1

Introduction

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This book is the outcome of a three-year-long EU Horizon 2020 project named Combating Fiscal Fraud and Empowering Regulators (COFFERS). The project ran from November 2016 until December 2019, to do quality research that could bring tax money back into the public coffers and by doing so help to reduce increasing inequality.

For the first time, researchers from law, economics, sociology, political science, and accounting worked together in order to assess new international tax policy measures and what they imply for the EU and its Member States. Researchers from 15 countries (Argentina, Australia, Austria, Bolivia, Czechia, Denmark, Germany, Greece, Ireland, Israel, the Netherlands, Russia, Spain, Turkey, and the UK) tried to understand the changes in the rules of the game of international tax policy. The universities involved were City University London, Warwick University, University of Leicester, Istanbul Kemerburgaz University, Bamberg University, Charles University Prague, Copenhagen Business School, the University of Limerick, and Utrecht University, as well as the non-profit organization Tax Justice Network. Scholars who had experience with studying complex company structures and tax avoidance, or the role and behaviour of tax experts, merged with scholars who had studied the criminal side of not paying taxes such as tax evasion and money laundering. The multidisciplinary nature of this group of researchers is a novelty in itself, since tax avoidance, the legal part of not paying taxes, and tax evasion, the illegal part of not paying taxes, had so far been studied by separate fields. The project, led by Prof. Brigitte Unger, was one of the largest research projects on tax evasion in Europe, if not the whole world. This book seeks to present some of the most significant findings on the new tax regime, as well as its strengths and the unintended provisions or loopholes that can arise.

1.1 Background

In the wake of the financial crisis and the ensuing fiscal crisis, international organizations, as well as the EU and its Member States reacted by putting forth

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new tax policy regulations at the national and international level.[1] These innovations constitute a significant change, in tax policy and for the EU fiscal regime, potentially even signifying a paradigm shift (Picciotto, 2019) after a long drought of tax policy regulation at an international level.

A great deal of the problems of international taxation were well understood already in the 1930s. The regulations introduced then, which were taken over and reinforced by the OECD from the 1960s onwards, were designed for an era that had died before the onset of capital account liberalization and the rise of globalization later in the 1970s and 1980s. Accounting and tax regulation survived without severe challenge until the mid-1990s. This despite that the prevailing structure was a decidedly twentieth-century one, consisting of transfer pricing regulations, controlled foreign company rules, the treaty system, rules on source and residence-based taxation and nascent anti-money laundering regulations, all of which were hindered by numerous layers of opacity worldwide.

In 1998, the EU started with a Code of Conduct for its Member States to reduce tax competition. Two years later, in 2000, the OECD launched the Harmful Tax Competition Report. These initiatives attracted heavy criticism. One was that it was unfair to put the blame only on small islands since no OECD country was included in the list of Harmful Tax Competitors. The other criticism was that the list was useless, as EU countries known for being tax havens, like Luxemburg, did not accept the Code of Conduct (see Sharman 2006; Radaelli 2003; Unger and Ferwerda 2008).

Before the developments aimed at reducing tax avoidance, a new international regime of fighting money laundering had already started. In 1986, after a hopeless war on drugs, rather than chasing drug dealers, the Clinton administration came up with a new approach: follow the money. Instead of trying to catch drug dealers, the new policy aimed at depriving drug dealers of reaping the benefits of their crime, in order to discourage them. Pushed by the US, the intergovernmental organization named Financial Action Task Force (FATF) set up in 1989 (see Sharman 2006). In the late 1990s, the European Union jumped on the bandwagon by implementing the first Anti-Money Laundering (AML) Directive. This directive expanded in scope and importance swiftly, from initially covering drug crimes to eventually reaching corruption and terrorism financing. In 2012, the FATF added to its standards that tax crimes should be a predicate crime for money laundering. The fourth EU AML Directive in 2015 followed suit. From 2018 onwards, countries have to criminalize tax evasion severely. Tax evasion, a white-collared crime, was put into the same basket as drugs, corruption, human trafficking, and terrorism financing. This regulatory change means that drawing the line between what is tax avoidance and what is tax evasion has become more

[1] Parts of this introduction have drawn inspiration from the COFFERS proposal. The document is available at www.coffers.eu

important, as the latter can now be a serious crime and hence a predicate offence for money laundering.[2]

The international fight against money laundering and tax fraud soon spread over the whole world. By today, almost all countries—more or less voluntarily under the threat of being blacklisted with severe economic consequences—have signed to comply with anti-money laundering standards. This push and experience of how to fight money laundering have certainly also influenced the speed in which international tax policy has developed.

It was, once again, the United States, who made the first decisive move towards a more international tax regulation with the Foreign Account Tax Compliance Act (FATCA) in 2010 (Sharman 2006). Since this, financial institutions from all over the world have to report assets held by US account holders to the American Internal Revenue Service (IRS). The EU followed by enacting Automatic Exchange of Information (AEoI) which obliged Member States to report accounts held by foreigners to the country of residence of the account holder. Under pressure from the G8, when the issue of corporate tax abuse had become a hot political issue, the OECD adopted Country by Country Reporting (CbCR) in its Base Erosion and Profit Shifting (BEPS) initiative (Action 13 on *Guidance on Transfer Pricing Documentation and Country by Country Reporting* out of in total 15 Actions). Multinationals, with a turnover of over 750 million Euros, are compelled by CbCR to disclose how much profits were made in each country in which they operate; as well as their turnover, the amount of taxes paid, number of employees and a description of their activities and the value of their assets.

In 2011, the Legal Entity Identifier (LEI) was put forth by the G-20. It is a 20-digit code that is the same globally for each legal entity. Before, each country had a different code system to recognize the counterpart corporation of financial transactions. One reason for the financial crisis was that financial institutions could not identify and trace the risk exposure of diverse companies. Currently, the US and the EU require corporations to use a LEI when reporting the details of transactions of Over the Counter Derivatives to financial authorities (see Chapter 9). If applied to all companies, LEIs would allow identifying the beneficial owner of any—however complicated—corporate structure.

Compared to the period before 2010, the speed at which new regulations are taking place is remarkable. The US, the G-8, the G-20, the OECD, and the EU (through diverse DGs such as TAXUD and DG Home) all initiated and put forth new regulations. This ‘hot phase of regulation’ (see Chapter 2) means that policy initiatives exist parallel and have a higher chance of being successful than earlier

[2] For further information on the grey zone between tax avoidance, tax evasion, and money laundering see the results of the COFFERS Vienna conference and for a short and comprehensive overview of the history of money laundering and how it connects to tax evasion see the video of Brigitte Unger titled Money Laundering Regulation—from Al Capone to Al Qaeda. Both are available at www.coffers.eu.

initiatives. At the same time, there is a risk for an increase in loopholes that can stem from these new regulations since they were not developed consecutively but in parallel by different institutions or by independent departments within the same institution.

1.2 Aims and Objectives of the Book

This book aims to analyse the impact of the new international regulations on the scope and scale of tax evasion, tax avoidance, and money laundering. We do so by proposing a new way of viewing taxation issues like a tax ecosystem, a space based on the 'recognition of sovereign jurisdictions and their legal systems, political mandates from states and intergovernmental organizations, markets interests from corporations and other private actors, and of normative agendas from activists and civil society' in Chapter 2. The tax ecosystem remains as a guideline throughout the book and through the analyses of global policies that have affected this ecosystem. In particular, Automatic Exchange of Information (tax authorities abroad have to be informed if foreigners hold assets in a country, see Chapter 7); Country by Country Reporting and Base Erosion and Profit Shifting which aim to reduce the possibility of companies to shift profits into low tax havens (see Chapters 3, 6, 7, and 8); Legal Entity Identifiers, an initiative by the G-20 to give companies a trusted 20-digit code technology which could indicate the origin, activity, and ultimate beneficial owner of a company (see Chapter 9) and anti-money laundering policy (see Chapter 13). The book derives policy recommendations for an improved international tax system by analysing the new regulations from different fields and perspectives, such as law, political science, accounting, and economics.

Furthermore, this book seeks to add to an increasing amount of literature on the pervasive effects of tax evasion and tax avoidance, the actors involved in managing and designing tax avoidance and evasion schemes, the evaluation of global policy tackling it, and the estimation of how much money is lost. We add to the literature on tax effects by proposing in Chapter 4 new ways of measuring the tax gap; this chapter adds to existing literature focusing on the number of governments that prepare tax gap estimates or definitions of what tax gaps are/should be (Mazur and Plumley 2007; Murphy et al. 2019). Chapter 5 is a comprehensive overview of illicit financial flows and adds to a vast literature of IFF and its effects by compiling the estimates in one chapter; by doing so Chapter 5 also incorporates previous work of other authors in the book such as Cobham and Jansky (2017) and Janský and Palanský (2019). Chapters 6, 7, 8, 9, and 13 seek to add to the literature that measures the effects and design of global financial governance instruments such as CbCR, AEoI, LEI, FATF Recommendations. Research on this has been done by organizations such as the

OECD, non-governmental institutions such as our partner Tax Justice Network and researchers such as Johanessen and Larsen (2016) and the previous work of two contributors of this book Leo Ahrens and Fabio Bothner (2019). When it comes to the actors involved in the tax ecosystem, we add to the literature by deepening the analysis on individual actors as well as corporate actors.

When it comes to individuals the research in Chapter 12 on accountants and tax experts complements existing literature on the role of big accountancy firms (Jones et al. 2018). Furthermore, Chapter 10 on the rise of Luxury Freeports is a contribution that fills a literature gap on non-financial wealth kept in tax havens (Zucman 2015). Through Chapters 3 and 11 we expect to contribute to an increasing amount of literature interested in the behaviour of corporations through an analysis of sophisticated financial engineering by big corporations in Chapter 3 and the analysis of Uber in Chapter 11.

1.3 Scope and Content

The book views the new regulations (AEoI, CbCR, BEPS, LEI, AML) as a regulatory shock to a tax ecosystem (see Steinmo and Swank 2002). Similar to a 'real ecosystem' in ecology, after a shock, some species will become bigger, others will die out, and others will move to new niches in order to survive. Species in the tax ecosystem are jurisdictions, companies, tax experts, and the international community all acting in an environment of constant legal and political changes. Chapter 2 in this book gives an overview of the diverse actors of the tax ecosystem.

We study the reactions of the actors of this ecosystem to the changes in regulation such as jurisdictions, companies, and tax experts. We find that some countries will specialize in new forms of tax competition (see Chapter 7), while other countries will try to ignore the new regulations (see Chapter 6). Companies will react as well, some will develop new ways to commit tax avoidance, and others will decide to restructure. New types of companies will also appear (see Chapters 3 and 11).

The individuals that work in the tax ecosystem such as tax experts, tax advisors, lawyers, and accountants will also respond and react to the new regulations by changing their behaviour and perceptions of what is correct (see Chapter 12). This group of professional financial service providers who were once busy detecting loopholes in the international tax system and advising companies on how to avoid paying taxes now has to discover new loopholes for their survival in a new regulatory regime. Once they discover this, the regulatory system will need to update and adjust once again to the changes. This need for update is why the legal system is constantly updating and why we research the role of changes in anti-money laundering regulation and their expansion to tax crimes across the

EU, to understand how countries can implement international regulations too heterogeneously (see Chapter 13).

In order to estimate the dimension of the problem, we provide diverse estimates on tax avoidance, tax evasion, tax gaps, and money laundering (see Chapters 4 and 5). In addition, we provide new indicators to rank countries according to how harmful they are for international tax competition and as secrecy providers (see Chapter 6 and 8; and the first COFFERS PhD, Meinzer 2019).

Finally, Chapter 14 derives policy recommendations by modelling a tax ecosystem with its diverse actors through an agent-based model. This allows for a more comprehensive study of the effect of policy reforms. Contrary to former economic models, agents do not have to be rational, but can also act irrationally and based on coincidences. When there are shocks, one cannot predict the future based on past events. Agent-based models, however, allow making predictions of the future also under big shocks. The only assumption needed is that people's behaviour is stable. The agents in the model will use their old behavioural patterns to overcome these big shocks. The interdependence of agents in the international tax policy regime becomes clear when one sees the complexity and outcomes of this model.

We focus our study mainly on analysing the EU Member States. Nevertheless, when analysing global issues, we include the whole world, such as complex corporate structures using tax havens to avoid taxes, or the estimation of tax evasion or money laundering flows.

1.4 A New Area of Research

The book opens a new area of research, in that:

- It chooses an evolutionary approach, the tax ecosystem approach, by analysing the reactions to regulations and the readjustments needed. The advantage of this approach is that it can look forward. Backwards-looking approaches that then try to extrapolate past experiences into the future are not adequate when analysing significant shocks. So far, tax policy has not been analysed from this angle.
- It takes on an interdisciplinary approach because analysing tax policy and regulation needs authors of diverse disciplines: economics, accounting, law, sociology, psychology, political science, and public administration.
- It provides new estimations of tax evasion, tax avoidance, tax gaps, and money laundering, using diverse methods and methodologies.
- It identifies loopholes in the existing international tax regime.
- It wants to empower regulators by suggesting policy recommendations on how to improve the international tax regulatory regime.

The topic we enquire on is very new, some regulations studied have only been in place since 2018. The impact of these new international regulations on tax evasion, tax avoidance, and money laundering has not been done so far. Hence, this book wants to empower regulators and enable them to take further actions towards reducing tax avoidance, tax evasion, and money laundering on time.

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