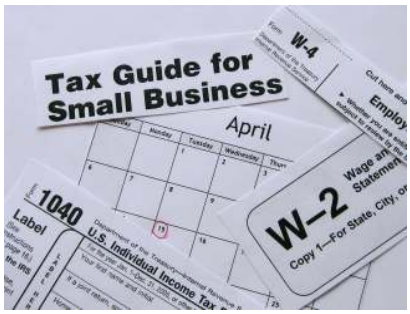
TAX HAVENS – A MORAL PROBLEM, A FINANCIAL LEAK

by Cal Ledsham[•]

Taxation is essential for the smooth, fair and well-ordered peace of Australian society, but the complexity and technicality of tax policy as an area of public policy mean that people find it difficult to take an interest in.[1] Governments need sources of funding for the services they provide to society, and the continual and fair means to continue to raise revenue. The problem with tax havens is that they allow certain citizens and corporations to evade paying their fair share of tax, and prevent governments from raising revenue fairly.

In this paper, I first outline briefly how international tax havens operate; they render Australian law unenforceable and allow for a significant division of the Australian tax base into standard tax payers and wealthy tax-evaders. This description of the Australian situation is then followed by an overview of both the origins of the tax-haven system and the attempts over the last decade to combat it (attempts that have been only modestly successful). I then sketch the moral issues at play and how social justice activists should respond with regard to these issues. As it turns out, the Australian government is more hamstrung than blind or deaf – it is actually very well aware of injustices, and very willing to rectify them, but has limited power to do so.



Courtesy GossamerLL

Introduction

The Australian Taxation Office (ATO) maintains that there is abusive use of tax havens.[2] It refers to the effect of this use as "revenue leakage" and also notes that maintenance of the Australian community's confidence in the fairness of the tax system is vitiated by such abusive use. The concept of revenue leakage suggests a more cautious outlook than the earlier description of "race to the bottom" used by the OECD to justify its campaign in 1998 (on this campaign, see below). One should note that "revenue leakage" suggests either that revenue must be gathered from other sources, though to tax these sources in lieu of those abusively using havens is unjust; or alternatively, that less revenue is available than would otherwise be the case. This means that various state-funded projects directed toward the common good will be unable to be fully undertaken. So, the abusive use of tax havens means that the common good is inadequately pursued, or put otherwise, that some are paying more than their 'fair share' to cover the deficit created by abusers.

[•] Dr Cal Ledsham has recently started lecturing (2008) in philosophy at the Catholic Theological College, Melbourne. His academic specialisation is medieval and early modern philosophy (PhD Leuven), and he has an interest in ethics and international justice issues.

[1] Good examples of this sort of applied analysis are the ACSJC papers, for example, *Common Wealth for the Common Good* (1992), and *A fair Society? Common Wealth for the common good: ten years on* (2003).

[2] Australian Taxation Office submission to US Senate Committee on Homeland Security and Governmental Affairs, retrieved 25 Nov 2008 from http://www.ato.gov.au/corporate/content.asp?doc=/Content/00155700.htm.

There is a general problem that is caused by tax havens, and this is the difficulty of enforcing the law. The ATO summarises this issue:

> Essentially, the main impediment to the ATO posed by tax haven secrecy laws arises from the difficulty of obtaining basic information that may be indicative of fraud and evasion. This is a "Catch 22" situation – without knowing that a person has funds in a tax haven, it can be difficult to identify or prove fraud or evasion. Without having identified fraud or evasion, access to relevant information is precluded by the secrecy laws of the tax havens.[3]

The proper authorities cannot obtain information on possible tax evasion, and thus cannot ascertain whether citizens have complied with tax law. In the fiscal year up to June 2007, about $16 billion AUD was sent directly to tax havens from Australia, and approximately $18 billion AUD was sent directly from tax havens to Australia.[4] To put these numbers in a global perspective, the Tax Justice Network (the eminent NGO in this area) has estimated that there is approximately $US11.5 trillion in assets held offshore by High Net Wealth Individuals (hereafter HNWIs), and that tax revenues owing on these assets may be as high as $US255 billion per annum. It is estimated that a third of the wealth of the world's HNWIs is held offshore. The estimates of the assets of HNWIs lie somewhere between $US5.8 and11.5 trillion.[5]

Courtesy YM at stock.xchnge

As is evident, Australia's place in this scheme is rather small compared to the trillions of dollars in total in the offshore system. Yet even though our place in the scheme is minor, Australia is significant not only in the degree of wealth its citizens hold offshore, but also in its position as a middle-power western democracy with moral influence. We should address the problem, and not allow for any complicity that allows it to congeal into a legitimate customary practice.

For the purposes of this paper, there are two groups who are the users of tax havens: corporations (*lato sensu*, i.e. for-profit legal/artificial persons), and individual taxpayers. There is a considerable barrier to entry to the financial benefits of a tax haven: setting up business in one is administratively difficult and expensive. Accordingly, the individual users of tax havens are wealthy – they are most often described as High Net Worth Individuals. HNWIs. The HNWIs attract most media attention and are the more prominent targets of community outrage. This is understandable because there is a direct comparison to be made between the targeted HNWI and each of us as individual tax payers.

There is less scrutiny of corporate users of tax havens. This tendency is derivative of habit of seeing corporations as entities distinct from the collection of governmental,

---

[3] Australian Taxation Office submission to US Senate Committee on Homeland Security and Governmental Affairs, retrieved 25 Nov 2008 from http://www.ato.gov.au/corporate/content.asp?doc=/Content/00155700.htm.

[4] Tax Justice Network. Briefing Paper 0 the price of Offshore. See www.taxjustice.net.

[5] The *Overview of the OECD's work on International tax evasion: brief for Journalists*, 29 September 2008 (p. 2) gives a good summary and tabulation of different figures offered by various bodies.

legal and social institutions provided for out of national tax revenues, which enable both the parameters for their existence and the social peace that are equally a pre-requisite of their existence and prosperity. Nevertheless, the corporate use of tax havens attracts less attention. This lack of attention has been facilitated by policy derived from the political rhetoric of 'globalisation', and has been part of a more general move since the 1980s wherein corporate civil entities have pushed aside civic organisations in their demand for political favour, and have sought to claim a civic legitimacy far beyond that claimed in previous decades. This political movement has gone hand in hand with campaigns for lower taxes and reductions in government amenities, privatisation of government assets, anti-red-tape politics and anti-corporate tax campaigns. This corporate-favouritism has been most often associated with the New Right, but one finds that it has as often been facilitated by centre-left and soft-right political parties in western countries (*vide* the Hawke/Keating government and Blair/Brown in the UK).

A short history of tax havens

The modern system of tax havens emerged during what we can think of as the 'long decolonisation', from WWI to the 1980s. Political entities associated with, but semi-detached from, the great powers were granted special tax power, and privileges. For example, historically speaking, the Isle of Man, the Caribbean states, and Monaco are political entities associated with, and under the sovereignty of, great European powers such as England or France (or Norfolk Island in the case of Australia).[6]

In the 20th century the anachronistic administrative features of these political entities began to be exploited for the purpose of tax minimisation.[7] This was often initiated as an attempt to copy legal arrangements for secret banking established in Switzerland. Swiss banking has a heritage that goes back at least to the French Revolution, and perhaps even to the Wars of Religion as a place to deposit wealth safely and discreetly. Swiss secrecy laws were strengthened to their modern form in 1934 when it became a criminal offence to divulge banking information to governments. This was combined with a very strict definition in Switzerland of tax evasion, such that most financial abuses are not regarded as such under Swiss law. The result of this is that governments such as Australia cannot enforce their tax laws, because their citizens and corporations can put their wealth behind the veil of Swiss secrecy.

After WWII, tax havens emerged elsewhere replicating Swiss law on banking secrecy. This proliferation became very problematic by the 1980s, and positively pandemic by the 1990s, with the number of tax havens exploding in these decades to its current point of somewhere between 30-80.[8] There is some evidence that the formation of some tax islands in the 1960s occurred as a result of government policy

---

[6] On Norfolk Island in relation to Australia, see Van Fossen, A. B. 'Norfolk Island and its tax haven'. *The Australian Journal of Politics and History*. 48(2), 2002:210-225. Partial online version at: http://goliath.ecnext.com/coms2/gi_0199-1833350/Norfolk-Island-and-its-tax.html

[7] J. Sharman, *Havens in a storm: the struggle for global tax regulation* (Ithica: Cornell University Press, 2006. Hereafter Sharman, *Havens*). 22.

[8] The ATO lists approximately 30 tax havens, based on the criteria of (1) little or nominal taxes, which can be used by non-residents to escape taxes in their own country; (2) secrecy provisions that make exchanges of tax information possible, and (3) lack of transparency in the legislative and administrative control so that it is difficult to apply their laws to users of the tax haven. The ATO stops identifying a jurisdiction as a tax haven once it has an information exchange agreement with the Australian government, regardless of how effective that agreement is in allowing the exchange of information. Thus, the Australian count of havens is far lower than the concrete count put forward by NGOs.

in first world nations, in particular as part of the process of decolonisation – little political entities were set up as tax havens to ameliorate their poverty by their ex-colonisers.[9]

One should note, however, that the world tax haven system is of relatively recent origin (Switzerland aside). It can even be considered an unintended consequence of bungled decolonisation that needs to be set right. It is not often remarked in the literature, but its recent origin means that the international tax haven system cannot be defended as part of some sort of 'natural' operation of the free market, and nor can it claim the political legitimacy that might derive from longevity. The first point is extremely important – much economic analysis assumes a backdrop of a "natural" arrangement of things, which is quite often not natural at all, but the result of statecraft (e.g. urbanisation via land-enclosure). Tax havens are not natural entities with natural rights or the legitimacy of tradition.

The OECD campaign

In the mid-1990s the OECD began to look at the issue of tax havens, and launched a campaign to stop tax havens from driving corporate tax revenues downwards in western countries. Tax havens caused 'fiscal degradation' and a "race to the bottom" for tax revenues.[10]

In 1998 the OECD released a report entitled 'Harmful Tax Competition: An Emerging Global Issue', which started the ball rolling against the tax havens. It defined tax havens, outlined harmful tax practices, and made policy recommendations against harmful tax practices.[11] It argued that tax havens threatened the financial stability and total revenues of the OECD member states. Such tax competition has the pernicious outcome of shifting the impact of taxation from capital/profit to those factors of production that are immobile across state borders, such as land and labour.[12]

There were two issues conflated in the OECD campaign – the question of banking secrecy and the issue of low-taxation jurisdictions being accessible in a globalised economy. The latter was to be decisive eventually in allowing advocates effectively to neuter the OECD campaign against banking secrecy. Tax-haven advocates have depicted the OECD member countries as aggressors trying to harm the economies of the tax havens, to engage in regulatory colonialism, and to instigate socialism and a single world government. This latter movement against low taxes is not a concern of this paper, but was decisive in setting the Bush regime against the OECD initiative in 2001, effectively neutering it.

The 1998 report eventually led the OECD to work towards making the countries of the OECD engage in information exchanges, to stop banking secrecy, and to eliminate corporate structures (i.e. both certain forms of trusts and company arrangements) that were intrinsically apt for tax secrecy.[13] These objectives were agreed to in principle and instituted to some extent in a weakened form by 2003. The European Union at the same time instituted arrangements for banking transparency among its member states.

---

[9] This assistance of ex-colonisers in structuring the financial services sector in tax haven jurisdictions was also encouraged (astonishingly) by international economic development agencies, such as the World Bank. See Sharman, *Havens*, 24.
[10] Sharman, *Havens*, 28-29.
[11] Sharman, *Havens*, 41-3.
[12] Sharman, *Havens*, 29.
[13] Sharman, *Havens*, 40-41.

Those not willing to be transparent collected a withholding tax on interest payments in lieu of disclosure (Switzerland, Andorra and Lichtenstein). The absence of these three countries effectively neutered the EU initiative. Both Switzerland and Lichtenstein have strongly criticized the EU and the OECD for attempting to promote action against tax havens.

The 1998 report was followed by another in 2000, 'Towards Global Tax Co-operation', that reported on those countries that were still tax havens, those that had signed on to the transparency initiative, and the time-line on which they would institute their commitment to fulfil the OECD requirements for transparency. It also outlined measures that OECD members could take against those jurisdictions that had not come to the table. Opposition to the OECD process took root as a result of the 2000 report. In particular, the Commonwealth Secretariat was sympathetic to, and lobbied for, the Caribbean tax islands. Switzerland was uncooperative, and elements of the US political right engaged against the OECD initiatives.[14]

Further reports throughout this decade continued pursuing the issue but the nature of the campaign changed and the initial force of the initiative was lost. The movement against tax havens lost what momentum it had had in 2001 when the US left the OECD initiative for ideological reasons.[15] From 2001 onward, the OECD changed its tack from an interventionist, aggressive stance to one that was non-interventionist, non-belligerent, free of economic pressure against tax havens, and treated the tax havens as dialogue partners in a conversation about harmful tax practices. It strove to realize joint initiatives based on consensus that would be implemented only if agreed to by all participants in the conversation.[16] This sort of consensus-style stood in contrast with the 1998-2000 approach of depicting the tax haven system as an aggressive financial structure that needed to be combated and its pernicious effects on western economies repelled.[17] The OECD still produces reports on the issue, but compared to the tenor of its 2000 report, it is seemingly moribund.

In addition to the OECD campaign, there has been a growth of bilateral tax information-exchange agreements between tax havens and developed economies over the last few years.[18] The OECD has played an important role in developing a model exchange-agreement, which has been widely adopted. These bilateral information exchanges are a good thing; but are suboptimal in comparison to multilateral arrangements for three reasons. First, they tend to block the exchanged information from being given to third-party governments. This means that the transparency is only limited to those states with agreements. Second, the recently established agreements tend to be limited to developed economies and tax havens; developing economies are not part of this process.

---

[14] Sharman, *Havens*, 58-63.

[15] Sharman makes the case that the Bush administration was not acting as a result of pressure from its business lobby, but that the US decision to leave off the process resulted from the ideology of the Bush Administration. See Sharman, *Havens*, 50-51. He also discusses the mixed reception of the OECD initiative in the business community, noting that the corporate sector included both advocates and opponents of the OECD initiative. See Sharman, *Havens*, 64-67.

[16] From 2003 onward, countries which were formerly labelled as tax havens were renamed as 'participating partners' in the tax transparency dialogue. See Sharman, *Havens*, 100, 149-150.

[17] The focus of Sharman's *Havens in a Storm* is to trace the change of language from a confrontational stance to a cooperative stance, and to investigate it in relation to idealist and realist theories of geopolitics and international relations. See Sharman, *Havens*, 74-75.

[18] http://www.oecd.org/document/33/0,3343,en_2649_33767_41570785_1_1_1_37427,00.html.

Third, the agreements only cover one tax haven at a time, and are limited in the scope of the information that can be exchanged. This means that there is still a tax-haven system in existence; an agreement merely means that one component has been eliminated, i.e. one particular tax haven. In a globalised world where relocating abusive tax arrangements is inexpensive, with a large number of alternative havens at hand, the current coverage of bilateral arrangements is woefully inadequate to stop abusive arrangements. The universality required to stamp out banking secrecy cannot be comprehensively implemented – one leak still makes a leaky bucket.

Indeed, there has been some demand for an international tax organisation that could not only coordinate tax arrangements among countries in order to realise the equity claims of western nations (who could, and are, slowly doing this bilaterally), but also the equity concerns of developing countries. The argument for an international tax organisation alongside the UN and such bodies as the OECD raises concerns as to what sort of 'teeth' it would have, and whether it could impose unitary taxes. The difficulty, according to proponents of a teethed world-tax organisation, is that the OECD has operated in the interests of western developed countries,[19] and has ignored or marginalised the concerns of developing countries. I do not want to consider this sort of proposal in this paper; I merely note that the problem of tax policy is dire enough that people have seriously countenanced such a solution.[20]

In recent years, there has also been some initiative on the part of Democratic congressmen and senators in the US to engage with the tax-havens issue, and it seems to be the subject of campaign promises on the part of the Obama Administration. Exactly how far and how quickly any legislative change will be undertaken is not clear; nor is it clear whether any campaign will be merely superficial or whether it will rather address substantial issues.

The main bill currently working its way through the senate is the Stop Tax Haven Abuse Act, sponsored by Senator Carl Levin.[21] It changes the onus of proof from people transferring monies to, or 'interacting with', non-sharelisted financial entities (e.g. trusts, bank accounts) to the default that the transferee is deemed to be the beneficiary. This means that cases against tax abusers become easier to prosecute; the beneficiary of finances does not have to be discovered sitting behind a wall of secrecy. Further, any such account is deemed, by virtue of its location in a haven, to fulfil requirements that it be reported to the Internal Revenue Service. It also strengthens law requiring that transactions have economic substance, and are not merely undertaken for the purpose of evading tax. As noted, the bill seems to be very robust and should be commended; it is not clear how it will translate into policy outcomes. So, there is some potential for concrete actions rectifying the problem of

---

[19] Tax authorities from some developing countries have begun to form networks to tackle the difficulty of aggressive tax planning in relation to their taxation base, their development-capacity and the attainment of the Millennium Development Goals. See the *Pretoria Communiqué*, International Conference on Taxation, State Building and Capacity Development, Pretoria 29 August 2008, hosted by the South African Revenue Service:
http://www.sars.gov.za/Tools/Documents/DocumentDownload.asp?FileID=22308

[20] I refer the interested reader to Francis Horner 'Do we need an international Tax Organization?' *International Tax Notes*, 24:179, Oct. 8, 2001. While the positions therein are given only in a private capacity, it is worth recognising that Horner is a foreign policy advisor with the Office of International Justice and Peace, Catholic Bishops conference.

[21] See http://levin.senate.gov/newsroom/release.cfm?id=308949 for a summary of the bill

abusive secret offshore jurisdictions emerging in the political system, but progress has been uneven.

Key issues

The common element allowing for financial abuse is lack of transparency of beneficial ownership. This needs to be addressed and governments need to be clearly notified that they have a supportive constituency for the work of tackling tax abuse. The problem of tax havens should not be an issue on which politicians should have to lead the electorate (commendable as such leadership is), but one on which they fulfil the will of their electorate. They should be being pushed by their electorate, rather than pulling it along. We should encourage activity of governments in pursuing bilateral information-exchange agreements, while being aware that the emergent system of bilateral information exchange is not perfect.

The arrangement of agreements as it has progressively unfolded on an ad-hoc basis after the demise of the OECD's strong, multilateral campaign against the havens is unwieldy, and incomplete. A patchwork of bilateral exchange agreements has the potential to exclude those countries (especially developing and southern countries) without the diplomatic/economic 'clout' to negotiate transparency in a bilateral MOA, convention or treaty.[22] Australia should continue its negotiation of Tax Information Exchange Agreements in bilateral agreements, but this really is a second-best option: the 'I'm all right, Jack' option.

We also have a duty to monitor and evaluate government policies against tax havens envisaged in the future, such as economic sanctions and the cancellation of foreign aid,[23] which must be assessed against norms of equity, proportionality and efficacious targeting. In particular, it should be clear that any such defensive processes should not target the poor and impoverished, rather than the wealthy and the ruling elites responsible for relevant financial policies. This is very important, because as the revenue leakage from tax havens becomes more apparent and widely known, the pressure to act is likely to swell, and could lead to vituperative and aggressive policies against the havens.

The tax-haven problem creates a puzzle over the moral implications of the idea of sovereignty in international relations. It is not clear to what extent the moral strictures traditionally associated with state sovereignty can be morally sustained: perhaps they need to be rethought. While not constituting a cause for war, the activity of tax havens seems to be aggressive enough, and unjust enough, to warrant some sort of assertive interference and prevention on the part of western governments. The difficulty here is that the moral validation of assertive interference by state actors against tax havens[24] seems to unsettle the established conception of the traditional norms of non-interference of states in one another's sovereign domains. One does not want a situation of bullying in the international system – where the tax-haven problem is

[22] Such as the Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (1982).

[23] 'Defensive measures' such as these were already envisaged by the OECD in the early stages of its campaign, but were dropped early in the 2000s.

[24] Such as the German intelligence service's purchase of leaked data from the LTD Group in Lichtenstein, which has lead to the pursuit of prosecutions of the bank's customers by western governments.

rectified with disrespect for the legitimate national autonomy of the countries involved.

There is also a moral problem of respecting subsidiarity with the work being undertaken by international organisations against tax havens, such as the OECD. A balance needs to be struck between countries going it alone, and attempting to rectify the problem bilaterally (and potentially therefore unjustly), and, on the other hand, delegating power unnecessarily to fix the problem to overarching large, multilateral organisations.

What Australia can do

There are also some things we can do to support the Australian government's campaign against tax havens in concrete, within Australia. We should support governments' campaign of education and communication against the abusive use of tax havens.[25] As the ATO has put it: 'don't get mixed up in dodgy tax haven arrangements and, if you have, come clean!'.[26]

The church can offer a 'social justice' context for this ethical imperative. We can lobby to ensure that the ATO and other relevant bodies have the resources to deter, detect, disrupt tax-haven schemes associated with abusive practices and (in some cases) criminal activity such as money laundering. This will include careful attention to the staffing situation at the relevant government bodies, particularly in relation to recruitment and imminently forthcoming waves of retirement of many experienced staffers. The state needs an effective capacity to rectify the problem of tax havens, and this needs a groundswell of support, not just the endorsement of the officials involved.

We should also encourage Australian attention and support for Levin's Stop Tax Haven Abuse Act, and check to see if it can shed light on areas of Australian legislation which could be similarly upgraded/strengthened (in enhancing both penalties and the reach of the law).

We should also be able to provide an ethics of what it is to be a just-tax payer in relation to the concept of "tax minimisation". The concepts of tax minimisation and minimal compliance need to be carefully thought through, and ethical rules of thumb developed to distinguish pernicious versions of it from legitimate ones. The tradition of the 'fair go' can help here. There is also a larger difficulty in conducting a campaign against tax havens concerning their corporate abusers. The problems of tax havens and abusive tax structures should not be conceived primarily through the prism of 'envy politics' with regard to HNWIs. Focussing on the tax evasion of very rich individuals is emotive, and perhaps a spark for raising general awareness of issues, but ultimately they are not the main locus of injustice. Most of the revenue losses actually lie with corporate abuses of tax havens. Catholic teaching on sinful structures has a place alongside personal sin, and can be used to clarify the moral stance of business. Hopefully, with some careful attention, we can rectify the

[25] For example, the ATO booklet on tax havens directed at taxpayers: "Tax havens and tax administration" available at http://www.ato.gov.au/content/downloads/LBI_46908_Tax_Havens_w.pdf

[26] Australian Taxation Office submission to US Senate Committee on Homeland Security and Governmental Affairs, retrieved 25 Nov 2008 from http://www.ato.gov.au/corporate/content.asp?doc=/Content/00155700.htm.

injustices caused by the tax havens, by changing people's apathy and acceptance of them, and make it easier for governments to counteract their pernicious effects.