Understanding Offshore Finance: The Panama Papers in Perspective

Andy Hira, Brian Murata, and Shea Monson ahira@sfu.ca

Updated: Mar. 17, 2016

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Acknowledgements: Norbert Gaillard, Patty Hira

The Western financial system is rapidly coming to resemble nothing as much as a vast casino. – Susan Strange (1986, 1).

Introduction

In April 2016, the International Consortium of Investigative Journalists (ICIJ) announced the release of 11.5 million leaked documents from the Panamanian law firm Mossack Fonseca dating back to the 1970s. The documents were leaked originally to the German newspaper Süddeutsche Zeitung, who then contacted the ICIJ for help. The Panama Papers help to shed light on how wealthy individuals and corporations around the world use offshore financial centres to hide wealth and evade taxes. News that prominent leaders such as UK PM David Cameron and Icelandic PM Gunnlaugsson had such accounts created public awareness about how widespread such practices are. The issue dates back to the 1980s when offshore centres were set up; in 1998 the OECD published a report about "harmful tax competition" from offshore centres. The Panama Papers reinforce the perceptions of widespread injustice in the financial and taxation systems, which feeds into a wider discourse centred around global and national inequality. As Susan Strange pointed out in 1996 (63), the social and political consequences of the failure of governments to harmonize taxes is "almost entirely overlooked" in the political science and economics literature. The consequences, as we discuss below, include an increasingly disproportionate burden on individual taxpayers, exacerbating inequality, and increasing resort to debt by governments This paper examines issues around global tax evasion, including obstacles to reform and possible paths forward.

The existence of a parallel offshore financial system is alarming for a number of reasons beyond loss of tax receipts. In fact, it undermines faith in national financial systems and, indirectly, political legitimacy based on fairness in democracies. Moreover, the parallel system abets a wide range of illegal activities, from terrorism to narco-trafficking. Leading up to the global recession of 2008 was an increase in deregulation at both the national and global levels, matched by an increasing sophistication of global financial instruments.

Attempts to repair the global financial system after the 2008 global recession, from creating the Financial Stability Board to new capital reserve requirements for banks under Basel III, fall far short of addressing the issues. In addition to the growing complexity of financial instruments, such as collateralised debt obligations, mortgage-backed securities, and derivatives, the proliferation of development of new instruments such as special investment vehicles and transfer pricing allow companies and individuals to avoid the collateral obligations for risky behaviour, thus institutionalising moral hazard into the global financial system. In fact, the

OECD estimates that some 60% of world trade actually takes place *within* MNCs (Love 2012). These are compounded by the breakdown of financial evaluation systems, such as credit rating agencies, who operate in arenas rife with both moral hazard and conflicts of interest (Gaillard and Harrington 2016). There are more fundamental issues at the centre of risk assessment more generally in terms of investment decisions, ranging from biased selection of historical periods to assumptions of normal distributions for security and price-to-earnings ratios, ignoring that such distributions do not hold during crisis periods (Crotty 2009, 571-2). The end result is the growth of a financial sector that dominates but does not adequately feed into a productive sector, creating large profits for bankers and investors, but little employment, feeding into a cycle of idle capital and unemployment. In contrast to the foul cries of the financial sector then, this paper concludes that the post-recession moves towards re-regulation of the sector have been wholly inadequate. What is needed is a much more aggressive stance towards stabilising global finance in order to save its invaluable function to help grow the global economy. That can not be accomplished until there is a reckoning with the offshore financial system.

Tax Evasion in Global Political Economy Perspective

The Panama Papers incident can be seen in larger perspective, namely the challenges for fiscal policy of increasing globalization. The fact is that at the time of writing, the world economy is sitting in liquidity, with companies resting on cash while employment remains stagnant. Fiscal stimulus is impeded, in turn, by legitimate concerns regards massive deficits. The hoarding of trade surpluses in East Asia, and particularly China, highly constrain the possibilities for the US to take its traditional leadership role in leading the world economy out of recession. At the same time, growing concerns about inequality further reflect the weakness of states to respond to the concerns of their citizens through either investment or redistribution.

In part, this is a natural result of globalisation. Globalisation of supply chains has accelerated, with not only goods but also now services increasingly produced through flexible and modular supply chains (Hira and Hira 2007). However, it is not trade but growing constraints on fiscal policy that ultimately is eroding state power. Large n economic studies find the relationship between globalisation and capital taxation unclear- some studies find globalisation leads to higher taxes, while others find the opposite. The different results relate in good part to different measures of globalisation (Adam et al. 2013).

What is clear is that the Western state is increasingly constrained on a number of fronts. For example, the increasing size and scope of transactions through the internet, including via e-commerce, make taxation ever more challenging. Moreover, financial transactions are increasingly both global and electronic, often taking place through intra- or inter-corporate exchanges rather than through traditional currency transactions. The graying of populations while life spans increase puts an ever unfair burden on smaller cohorts of young workers. Automation and loss of jobs to cheaper labour abroad accent a widening gap in income inequality and perennial unemployment that threaten the ability to tax as well as income mobility. Meanwhile, large government deficits twinned with trade deficits in most countries, and most prominently the US, constrain the possibilities for a large Keynesian stimulus programme to shift economies out of recession and create new jobs. Low commodity prices, along with an attempt to shift away from fossil fuels, in turn, create an accelerating fragility in the developing world which has long depended upon Western consumers for growth. This era of doldrums has led to the rise of far right alternatives across the West. In the midst of this depressing scenario, the US dollar remains the one asset value of store and reliable transaction in which the world has confidence.

An international regime for taxation cooperation does formally exist, primarily functioning through the OECD Model Income Tax Convention, passed in 1963. The convention seeks to avoid double taxation, that is, two or more states taxing the same sources of income. The regime is built on the foundation of taxation by geographic origin of the entity. However, there is no enforcement, the focus is exclusively on income taxes, and it is a collection of bilateral rather than multilateral agreements (Paris 2003). Despite the international tax regime, empirical studies suggest strongly that there is corporate tax competition, leading to a lowering of rates over time (Genschel 2002; Overesch and Rincke 2011). Corporate taxes, in particular, declined markedly upon the adoption of neoliberal policies in the 1980s related to competition for "mobile assets" and the re-prioritisation of efficiency over redistribution (Swank 2006).

Classic global political economy approaches might suggest that a relative decline of the U.S. vis a vis China and Europe suggest that the enforcement role played by the hegemon is lost in monetary relations (Mastanduno, 2015, 189; Lippson, 1983, 269; Cohen 2008), and, by extension, the ability to create an effective global tax evasion regime. However, as the (IR) neo-liberal camp would argue, multilateralism, in this case, particularly regarding the need for a pact lies primarily through common interests shared between the US and the EU, is not necessarily tied to hegemony (Ikenberry, 1999, 125-129; 2001, 17). In fact, the strains on the euro zone over the last decade can be seen clearly in the light of fiscal and debt crises in its southern member-states. Considering this, any decline of the US in global terms should in fact accelerate its efforts, along with those of slipping Europe, to recapture fiscal rents and revive its status.

It is important, furthermore, in framing this issue to move beyond the simplistic argument about whether or not states have lost power to the forces of globalisation and corporations. Polarized arguments abound with some contending that states have the upper hand (Weiss 1998), while others conclude that state power is increasingly impeded by global financialisation (Strange 1986, 3; Cerny 1994). Such arguments are logically traced back to the shift towards flexible exchange rates amidst the unravelling of the Bretton Woods system by the US in the early 1970s, in part, in response to inflation created by the Vietnam debacle. Financial innovation from Eurobanks to automated trading to dark pools of capital has quickly outpaced both regulators and the ability of risk analysts to make accurate assessments. As I point out in my analysis of the 2008 recession, financial models are based on a faulty view of human behaviour as rational, when in fact it is driven in good part by emotion and has herd-like tendencies (Hira 2015). Yet, as Glassman (1999) pointed out, the nature of global regimes in finance, as elsewhere, reflect the interests of dominant forces on the domestic level. Thus, though there are clearly constraints, the state still has choices about how to react to globalisation through domestic policies, as Linda Weiss pointed out (1998). A foremost example is state policy in East Asia including China (Hira 2007). One must conclude, then, that states have supported global financialisation, not been subject to it (Helleiner 1995).

International financial evasion reforms must therefore be seen in a two level game perspective (Putnam 1998). Simply put, states have, through changes in domestic political interests, moved to support financial globalisation. This trend fits in generally with Mancur Olson's prescient suggestions in *The Rise and Decline of Nations* (1982) about the rise of private special interests being able to crowd out public collective goods at the national, and by extension, global level. This perspective explains the weakness of state enforcement of international tax evasion norms, which share broad acceptance between Washington and the EU. The fact of such is reflected in the important lobbying power of Wall Street and London financial interests in their domestic politics. It remains to be seen if the growing power of financial over productive interests will continue or be challenged as reflected in the most recent swings to the right, including both anti-financial and anti-globalisation/trade candidates such as Trump and Le Pen.

Nonetheless, it is important to point out that in reality, state and corporate interests are often intertwined, even if contradictory in formal terms. The steady mergers and acquisitions which gained pace in the 1990s also suggest that corporations clearly have common interests in regards to maintaining financial havens. The challenges of states to unite against them seem slim when there is competition to capture production for local multiplier effects. In short, states and corporations are complex collections of different actors with shifting and often conflicting purposes. For these reasons, this paper will choose to focus on examining tax evasion as a policy issue that can be tackled, understanding that if erosion of the tax base continues, states and the companies who depend upon a stable regulatory environment and demand will eventually come to a political consensus to ramp up past the initial efforts described below.

Understanding the Scope of the Problem

In 2010-11, Findley et. al (2014, 182) conducted a very interesting experiment. The contacted 3,771 firms around the world who specialise in incorporation service by e-mail requesting assistance in setting up shell corporations. Over a fifth (22.1%) were willing to provide services without any photo identification and almost half (48%) did not request proper identification (61 & 169) Even more sobering is the result that signals of corrupt origins of money in e-mails or of knowledge of international standards of transparency yielded no significant response from potential providers (171).

The OECD uses the term base erosion and profit shifting in its research on offshore tax havens. It estimates that tax evasion results in the losses of $100-240 billion annually for 4-10% of global corporate tax income revenues (http://www.oecd.org/tax/oecd-presents-outputs-of-oecd-g20-beps-project-for-discussion-at-g20-finance-ministers-meeting.htm). Zucman (2015, 3-4, 36, 47) gives some alarming estimates about the amount of wealth held in offshore tax havens. Considered globally, 8% of the financial wealth of households or $7.6 trillion is held offshore. $5.3 trillion is held in offshore havens, and $2.3 trillion (30%) by foreigners in Switzerland alone. In terms of corporations, 55% of all foreign profits, totalling at least $130 billion annually are kept in tax havens by US companies alone. The end result is a loss of at least $200 billion in taxes every year to governments around the world. Other authors estimate even higher levels of hidden wealth. Palan et al. (2010, 5) put the figure at $12 trillion in 2007, equivalent to the entire US annual GNP. Developing country companies and individuals are as, if not more, involved in offshore financial havens. Buckley et. al (2015) estimate that at least $74.7 b. of FDI were funnelled from China through the Caymans, the British Virgin Islands, and Hong Kong, and another $116 b. from them into China. Moreover, "the vast majority" of Chinese firms listed in the US are incorporated offshore. One of the largest and most admired global companies, Apple, created a subsidiary, Apple Operations International, that had income of $30 billion from 2009-12, but "filed no corporate tax anywhere" (Cobham et al. 2015).

It is a common and increasingly reported occurrence that large multinationals pay little to no taxes in major countries where they operate. Haberly and Wójcik (2015) note that BEA (US Bureau of Economic Analysis) data from 2012 suggests that more than half of the FDI stock of US nonfinancial firms ($1.9 trillion) is attributed to overseas holding companies rather than functional subsidiaries. Nearly a third of the total FDI stock of US firms is held in 3 jurisdictions: the Netherlands, Luxembourg, and Bermuda. They conclude that at least 30% and possibly 50% of all FDI is related to offshore havens.

As an illustration, according to a report by the UK Parliament (http://www.publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/716/71605.htm) in 2013, Starbucks reported that it had lost money in 14/15 of the years it operated in the UK, despite managing a 31% market share. It paid 4.7% of its profits to its Dutch affiliate for intellectual property but did not provide details on what this constituted. In turn, the Dutch company paid a Swiss affiliate for coffee with a 20% mark up, which is then passed on to the UK company. In addition, a loan between the US and UK Starbucks businesses was set a "higher rate than any similar loan we have seen." The end result was that Starbucks paid no corporate taxes in the UK. In turn, despite sales of 207 million pounds in the UK by Amazon, it paid only 1.8 m. in taxes. After enquiry, the commission found that Amazon's European holding company had a profit of 301.8 m. euros, but paid no taxes. Yet, 25% of all of Amazon's international sales took place in the UK, including inventory warehouses with 15,000 employees there. Google keeps its non-US corporate headquarters in Ireland. It had 396 m. pounds in revenues in 2011, but paid taxes of only 6 m. pounds, despite having 1,300 employees there. Google keeps an entity in Bermuda to manage its intellectual property royalties.

Besides tax avoidance for the wealthy and corporations in the West, offshore financial havens serve all customers, from narco-traffickers to terrorists to corrupt officials and dictators. In fact, it was the 9/11 destruction of the World Trade Centre that spurred new action. As Brittain-Catlin (2005, 211) states:

> "Post-9/11 scrutiny showed Bin Laden to be, among other things, a grand master of offshore economics. His use of established offshore networks, with their protected freedoms and secrecy setups, had bewitched investigators and was still no less impenetrable. To this he had added private banks, in Africa and elsewhere, where supervision barely existed, and a network of charities, many with legal status in Western countries….There was the *hawala*

system, an international money transfer system that bypassed banks and allowed payments to be made in one place in return for cash being provided in another, with no record of the transaction….There were the tens of thousands of "money service" businesses in the United States alone that offered easy and unsupervised check cashing, wire transfer, and currency exchange facilities, not to mention transfer points for gold, diamonds, and other precious commodities."

The results for developing countries are devastating, leading to a significant loss of revenues and helping to fuel and facilitate widespread corruption. An estimated $600 billion has left Africa since 1975, with 90% remaining abroad, therefore Africa is a net creditor to the world. Ironically, therefore, Northern states who are relatively efficient are integral to corruption in the South (Christensen 2012, 334-5). The infamous cases of US-based Riggs Bank knowingly taking millions from Chilean dictator Pinochet and Equatorial Guinea dictator Obiang and hiding it in secret accounts in 2002-4 are symptomatic of how the financial system abets corruption in the developing world. Widespread reports of cash payments for real estate in major cities around the world reveal the global extent of money laundering. Corruption is one of the central obstacles to development, undermining public trust and accountability, and haemorrhaging finances as well as facilitating tax evasion. New accountability arms in developing countries are thus stymied in their efforts to create transparency among public officials (Hira 2016).

To a large extent, the flow of monies from developing countries reflects weak financial systems in which large segments have no access to and/or no confidence in borrowing or savings (Hira and Gaillard). In situations where political risk also exists, such as China, it is not surprising that companies and individuals seek outside investments. Thus offshore havens are a conduit to outside markets. The Panama Papers named a number of prominent officials from the developing world, including Pres. Macri of Argentina; Correa of Ecuador; and numerous others from around the globe.

Brief history of offshore financial havens

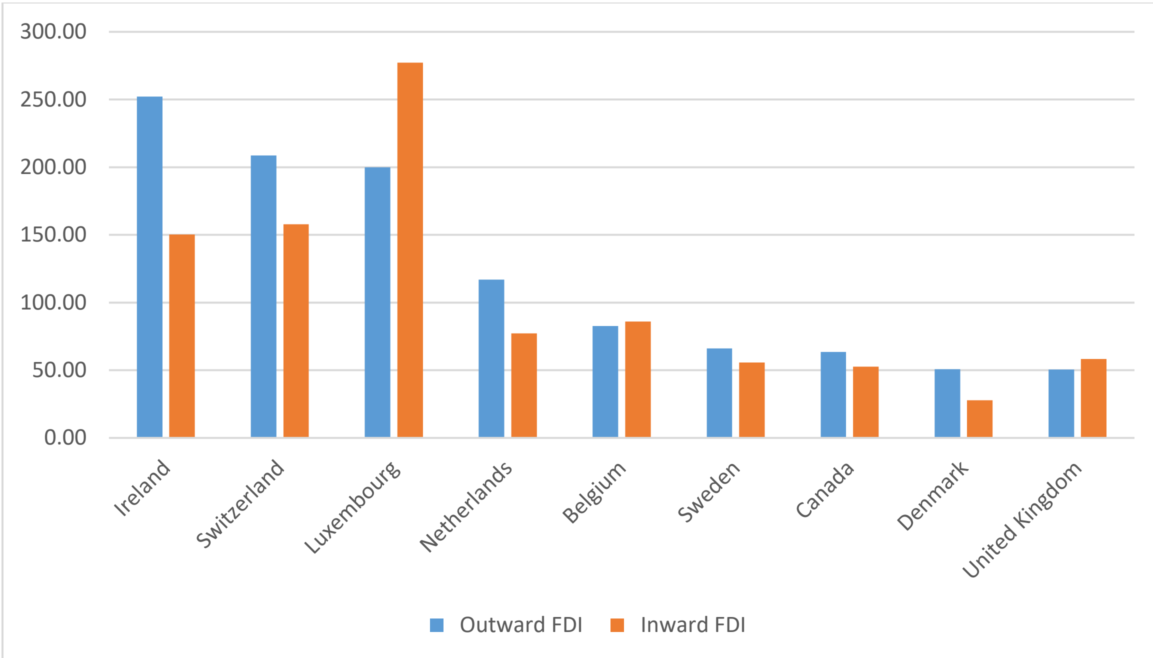
Swiss financial centres took off in the 1920s when the larger European countries began to raise taxes. Wealthy European families had paid little to no taxes throughout the 19th century, and wealth shifted from land-based to financially-based, as large companies and governments began to issue stocks and bonds. The Swiss Bankers Association was established in 1912, and pushed the government to set high interest rates, attracting capital, and to use the Swiss National Bank as a lender of last resort. As a result, Swiss bank assets increased 10 times between 1920-38. In 1974, Switzerland held almost a third of all US stocks held by foreigners. Foreign wealth in Switzerland reached $2.3 trillion in 2015, an 18% increase from 2009, when the G20 countries declared the "end of banking secrecy" (Zucman 2015, 8-9; 14; 21; 29). Of the $2.3 trillion, Zucman (2015, 31) estimates that 1.3 billion comes from Europe; $230 b. from the Gulf petrostates and the same amount from Asia; $220 b. from Latin America; $150 b. from Africa; $80 b. from the US; $40 b. from Canada; and $70 b. from Russia. As of 2012, Canada alone had over $155 billion in offshore havens (Denault 2015, 2).

In the 1980s, new offshore banking centres emerged, including Hong Kong, Singapore, Luxembourg, the Bahamas, and Jersey, Guernsey and the Isle of Man off the UK. The attraction of these locations is that not only shell companies, but also mutual and hedge funds, trusts, and foundations located there pay no taxes. Shaxson (2011, 67-9) notes the close ties between London and the UK offshore havens. The London financial centres grew in part through creating the Euromarkets in the 1950s as a way for Wall Street firms to escape Glass-Steagall provisions (from 1933) against US banks engaging in investment activities. In general, London is far less regulated than New York is, such as not having accounting provisions a la Sarbanes-Oxley; many Russian firms are listed in London for these reasons. According to the "domicile" rule, wealthy foreigners can come to London and avoid tax on all non-UK income.

The revelations of the Panama Papers highlighted a series of stories around offshore financial havens that have picked up steam since the 2008 financial crisis, such as the 2008 leak about the Swiss bank UBS aiding US citizens to evade taxes, and the Luxembourg Leaks of 2014 in which the ICIJ revealed corporate tax avoidance schemes leaked from consulting firm PriceWaterhouse Coopers. An emerging part of that discussion is the fact that offshore tax havens are not limited to small palm-fringed islands. The Tax Justice Network (TJN) created a financial secrecy index (http://www.financialsecrecyindex.com/) to rank the lack of transparency by tax haven that begins to examine the ways to measure the activity of numerous havens. While Switzerland takes the top spot, the rest of the list is somewhat surprising. The US ranks 3rd, Germany 8th, Japan 12th, and the UK 15th.

One of the most interesting aspects of international economic analysis is the inability to trace foreign direct investment, a key financial flow for the global economy and supposedly vital to economic growth. The following graph shows the fact that tax havens and shell corporations are used in small economies to redirect investment flows, making their origins impossible to determine with any confidence. We have ranked the top 9 economies in terms of FDI flows. Notice how much larger the stocks are in the 3 haven countries of Ireland, Switzerland, and Luxembourg.

Fig. 1: FDI Stocks, Top 9 Countries 2014 (% of GDP)



Author from OECD Factbook 2016-16.

Lest we be accused or rigging the statistics by looking at % of GDP, we also looked at FDI inflows in total amounts for 2015. The following table shows that among the largest economies (with Russia curiously absent) are several offshore havens, including Hong Kong, Ireland, Switzerland, Singapore, B.V.I. and Luxembourg who are the top recipients of FDI in total amounts. It is notable that Cayman Islands ranks 3 places below the bottom of this list.

Table 1: FDI Flows by Country, Top 18, 2015 ($ millions)

United States	379,894	Canada	48,643
Hong Kong, China	174,892	India	44,208
China	135,610	France	42,883
Ireland	100,542	United Kingdom	39,533
Netherlands	72,649	Germany	31,719
Switzerland	68,838	Belgium	31,029
Singapore	65,262	Mexico	30,285
Brazil	64,648	**Luxembourg**	24,596
British Virgin Islands	51,606	Australia	22,264

Source: Author from UNCTAD *World Investment Report 2016*

Why is so much of global finance going to relatively small and sometimes obscure destinations like the Cook Islands? To answer that question, we examine the basic parameters of the offshore finance world.

<u>Basics: How offshore havens work</u>

The historical basis of taxation for individuals is citizenship, and for companies on where their command and control activities take place. Global taxation follows some established principles. One is that double taxation (taxing the same income twice) should be avoided. This means countries depend on citizens to report their taxes elsewhere and give them credit for doing so. Naturally, it sets up competition for lower taxation, in order to attract business and investment. A second principle is that business (active) income should be taxed primarily by the country of source, and investment (passive) income by the country of residence. These two principles are increasingly difficult to put into practice.

Establishing Domicile

The law firm, Mossak Fonseca, whose e-mails were hacked to create the Panama papers, demonstrates a rather routine set of procedures for tax evasion. In simple terms, the law firm would set up a shell corporation (formally known as an international business corporation) registered in an offshore haven such as the British Virgin Islands. There are several variations of shell companies. For example, the limited liability partnership (LLP), under which companies can set up a separate company for ownership of assets from the one creating income from those assets, again separating taxable income into a tax haven-protected entity. A protected cell company (PCC) sets up separate companies with a shared management structure. This allows for an additional layer of obfuscation of income and assets, whereby the relations and activities among the companies are unclear. One company's activities therefore, can not lead to liability for another one. Another common practice is called an "inversion." In this case, a subsidiary is established in a tax haven, and then inverts the situation by reversing roles and becoming the parent company. This allows the company to move income to no or low tax havens. The practice is widespread- Virgin Corporation licences its logo to all operations from its company based in the British Virgin Islands; Microsoft holds its copyright in its company in Ireland, where it faces lower taxes (12.5% vs. 35% in the US). (Palan et. al 2010, 88-90).

Offshore havens treat non-residential financial transactions preferentially, so that locals can not partake. These offshore havens guarantee financial secrecy and low or non-existent tax rates for non-residents, generally in exchange for annual registration fees of a few hundred dollars. In fact, the registration requirements for companies are very simplistic, meaning that little to no information about the company exists. The main loophole is based on the fact that countries tax companies based on their "tax domicile," that is, where their central management and control is located. Though companies setting up subsidiaries or headquarters in havens are prevented from focusing on local operations, as a way to prevent local companies from taking advantage of the rules, there are often requirements that locals be appointed on the board of directors and a certain number of board meetings take place there. As a result, locals frequently "rent out" their names to companies. For example, in 2012, the British Virgin Islands had 830,000 companies registered but just 31,000 residents, as compared to Norway with 270,000 and a population of 5 million. A BVI resident had on average 27 directorships as opposed to 0.05 for Norwegians (Schjelderup 2016). In fact, in a World Bank study of offshore jurisdictions as part of its Stolen Asset Recovery programme, only 1- Jersey- required a government body to record the "beneficial" owner (Van der Does de Willebois et. al 2011, 71).

The wealthy individual or company could even have the firm hire a 3rd party to register the company in their name, so that the investor could not be traced. The 3rd party could be a distant relative or simply a stand in from a different country with lax tax regulations who is paid for their service by the law firm. The individual could then transfer funds to the company, such as having the company charge consulting fees, transferring the cash to an account through the law firm, or creating a charge for the company for a "bad investment" or goods (not delivered) with a Panama invoice. The company (and through them, the investor) could then use the account to make personal transactions, such as paying college tuition for their family members. The dodge is used commonly in the US to avoid gift and inheritance taxes from parents to their children. It is also used to simply hide income earning assets from taxes. Purchases of assets through company, foundation, or trust accounts are often wired through several different global accounts, sometimes with different shells, making detection by tax authorities extremely difficult. The legal fees are minimal considering the size of the assets hidden, often less than $10,000, and the accounts can be set up in a matter of hours (Gates 2016; Lipton and Creswell 2016; Christensen 2012, 333).

Individual Strategies

Offshore financial centres serve a similar role in terms of wealthy individuals seeking to avoid inheritance taxes. Individuals can set up shell corporations in which their salaries or other income is paid. They make themselves employees of the companies and then receive minimal salaries to lower income taxes. In addition, the companies can be used to recategorise income into capital gains or dividend income to lower taxes and avoid social security payments (Palan et. al 2010, 91). An Integrated Estate Plan (IEP) is intended to protect the wealth of an individual through mitigating estate taxes and providing increased protections and control for the individual (Engel, 2002, 7). As with corporations, personal trusts set up in offshore centres are not taxed, which for personal estates allows wealthy individuals to avoid having their assets subjected to estate taxes. The privacy afforded by offshore trusts allows for individuals to keep the extent of the wealth private as well as to protect the estate from claims against it (Metaxatos, 2008 173-175; Engel, 7-8). Any challenge or deposition of the estate must be conducted in the jurisdiction where the offshore trust operates, which typically involves significant standards of proof that fall on the challenger, thus protecting the settlor by limiting their exposure to liability. Wealth transferred to an offshore trust as part of an IEP can also be distributed in any manner the settlor of the estate chooses, allowing wealthy individuals to circumvent forced heirship laws which exist in many jurisdictions to stipulate how the estate's assets are to be distributed.

Trusts and Foundations

Trusts and foundations are popular vehicles used in offshore finance. In addition to shell companies, trusts and foundations are typically used to control offshore financial assets, such as equities and bonds, as well as tangible assets such as real estate, gold, or even yachts (Palan et al. 2010). Both entities benefit in practice from the secrecy surrounding their founders, beneficiaries, and other parties associated with their operation.

Trusts

Trusts are contractual agreements between two private individuals that create a barrier between the legal owner of an asset and its beneficiary, and this arrangement allows for the transfer of legal ownership of property or financial assets to another person on behalf of a third party (Palan et al. 2010, 92). In short, trusts are agreements whereby a third party (the trustee) manages the assets of an individual (the settlor) for the future benefit of another individual (the beneficiary). Trusts require their creators to forgo any interest from income arising from them. However, in practice, the offshore finance industry assists individuals evade tax obligations by creating arrangements that appear like trusts; in these cases, trusts are often run by 'nominee' trustees who are residents of a tax haven (Palan et al. 2010, 92). Trustees are liable for tax on income they receive from trust assets unless that income must be paid to another person under the terms of the trust. In cases of offshore trusts, the trustees are usually professionals who ensure trusts earn and accumulate income tax-free, and because such trusts are located offshore, they do not have to declare to tax authorities the payment of income to beneficiaries that do not live in the tax haven where the trusts are located – income is paid into beneficiaries' offshore accounts without the knowledge of home jurisdictions. Once assets are transferred to an offshore trust it is difficult to trace them back to their owners, which is compounded by the widespread absence of registration procedures (Palan et al. 2010, 93).

Van der Does de Willebois et al. (2011) acknowledge that the majority of trusts are used for legitimate purposes, such as estate planning, managing charitable donations, and corporate functions such as isolating funding for an employee pension plan from a business' assets. However, Christensen (2012) notes charitable trusts are regularly established for the purpose of owning 'special purpose vehicles' used for international tax planning and hiding assets and liabilities off balance sheets. With a few exceptions, no jurisdiction currently requires trusts to register in a publicly accessible register and many, such as Panama, have enacted strict confidentiality laws, prohibiting the disclosure of information regarding trusts (van der Does de Willebois et al. 2011, Tax Justice Network 2009). In regards to Panama, only trusts holding property in Panama must be registered, and the agent must be a Panamanian lawyer (van der Does de Willebois et al. 2011).

Trusts are effective for evading/avoiding taxes due to two main reasons: the separation of parties involved in their establishment, and the secrecy surrounding them. Once a trust is formed, its assets legally do not belong to the settlor or to beneficiary parties, though the trustee has a fiduciary duty to manage the assets (van der Does de Willebois et al. 2011). With the separation of legal and beneficial ownership, it is often difficult for private or public parties to enforce claims against these assets unless it can be demonstrated that the trust was specifically established to evade claimants such as creditors (van der Does de Willebois et al. 2011). The separation between parties also complicates how to tax the trust and authorities cannot easily find the assets to tax them due to secrecy (Tax Justice Network 2009). Further, even if a trustee can be discovered, the trustee may be bound by a confidentiality agreement not to reveal who the settlors or beneficiaries are, and oftentimes in a jurisdiction with secrecy the trustee will be an anonymous trust company that specializes in being a trustee for many trusts, with no clue to suggest who the settlor or beneficiaries are (Tax Justice Network 2009).

Foundations

Foundations can be best described as a form of trust recognized as having a separate legal existence similar to a limited company (Palan et al. 2010, 93). Foundations are a form of 'unowned' economic entity, whereby contributors cede rights of ownership, control, and beneficial interest from donated assets to the foundation, and in many jurisdictions, foundations are simply corporate vehicles intended to benefit a cause rather than to provide a return on investment (van der Does de Willebois et al. 2011). Foundations traditionally require that property from donors be dedicated to a particular purpose, and income derived from assets is used to fulfill the intended purpose (van der Does de Willebois et al. 2011). Among the principal tax havens, the Netherlands Antilles, Austria, Denmark, Panama, the Netherlands, Liechtenstein, and Switzerland allow the creation of private foundations, and many tax havens demand only minimal disclosure; in an extreme case, no approval is needed to create one in Panama (Palan et al. 2010). In terms of registration, Panama only requires that a foundation's charter be filed with the Public Registry Office (van der Does de Willebois et al. 2011). The success of foundations is due to their combination of secrecy with a legal existence separating it from the lawyer that manages them and from the settlor, and their non-taxable status (Palan et al. 2010).

With Panama's perception as a tax haven, the Panamanian Foundation warrants some description. Formally the Panama Private Interest Foundation, the Panamanian Foundation was established by legislation in 1995 and is jointly modeled on the Liechtenstein foundation, the Panamanian corporation, and the common law trust (van der Does de Willebois et al. 2011). A Panamanian Foundation is established when assets are transferred to it, and the founder specifies the foundation's purpose in a charter or in bylaws, which are public or private documents, respectively, and which specify one or more beneficiaries (van der Does de Willebois et al. 2011). While separating the founder from legal ownership of the foundation's assets, Panamanian foundations also combine a high level of control with strict confidentiality; founders, foundation council members, and beneficiaries may be corporate bodies from any jurisdiction, with any of them controlled by the founder (van der Does de Willebois et al. 2011). It is common to use so-called nominee founders – usually a Panamanian law firm that must act as the registered agent – so that the original founder's identity, which is usually included in the foundation's charter document, remains unregistered (van der Does de Willebois et al. 2011).

Tax Abuse of Charities

Based on results from its 2008 survey, the OECD (2009) identified numerous methods in which charities' tax-exempt status is abused for tax evasion and money laundering. The OECD found evidence suggesting the abuse of charities for such purposes is largely organized. Tax authorities across nineteen countries identified many general methods and schemes, including, among many others:

1) An organization poses as a registered charity to perpetrate tax fraud;

2) A charity wilfully participates in a tax evasion scheme to benefit its organizers or directors, which can occur with or without an intermediary's assistance;

3) A charity is unknowingly abused by a taxpayer or third party, such as a tax return preparer who prepared and submitted false charitable receipts;

4) Issuing receipts for payments that are not true donations;

5) Misuse of charity funds by charities;

6) Criminals using charity names to collect money;

7) Terrorist organizations using charities to raise or transfer funds to support terrorist organizations; and

8) Manipulation of the value of donated assets

The most prevalent scheme identified involves charities selling donation receipts for a commission. Under this scheme, a donor may receive amounts such as $10,000 in donation receipts for a $1000 cash payment to a charity. The OECD estimates that a government may end up paying 40% for each $1 in false donations, and very little (if any) of the donation money ends up supporting a charitable purpose. The Canada Revenue Agency (CRA) noticed that charities and tax return preparers who had previously been identified as being involved in false receipting continue to issue false receipts. This practice is more prevalent due to advances in printing technology, though most suspicious activities seem to involve tax return preparers and electronic service use.

Tax authorities use several indicators to detect possible cases of tax evasion and/or money laundering involving the abuse of charities. These include taxpayers who report low or moderate income abruptly changing their donation patterns; taxpayers with no donation history suddenly making donations in varying ranges; high ratios of donation amounts to net incomes; multiple charitable causes with no apparent connection; donors with the same community/cultural backgrounds and relationships; donors working together in similar work or for the same large company; donors providing insufficient documentation or information when approached by tax authorities; and taxpayers making donations under $500, who made $3000 or more in charitable donations during the subsequent tax year, and cases where the tax advantage is $1000 or more.

Some countries use a combination of intelligence gathering, risk analysis, risk profiling, and data matching to detect tax fraud and/or money laundering resulting from charity abuse. Useful information for tax authorities includes charities' registration documents for names, titles, and addresses of officers; donor's income tax returns, such as receipts, income, donation history, and charities donated to; charities' books and records for revenue, payments to highly-paid employees or contractors, and general balance sheet information; banking records; informant leads; open-source information including internet and media scans; and collaboration with domestic intelligence and law enforcement agencies.

The OECD notes the US has exclusive access to tax-related information regarding charities and donors and has unique experience in analyzing such information, mainly through using joint task forces. Within the Internal Revenue Service (IRS), civil examiners in the Tax Exempt and Government Entities (TEGE) section have strong familiarity with the charitable sector, and the IRS has established mechanisms to ensure that TEGE and IRS Criminal Investigation (CI) collaborate. In addition, the Department of Justice's Terrorist Financing Unit is leading a multi-agency effort to investigate and prosecute charities that are involved in providing terrorist support. Working with IRS agents, prosecutors review filings and compare disclosures with information from other government agencies. In Canada, some CRA investigations are jointly conducted with law enforcement agencies such as the Royal Canadian Mounted Police (RCMP).

Moving forward, the OECD recommends that countries vulnerable to the risk of abuse of the charity sector implement good practices including maintaining a central registry of all suspicious activities to identify and analyze trends; maintaining reliable information on the level of threat, vulnerability, and compliance; implementing multifunctional and multi-agency teams; implementing an automated cross-check system; inputting an abuse of charities indicator on suspicious files; and establishing a mechanism to facilitate information exchange between tax authorities, law enforcement agencies, and other relevant bodies.

Examples of Corporate Strategies including transfer pricing

A 2015 Congressional Research Service report (Gravelle, 9-14) offers the following overview of how US corporations use offshore finance to avoid tax through common practices. Income earned by foreign subsidiaries is not taxed by the US until it is repatriated to the US parent as dividends, with some exceptions related to passive income (Subpart F). Credit for foreign income taxes is also given upon repatriation to avoid double taxation, excluding domestic income. A company can borrow more in a high tax jurisdiction and less in a low one to reduce taxes. Companies furthermore use the practice of "earnings stripping" whereby the borrowing is done by related firms or through foreign borrowers who are not subject to US taxation. Firms use "inversion," by which they move the parent company abroad, or merging with a smaller foreign company, so that US operations become a subsidiary. Companies may also prefer to use contracts with a company in a high tax area to avoid reporting profits earned in that country. Under cross crediting, firms can use foreign tax credits to reduce their US taxes once they repatriate it. The practices of corporate tax mitigation, while ostensibly problematic in that it leads to a loss of tax revenue, are not expressly unethical- the nature of the global financial system and open markets will encourage such practices (Gilligan, 2004, 22).

Another practice that has received a great deal of attention is "transfer pricing". Generally, businesses buy and sell services at prices dictated by the market, a price usually considered to be at "arms length" – e.g., that two unrelated parties have made an arrangement that reflects current market valuations in relation to the provision of such services. When the parties to the transaction are related, the price is not considered to be a fair market price, but that of "transfer price", from which there can be a benefit to the multinational corporation engaged in such practices due to differential tax rates (McCann, 2006, 115). Such tax rates provide incentives for a corporate entity to establish decentralized autonomous entities in tax haven jurisdictions, which are never-the-less vertically integrated within the entire structure of the multinational corporation (Cecchini et. al., 2013, 32).

The general structural consideration is to create an associated corporate entity operating in a jurisdiction with a lower tax rate relative to that of the parent company. Under this strategy, the company raises the price of purchases and lowers the price of goods and services sold by branches in high tax jurisdictions to other branches in lower tax ones. It is difficult to detect this strategy as there may not be readily available prices for comparable items. Profits can be shifted to holding companies in tax havens such as the Caymans where there is no tax. Typically, such international or offshore business companies pay no tax if their revenue did not originate in the offshore financial center (McCann 61-62), the result of such transfer pricing is to effectively transfer profits into low- or no- tax jurisdictions.

A related practice is to use interest payments to dodge taxes. For example, capital is borrowed in a high tax area, where interest payments are deductible, and shifted to a low tax area where expenditures take place. Similarly, interest payments can be received in a low/no tax area. Moreover, lending charges to subsidiaries can be inflated to move funds to low tax jurisdictions. Companies avoid payroll taxes through placing employees under a foreign subsidiary, even as they are working in the home country. Hybrid mismatch arrangements are when a company reports an income payment for deduction purposes in one entity but does not report the income in the jurisdiction of the receiver. Even more common is to use trademarks, copyrights, and patents to shift valuation, as it is exceedingly hard to put a valuation on them (Beer and Loeprick 2015; Karkinsky and Ridele 2012). Detection can be particularly difficult in MNCs that cross multiple sectors. As Palan, et. al (2010, 91) conclude: "The offshore operations of many MNEs are a charade."

While there are numerous ways transfer pricing can benefit a multinational, an example can serve to illustrate the process and to show the difficulties in determining the actual tax liability of company in question. In the 1980s, *Forever Living*, a company owned by Rex Maughan, sold the international distribution rights for the company's products to a non-resident company in the United Kingdom at a cut rate (a use of transfer pricing). This non-resident company immediately sold those rights to a second UK company, which licensed the actual distribution to a Dutch Company *Batrax Rotterdam B.V*, which received the royalties garnered from the distribution related to global sales. The royalties were transferred back to the second non-resident U.K. company which transferred the funds to a Swiss bank, from which the funds were then moved through trusts in the Channel Islands. The profits were transferred back to the owner Rex Maughan from these trusts as loans to *Forever Living* to be used in other business ventures (Lewis and Allison, 2001, 1-5).

The ultimate tax liability of *Forever Living*'s international distribution remained with the company, though it was filtered through various international subsidiaries. The international element, the difficulty of following the financial records of the subsidiaries across all of the jurisdictions in which the operate, is what allows such multinationals to seek out moving profits from operations from a high tax jurisdiction (in this case the United States or the United Kingdom) to a tax haven (Switzerland and the Channel Islands). The complexity of these arrangements, and tracing the flow of capital, is often exacerbated by the level of banking secrecy common to tax havens, making determining the actual tax liability of the transnational in the originating country inherently problematic in cases like these, if not outright impossible.

Multinationals can also profit from offshore centres through specialized mechanisms to manage corporate debt (McCann, 60). Specialized debt management entities are known as special purpose vehicles (SPVs), which involve the pooling of the debt of the parent company and transferring it to an associated or subsidiary entity. This is done in order to shield investors of the originating institution from the credit risk associated with the debt (Stowell, 2010, 48). SPVs can take a number of forms, all of which involve sercuritisation, through the transferring of assets and debt to a separate legal entity (456-7). Collateralized debt obligations (CDOs), are securities where the debt in question is backed by other assets in various tranches which compensate the purchaser for the risk of default (49), or as a similar security where the backing assets are high-yield bonds (CBOs). Securitization of debt can also occur through credit default swaps, where the party purchasing the security is paid if the underlying debt results in a default, (106), and in structured investment vehicles (SIVs), which generate returns through credit spreads between the assets and liabilities (185). SIVs operating offshore or with other offshore subsidiaries serve a dual role in both mitigating credit risk as well as generating profits that are taxed at a much lower level (if taxed at all) than would be if the SIV was operated domestically. As Gaillard and Harrington note, SPVS and SIVs are often used to mitigate risk from balance sheets and avoid downgrading of corporate debt (43).

These debt management systems and other complex, dynamic tax avoidance schemes are notoriously difficult for regulators to monitor, as demonstrated by their role in the 2008 financial crisis (Hetzel, 2012, 181-183). The overall effect of offshore havens, in relation to multinational transfer pricing and SIVs, is to create a system where the investments and structures of multinational corporations become virtually untraceable.

Last but not least, MNEs set up "captive insurance companies." They are created in tax havens to manage risk and minimize taxes. They allow companies to reduce reserve and capital requirements and manage catastrophic risk through reinsurance systems, whereby the reinsurer agrees to pay out some of the claims of the original insurer. Palan et. al (2010, 96-7) estimate that at least 5,000 such companies existed as of 2007, with Bermuda, the Cayman Islands, Vermont, the British Virgin Islands, and Guernsey heading the list.

Money Laundering

The same mechanisms that allow for tax mitigation for corporations and individuals can be used for money laundering. The goal of money laundering is to integrate funds garnered through illegal activities into the legitimate finances of the launderer though disguising/"anonymizing" the source of the funds and conference an appearance of legitimacy.

Money laundering takes place in three main steps: Placement, Layering and Integration. Placement is the step where the funds that are to be laundered are placed in a financial institution, through depositing cash, the use of wire transfers or checks, or the transfer of gold or other luxury goods (Turner, 2011, 8-9, 73). Layering: this step involves stratifying the financial transaction – other transactions are conducted with, and around, the capital that is to be laundered. This can involve moving funds from one account to another, from institution to institution, shifting the money from one asset type to another through various accounts related to shell companies. The layering process can also include various financial accounts associated with the purchase of high-value items, currency equipment sales as well as the purchase of legitimate business or real-estate (9). Integration, the final step, involves returning the laundered capital back to the perpetrator. The goal would be to use mechanisms that will withstand ordinary scrutiny and hence will give the sought legitimacy. This often takes the form of loans from the layered transactions or holding/front companies back to the perpetrator (9-10, 74, 89-90).

The secrecy aspect of the offshore financial system aids in giving legitimacy to laundered funds. However, the legitimacy does not come from the banking itself, in that truly anonymous bank accounts were phased out of the international banking system in 2000-1. Shell companies, consisting of nothing more than a legal personality and a registered name, are accorded all of the banking privileges of an individual are the primary mechanisms used in the layering stage (Sharman, 2011, 70-7). The transactions of various shell companies are kept private by the secrecy laws in offshore banking centre. This, in combination of the transnational aspect of international banking (providing a further impediment to law enforcement and regulators in that international cooperation is required in order to conduct a money laundering investigation) results in movements of funds, which become very difficult to trace. Banks aid in the "anonynmization" process by offering an above average degree of information asymmetry- only a small number of operators in privilege positions know the origins and destinations of the capital flows of the banks themselves (Masciandaro and Portolano, 2004, 132). Thus there are only a few individuals in the position to notice irregularities that might indicate questionable or fraudulent transactions.

The banks themselves also play a role in the integration stage, where the laundered funds are reincorporated into the finances of the launderer. As noted above, the goal of money laundering is to achieve the appearance of legitimacy of the funds at this stage. In order to accomplish this, money laundering uses the participation or inclusion of otherwise law-abiding citizens or entities (Turner, 7). Banks can either directly or inadvertently facilitate money laundering by providing launderers with the ability to move and layer their funds. Banks are already involved with the movement of large sums of money, which aids in disguising the origin and destination of proceeds from illegal activities (15-16). When the funds are sent back to the launderer, either as a transfer or as a loan, they appear to be coming from corporate entities through legitimate banks operating in foreign countries, thus conveying a sense of legitimacy of the source of the funds.

Mini Case Study Examples

Recent cases conducted as "international asset recovery" under a variety of international legal frameworks, such as the UN Convention against Corruption (2005) have been carried out by Western governments against developing country governments as detailed below. However, there is likely to be some reversal by the new US Trump Administration.

Teodoro and Teodorin Obiang

The Obiangs, the ruling family of Equatorial Guinea, have generated an estimated $115–$300 Million USD through embezzlement and extortion (Burke, 2017). This wealth was used to buy numerous luxury properties in Paris and Malibu, a private jet, luxury cars and various collectables and artworks by Degas and Renior. Teodorin Obiang, son of President Teodoro Obiang Nguema, is accused by a French prosecutors of laundering nearly $115 million of revenue generated by a “revolutionary tax” on wood sales. The leadership of the Obiangs has long been accused of expropriating and laundering the significant oil revenues of Equatorial Guinea (Mouawad, 2009; Allison, 2014).

According to *Human Rights Watch* (2009), much of the wealth expropriated by the Obiangs was laundered through the *Riggs Bank* in the U.S. While offshore accounts are common among resource producing states to facilitate transactions from transnational corporations in terms of payments for services as well as expenditures related to resource development. However, in this case, the Obiang family retained complete discretionary control over the accounts in the Riggs bank. Further, the deposits from oil revenue were deposited into numerous accounts at the Riggs Bank along with the President’s other income, making the accounting of funds quite complicated. As a result, the source of funds that the Obiang family used to purchase property in the United States was indeterminate. Shell companies were also created in Riggs Bank affiliates in the Bahamas, through which transactions were processed that did not pass common due diligence tests. Proceeds from contracts between international oil companies, as well as joint ventures, were shunted through these accounts. In this case, the laundering of illicit funds acquired by Obiang family were laundered with the assistance of Riggs Bank as well as the multinational oil companies which conducted business with or in Equatorial Guinea.

In the recent legal cases brought against Teodorin Obiang by the US, Swiss, and French Governments, illicit revenue was shunted through the numerous banks within U.S. and Europe which has been used to purchase luxury properties (Open Society Foundation, 2010). These funds, after being deposited in U.S. accounts were sent through accounts in Spain, and then through various shell companies. Thus the destination of the originally expropriated funds become obscured through the various transactions between these entities. As well, assets were purchased within the United States and then transferred to France for the personal use of the Obiang family (Allen, 2011). The US case was settled in 2014 that required Obliang to sell a $30 million mansion in Malibu under the Kleptocracy Asset Recovery Initiative. A similar case against the Malaysian government’s pension fund is ongoing (US Dept. of Justice 2014, US FBI 2016).

Mexican and Columbian Drug Cartels and HSBC, Wells Fargo (ex. Wachovia)

In a settlement with U.S. Federal authorities, HSBC admitted to facilitating the laundering of $881 Million USD from Columbian and Mexican drug cartels. (CBC, 2013). In this case, HSBC intentionally routed electronic transfers of funds in such a way as to avoid triggering banking regulatory safeguards. In addition the payment messages were altered in order to disguise the identity of those entities depositing funds to the bank. In the settlement, HSBC agreed to pay a $1.9 Billion USD fine.

As of 2011, Wachovia (now apart of Wells Fargo) was found to be facilitating laundering of money on behalf of the Sinaloa Cartel (Vulliamy, 2011). Whereas HSBC attempted to hide the identity of the depositors, Wachovia permitted deposits in amounts that ought to have triggered enhanced scrutiny. Wachovia issued travelers' checks to clients that far exceeded what would normally be used for that category of financial instrument. Further, these oversized checks were found to have sequential serial numbers and the deposits were likewise made sequentially. Such activity would have normally triggered increased scrutiny, however this did not occur.

Such occurrences also happen at a smaller level: in 2015, two Colombian Citizens were sentenced to a term of incarceration for laundering money through wire transfers handled by U.S. Banks (IRS, 2016). Money was sent by wire transfer from Columbia to banks within the U.S. This money was then withdrawn and then sent back to Colombia through a different wire transfer service thereby obscuring the source of the original funds.

BNP Paribas and International Sanctions

In 2015, BNP Paribas admitted to facilitating banking services for the Sudan, Cuba and Iran in contravention of U.S. sanctions (Raymond, 2015). Under U.S. sanctions, these states were forbidden from conducting transactions within the international banking system. BNP Paribas stripped identifying information related to the transactions as to allow the transactions to pass through the U.S. financial system without triggering the applicable safeguards.

Russia-Nauru

Following the financial instability of Russia in the late 1990s, billions of dollars were transferred from Russian banks to banks on the Pacific island nation of Nauru (Hilzenrath, 1999). Where the cases described above involve banks violating or failing to uphold domestic banking regulations in such a way as to facilitate money laundering, this case is based on the laws of Nauru. Privacy laws as related to banking rivaled, if not exceeded the infamous discretion offered by Swiss banks. Domestic laws of Nauru placed a premium on privacy as related to financial transactions making it exceptionally difficult to track capital held by Russian organized crime.

Igor Volkov and Deutsche Bank

Between 2011 and 2015, a Russian broker named Igor Volkov would book trades to buy and sell a specific stock through separate accounts with Deutsche Bank (Caesar, 2016). These were 'mirror' trades where the sell and buy orders were posted at the same time for the same amount. Volkov would sell assets from his clients in Russia through Deutsche Bank and then purchase the same volume from a different account, one registered in an offshore haven such as the British Virgin Islands. While oligarchs were the direct clients of Volkov, the intermediary offshore entities were operated by middlemen who would then transfer the wealth into other offshore accounts belonging to the oligarchs. Volkov effectively facilitated capital flight in excess of over $10 Billion USD.

Liberty Reserve

Liberty Reserve was an electronic payment processor, operating out of Costa Rica, and has been accused of facilitating money laundering for criminal enterprises (Cloherty, 2013). Liberty Reserve used digital currency transactions between multiple accounts on behalf of their clients, thereby obscuring the source of the wealth. In addition, no verifiable information was required in order to set up an account, which made *Liberty Reserve* an attractive money laundering option for organized crime. Currency would be taken in trough wire transfers and then traded digitally within the bank, and then deposited in another institution (Santora, Rashbaum and Perlroth, 2013). However, rather than depositing the funds directly, Liberty Reserve would utilize separate third party distributors, further obscuring the source and destination of the funds deposited.

Semion Mogilevich

Assumed to be one of the most influential Eastern European organized crime bosses, Semion Mogilevich has been accused of operating a long standing money laundering operation (United States Justice Department, 2007). In laundering illicit profits from Eastern Europe, Mogilevich deposits money into the accounts of business he operates within the United States, which then conduct transfers to subsidiary and associated firms all of which are registered corporate entities. Through fraudulent records, a paper trail for the cash flow is established, thereby legitimizing the wealth, which is then dispersed back into similar corporate entities in Europe or into offshore accounts.

Reform Efforts

TIEAs

In 2002, the OECD developed the Model Agreement on Exchange of Information in Tax Matters (TIEAs, or Tax Information Exchange Agreements). This derived from concerns related to the loss of revenues to money laundering. These concerns led to the creation of the FATF (Financial Action Task Force, www.fatf-gafi.org/about), an intergovernmental group that came out of the G-7 meeting in Paris in 1989. The FATF sets out guidelines for measures to counter money laundering. It includes self- and peer-assessments of reporting and, from 2000, a list of non-cooperative countries who could be sanctioned. It has regional offices around the world (Jakobi 2015). Such efforts pushed the OECD to release its 1998 report *Harmful Tax Competition: An Emerging Global Issue.* The OECD set up model agreements that could be signed bilaterally for the disclosure of financial information. While not binding, peer pressure placed on offshore havens led to a large number of them signing the agreements, through the threat of blacklisting. The 1998 report was the start of a wave of policy innovation towards global banking.

According to Denault (2015, 49) TIEAs are full of loopholes. For example, Canada uses them to attract capital from Caribbean countries into its financial system to avoid local taxes, as under the agreement they are not taxed in Canada. Under its TIEA with Switzerland, if the government wanted information on a Canadian's supposed assets there, it would have to provide details on the individual's banking operations, information which it does not have because the TIEA does not allow for the free flow of information! (127) Moreover, there are no time limits for responding to requests for information from Canadian authorities (Kerzner and Chodikoff 2016, 404). Denault therefore concludes that Canada's apparent moves to fight against tax evasion are nothing more than "smoke and mirrors" (190). His conclusion is reinforced by a study commissioned by the Norwegian Government, which concludes that tax treaties do nothing to improve transparency or the transfer of funds back to the country where companies are domiciled (Govt. of Norway 2009, 13).

US FATCA

Earnest reform in the US came after the release of secret documents in 2007 by Bradley Birkenfeld of UBS bank revealing that many US citizens were evading taxes by placing money in secret accounts in Switzerland. The subsequent indictments helped to bring down Switzerland's oldest (270 years) bank Wegelin in 2013. In 2010, the US enacted FATCA (Foreign Account Tax Compliance Act) in order to force overseas banks to disclose information about Americans holding accounts abroad. FATCA also applies to other financial entities, such as foundations. It imposes a 30% withholding tax against non-compliant financial institutions. In 2012, France, Germany, Italy, Spain and the UK issued a joint statement in support of FATCA (Rahimi-Laridjani and Hauser 2016, 10). FATCA is to be extended to a number of Caribbean havens from 2017 (Snyder 2015).

OECD- CRS

In response to FATCA, in 2014, the OECD developed a similar provision called the Common Reporting Standard (CRS). The CRS Handbook with guidelines for information sharing was published in 2015. As of 2016, 96 jurisdictions have signed onto CRS, with the first exchanges of information to take place in 2017 (Rahimi-Laridjani and Hauser 2016, 10).

In April 2016, the OECD joined with the IMF, the UN, and the World Bank to announce "the Platform for Collaboration on Tax," to coordinate their research efforts in response to states' concerns about tax evasion. The OECD's Base Erosion and Profit Shifting Package (BEPS) (https://www.oecd.org/tax/beps/beps-about.htm) is an effort to address the loss of tax revenue from the use of offshore financial centres, dating from 2013. It estimates that between $100-240 billion are lost annually. It suggests diplomatically that "gaps and mismatches" in tax rules lead to profit shifting to low or no tax havens. BEPS includes developing countries. BEPS has 4 main initiatives (background brief). The first is "model provisions" for treaties between countries that impede the use of "conduit" (shell) companies to channel investments to lower tax jurisdictions. It refers here to treaties between states in regard to tax provisions. The second is "country-by-country reporting" on MNE profits, tax and other activities to assist auditors. The third is "a revitalised peer review process to address harmful tax practices" including patent boxes and a commitment to transparency, referring to the sharing of information. Patent boxes refers to preferential tax treatment for income deriving from an innovation. Companies sometimes park a patent in a country even if innovation activity is not taking place there to take advantage of such provisions. The final one is "an agreement to secure progress on dispute resolution" through "the mutual agreement procedure (MAP). The OECD has a Committee on Fiscal Affairs (CFA) of experts from participating countries to coordinate activities. The OECD will develop toolkits to guide developing countries. There is particular concern about the digital economy.

The EU Savings Taxation Directive and Directive on Administrative Cooperation

The European Union (EU) has largely been at the forefront in the development of mechanisms for automatic information exchange (Christensen III and Tirard 2016). On July 1, 2005, the EU's Savings Taxation Directive (the Directive), formally Council Directive 2003/48/EC, came into force. Politically, the Directive's fruition was dependent upon the cooperation of non-member jurisdictions (Sharman 2008). The Directive's goal was to allow EU Member States to tax the foreign interest income of their residents (Hemmelgarn and Nicodème 2009), who were deemed "beneficial owners" as they were interest income recipients. Originally, the Directive utilized automatic information exchange but allowed Austria, Belgium, and Luxembourg to levy a 35% withholding tax for a transitional period. Under this arrangement, the three Member States did not share information but shared 75 percent of the revenue from the withholding tax with the Member State of the beneficial owner's residence, but this arrangement was transitional as there was to be full disclosure once secrecy laws were revised by January 1, 2015 (Christensen III and Tirard 2016). Various Member State dependent territories, including several Caribbean jurisdictions, and Lichtenstein, Switzerland, Andorra, Monaco, and San Marino, also maintained a withholding tax regime (Michaels et al. 2007).

The Directive's limitations included that beneficial owners to be taxed only included individuals (natural persons), the lack of clarity on its application to innovative financial products, and the definition of 'paying agent' only being the last intermediary paying interest for the immediate benefit of an individual, which led to a routing of interest payments through intermediaries so that final payment is made by an agent outside the EU (Michaels et al. 2007). In regards to the entities liable for taxation, Swiss tax authorities issued a memo stating legal entities that did not fall under the Directive's scope included companies in the Cayman and Virgin Islands, trusts and companies in the Bahamas, companies and foundations in Panama, and trusts, holdings, and foundations in Liechtenstein, among others (Zucman 2015, 71). However, Sharman (2008) notes that despite the predictions of capital flight, major financial centres among EU Member States and dependent territories enjoyed steady growth, and regulatory arbitrage and capital flight failed to emerge. Though there was some movement of funds to Singapore, Hong Kong, and other non-participating countries, the magnitude of outward capital flows was far lower than would be needed to explain the low tax revenue totals (Sharman 2008). Sharman concludes it is not so much the power of capital flight that frustrated the European Commission's ambitions, but rather the loopholes created during the negotiation process, especially those pushed by the UK and Luxembourg including the exemption of companies, trusts, many kinds of bonds, and innovative financial products.

The Directive's lukewarm effectiveness was echoed by the EU's own research. Deposits from non-bank depositors did shift to third countries outside the Directive's scope, but this was a trend before the Directive came into force, though its anticipation could have induced some investors to shift their deposits (Hemmelgarn and Nicodème 2009). Hemmelgarn and Nicodème further found that while there was a shift from interest to dividend income, the Directive did not lead to major changes in European households' savings income. The weakness was attributed to the Directive's loopholes, including its narrow geographical scope, its definition of beneficial owner that did not include entities such as companies, and its narrow definition of interest that did not capture more innovative financial products and life insurance products (Hemmelgarn and Nicodème 2009). More recent research found that the main effect of the Directive was encouraging more Europeans to transfer wealth to shell corporations, trusts, and foundations, with the most visible case being Switzerland (Zucman 2015, 72). In 2005, six months after the withholding tax's introduction, the accounts in Switzerland owned by shell companies increased by 10% over 2004 levels (Zucman 2015, 72). Despite Switzerland being a withholding tax state, the actual amount of tax paid was significantly low. If all interest and dividends earned in Switzerland by EU residents were subject to the full 35% tax, the tax would have generated €20 billion per year, but in 2012, Switzerland only paid €300 million to the EU – or sixty times less (Zucman 2015, 73).

Upon its review of the economic data, the European Commission (2012) concluded that updating the Directive in terms of product type, transactions, and institution type, is needed to address the possibilities for circumvention. The Commission proposed several amendments in 2008, which extended the scope of the Directive to include income from innovative financial products and certain life insurance products, and were subsequently adopted by the European Council under Directive 2014/48/EU on March 24, 2014 (European Commission 2015). While the original Directive did not cover interest from investment funds, pensions, innovative financial products, and payments through trusts or foundations, the amendments closed these loopholes so that information on these types of income are exchanged on an automatic basis within the EU (Rettman 2013, Blevins Franks 2014). Member States are obliged to apply the reforms from January 1, 2017 (European Commission 2015).

On March 21, 2014, the European Council concluded in its proposal to repeal the Directive that the OECD's Global Standard be the method for automatic information exchange applied within the EU's borders (European Commission, 2015). Stakeholders – namely financial institutions and intermediaries – reported the financial sector was introducing new or adapting existing IT systems in preparation for the US FATCA and emphasized the need for future EU legislation to be aligned with the OECD Global Standard in order to reduce compliance and administrative burdens (European Commission, 2015). When European finance ministers reached agreement on the Directive amendment, EU Tax Commissioner Algirdas Semeta stated the law "promises full and lasting tax transparency in Europe…Bank secrecy is dead" (Dendrinou, 2014). The new EU law aimed to ensure that Member States share as much information among themselves as they have committed to share with the US under FATCA (Dendrinou, 2014).

The most recent EU initiative is Council Directive 2011/16/EU, the Directive on Administrative Cooperation (DAC). DAC was amended by Council Directive 2014/107/EU, which extended the cooperation between tax authorities to automatic exchange of financial account information (Christensen III and Tirard, 2016) and entered into force on January 1, 2016. The amended DAC led to the repeal of the original Savings Tax Directive and its 2014 amendment, and in cases of overlap, DAC prevails given its broader scope (European Commission Taxation and Customs Union 2015). DAC implements the July 2014 OECD Global Standard on automatic information exchange within the EU, covering interest income, dividends and other types of capital income, and the annual balance of the accounts producing capital income (European Commission Taxation and Customs Union 2015). The new DAC also contains a 'most-favoured nation' clause, whereby if any Member State agrees with a non-EU state to wider cooperation than required by the DAC, that Member State cannot refuse to enter into similar cooperative agreements with any requesting Member States (Christensen III and Tirard 2016). For so-called "Third Countries" such as Switzerland and Lichtenstein, amendments to savings taxation agreements to convert them into CRS-based reporting should apply from January 1, 2017, while for dependent territories including the Cayman Islands and British Virgin Islands, all territories committed to apply CRS-based reporting and it is thus expected that their bilateral agreements will be soon replaced with CRS-based agreements (Deloitte 2016). Overall, the EU is on a trajectory to apply global standards of information-sharing within its own borders and with its traditional tax havens.

Obstacles to Resolution

Continuing Lack of Transparency

What constitutes transparency in financial markets? In introducing their financial secrecy index, Cobham et al. (2015) suggest 3 main factors, whether: 1) relevant information is on public record and accessible; 2) access to certain private financial data is available to relevant public authorities, such as tax administrations and police; and 3) information is shared effectively with foreign counterparts. To a large extent, the modern system relies upon bank reporting of suspicious activity (suspicious activity reports, or SARS, in the US) under the guise of "customer due diligence" or "know your customer" guidelines. There are reasons to be doubtful about the effectiveness of SARS based on the lack of correlation with prosecutions. Non-currency transactions are even harder to track; banks only rarely are required to report on wire transfers (Cuéllar 2003, 425 & 432). Even if frequent wire transfers take place, criminals use "smurfing," breaking cash up into smaller pieces and using proxies so that the connections among them are very hard to establish.

In terms of transfer pricing, Article 9 of The OECD's Model Tax Convention suggests that MNCs should use the "arm's length principle," whereby transactions between associated units should be seen as though one were selling to a separate entity. Thus, each transaction should be comparable to what would occur with a third party. However, multiple research papers show that such principles are ignored in practice, though it is difficult to separate out transfers in estimations (Hunter et al. 2015, 76).

OECD and other efforts have fallen short in terms of information exchange, leading some to question basic principles about taxation. For example, some scholars are now arguing for a "limitation on benefits" principle to avoid double non-taxation. That is, where the preferred jurisdiction, such as an offshore haven that is the home of a company does not tax, the secondary jurisdiction, such as the US where a company operates, should (Avi-Yonah 2015, 310). The OECD places emphasis on transfer pricing guidelines in regard to intangibles, a generic category used by companies in financial reporting. Intangibles can be anything from intellectual property to trademarks to software use. There is no question that intangibles are growing in importance in economic activity, however, there is limited knowledge about how to harness or develop such aspects productively (Andrews and de Serres 2012). The OECD uses the term "value creation" as a way to locate where taxation should take place, i.e. where substantive economic activities are located vs. where they are reported. There is also concern with base erosion through interest expense deductions, which can be abused through intra-group or third parties loans that are used specifically for the purpose of reducing revenue reporting. The OECD seeks to avoid "hybrid mismatch arrangements" through greater tax coordination. Examples given are: "costly multiple deductions for a single expense, deductions in one country without corresponding taxation in another, and the generation of multiple foreign tax credits for one amount of foreign tax paid" (OECD 2015, 13).

The US and the EU have reached several impasses in regard to information exchange. In general, a lack of harmonization and fragmentation of institutional reporting across jurisdictions inhibit information flow (Takáts 2007, 235-6). Moreover, many banks see third party software and training as sufficient to check for money laundering (Liss and Sharman 2015). Levi (2007, 275) concludes that the software currently being used depends upon "the automated checking of multiple lists (where name spellings themselves generate many false positives and opportunities for evasion through slight spelling changes), and "there are no clear models available to predict which funds are likely to be used for criminal or terrorist purposes and which are not."

Example- Ineffective Action on Terrorist Financing

For example, the US has initiated the Terrorist Finance Tracking Program (TFTP) whereby it shares with Europe SWIFT (Society for World Inter-bank Financial

Telecommunications) data related to interbank transfers. However, the European Parliament has raised objections to the TFTP including not agreeing with the list of terrorist groups and privacy concerns (Kingah and Zwartjes 2015). The dispute over TFTP appears to have been worked out, partly through maintaining data in Europe and allowing Europol to refuse requests for data by the US Treasury. However, terrorists have effectively responded to efforts through several adjustments. They may not launder money at all, using legitimate businesses to send money to individuals, or using the *hawala* informal networks common in the Islamic world and involving person to person lending. Some estimate *hawala* flows to be at least $200 billion annually. While cash may be given in one country after a signal from a (informal) *hawaladar* network agent, payment may be received in a variety of ways, from payment through other transactions to the receipt of goods or favours (Razavy and Haggerty 2009). Because *hawala* is a response, in part, to Islamic proscriptions against usury, and in part based upon informal networks of trust, it is highly unlikely that any formal regulatory process will be able to monitor it (Razavy 2005). Beyond this, terror groups and the financiers (reportedly some with indirect ties to the Saudi royal family) have used religious non-profit organisations as conduits for financial flows and investments, sometime using shell corporations and couriers to cover their tracks (Raphaeli 2010). The general granting of tax free status to religious organisations in the West helps to obscure their activities.

If non-profit organisations are used, the chances of detection are slim as this sector is poorly regulated. Furthermore, the shift to low cost tactics such as lone wolf attacks in Nice and San Bernadino in 2015-16 mean that financing can be done by the individuals themselves. Furthermore, terror groups have diversified their funding sources so that if one stream is detected several others take its place (Shillito 2015). Last but not least, the shift from the use of wire transfers to mobile money or bitcoin transfers creates even more challenges for tracking (Vicek 2012). We should point out that the costs for terrorist activities are quite small. The estimates for the costs of the 9/11 attacks are put at $500,000 and for the bombings in Bali, London, and Madrid at 1/10th of that (Sharman 2011, 31).

For the most egregious cases, there appears to be some effort to crack down on the purchases of assets by corrupt strongmen from the developing world. For example, in 2016, under the new Kleptocracy Initiative and requirements to reveal cash buyers of high end real estate in 2016, the US Dept. of Justice prosecuted several cases of corruption of public funds used to purchase assets in the US, including cases against the ruler of Equatorial Guinea, the sovereign wealth manager of Malaysia, with direct ties to the Prime Minister, and the daughter of the President of Uzbekistan. Reports noted that most of the transactions tool place through shell corporations.[1]

However, given that the vast majority of financial transactions in the developing world are outside the banking system, and that the banks there lack management and information

[1] See for example http://www.nytimes.com/2016/02/17/business/wanted-by-the-us-the-stolen-millions-of-despots-and-crooked-elites.html and http://www.nytimes.com/news-event/shell-company-towers-of-secrecy-real-estate

capacity, it seems like a tall order to create adequate information flows for many transactions. Indeed, Eckert and Biersteker (2010, 253, 257, and 263) note that despite the US Government's self-assessed grade of A- on efforts to combat terrorist financing, they cite 2 US government officials that most metrics to monitor the assets of terrorists are seriously flawed, and that it is "impossible" to stop financial flows to terrorists. The best that can be hoped for is to "constrict" the environment. They conclude, "Terrorist financing remains a little understood and inadequately researched topic (263)."

Lack of Enforcement Tools

Even if information exchange is established, it will be insufficient to prevent evasion and money laundering. The FATF process of mutual evaluations focuses on legislation and the existence of a financial intelligence unit (FIU) but largely ignores the effectiveness of ongoing monitoring, implementation, and enforcement activities (Biersteker et al. 2007, 241). Tsingou (2010, 623-4) concludes that efforts to combat terrorist financing and money laundering have been ineffective. Membership in FATF has been too limited; for example the UAE is not included. Moreover, removal from the non-compliant "blacklist" has been perfunctory following legislative changes to the banking system. Even within nations, such as the US, there is a lack of clarity over regulatory oversight roles. She therefore concludes (629) about the anti-money laundering/counter financing of terrorism regimes that both do "not rely on provable effectiveness but rather, (are) is mostly symbolic; the more honest aim of the regime is to serve wide ranging policy goals without actually threatening the core of the financial system."

The OECD highlights the particularly vexing issues of how to establish the presence of a "permanent entity," meaning even if a company has a nominal headquarters elsewhere, it has an effective (and taxable) presence in a particular area. The second issue is how to evaluate transfer pricing so that it is reasonable. A third is to try to avoid both zero and double taxation, requiring considerably improved coordination of both codes and reporting (OECD 2015, 13). After an extensive review, Sharman (2011, 43 & 50) concludes that the FATF, while improving information recording and accountability, has made no discernible impact on money laundering. At the same time, it has vastly increased the costs for compliance. Even when anti-money laundering cases are found, as was the case with Lloyds, Credit Suisse, and Barclays in 2009, there is little in terms of consequences beyond "transitory embarrassment."

The think tank/NGO tax justice network (TJN) (http://www.taxjustice.net/2015/10/05/press-release-oecds-beps-proposals-will-not-be-the-end-of-tax-avoidance-by-multinationals/) criticised the OECD for not going far enough in its proposals. While lauding the OECD's requirement that companies provide "country by country" reporting of profit, activity, employment and sales in each country where they operate, they note such reports will only be filed with home country tax authorities, not made public (or available to other countries). Under its FAQ section, the OECD's BEPS project notes that efforts are "soft" legal instruments, meaning that they are not binding. The main tangible outcomes seem to be increasing pressure on disclosure of account holders, which has already put pressure on the

Swiss banking system. However, whether such efforts will be effective in the multitude of other offshore havens is dubitable.

In sum, as with most other global issues, transparency and enforcement are lacking. In regard to TIEAs (Tax Information Exchange Agreements), the state requesting information must provide "significant accurate information" regarding " a specific person, transaction, account, trust or company," along with evidence about "why it believes the requested jurisdiction holds the information in question and demonstrate that it has exhausted all other means of information (within reason). Trusts are considered private agreements and are not subject to public disclosure rules. Even where company registries exist in offshore havens, they tend to have scant information. In fact, the FATF has been largely ignored in practice. There is very little to no reporting of important financial transactions used by money launderers through non-financial agents, such as casinos; real estate agents; precious metals/stones or high value goods (such as art or antiques) dealers; lawyers, accountants, and consultants; and trust companies (Choo 2014). Common practices include exchanging cash for chips and then getting clean money at casinos; hiring third parties who are clean to send money transfers; purchasing insurance and then recouping money through false claims with kickbacks to the insurance companies; falsifying invoices to hide higher revenues; purchasing gems or precious metals, such as gold; and using pre-paid credit or gift or phone cards (Unger 2007, 133, 139, 144, &147). Problems extend to sea transport, where flags of convenience allow vessels to avoid fishing licenses or abide by environmental or labour standards. Similarly, many airline companies use leased planes from companies registered in offshore havens (Shilliot 2015; Schjeldrup 2016). Ultimately, illicit cash flows are intricately intertwined with legal ones, making detection exceedingly difficult.

Lack of US Reciprocity

In line with FATCA, the IRS (Internal Revenue Service) of the US offered citizens offshore voluntary disclosure programmes from 2009 whereby criminal penalties would be waived if overseas accounts designed for tax evasion were disclosed within a grace period, subject to payment of modest penalties. The IRS also used information from the efforts to track down other citizens who had not reported. The programme was considered a major success bringing in an estimated $5.5 b. from 2009-12. However a 2013 GAO (Government Accountability Office) report concluded that billions more were offshore and that data existed to find them. Moreover, the IRS was inadequately publicizing its programmes to US citizens living abroad.

Despite serious efforts to receive information by the US under FATCA to obtain more information about Americans holding money overseas, it does not provide nearly the same level of information to other countries about their citizens' holdings in the US. While it promised reciprocity in principle, it has not provided any timetable for achieving it. The US has not complied with CRS reporting requirements (Knobel 2015). In fact, there are a number of ways that non-US citizens can avoid reporting requirements for deposits held in the US. This raises the spectre that US citizens will find non-citizens to act as their trustees for them while keeping their holdings in the US without reporting them! (Cotorceanu 2015). Moreover, CRS does not impose penalties; these are left up to individual jurisdictions to decide. More problematic still is the lack of a global registration process for determining whether a financial institution is consistently compliant. There are naturally serious concerns within the banking community about these new reporting requirements (Rahimi-Laridjani and Hauser 2016, 13-14). By one estimate, the US is the destination for 18.9% of all global money laundering or $538.1 billion, more than 4 times the amount going to the next destination, Cayman Islands (Schneider 2013, 691).

US efforts to promote global tax reform appear duplicitous in light of the emerging facts. In the aforementioned Findley study sending out e-mail incorporation requests to legal firms around the world, the differences in level of compliance with international standards between international providers and US providers was remarkable. Only 16.4% of those in the international pool did not require any photo identification to open a shell corporation, while a staggering 41.5% in the US pool were similarly negligent. In fact, only 9 of the 1,772 US providers contacted required full, certified identification disclosure (Findley et. al 2014, 170). A World Bank report notes the following numbers of international business corporations: 500,000 (40%) in the British Virgin Islands, with around 70,000 new companies formed each year; Panama with 320,000, and Belize, the Seychelles, the Bahamas, and the Caymans with approximately 50,000-70,000 companies each. In the UK, around 362,000 companies were formed in 2009-10. By contrast, there are a total of 18 million corporations in the US, and approximately 2 million new ones per year (Van der Does de Willebois et. al 2011, 136-7). A 2016 USA Today investigation of the Panama Papers revealed that more than 1,000 shell companies were set up in US states including Nevada, Wyoming, Delaware, and Florida. Only 100 of these had officers based in the US. More than 600 of the remaining had addresses in Panama or the Seychelles. Nevada and Wyoming-based corporations have been tied to scandals in Argentina, the Operation Car Wash involving the Brazilian state oil company, Petrobras, and a corruption scandal at FIFA, the global soccer federation.[2] In fact, states are free to write their own trust laws, allowing for individuals to shield their assets. This has led to states such as Nevada to become havens for secret trusts, followed more recently by others, such as New Hampshire, in a race to the bottom.[3] In the U.S., states such as Delaware act as nominal headquarters for companies, allowing them to avoid paying state taxes where activity takes place. An estimated $9.5 billion in taxes from 2002-12 was saved that way. Before WorldCom collapsed in 2002, it shifted $19.4 billion in intellectual property to a holding company in Delaware to reduce taxes. Corrupt figures from Viktor Bout, the Russian arms dealer known as the "merchant of death" to Jack Abramoff use the remarkably easy procedures to set up sham "shell" corporations.[4] As a result, Delaware is the state of incorporation for many of the largest

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[2] http://www.usatoday.com/story/news/2016/04/07/1000-secret-nevada-firms-and-most-trace-2-overseas-addresses/82760186/

[3] Patricia Cohen, States Vie to Shield the Wealth of the 1 Percent, Aug. 8, 2016, *The New York Times* http://www.nytimes.com/2016/08/09/business/states-vie-to-protect-the-wealth-of-the-1-percent.html [accessed Oct. 6, 2016]

[4] Leslie Wayne, How Delaware Thrives as a Corporate Tax Haven, *The Washington Post*, June 30, 2012, http://www.nytimes.com/2012/07/01/business/how-delaware-thrives-as-a-corporate-tax-haven.html [accessed Oct. 6, 2016] and Lynnley Browning, Critics Call Delaware a Tax Haven, *The New York Times*, May 30, 2009, http://www.nytimes.com/2009/05/30/business/30delaware.html, [accessed Oct. 6, 2016]

US corporations, including Wal-Mart, Exxon Mobil, Chevron, Berkshire Hathaway, Apple, Phillips 66, GM, GE, and Ford. It is the legal home, in fact, of 54% of all public companies. Fees from companies constitute 26% of the state budget or $1 billion in 2015.[5] Nevada had 307, 210 corporate entities listed in the state as of Aug. 2016, 22,060 of which had addresses from outside the U.S. In 2015-16, the state collected nearly $144 million from corporate registrations, filings, and associated charges. Its history as a tax shelter dates back to 1991, when lawmakers decided to compete with Delaware as a centre for incorporation. In 1996, they passed a law that any tax increase would require a 2/3 vote in both the Senate and Assembly. In 2001, they went further by limiting corporate liability. You can register a corporation or partnership on-line in 10 minutes in Nevada *without providing any identification*.[6] A World Bank study suggests that US jurisdictions are among the worst in terms of the amount of information required for company/trust registration (Van der Does de Willebois et. al 2011, 92).

Companies use their Delaware/Nevada incorporations to avoid paying taxes in part through transfer pricing. In the WorldCom case, royalty payments were made by entities in other states to the Delaware incorporation. These payments are not subject to tax, and reduce the earnings and thereby tax payments elsewhere. Another dodge involves using a Real Estate Investment Trust (REIT), which, once incorporated into Delaware, can receive rent payments from subsidiaries. These are tax free since Delaware does not have corporate taxes on investment income. Estimates by the *Wall Street Journal* are that Walmart avoided paying $230 million in state taxes this way from 1998-2001. Similar schemes are used around intellectual property payments. However, there are new arguments by other states that “economic nexus” or where economic activity takes place requires some payment of local taxes (Dyreng, et. al 2013).

Based on reporting the CBC and Toronto Star, Canada is increasingly being used a tax haven as well, which they call “snow washing.” Canada does not require companies at either the federal or provincial level to list the name of real owners or operators. Limited partnerships do not have to pay taxes in Canada if owners don’t live here. The Panama Papers revealed that Mossack Fonseca used Canada regularly to launder money from South America, wiring transactions through Canadian shell companies, and reporting to the Canada Revenue Agency (CRA) that “no activity to report” meant that no tax was due. Equally invidious is the use of TIEA agreement countries to hide Canadian money. Reports reveal that Canadian corporations and individuals have parked at $80 b. in Barbados. More than 1,000 Canadian companies including stalwarts such as PetroCanada and Loblaws have subsidiaries there. The *Toronto Star*, in addition, reported on several individuals who had hired out their names as corporate directors to hundreds of Canadian companies, when they had nothing to do with them (Dubinsky 2016a/b; Oved and Cribb 2017; and Seglins, et al 2017). A Sept. 2016 (FATF and AMG) assessment of Canada, while generally positive, states that there is “a high risk of misuse” of nominee ownership because of a lack of meaningful beneficial ownership requirements (7-8). Moreover,

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[5] Liz Hoffman, Dole and Other Companies Sour on Delaware as Corporate Tax Haven, *The Wall Street Journal*, Aug. 2, 2015, http://www.wsj.com/articles/dole-and-other-companies-sour-on-delaware-as-corporate-haven-1438569507 [accessed Oct. 6, 2016]

[6] McClatchy Washington Bureau, Nevada shelters offshore shell companies, *Times Record*, Aug. 14, 2016, found at: http://www.swtimes.com/news/20160814/nevada-shelters-offshore-shell-companies [accessed Oct. 6, 2016]

a 2016 report by Transparency International Canada (TIC) sardonically notes that it is "harder to get a library card" than to register a company in regard to identification requirements. It also points to the fact that Canada still allows bearer shares, which are physical documents similar to bonds that companies pay out to whomever holds them. Meanwhile, there are millions of trusts in Canada, but only 210,000 report to the CRA because they are treated as private contracts, subject to attorney-client privilege. While banks are supposed to identify beneficial ownership for new accounts (after 2014), no such obligation exists for real estate brokers, precious metals/gems dealers, or accountants. TIC's investigation of the luxury real estate market in Vancouver revealed that shell companies were the owners of 30% of titles from 2006-16.

In Aug. 2016, the European Commission ordered Apple to pay Ireland and other members of the EU $14.5 billion in back taxes. The ruling suggested that Apple had created a shell that received finances but without much real activity in Ireland, thus diverting revenues from across Europe because of special deals created by the Irish government. The commission viewed such deals as one off special treatment that created unfairness to European competitors. It followed similar cases against Starbucks in the Netherlands and Anheuser-Busch InBev in Belgium. Luxembourg is also home to many holding companies for multinationals seeking to avoid tax, including PepsiCo, FedEx, Ikea, and Amazon. Even the Canadian federal pension board set up Luxembourg companies to reduce taxes on German properties. The US reaction has been strongly negative, suggesting that such "clawbacks" harm its own ability to collect taxes on multinationals.[7]

Conclusion: Policy options

From a political perspective, the attrition of fiscal capacity has not yet reached crisis proportions that would begin to arrest its marked deterioration from its post-war Keynesian heyday. Even the reforms in the wake of the 2008 recession, such as Dodd-Frank, became heavily watered down by financial lobbies. However, the Brexit and Trump successes, along with the general rise of reactionary globalisation suggest that such a day in fact may come. As Strange pointed out in 1998 (139), both greed and fear abound in financial trading. Too much of these elements can undermine the very foundations of confidence in financial systems. Financial systems are thus a classic collective action problem, with risk taking by individual traders and banks having the potential to tear asunder the very systems by which they make their livelihoods. The fact remains that US leadership is essential for progress on tax evasion and reducing global financial risk. It is still the closest thing we have to a lender and currency provider of last resort (Strange 1986, 176), and thus wields leadership power in terms of regulatory norms.

It is therefore unlikely for now that the OECD or any of the other efforts will establish what would be needed to wipe out tax avoidance, namely a global tax administration (not necessarily in the form of a central entity). The answer is not simply to lower taxes across the

[7] http://www.nytimes.com/2016/08/31/technology/apple-tax-eu-ireland.html and https://www.icij.org/project/luxembourg-leaks/leaked-documents-expose-global-companies-secret-tax-deals-luxembourg

board to minimal levels, as many conservative pundits suggest. It takes easy reflection to realize that growth and high taxation are compatible, and tax evasion can be minimized, if one only looks at the Scandinavian economies. In a 2014 study, Kleven suggests that are three key policy lessons from these cases. First, Scandinavian countries have a broad tax base (particularly VAT) with very few deductions or loopholes. Second, information reporting is quite thorough. Third, and perhaps most importantly, there is a broad consensus around progressive taxation as redistribution is not just about safety nets but also about tangible support to businesses, such as retraining programmes. Some form of fiscal tax harmonization may be feasible, albeit still remote under current conditions. Such efforts would be highly complex, requiring considerations of flexibility for local conditions and perhaps equity among regions with different sizes and types of fiscal base (ability to tax and sources of revenue) (Gaigné and Riou 2007).

TJN offers two suggestions to move forward in regard to transparency (http://www.taxjustice.net/topics/corporate-tax/taxing-corporations/). The first is transparent country-by-country reporting of corporate activities, as discussed above. The second is unitary taxation, where a company's taxes would be allocated to the different jurisdictions where it does business on the basis of variables such as "sales, payroll, and physical assets." TNCs would be treated as a whole, rather than as separate subsidiaries, ignoring transfer pricing.

The United Nations' Practical Manual on Transfer Pricing furthermore offers a number of suggestions for monitoring for transfer pricing. Under the Comparable Uncontrolled Price Method, transfer prices would be compared to comparable transactions (196). Under the safe harbour rules, if a company reports profits below a certain threshold, a country may choose alternative methods for establishing tax burdens (73). This and the arm's length rules bring up, of course, the question of what is really "comparable." A study of French company transfer payments for 1999 concluded that French tax authorities had lost at least 390 billion euros due to under-reporting. However, 450 of the 2.495 firms sampled accounted for 90% of the exports to 10 tax havens, including Switzerland, Ireland, and Singapore. Just 25 firms accounted for 50% of all intra-firm exports to the tax havens (Davies et al. 2015, 21). Therefore, concentration on the leading firms makes reform seem much more feasible. A study by Marques and Pinho (2016) of the behaviour of 27,278 foreign subsidiaries in Europe found that increasing the strictness of transfer pricing rules (using the aforementioned arm's length principle) in fact appears to reduce profit-sharing between host companies and subsidiaries. Loshe and Riedel (2013, 3) find similarly that increasing strictness in European transfer pricing rules may reduce profit-shifting behaviour by as much as 40%.

We can summarise by creating a priority list for beginning to regulate offshore financial tax evasion. The first would be steps towards increased transparency and accountability. Beyond the steps noted above, the foundations of the financial system's auditing and accountability systems, including corporate statements, need serious attention. Transparency extends to the local level, such as New York, LA and Vancouver, where new regulations require disclosures of the citizenship of purchasers of real estate in certain instances, for example. Transparency, as demonstrated by the US FATCA efforts, can be enforced in offshore havens if there is consensus among the largest Western economies. Of second urgency, then, is the desperate need to convince Washington to adopt the same levels of transparency for its onshore havens. This could go hand-in-hand with wider discussions around a third priority, which is to change tax principles to place of activity rather than state domicile. Such as step, while intuitive and foundational, would require extensive policy investigation, for metrics of how to measure and assign tax responsibility for certain types and levels of activities. Last but not least, all of these measures should be tied into movement towards global tax harmonisation, so that the developing world can be brought on board with the same principles. The benefits to the latter are unfathomable and could lead to a greater fiscal policy revolution and improvement of state capacity than has been considered so far.

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