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The Curse Of The Treasure Islands: How Tax Havens Are Sinking Europe's Economy

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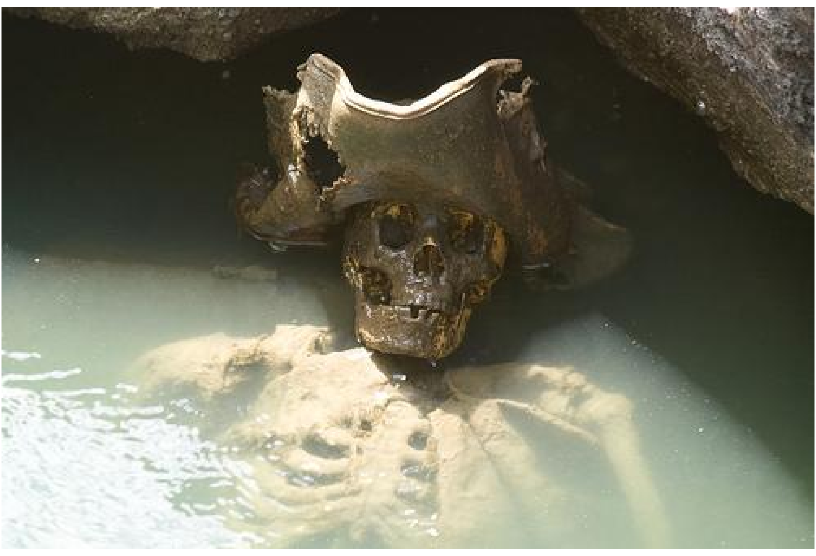

EU states lose an estimated €1 trillion in potential revenue every year from tax evasion and avoidance activities. Much of this amount, it turns out, has been squirreled away to offshore tax havens – known otherwise as "treasure islands". Can anything be done to recoup these losses?

English accountant Richard Murphy is a controversial figure. His pioneering work for Tax Research UK on exposing tax avoidance and evasion made him a target for the barbs of financial elites - who wanted to protect their interests from his sharp scrutiny – but also led to him being described as a "heroic figure…driven by admirable moral fervour", by the Daily Mirror newspaper.

According to Murphy, an estimated €1 trillion a year was being lost in the EU due to the twin evils of tax evasion and avoidance. Not surprisingly, this figure has been disputed by the corporate world, though the European Commission, in a recent report, used the same figure as Murphy's in quantifying the EU tax gap – an implicit acknowledgement of his unique expertise in this area.

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In the meantime, Murphy has been battling hard to expose offshore tax avoidance schemes. His work for the London-based Tax Justice Network for instance has ruffled quite a few feathers. When the organisation launched its Financial Secrecy Index in 2011, which gave all tax havens an opacity rating, the head of the Cayman Islands' Monetary Authority described Murphy as "the leader of the international tax Taliban".

Naturally, Murphy was delighted.

"If the tax havens are hurting, then what we're doing is working," he said.

The English accountant's "moral fervour" can be traced back to his experiences working for KPMG, one of the world's biggest accountancy firms, during the 1980s.

"At that time no one anywhere realised the threat to the world economy that offshore tax havens posed."

"What I saw can be summarised simply: Offshore was clearly a world of make-believe. In most cases nothing ever really happens in an offshore company. All its decision-making, all its accounting, all its paper work is really done somewhere else. The pretence was corrosive, for the people involved, for the business, and maybe more widely, as I realised later."

Murphy's Mission

Acccording to Ronen Palan, a Professor of International Political Economy at the University of Birmingham and co-author of Tax Havens: How Globalization Really Works, Murphy's passion to expose tax evasion may have arisen after getting "sick and tired" from "working for people whose big business is tax avoidance."

"Murphy is a very serious accountant, one of the best around and his work should be taken seriously," said Palan.

"He is well-known, but is his work shunned by the current government who prefer to rely on accountants and lawyers from industry, although they are obviously protecting the interests of the financial elite," Palan added.

Since embarking on his mission, Murphy has produced several influential reports detailing the scale of tax evasion and avoidance and has outlined plans on how to prevent it. Using new data from the World Bank published last year on the size of shadow economies, his recent report, Closing the European Tax Gap, estimated that the amount lost to tax evasion, which is illegal, was €860 billion a year.

It is much harder to quantify tax avoidance, which is legal but unethical. But Murphy is reasonably confident in proposing a conservative figure of €150 billion a year in the EU. This means that evasion and avoidance together cost the EU around €1 trillion a year, which could cover the cost of 105.8 percent of total health-care spending in EU countries.

The tax lost to the EU's shadow economies is 17.6 percent of total government spending, Murphy argues in the report. Only in two cases – Luxembourg and Austria – is the tax lost less than 10 percent of revenues, he noted; and even in efficient countries, such as Germany, almost one euro in six is lost to tax evasion.

Based on Murphy's figures, tackling tax evasion could clear the budget deficits of 16 EU states:

"The findings add a new policy agenda to public debate on the world's financial crisis. For example, Italy loses €183 billion to tax evasion a year, which is the most in Europe. Its current debt of €1.9 trillion represents just over 10 years tax of tax evasion. If more had been done to tackle rampant tax evasion, Europe would not be facing a crisis today."

Treasure Islands

Much of the money is hidden away from the taxman's gaze in international tax havens. The Tax Justice Network argues that there is at least US$11.5 trillion held in tax havens, which equates to around US$255 billion in unpaid tax per year.

What's more Murphy's estimates are nowhere near outrageous. In fact, the European Commission's recent report suggested even higher figures. According to the EC, US$20 trillion was hidden in just the Cayman Islands, Switzerland, Singapore, Hong Kong and Jersey alone.

Today, a third of the world's GDP is being channelled through tax havens and more than half of the money passed around the globe each day moves through these accounts. There are about 3 million global corporations with no identifiable owner and the Organisation for Economic Cooperation and Development (OECD) estimates that 60 percent of world trade consists of transfers within multinationals, who pass profits to anonymous subsidiaries in tax-free jurisdictions.

The Cayman Islands, a British overseas territory in the Caribbean Sea, is the world's worst offender. It is the only place in the world with more businesses than people – 55,000 citizens compared to around 60,000 registered businesses and trusts – and as of June 2011, there were 250 banks registered there that had assets of US$1.78 trillion, including 40 of the world's biggest 50 banks. This makes the cluster of three small islands the world's fourth largest financial sector.

Of course, banks registered in the Caymans are not at all interested in the tropical climate. In exchange for a name on a plaque, these banks get to be based in a country that guarantees to charge them no tax and will not disclose any information about their accounts.

"Tax avoidance has gone on for 80 years but offshore rates of avoidance have risen phenomenally since capital market liberalisation in 1980," said Murphy. "It became possible to move your money around the world in a way that made it much easier to hide it from view."

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Murphy's "Law"

Nevertheless, Murphy still believes that tax havens can be beaten using three simple measures, shattering their secrecy for good in the process.

"First, all tax havens must put details of the ownership of all companies and trusts located there, and the accounts of those organisations, on public record."

"Second, all multinational companies must publish accounts that reveal their use of tax havens."

"Last, all tax havens should be required to exchange information each year on the income recorded within them belonging to the citizens of other countries with the places where those people really live."

"If we introduced these measures, those committing tax crimes would no longer have places to hide the proceeds of their crimes. Nothing could make a bigger contribution to solving the world's financial crisis," he said.

In addition, Murphy has many other solutions to the dual problems of tax avoidance and tax evasion. Tax avoidance, for instance, could be tackled, he says, using a general "anti-avoidance principle", which would allow tax authorities to investigate taxpayers who add artificial clauses into a transaction to avoid tax.

"It's very important as it puts the burden of proof onto the taxpayer. It's designed to stop the kind of Channel Islands scheme which the multi-millionaire British comedian Jimmy Carr used to reduce his tax liabilities," Murphy opined.

However, in order for tax authorities to do their job successfully, they need to be properly funded, Murphy says. Sadly though, a culture of cuts across Europe has been diminishing the taxmen's powers. In the UK, for example, 44,000 of the HMRC's (Her Majesty's Revenue & Customs) 55,000 staff went on strike in June this year to protest against plans to cut 10,000 posts by 2014-2015.

"The UK's senior tax officials' union estimates a yield of £10 for every £1 spent, which means that cuts are a false economy," said Murphy. "Tax authorities raise money and spend modest sums to do so."

Additionally, Murphy said that the HMRC cost just over £3.9 billion to run in 2010â¯ 11, whereas tax receipts were at £447 billion. According to his own estimates, the UK's tax gap is £95 billion, but even using the official HMRC figure of £35 billion, the yield on further expenditure would be high.

In the UK, which is one of the EU's most tax-compliant countries, tax evasion by small businesses remains a big problem. The HMRC estimates that 46 percent of all small businesses in the UK under-declare their tax in the UK, while the pandemic is even worse in other EU countries, such as Italy and Greece.

Murphy suggests that all businesses with turnovers of less than €1 million a year should be required to submit a breakdown of their sales turnover with their accounts. They should disclose their top ten customers by value, plus the total of other sales. If those exceeded 70 percent of sales then no further analysis would be needed. Otherwise, monthly or weekly sales revenues would also need disclosure. The openness would make it far easier for tax officers to keep tabs on businesses.

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Additionally, Murphy favours introducing a measure that has already proven to work in tackling tax evasion in Italy. The idea is to seek the "smoking gun" of tax evasion in government-maintained databases that indicate which citizens are more likely to be wealthy. This information can be correlated with tax return data to locate anomalies in lifestyles.

Back in June, this year, the tactic produced spectacular results in Cortina d'Ampezzo, a winter playground for the rich and famous in the Italian Dolomites. Tax officials traced the owners of 133 Lamborghinis, Ferraris, SUVs and other expensive luxury cars that they found parked in the snowâ¯ lined streets.

According to the Daily Telegraph newspaper: “They found that 42 of the owners – nearly a third – had declared incomes of less than €22,000 a year. A further 16 claimed to be earning less than €50,000 a year. The investigation highlights a nationwide problem of Italians cheating the tax man by hugely underâ¯ declaring their incomes, or declaring no income at all.”

But the political will to introduce these, and other measures, is not yet present in many European countries, claims Professor Palan:

“When I first started investigating tax avoidance I thought there was a simple explanation. The rich, large business elite benefited from it and through lobbying they got the politicians on their side. Of course, many politicians are already from the financial elite….

“I began to question that simple assumption [of course]; but, since the financial crisis, I’ve seen such enormous sums of money spent by the financial industry to deflect attention from tax havens that I have slowly and cautiously returned to my original assumptions!”

By David Smith, EconomyWatch.com

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