It should be a requirement that politically exposed people declare their net wealth under oath and that therefore they have to be the subject for audit if they want to hold public office.

**Brigitte Unger:** What you mentioned - the presidents putting money of the state into Swiss accounts - is also a matter of definition of politically exposed people. As long as they are active, how immune are they and what can they do? Even within Europe, we found out that countries have very different definitions of who is protected, who cannot be checked with regards to tax evasion or money laundering - because he has immunity. This difference poses a problem as a politically exposed person can very easily shift his or her money to another country within the Euro zone and thus avoid certain regulations. With regards to corruption, we are just finishing a project where we tried to look at corruption with money from EU funds in eight countries. In total, about fifteen per cent in total get lost through corruption. A minor issue, maybe. But an important issue is compliance. At the moment, we have a situation which does not create true compliance – we have a FATF that forces countries to do something. The countries do it in order to fulfil the standards and for not to be blacklisted and that's it. However, for the money laundering and tax evasion combat, we need true compliance which means countries must be convinced that this is something meaningful. The actors in the countries must also be convinced. That means all people you need to stop tax evasion - banks, lawyers, accountants, tax advisers, tax payers themselves - would have to be convinced that this is something that shouldn't be done. At the moment this is the problem, especially with the anti-money laundering policy. It is something that gives us the feeling 'we don't really know what it is for but as long as we don't get criticised by the FATF, everything is fine.' There is a tendency for compliance as lip service, not for true compliance. What I see as important for Europe is to change this - create true compliance by convincing people that the only way to fight tax evasion and crime is to work together to identify criminals. Especially be aware that there are thousands of highly paid professionals – notaries, tax advisors, accountants – that are advising people on how to avoid taxes. They should be called back to do meaningful things rather than just increasing the GDP by advising on how to cheat on taxes.

*We heard about the situation and role of Delaware and the problem of the US as a tax haven. What are technical and legal possibilities of the administration in Washington to push for stricter regulations there? Do you see anything like this happening?*

**James S. Henry:** I would love to have the Obama administration clean up Delaware and require companies to declare their beneficial owners and Senator Levin has introduced legislation. It is a political fight with very influential state corporation registries that make revenue from Nevada, Delaware, Alaska or South Dakota. There are thirteen states now that offer domestic trusts with asset protection as strong as the Cook Islands. It has become a big problem onshore as well as offshore. If we do not figure out how to get hold of this haven industry across *all* countries, ordinary tax payers who see all this tax evasion going on will lose confidence in their governments. But tax payers' compliance is fundamental; it depends on voluntary compliance in most democracies. We will end up with a doomsday approach where you go around and ask each peasant how many cows and how many sheep he has. That is not a society that we really want to live in. We want one where

people believe that the tax system is fairly enforced and that they can trust that their neighbours are not getting away with crime. Unfortunately, in every country this is still a work in progress.

*You mentioned the naming and blaming of tax evaders in the UK. What were the effects of this tactic? What I find interesting as well is that Starbucks serves fair trade coffee and most people would imagine that fair trade coffee is also fairly taxed coffee. Obviously it isn't.*

**Brigitte Unger:** In relation to naming and shaming, fair trade coffee from Switzerland is a good first idea from Starbucks, fair taxed coffee might be the next good one.

**James S. Henry:** We have an endless number of cases of naming and shaming. We can go back thirty, forty years. We basically know what the problems are in this area and they have grown. But the character of the problem is still much the same.

*It was previously mentioned that only four per cent of all people worldwide own the large majority of wealth and thus also own laws, weapons, courts and the police – they have all the power. How is this possible? Ninety six per cent of all people are simply wondering: What is happening here? They don't understand how this is possible, they feel that they are victims. And the remaining four per cent simply continue. Is there an explanation on how this is possible?*

**Martina Neuwirth:** I may add a final question: Imagine that you find a magic lamp and when you rub it, a ghost comes out. The friendly ghost says: "You are free to choose three measures that put an end to money laundering, tax evasion and corruption". What would you choose?

**Gubad Ibadoglu:** In my understanding, all problems of corruption, shadow economy or money laundering depend on the level of transparency. It is very important to have access to information. There are two main actors whose accountability is essential - the government and the companies. Within the government, civil servants should be obliged to disclose their incomes and on the company side, free access to data of the company should be provided. This will reduce corruption and the level of money laundering.

**Brigitte Unger:** My first wish has to do with the previous question on the distribution of wealth. Never before the gap between the rich and the poor was so wide and the distribution of wealth so unequal. But we should keep in mind that in history, we have also seen shifts in distribution, such as the French Revolution that radically changed the social order. Personally, I think that the big problem behind money laundering and corruption is this unequal distribution of income and wealth in the world. If we change this, we do not need to deal with all the symptoms that result from it. My second wish is related directly to the issues of money laundering and tax evasion. We need more transparency - central registries, such as a company registry and a central bank registry to find tax evaders. Austria is currently refusing to implement such measures. My third wish is that the recently upcoming social movements become even more active to push politicians to do something against tax evasion and money laundering.

**James S. Henry:** There is an Austrian singer – Hubert von Goisern – who said that he was perfectly happy to pay half of his income to the government as long as it was well used. A famous U.S. multimillionaire in the 1930s, Edward Filene, who ran a department store in Boston, said the same thing - that he was happy to pay seventy five per cent of his income to the government because he got a hundred per cent of his income from the American people. The issue for him was how well it

was used. Much of what we are talking about today is about people not having confidence that their government are really doing good with the money they are getting. Those of us that are in favour of tax enforcement or fair taxation, have an obligation to make sure that on the spending side, we do as good a job as possible. Many of the governments are falling short in that area.

We basically know what the problems are. The real scandal is that the government institutions - the EU government, the OECD, G8, G20 - have done nothing to clean up these problems . There are simple things that can be done in corporate or individual taxation like changes in the corporate tax system to make it difficult to transfer funds through very low tax havens. That could be relatively easy dealt with. What we see is the OECD actually recommending a list of fifteen specific reforms in that area this summer, such as changes in the automatic information exchange, beneficial ownership registration, country by country reporting – these sound technical but they will make a real difference. I am mostly concerned about developing countries, because they are the ones that are the biggest victims of this system. At the bottom line, there is no substitute for ordinary citizens getting involved in this; it is an on-going battle between very powerful interests and the rest of us. At least, in democratic societies, we have a chance to influence the government. We don't want tax authorities to be spying on us all the time and we would like to minimize the intrusions on privacy. But there is a balance with the interests we all have: that the wealthiest classes and companies pay their fair shares. I would like to see more people involved in the tax justice movement. Once you do that, you will discover not only that there are outrageous things but that there are also solutions. And that is the best thing of all.