

# Winning the Tax Wars

## Tax Competition and Cooperation

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The title of this book, “Winning the Tax Wars,” is very evocative. It refers both to the war against tax unfairness and to the victory of quality of life in our societies.

Throughout the chapters, we learn that this sophisticated war will be waged through negotiations between states, the firm persuasion of global financial elites, inter-state collaboration and the conclusion of multilateral agreements and treaties. As for the expected victory, it would be that of a growing global awareness regarding three fundamental issues – tax competition, tax avoidance and tax evasion – which reduce the power of sovereign states and limit their spheres of public action in key sectors such as the environment, education and health.

The globalization of trade, the digitization of the economy, tax competition between sovereign states, the erosion of the tax base and the transfers of profits have all revealed the weaknesses of a traditional tax system that has reached its limits. For more than a decade, under the impetus of large international organizations such as the OECD and the UN, numerous states and groups of states have met and tried to join their efforts in creating a new international tax system designed to counter tax avoidance and evasion. The inter-state exchange of information on tax planning schemes and strategies constitutes the core measure of this tax collaboration. In this regard, Tax Inspectors Without Borders (TIWB) is an essential initiative for international tax transparency.

In addition, we cannot underestimate the importance of tax whistleblowers, which have courageously brought to light the deviant behavior of the ultra-wealthy and their advisers and disclosed to the global public the names of those for whom greed trumps the collective interest. It is high time to adopt robust measures to protect whistleblowers against retaliation in order to legitimize their action.

Above all, destructive tax competition is a topic of rising concern, particularly for developing countries that experienced tax wars during the recent years. Many tax systems are moving to a territorial tax system which makes it even more necessary to understand the transnational implications of national tax policies, as well as the reactions of local governments.

In the end, the goal is to revive the notions of common good and general public interest, which now transcend national borders and are attached to the international community of men and women. We must increase the level of transparency and accountability of private and public economic actors and restore the citizens' trust in the fairness of our global governance systems.

The Honourable Louise Otis

Preface

The title of this book, *Worlding the Tax Wars*, is a play on words. It is a reference to the war against tax avoidance and the search for a global public good. It is also a reference to the search for a common good and general public interest, which now transcend national borders and are attached to the international community of men and women. We must increase the level of transparency and accountability of private and public economic actors and restore the citizens' trust in the fairness of our global governance systems.

Introduction

Tax wars have been a feature of modern states. These wars of polarization of the common good (the French Revolution (1774) are a classic example. The French Revolution, which was a war of polarization of the common good, but now covers the entire world, is a classic example of a war of polarization of the common good. The French Revolution, which was a war of polarization of the common good, but now covers the entire world, is a classic example of a war of polarization of the common good. The French Revolution, which was a war of polarization of the common good, but now covers the entire world, is a classic example of a war of polarization of the common good.

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## CHAPTER 5

# Offshore Tax Investigations, Tax Whistleblowing, and Global Tax Compliance

Louise Otis & Brigitte Alepin\*

## §5.01 INTRODUCTION

This chapter questions and reflects on what our understanding of the global tax system would be, without the results of the offshore tax investigations that have recently taken place in the United Kingdom (U.K.), France, the United States (U.S.), Luxembourg, and Panama, given the information revealed by the different leaks and whistleblowing. It argues that to adapt our tax systems to the demands of the twenty-first century, it is crucial to know how tax is treated in the real world, to ensure that all taxpayers pay their fair share, and to use more of these tools to further promote transparency.

Also, this chapter considers the numerous interlinkages between offshore tax investigations, tax whistleblowing, and global tax compliance. Offshore tax investigations and tax whistleblowing are relatively new and powerful practices that are increasingly playing a role in implementing a better system for global tax compliance. The second half of this chapter analyses the present system and proposes thoughts on global tax compliance for the twenty-first century.

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§5.02[A]

**§5.02 OFFSHORE TAX INVESTIGATIONS AND TAX WHISTLEBLOWING****[A] Definitions and Importance****[1] Offshore Tax Investigations**

Offshore tax investigation connotes the in-depth inquiry into the affairs of taxpayers to disclose information hidden, intentionally or unintentionally, from the tax authority in a particular country. These investigations can find the facts, increase transparency, help change what is going on in the world, and increase tax fairness.

These investigations are being conducted by States themselves, the media,<sup>1</sup> interest groups, and in some instances individuals (International Consortium of Investigative Journalists (ICIJ) 2013). Sovereign States engage in offshore tax investigations via their tax administrations, which they empower to audit taxpayers. To make these investigations productive, States must collaborate, through their tax administrations, to reveal the consequences of the actions or inactions of taxpayers, individuals, or companies operating internationally. In addition, some States and other political entities, like the U.S., the U.K., Australia, France, and the European Commission, carry out important and popular tax investigations via special committees, probes, and subpoena powers.

In August 2016, for example, the European Commission (EC) ruled that Ireland granted undue tax benefits to the Apple corporation, to the value of EUR 13 billion.<sup>2</sup> This decision spurred legal, economic, and political controversies across the globe. Ireland challenged the EC's decision, claiming that it violated the country's fiscal sovereignty. Meanwhile, States other than Ireland have laid claim to the EUR 13 billion, alleging that part of the profits should have been paid to them, on the basis of their being the host countries where the significant economic activities of the company actually took place.

During the last 10 years, tax journalists working primarily for the media have engaged in important tax investigations. In 2013, Thomson Reuters revealed that, while Google said it didn't sell in countries like Britain and France, it advertised "sales" jobs in London and Paris, which it indicated would involve "negotiating deals" and meeting "sales quotas." These investigations by Thomson Reuters led to raids of Google headquarters in Paris and fines imposed on the company (Rose and Labbé 2016). Similarly, investigations by Thomson Reuters' Tom Bergin revealed that Starbucks had paid just GBP 8.6 million in corporate income tax despite a U.K. turnover of GBP 3.1 billion between 2000 and 2013. The investigations took four months and involved combing through accounts across a dozen countries going back 14 or 15 years (Marsh 2015).

Non-governmental organizations like Oxfam and Tax Justice Network are also very proactive in investigating the taxes that multinationals are or are not paying.

The ICIJ investigations into Luxembourg's tax rulings (LuxLeaks) revealed the tax-avoidance schemes in Luxembourg and contributed to formulating measures aimed at regulating tax-avoidance schemes beneficial to multinational companies. These investigations revealed the active participation of tax administrations, such as the Luxembourg's *Administration des Contributions Directes* (Luxembourg's Inland Revenue or LACD) in the facilitation of tax avoidance by multinational companies. Omri Marian, in what he has described as "investigative journalism at its best," informs us that LACD assisted multinational taxpayers to erode the tax base in jurisdictions other than Luxembourg, without attracting any real investment into Luxembourg. Luxembourg's tax administration served as a conduit, or intermediary agent, between the jurisdiction of the investor and the jurisdiction of the investment, eroding the tax bases, both at source and at residence, in return for fees for tax-avoidance services. LuxLeaks helped reveal the arbitrage manufacturing<sup>3</sup> which took place in Luxembourg. Omri Marian further believes that a contributing factor that enabled arbitrage manufacturing to take place in the LuxLeaks scandal was the fact that the rulings were never made public. He then recommends that "light be equally shone on the practices and laws of governments and their tax administrations ... and not just on corporations."

The Panama Papers leaks involved 370 journalists, working in 25 languages, digging into 11.5 million documents to reveal Mossack Fonseca's inner workings. This investigation traced the secret dealings of the firm's clients and revealed the use of shell companies by the rich for fraud, tax evasion, and money laundering, amongst many other lawful or unlawful purposes.

Offshore tax investigations are important, given that most States shift the burden of tax revenue to domestic taxpayers to compensate for the international taxpayers that pay little or nothing in taxes. We should fear the reactions of domestic taxpayers if, in addition to what is frequently felt as an unfair transfer of the tax burden, they have the impression that taxes are administered with more flexibility and less severity for international taxpayers. It is therefore very important for countries to adopt, as soon as possible, their practices in order to efficiently audit and investigate international taxpayers.

**[2] Tax Whistleblowing**

Recognition of the fundamental value of whistleblowing has been increasing over the last 30 years. According to the U.S. Government Accountability Project (GAP), a leading organization in whistleblower protection and advocacy, whistleblowing is the disclosure of information providing evidence of illegality, gross waste or fraud, mismanagement, abuse of power, general wrongdoing, or a substantial and specific danger to public health and safety.

Transparency International (TI), a global organization against corruption, has identified whistleblowing as an effective tool in the prevention and detection of

1. For example, the offshore tax investigations conducted by the International Consortium of Investigative Journalists.

3. Omri Marian describes this as a process in which, in return for a fee, a jurisdiction issues a regulatory instrument to a taxpayer who resides outside the jurisdiction, in respect of an investment located outside the jurisdiction.

Other positive aspects of offshore tax investigations include: Ireland's decision to stop allowing tax residency blanks; the proposed U.S. rule to mandate country-by-country reporting (CBCR); the EU's actions on sweetheart tax deals; and invalidation of some deals as illegal state aid, among others. Dismantling secrecy laws and practices is a necessary step towards ensuring global tax compliance. All relevant actors are enjoined to engage in offshore tax investigations, if we are committed to having a transparent world.

Also of importance is the benefit of whistleblowing in exposing taxpayers' tax frauds or evasion strategies. For instance, Daniel Schlicksup's whistleblowing led to investigations into the activities of Caterpillar and its transfer-pricing practices by both the U.S. Securities and Exchange Commission (SEC) and the Senate Permanent Subcommittee on Investigations. Bradley Birkenfeld blew the lid off UBS' tax-evasion practices, which led to the prosecution of UBS for conspiring to hide USD 20 billion in assets.

Many States have agreed to financially compensate tax whistleblowers. The U.S. pays eligible whistleblowers up to 30% for voluntarily reporting information that leads to a successful judicial or administrative action in which the SEC obtains monetary sanctions of at least USD 1 million.<sup>7</sup> The Canada Revenue Agency in 2014 instituted the CRA Whistleblower Program, also known as the Informant Leads Program. This program encourages whistleblowing and rewards whistleblowers whose information leads to over USD 100,000 in additional federal tax being assessed and collected.<sup>8</sup> The award, which is between 5% and 15% of the federal income tax collected, has led to an increase in the number of informants to the revenue authority. Other countries, like France and Britain, have adopted similar tax whistleblowing programs. However, when it comes to mega whistleblowing, most countries seem to refuse to pay these awards, instead placing emphasis on protections. Australia and France are proposing new whistleblower protections for people who disclose information about tax misconduct. Under these new rules, informants will have their identity protected and will be protected from victimization as well as civil and criminal action for disclosing information.

Blowing the whistle on tax practices of large organizations and their clients is generally felt to be like committing suicide, for the whistleblower. For example, Hervé Palclani's exposure of HSBC Switzerland's conspiracy to commit or enable tax fraud led to his arrest in several countries. Bradley Birkenfeld's and Daniel Schlicksup's whistleblowing led to their arrests and detention. These arrests were carried out, despite the public benefits of their revelations, on the premise that they either were in breach of privacy or revealed legal acts in breach of confidentiality agreements. If we are committed to ensuring global tax compliance, those who lift the lids on the activities of tax gamblers and harmful tax planners must be protected, and we should ensure they suffer no harm. This protection must be global.

7. <https://www.sec.gov/whistleblower>.  
8. <http://taxsolutioncanada.com/cra-whistleblower-program-who-does-it-and-how-it-could-happen-to-you/>.

corruption and tax wrongdoings. As pointed out by TI, the clandestine nature of corrupt behavior means that it may never come to light unless cases are reported by people who discover them in the course of their work. But reporting can come at a high price: whistleblowers often expose themselves to great personal risks in order to protect the public interest. As a result of speaking out, they may lose their jobs, dampen their career prospects, and even put their lives at risk.<sup>4</sup>

Tax whistleblowing is probably as old as tax evasion, but the possibility to stock the tax profiles of millions of taxpayers on one disk has given a new dimension to tax whistleblowing, an enormous power to the whistleblowers, as well as a potentially immense value to the information they obtain. This new reality may oblige policy makers to revisit their traditional treatment of tax whistleblowing. For the purposes of this chapter, this new phenomenon is called "mega tax whistleblowing."

### [B] Responses from Governments and International Organizations

Beyond revealing the facts, providing relevant information, and promoting transparency, offshore tax investigations and tax whistleblowing influence the policies and laws of domestic and supranational bodies.

The investigative results of the ICLJ led to the European Commission rulings against Fiat and Starbucks' operations in Luxembourg and the Netherlands, respectively. The active participation of tax authorities of sovereign States in tax evasion and avoidance, brought to the fore by LuxLeaks, amplified calls by other nations for the offending countries to give up their tax havens. Michel Sapin, French finance minister, has urged Britain to go "right to the end" in stamping out tax secrecy in its overseas territories and crown dependencies, which continue to act as tax havens for the wealthy (Chrisafis 2016). Furthermore, French authorities, in clamping down on offshore tax avoidance, sent McDonalds France a EUR 300 million bill for unpaid taxes on profits believed to have been funneled through Luxembourg and Switzerland. The French government has committed to seeking tougher EU sanctions on people who facilitate tax evasion, as well as stronger measures to ensure that countries allowing tax evasion will be subject to coordinated countermeasures by other States.<sup>5</sup>

The Panama Papers revelations likewise elicited strong reactions from governments. U.K. officials have commenced investigations into British taxpayers mentioned in the leaks. The Australian Tax Office is investigating more than 800 wealthy clients of Mossack Fonseca, in conjunction with the Australian police and the anti-money laundering regulator, AUSTRAC. Panama, for its part, has asked to join the OECD's Multilateral Convention on Mutual Assistance, a move widely praised as a major step towards tax transparency and effective exchange of information.<sup>6</sup> Panama has likewise committed to the automatic sharing of financial and tax data with other countries,

4. <https://www.transparency.org>.

5. <http://ca.reuters.com/article/businessNews/id/CAKCN0X81YI>.

6. <http://www.oecd.org/dataoecd/20/14/49782222.pdf>.

International organizations have produced guidelines and regulations regarding whistleblowing. The OECD (2012) has stated that: “[The] protection of both public- and private-sector whistleblowers from retaliation for reporting in good faith suspected acts of corruption and other wrongdoing is therefore integral to efforts to combat corruption, safeguard integrity, enhance accountability, and support a clean business environment.” An adequate whistleblower law for government and corporate employees should possess: sufficient internal and external disclosure channels; opportunities for anonymous reporting; an agency to investigate disclosures and complaints; transparent/accountable enforcement of laws; a confidentiality guarantee; and penalties for retaliators (Worth 2014, 7).

The European Union has resolved to protect whistleblowers who act in the public interest or only in order to expose misconduct, wrongdoing, fraud, or illegal activity in relation to corporate taxation in any Member State. The EU believes that such whistleblowers should be protected if they report suspected misconduct, wrongdoing, fraud, or illegal activity to the relevant competent authority, and also if they report their concerns to the wider public, in cases of persistently unaddressed misconduct, wrongdoing, fraud, or illegal activity in relation to corporate taxation that could affect the public interest.

The United Nations (UN), for its part, guarantees the protection of its staff, interns, or UN Volunteers, from being punished for reporting misconduct or for cooperating with an official audit or investigation.<sup>9</sup> The UN’s protection-against-retaliation policy was enacted to encourage staff to report internal corruption, fraud, abuse of authority, and other cases of serious misconduct, so as to protect the integrity and interests of the organization. The Ethics Office and Office of International Oversight Services can take preventive action where a risk of relation has been duly identified.

On a global scale, the UN, through the UN Convention against Corruption, enjoins each State Party to consider incorporating into its domestic legal system appropriate measures to provide protection against any unjustified treatment for any person who reports in good faith and on reasonable grounds to the competent authorities any facts concerning offenses established in accordance with this Convention.<sup>10</sup>

In all organizations, including private corporations, the strength of the protection against reprisal is the foundation of the effectiveness of whistleblowing policies. The establishment of a prevention mechanism could effectively deter retaliatory measures. As soon as the disclosures of certain taxpayers’ fraudulent actions or tax-evasion methods have been identified as posing a risk of retaliation, effective measures should be taken in order to prevent or mitigate retaliatory actions against whistleblowers. Being bound by a confidentiality or non-disclosure agreement might not preclude a consultant or an employee from acting as a whistleblower and disclosing tax frauds or evasive tax devices. The reasonable expectation is that confidentiality agreements will

protect the employer against disclosure of trade secrets, proprietary information, and the like.

Confidentiality agreements will not protect corporations from the disclosure of information on illegal acts that may lead to non-compliance with the criminal justice system. If the confidentiality clause is in conflict with the law of the jurisdiction under which the agreement falls, its enforceability can be challenged. In this respect, withholding information on an employer’s illegal activity could in itself be illegal. A court might also rule that the unequal bargaining power between the parties provides a basis to challenge the confidentiality clause. Finally, a confidentiality clause in an employment agreement has to be reasonable to be enforceable. Criteria for reasonableness include the public interest. Certainly, disclosing tax frauds or evasive devices of taxpayers will be deemed to be in the public interest.

### [C] Guidance in Decision-Making

Offshore tax investigations and mega tax whistleblowing can be significant and useful to balance the books of sovereign States. However, if not carried out with extreme care, both can transform themselves into a threat to the proper functioning of the system.

Although the investigative efforts of media and interest groups are important and appreciated, they should remain an exception, because they can send the signal that tax authorities and governments are not doing their job, or are complicit in the tax gaming, as revealed in the LuxLeaks. In addition, most often, media and interest groups do not have the means and the knowledge that are available to tax administrations and governments to conduct these tax investigations. This can result in technical or judgment mistakes. Once these mistakes are made, and false information is released to the public, it is very difficult to correct the situation and prevent what should be the real interpretation of the tax situation.<sup>11</sup>

Tax whistleblowing that involves massive tax information, coupled with fraudulent taxpayers’ fear of being exposed, can represent a quick fix to the tax system. The work of the ICIJ, for example, can effectively represent a game changer for tax evasion and aggressive tax planning, because the last thing most public figures, multimillionaires, or multinationals wish to see is their name on these lists. However, policy makers have to consider many factors when dealing with this new form of tax whistleblowing.

Beyond protection, the decision to compensate mega tax whistleblowing poses controversies amongst sovereign States. The “against-compensation” group generally explains that it is not acceptable for a sovereign State to encourage something that is in contradiction with the domestic rules of privacy. This group fears the future of a system where a market would be created out of the activities of tax whistleblowers. On the other hand, the “pro-compensation” experts claim that a tax whistleblowing regime is not robust and convincing without financial compensation.

9. Protection against retaliation for reporting misconduct and for cooperating with duly authorized audits or investigations. ST/9CIB/2017/2.

10. Article 33 of the United Nations Convention on Corruption.

11. Albert Einstein said that, “The hardest thing in the world to understand is the income tax.” Therefore, we should not expect citizens to be able to differentiate between real and false conclusions of non-professional tax investigations.

Now that the whole world knows the nature and extent of illicit activities that deprive nations of critical resources to maintain public services, the time for prospective rhetoric is finished. Nations must act with the same vigor and the same audacity as individuals and corporations who use the deficiencies of the law and state controls to avoid their tax responsibilities. In this, compensation of whistleblowers can be a powerful tool for tracking tax wrongdoers in the highest national and international public interest. Evidently, sophisticated verification measures should guide policy makers before engaging in an incentive payment program.

It would be unrealistic to expect a commitment of all nations before activating a compensation program for whistleblowers. To mark a change, it would be sufficient that the Member States of the OECD, the G20, and the most important developing countries adopt a common policy: (1) setting criteria for remuneration; (2) identifying the nature of the investigative cases that would be subject to disclosure for which protection and payment might be offered; and (3) committing to share the information collected with the nations which may have an interest in the disclosure.

Concluding here, we must be mindful of State-sponsored offshore tax investigations and whistleblowing, which may arm ill-intentioned States or individuals with information detrimental to others. Today's world, faced with terrorism and cyberattacks, could be spared this evolving menace. Beyond the security issues associated with possession of information, another consideration is the ethical value and ownership status of information obtained through offshore tax investigations and whistleblowing. Should such information be treated as property, with the owner exercising unrestrained rights over it, or should we design international laws limiting the rights and uses of such property? Should an international body be formed to regulate the activities, outcomes, and exercise of offshore tax investigations and whistleblowing, or should a benchmark or framework be created, in the same vein as tax treaties, for offshore tax investigations and whistleblowing?

These are important issues to be considered when implementing a system of global tax compliance. But what exactly is global tax compliance? The next section analyses the present system for global tax compliance and proposes thoughts to improve it in the twenty-first century.

## §5.03 GLOBAL TAX COMPLIANCE

### [A] Definition

During the early 1900s, experts' main concern was to prevent the double taxation of companies engaged in cross-border activities, seen then and now, and rightly so, as a discouragement to international trade. Thus, countries formulated and entered into treaties to prevent this clogging of the flow of international trade. A few years later, countries returned to the negotiating table to address the menace of double non-taxation of multinational enterprises, tax fraud, and non-compliance.

As far back as October 1936, the Assembly of the League of Nations adopted the following stinging resolution:

The Assembly,

Considering that efforts to reduce the obstacle to the international circulation of capital must not have the effect of increasing fiscal fraud;

... Requests the Fiscal Committee to pursue vigorously its work for the avoidance of double taxation as far as possible, and also its work on the subject of international fiscal assistance, in order to promote practical arrangements calculated, as far as possible, to put down fiscal fraud.

Carl Levin points out that, echoing these words a quarter of a century later, U.S. President John F. Kennedy told the U.S. Congress in 1961:

Recently, more and more enterprises organized abroad by American firms have arranged their corporate structures - aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices which maximize the accumulation of profits in the tax haven ... in order to sharply reduce or eliminate their tax liabilities. ... I recommend elimination of the tax haven "device" anywhere in the world.

Global tax compliance denotes the adherence by international taxpayers to the tax laws and practices in the jurisdictions where the law requires such adherence. The determination of the duty of taxpayers to tax remittances has been a source of vigorous debate over the years.

Taxpayers take advantage of loopholes to pay reduced tax. This occurs most frequently against the spirit of the law but in compliance with the letter of the law. Omri Marian describes this as an international tax arbitrage (ITA), "a situation in which ... taxpayers rely on conflicts or differences between two countries' tax rules to structure a transaction ... with the goal of obtaining tax benefit..."

Carl Levin unapologetically describes such tax-avoidance schemes as "theft - the theft of public services and economic opportunity from all but a few select individuals." He further asserts that "tax dodging contributes to a growing income inequality that shocks the conscience." In the U.S., Senator Levin explained, firms hold USD 2.4 trillion offshore, deferring payment of U.S. taxes of USD 700 billion and denying the U.S. Treasury significant sums needed for physical and social infrastructure.

The effects of these tax-avoidance schemes are felt by both developing and developed countries, although developing countries are worse hit, considering that they are in dire need of revenues to finance physical and social infrastructure required for economic growth and social inclusion. Tax avoidance by multinational companies further increases developing countries' reliance on foreign aid, therefore making them more vulnerable to aid volatility (for further discussion, see Chapter 7). Thus, tax avoidance practices aggravate existing income disparities between developed and developing countries. This is especially disheartening, when one considers the vast natural and human capital resources of developing countries and the economic returns they bring to the world, over against the prevailing poverty and lower human development index often observed in these countries. The UN Conference on Trade and Development, in a 2015 publication, claims that developing countries lose USD 100 billion per year due to tax avoidance by multinational companies and as much as USD

The absence of agreed answers to these questions and others create rent-seeking and gaming potentials of the system. Carl Levin further cautions that “people of wealth and profitable corporations should not be able to benefit from the laws, resources, and protections provided by their governments without paying their fair share of the cost. Nor can they be allowed through tax avoidance and tax-evasion schemes to rob their nations of resources to the detriment of everyone else.”

### [B] The Present Compliance System for International Taxpayers

Global tax compliance is facilitated by domestic and international laws, policies, principles, and practices. Countries have provisions in their domestic laws requiring resident taxpayers to comply with the laws where they do business. Similarly, through international treaties, laws, principles, and guidelines agreed to by countries, taxpayers are mandated to be responsible global citizens. For example, the model tax treaties developed by the UN and the OECD greatly influence the actions or inaction of multinational enterprises engaged in cross-border activities. Also, the activities of the G7, G20, World Bank, IMF, and other relevant international bodies support developing countries with tax design and implementation, so that multinational enterprises comply with the tax laws in jurisdictions where they operate or derive profit.

However, as shown above, existing tax systems still fail to fully ensure that international taxpayers pay their fair share of tax and to stop tax evasion and avoidance that negatively affects developing countries. It is in response to the call to stamp out rent-seeking by multinational corporations that these complex techniques to avoid taxes have come under unprecedented scrutiny in recent years, and there now exist concerted efforts to address the challenges posed by tax avoidance and evasion.

In Equatorial Guinea, Article 19 of the Constitution provides that “Every citizen shall pay taxes according to his revenues.”

In Gabon, Article 20 of the Constitution provides that, “The Nation proclaims the solidarity and equality of all before the public charges; everyone must participate, in proportion to his resources, to the financing of public expense.”

Article 22 of Guinea’s Constitution provides, “Each citizen must contribute, to the extent of their means, to taxes and must fulfil their social obligations for the common good within the conditions determined by law . . . .”

Article 36 of the constitution of Madagascar provides, “The participation of each citizen in the public expenditures must be progressive and calculated as a function of their contributive capacity.”

Article 20 of the constitution of Mauritania provides, “Each must participate in the public charges as a function of their contributive capacity.”

Article 39 of the constitution of Morocco provides, “All support, in proportion to their contributive faculties, the public expenditures [charges] which only the law may, in the forms provided by this Constitution, create and assess.”

Article 10 of the constitution of Tunisia provides, “Paying taxes and contributing towards public expenditure are obligations, through a fair and equitable system. The state shall put in place the necessary mechanisms for the collection of taxes, and to combat tax evasion and fraud.”

Article 13 of the Déclaration Universelle des Droits de L’Homme of France: “L’impôt doit être réparti entre tous les citoyens en fonction de leur richesse.”

Article 53 of the Constitution of the Republic of Italy: “Every person shall contribute to public expenditure in accordance with their capability. The tax system shall be progressive.”

300 billion in total foregone development finance. Between 1970 and 2010, capital flight through tax-evasion and avoidance schemes stood at USD 814 billion, exceeding the official development aid of USD 659 billion and foreign direct investment of USD 306 billion for the same period.

To put this in perspective, from 2009 to 2012, Apple got away with sending USD 74 billion in profits to its Irish subsidiaries, even though Apple products were designed in the U.S., assembled mostly in China, and sold in Europe, Africa, Asia, and the Middle East, with relatively few sales in Ireland. Apple was able to assign USD 74 billion to Ireland, by taking advantage of a secret tax deal with the Irish government, which enabled Apple to pay a total effective tax rate of 1% in Ireland. Although Apple had three subsidiaries in Ireland, each claimed to have tax residency nowhere, which effectively led to tax dodging.

The question is, should duty require compliance with the letter of the law or both the letter and the spirit of the law? What is the letter of the law? What is its spirit of the law? Where should taxpayers pay taxes? Where profit is made, or where they owe economic allegiance? How do we determine the location of profit in today’s world of fluid business and mobile money? Should taxpayers be required to pay a fair amount of tax? What is fair, and where is fair?<sup>12</sup> How do we measure fairness? The constitution of many countries refer to “fairness,” “proportionality,” and “capacity to pay” principles. These countries include Algeria, Benin, Cameroon, Congo, Côte D’Ivoire, the Democratic Republic of the Congo, France, Gabon, Guinea, Italy, Madagascar, Mauritania, Morocco, and Tunisia.<sup>13</sup>

12. There are different ways to avoid paying the “fair” tax share that corresponds to a particular taxpayer. First, some tax laws are not enacted according to the “ability to pay” principle, often due to trade-offs between equity and efficiency. Second, it is possible that a taxpayer remits his/her tax obligation according to the law, and yet the tax burden is unfair because of the use of tax-dodging schemes; and third, a taxpayer can avoid the tax law altogether. Tax avoidance and tax evasion correspond respectively to the second and third situations. The first form of tax unfairness is not covered in this chapter.

13. Article 64 of Algeria’s constitution provides that everyone should participate in financing the public expenses, in accordance with his contributory capacity. It further provides that citizens are equals before the taxes, in the same article.

Article 33 of Benin’s constitution provides that all citizens of the Republic of Benin have the duty to work for the common good, to fulfill all of their civic and professional obligations, and to pay their fiscal contributions.

The Cameroonian constitution incorporates the African Charter on Human and Peoples Rights, which in its Article 29 provides that “The individual shall also have the duty: (6) to work to the best of his abilities and competence, and to pay taxes imposed by law in the interest of the society.”

Article 60 of the constitution of Congo Brazzaville provides that “Every individual shall be expected to work in measure with his capabilities and his possibilities and to pay his due contribution fixed by law for the safeguard of the fundamental interests of society.”

In Congo Kinshasa, Article 65 of the Constitution provides that “All Congolese are held to loyally fulfil their obligations concerning the State. They have, likewise, the duty to pay their taxes and duties.”

Article 27 of the Constitution of Côte d’Ivoire provides that “The duty of acquitting oneself of one’s fiscal obligations, in conformity with the law, is imposed on all.” However, the 2016 draft constitution in Article 43, enjoins the state to fight against tax evasion and avoidance. It provides thus: “L’Etat prend les mesures nécessaires pour garantir le recouvrement des impôts, la lutte contre l’évasion et la fraude fiscales.”

The Global Forum on Transparency and Exchange of Information for Tax Purposes, created in the early 2000s by the OECD in response to call from the G20, has 139 members on equal footing.<sup>14</sup> It is the agora for ensuring the implementation of the internationally agreed standards of transparency and exchange of information in the tax area. (See, however, the divergent assessments of this mechanism reflected, for example, in Chapter 3 of this volume.)

In 2013, the G20 mandated the OECD to address harmful tax competition and non-compliance by multinational companies. The OECD is at the forefront of such efforts through its Base Erosion and Profit Shifting (BEPS) project, which culminated in the BEPS report of October 2015. This and subsequent proposed efforts seek the inclusion, active involvement, and support of all countries. Central to the OECD's BEPS project is access to information. The OECD initiated, and has successfully persuaded countries to sign, the Multilateral Competent Authority Agreement for the Common Reporting Standards (CRS/MCAA), which promotes the automatic exchange of information among signatories to the Convention. Another major step by the OECD is the CBCR requirement of MNEs recommended in the BEPS Action 13 report (Transfer Pricing Documentation and CBCR).

As formulated by the OECD, "With country-by-country reporting, tax administrations where a company operates will get aggregate information annually, starting with 2016 accounts, relating to the global allocation of income and taxes paid, together with other indicators of the location of economic activity within the MNE group. It will also cover information about which entities do business in a particular jurisdiction and the business activities each entity engages in. The information will be collected by the country of residence of the MNE group, and will then be exchanged through exchange of information supported by such agreements as signed today." The OECD expects the first exchanges to start during 2017-2018, based on 2016 information. In the absence of exchange of information based on the CBCR and MCAA models, the OECD believes that the BEPS Action 13 report on transfer-pricing documentation provides for alternative filing so that the playing field is leveled.

For developing countries struggling with tax evasion, the OECD's CBCR model will offer a viable tool for addressing the problem only if they can actually receive and absorb the information that should be provided to them under the framework. To ensure that developing countries are able to take advantage of this opportunity, the World Bank, IMF, and UN, in conjunction with the OECD, are working on enhancing developing countries' capacity to exchange information with other jurisdictions, given the reciprocal nature of the CBCR.

At the European level, the EU has accepted the recommendations to introduce: CBCR of multinationals' activities; common consolidated corporate tax base (CCCTB); better protection of whistleblowers; extension of automatic exchange of information on tax rulings to all tax rulings, which will also be made available to the public; countermeasures towards companies that make use of tax havens; changes to the EU state-aid regime as it relates to tax through binding guidelines; and other measures.

Reacting to the LuxLeaks scandal, and the claim that the EU loses EUR 50-70 billion a year due to tax avoidance from corporate taxation, the EU is championing claims that corporate taxation should be guided by the principle of taxing profits where they are generated. A CCCTB is proposed for the EU, based on a formula-apportionment method, which reflects the real economic activities of companies and does not unduly advantage certain Member States. Also, the EU proposes to move to a mandatory common corporate tax base (CCTB) for Member States of the Union to cover MNEs and companies with no cross-border activity, with possible temporary exemption for small and medium-sized enterprises. This CCTB will provide a uniform set of rules for companies operating in several Member States to calculate their taxable profits. These recommendations, amongst others, aim to strengthen global tax compliance by multinational companies operating within the Union.

The U.S. has been a leader in the fight against secret bank accounts used to hide assets from tax authorities and ensuring that U.S. taxpayers comply with the tax laws and practices. In 2010, the U.S. enacted the Foreign Account Tax Compliance Act (FATCA), requiring financial institutions around the world to disclose to the IRS large accounts held by U.S. persons, or pay a 30% withholding tax on the institution's earnings obtained in the U.S.. Carl Levin informs us that the 30% hammer has forced financial institutions around the world, nearly 200,000, to agree to disclose to the IRS any large account of a U.S. client. Countries, following FATCA, are setting up similar bank account disclosure systems with global reach. Levin, speaking further on the secrecy that surrounds multinational tax payments, queries why no tax authority in the world, including in the U.S., has reliable, timely information about where a multinational corporation does business, declares profits, and pays taxes.

The OECD's CBCR, the EU's CCCTB, and the U.S.' FATCA, anchored on the availability and accessibility of information that had hitherto been unavailable, are expected to promote global tax compliance by multinational enterprises.

Carl Levin concedes that the international community has made some modest headway in the BEPS project, forging a consensus that multinational corporations ought to pay their taxes and pay them in the countries where they have actual economic activity. However, much more needs to be done, especially to allow developing countries to benefit from new rules and regulations intended to improve tax compliance worldwide.

### [C] Global Tax Compliance for the Twenty-First Century

As globalization challenges tax compliance across boundaries, tax policy making and administration must adapt to the new realities and find new ways of enforcing tax laws consistent with economic and social goals. The liberalization of the market economy through globalization and the cross-border trade that has emanated partly from the activities of multinational enterprises must now integrate advances in legal and tax systems worldwide in a coordinated manner. To effectively address global tax compliance issues is a larger discourse. Many questions remained unresolved.

14. <http://www.oecd.org/tax/transparency/>

In April 2016, the IMF, the UN, the World Bank Group, and the OECD agreed to set up a Global Platform for tax collaboration, to better support governments in addressing the tax challenges they face in a coordinated manner. The Platform should contribute to changing the global tax scene in order to provide a level playing field for developing countries.

Experts have advised that countries should consider the creation of an all-inclusive global tax body, just as the League of Nations did in the 1920s. The responsibilities of this global tax body should be unambiguous, well thought out, communicated, and adhered to. Omri Marian enjoins that, "Coordinated international efforts should target arbitrage-manufacturing practices." Achieving this, admittedly, is a Herculean task. As Carl Levin rightly notes, "There is nothing easy about tax policy."

The implementation of a well-functioning global tax compliance system adapted to the twenty-first century will necessitate that countries discuss, to a certain degree, how to treat multinationals caught engaging in tax fraud. Currently, each country applies its domestic laws to the specific parts of international tax structures that concern it. In France and Canada, for example, a multinational accused of tax evasion faces criminal punishment, including jail terms for top management officials, revocation of licenses, and restriction of operations. Because it is very long and costly for countries to criminally prosecute a multinational "too big to jail," only a few French and Canadian multinationals have actually been accused by States. The U.S. and the U.K., on the other hand, are proceeding differently. Instead of having the obligation to criminally prosecute the multinationals, they have adopted a system of transactional justice where it is possible to restrict the charges to economic penalties. This system allows these countries to obtain significant sums in economic penalties. For example, Swiss Bank – Credit Suisse was hammered with a USD 2.8 billion fine, after pleading guilty to a criminal charge of having helped its customers elude America's tax authorities. UBS was fined USD 780 million in 2009 for its tax-evasion practices.

CBCR by multinationals should offer many jurisdictions the opportunity to take coordinated actions against tax avoidance and tax evasion by multinational companies. Since citizens and domestic companies have to pay their taxes and respect increasingly complex tax laws, governments must also put in place the necessary measures to take action against international taxpayers that do not respect their laws.

The danger inherent in economic penalties is that it could create a different system for the wealthy and the powerful, where for example an SME found guilty of tax evasion would pay a penalty and see some of its executives go to jail, while an MNE would pay a penalty but avoid jail. In addition, a penalty for a multinational does not have the same connotation as for other taxpayers. Multinationals can hedge the risks and take advantage of the financial market to spread the potential burden of such a fine. Revealingly, Credit Suisse's stock price rose the day the guilty plea was announced and the fine imposed, rather than dipping.

It would be possible to moderate this danger by putting in place a system that:

- Targets and excludes violators from the organization. If clients or other organizations are involved in the criminal activities, the multinationals should be obliged to provide their names. Credit Suisse was not required to hand over

the names of its clients, denying the IRS the opportunity to go after those clients involved in tax evasion. As expressed by Carl Levin, "It is a mystery to me that the U.S. government didn't require as part of the agreement that the bank cough up some of the names."

- Provides stronger penalties for multinationals who reoffend, to make sure that it cannot become a recurrent scenario for a multinational to perpetrate tax evasion and then simply pay a penalty if caught.
- Considers presenting the measure as temporary or experimental. This could provide a window of opportunity, an amnesty for multinationals to clean up their business. Tax amnesties are popular. The U.S. has granted tax amnesty to Americans living in Canada and Offshore who failed to file their taxes for years. India, in its 2016 budget, offered domestic holders of undisclosed income and assets a one-time compliance opportunity to escape prosecution. This four-month window is for holders of unaccounted wealth to come clean by paying 30% tax plus a penalty of 7.5% and a similar percentage of surcharges. However, tax amnesties should remain a temporary comprise to repatriate billions of dollars, because populations are inclined to perceive tax amnesties as being unjust to taxpayers who complied voluntarily with the laws. Also, temporary tax amnesties can create expectations among taxpayers who hope such an amnesty will be granted again.

Clearly, a global tax-compliance system adapted to the twenty-first century must take into account the expected reaction of consumers. Will consumers stop buying the products of a multinational enterprise that fails to respect its legal and moral tax duties? The case of Uber is interesting, as clients in many settings continue to use Uber services, even though it is clear that the company is not paying appropriate taxes.

Finally, in an ultimate effort to bring an end to tax avoidance and evasion, the implementation of an International Tax Court (ITC) could be considered. A global tax court could balance out the inequality between the strength of legal representation at the disposal of multinational enterprises and the more limited resources often available to countries, especially lower-income countries. Such a global tax court, staffed by experts, would presumably be impartial and not easily swayed by the panache of the international legal and accounting firms hired by MNEs. Such a global tax court would be able to adjudicate cross-border disputes and resolve these promptly, a pattern with potentially far-reaching implications for States and other stakeholders.

However, the implementation of an ITC would pose sovereignty issues, given that taxation is still widely considered a matter of national jurisdiction. The statute creating the Court would have to be agreed and ratified by sovereign States, which would then be legally obligated to cooperate with the Court when required.

The composition and organization of the Court and the selection of its judges are not necessarily complex issues to resolve, since there are models emanating from other international courts, such as the International Criminal Court (ICC), the World Court, and various International Administrative Courts (UNAT, UNDT, ILOAT, WBAT) already in existence in international organizations. The independence of the ITC and the impartiality of its judges could be achieved through a thorough process of selection

taking into account regional diversity and systems of law. As with most international tribunals, the ITC would establish its jurisdiction through a mixture of the systems of law applicable in civil and common law countries. The procuracy, registry, working languages, and privileges and immunities would all be matters to be agreed among Member States.

The model would comprise a prosecutor's office independent from the Court itself, which would be in charge of investigations, analysis, and prosecutions. The applicable law would reflect principles from the major tax law systems of the world in language as neutral and universal as possible.

#### \$5.04 CONCLUSION

Addressing these challenges of globalization for global tax compliance will bring us closer to tax transparency and fairness in today's globalized world.

This chapter has made clear that, as tax information becomes available to stakeholders and secrecy laws are dismantled, sovereign countries will be better able to enforce their tax rules and regulations. To ensure availability and accessibility of information, offshore tax investigations must be encouraged and whistleblowers protected from victimization, oppression, and discrimination. International laws must also jealously protect the availability and accessibility of information. International bodies such as the UN, the World Bank Group, the OECD, and the IMF, in cooperation with regional tax organizations and bilateral government agencies, can promote tax compliance practices which respond better to modern-day business structures, with adherence to transparency, equity, and fairness.

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## CHAPTER 6

# Tax Competition or Tax Cooperation

Vanessa Houlder

The era of globalization has increased competition among governments for revenues and investment. The lifting of restrictions on trade and capital flows has put downward pressure on tax rates and encouraged a proliferation of incentives. These practices have come under closer scrutiny since the international financial crisis. Some economists argue that the current system is inherently unstable and the corporate tax needs to be redesigned to eliminate the incentive for competitive ratecutting. Despite questions over the willingness and ability of governments to coordinate tax policy, there has been a push to secure greater cooperation in the collection of revenues in recent years. A G20-led initiative to tackle "base erosion and profit shifting" has drawn up recommendations to reduce arbitrage and competition for highly mobile profits. A number of regional initiatives are aiming to strengthen cooperation on tax matters. Tax authorities are also preparing for more joint action on matters such as tax audits and information sharing.

#### \$6.01 INTRODUCTION

The trend towards greater economic integration of the last few decades has sparked fierce competition between countries for tax revenues and investment. Governments find themselves participating in what some perceive to be an unsustainable race to the bottom, involving the proliferation of tax incentives, repeated cuts in tax rates, a reliance on secrecy and the lax enforcement of tax laws. These practices have come under much closer scrutiny in the last few years, as governments attempt to rebuild their finances after the international financial crisis. Concerns about the effectiveness of tax incentives have intensified, particularly in the light of the problems faced by developing countries in collecting sufficient revenue to fund public services. The challenges faced by cash-strapped governments across much of the world have