

Troubling tax havens: Tax footprint reduction and jurisdictional arbitrage

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Hay, Iain & Beaverstock, Jonathan, 2015, *International Handbook of wealth and the Super-Rich*, London: Edward Elgar

1. Abstract

Crédit Swiss estimates that global aggregate wealth has reached US\$ 240 trillion in 2013 and is about to rise by 40% in the next five years. It is estimated that between 10 to 12% of global aggregate wealth is located in jurisdictions colloquially known as tax havens. The figure represents the ‘top end’ of global wealth: mobile capital controlled by large international firms and wealthy individuals. This chapter discusses the emergence of a global industry – with an estimated turnover of US\$ 50 billion dollars - whose main purpose and product is the reduction of individual and corporate tax footprint.

2. Introduction

It is well known among tax experts that tax-planning schemes are typically organised through a multitude of jurisdictions. Companies, large and small, are normally seen as unitary entities. They are referred to by their trademark names – Google, Amazon, IBM, British Telecom, BMW or Toyota, and so on – and are commonly thought of as American, British, German or Japanese, as the case may be. In reality, the vast majority of such companies consist of a multitude of companies, veritable ecologies in some cases, typically numbering in the hundreds or even thousands. They are registered in various jurisdictions, among which notable tax havens, such as Cayman Islands, British Virgin Islands, Jersey, Ireland, the Netherland or Luxembourg, feature heavily.

Within these ecologies, each corporate structure provides its own contribution, as it were, to the tax planning scheme of the parent company, insofar as it brings with it a unique bundle of corporate tax laws and regulations that are particular to the jurisdiction of its location. Considered in isolation, entities of this sort may appear innocuous. It is only when intertwined with other entities of different jurisdictions that such schemes reveal their true purpose, i.e. the exploitation of jurisdictional arbitrage for the purposes of minimising individual and corporate tax footprint. The

exploitation of jurisdictional arbitrage under such schemes may be blatant, but is hardly conspicuous. The industrial complex built around the business of selling tax minimisation strategies is contingent as well as dependent upon a thick welter of intertwined jurisdictions where arbitrage schemes can grow and proliferate out of sight.

To investigate the nature and mechanisms of tax arbitrage, this chapter explores the linkages between wealth and multi-jurisdictionality: How and why the corporate world operates as a set of global business ecologies on top of an undergrowth of jurisdictional networks. We start with a brief discussion of the concept of wealth. Our analysis will proceed from the premise that the lion's share of global wealth is in fact 'intangible'. Distinguishing between tangible and intangible wealth is crucial to operating another important analytical distinction at the level of tax reduction and wealth: that between tax minimisation schemes aimed at *accumulated* wealth, or 'wealth-already-accumulated', and those aimed at *accumulating* wealth, or 'wealth-to-be-accumulated'. The opaque relationship between tax minimisation schemes and wealth accumulation is at the heart of what makes tax havens just so troublesome.

3. Troublesome Wealth and Tax Havens

Troublesome wealth is, perhaps ironically, 'protected' wealth. As the principal strategy of wealth protection, the otherwise mundane activity of tax planning has become the kingpin of the most extraordinarily opaque system of wealth transfer in the world. The bulk of this system of wealth protection is aimed at escaping the clutches of public fiscal authorities. In a world with no common tax rules, the business of protecting, or otherwise concealing, wealth plays out mostly via clever strategies of capital transfers: complex international transactions can elude tax supervision through a complex maze of legal trap doors and escape hatches, to the point where the difference between avoidance and evasion – guile and crime – becomes all but immaterial.

In pursuance of either elusive or avoidant tax planning, the bulk of this enormous traffic of wealth takes place in and out of special tax zones, viz. tax havens. Also referred to as 'offshore financial centres' by their professionals or 'secrecy jurisdictions' by their detractors, tax havens are sovereign states or suzerain jurisdictions that offer international capital a system of eased tax regimes in direct competition with the regulatory provisions of other states. They can be defined broadly as 'any jurisdiction that satisfies two criteria. First, it has tax laws that are attractive to global investors and entrepreneurs. Second, it protects its fiscal sovereignty by choosing, in at least some cases, not to enforce the bad tax laws of other nations'. With the progressive expansion of state expenditure as

well as state coffers across most advanced industrialised countries over the past century, the minimisation of both individual and corporate tax footprint has become an expanding and lucrative business. Albeit an important strategy of financial growth and global competition, this industrial complex is less subservient to the economic interests of tax havens themselves than to those of the larger community of resident and non-resident accountants, lawyers, bankers, financiers and businesses who purchase the protection of offshore jurisdictions – essentially legal sovereignty – for the purposes of tax arbitrage.

There are many ways the Super-Rich can avail themselves of tax havens. Perhaps the easiest one, for both individual and businesses, is to establish an offshore trust or foundation. Exempt from registration in most jurisdictions, trusts separate the beneficiary of an asset from a trustee, often an offshore legal owner, who is assigned fiduciary duty to manage the asset for the benefit of the former. Alternatively, businesses, and increasingly also international financial institutions, can also establish a subsidiary, affiliate or independent company directly in a tax haven. Often set up as limited liability companies, or International Business Corporations (IBC), these subsidiaries are employed to store profitable capital, trade in financial markets, hold property rights and manage investment funds in complete anonymity with respect to the parent company, whose transactions with subsidiaries are concealed under the company's 'consolidated' accounts. Aside from transferring capital to one of the abovementioned offshore instruments, individuals have also the option of relocating their domicile or non-domiciled residency to a tax haven, or more drastically, renouncing both domicile and residency to live as PTs, permanent tourists exempt from tax and other legal obligations. The basic principle of both individual and business tax planning is to spread one's assets across a multitude of jurisdictions so that most profit and capital transfers disappear from the tax radar.

The beneficiaries of these offshore tax-planning schemes are the global elite. The Super-Rich, in particular, hold the rough equivalent of the U.S. annual GDP parked in offshore jurisdictions in direct competition with public fiscal authorities. The withdrawal of the product and the process of wealth accumulation from both fiscal and legal supervision spells trouble all around. Not only do tax minimisation schemes clear the way for money-laundering and other illegal activities, but they also skew the global distribution of income to the detriment of those individuals and businesses who lack the financial wherewithal, or moral proclivity, to engage in offshore tax minimisation schemes. As will be explained below, what makes such schemes particularly troublesome for the distribution of global wealth is that the intangible nature of most assets makes multi-jurisdictional tax arbitrage an instrument of wealth creation as much as of wealth concealment.

4. Intangible Wealth and Wealth Protection

The concept of aggregate global household wealth, despite a long intellectual heritage, has generated surprisingly little interest among economists. The focus of most writing in political economy falls on GDP trends, often treated as growth projections, as well as debt, trade data or even income distribution. Wealth accumulation, one of the primary objectives of most civilisations, seems to play a curiously small role in mainstream understandings of political economy.

This attitude is changing. Since 2009, the Swiss bank Crédit Suisse began issuing trend reports on the direction of global aggregate wealth. Its latest report, *Global Wealth 2013*, suggests that aggregated household wealth in 2013 stood at \$US 242 trillion, approximately three times the world's annual GDP. Crédit Suisse additionally goes on to estimate a 40% rise in global wealth over the course of the next five years. That figure is extraordinarily out of kilter with the current estimates of growth in the world economy, which most economists predict will rise very modestly over the same period. What accounts for such a widening gap between global wealth and global growth?

Behind this apparent contraction is a fundamental accounting magic. Economists tend to identify household wealth with 'tangibles', such as stock holding and real estate, in contrast to what they consider 'intangibles', such as human capital. Data on household wealth is typically referred to as 'net household wealth' and, accordingly, wealthy individuals are known as 'High Net Worth Individuals' (HNWI). The prefix 'net' refers, in this case, to the assumption that individuals 'own' two types of properties: 'tangible' properties, e.g. shares, real-estate, yachts and art, and 'intangible' properties, also known as 'goodwill'. Wealth data generally only accounts for net assets, i.e. accumulated wealth, as opposed to intangible assets.

The notion of goodwill and intangible assets is best understood in connection with the concept of 'futura'. The term, in John R. Commons' original reformulation of Böhm-Bawerk's and MacLeod's definitions of futurity value, refers to a 19th-Century legal innovation that marked a watershed in the development of capitalist institutions in the West. The idea of futurity, with its particular understanding of valuation, is the keystone concept that holds together the notions of wealth-already-accumulated and wealth-to-be-accumulated.

Historically, businesses were valued on the basis of two modes of valuations. One was based on replacement value, equal to the current market prices of a firm's assets, and the other was based on

liquidation value, which amounts to the value of a firms' assets upon cessation of business. In both cases, valuation is backward looking, in the sense that it reflects past business records and temporarily assumes the present company to have ceased operations. These valuations represent the power of creditors, who are seeking solid securities for their investment.

Yet, businesses are not set up to fail; they are set up to capture future income streams. A different mode of valuation was therefore developed in the late 19th century, primarily in the U.S., to better capture this reality. This mode was modelled after the principle of goodwill. In this view, firms are considered organic and future-oriented entities that only stand for what businesses are ultimately after: claims on future income streams. Accordingly, firms are treated as 'going concerns', i.e. institutional complexes embedded in time and invested in the future. The pervasiveness of increasingly highly valued goodwill, notably in the case of big corporations such as the Coca Cola Company, is testament to the fact that futurity, as a forward-looking mode of valuation, is truer to the everyday logic of business enterprises and particularly suited to explain the relationship between intangible wealth-already-accumulated (e.g. goodwill) and tangible wealth-to-be-accumulated (e.g. future income).

This distinction is of particular importance when investigating the dynamic between wealth accumulation and tax planning. In the business of wealth protection, intangible assets often call for special treatment. While some wealth schemes are primarily intended to protect wealth that has already been accumulated, generally referred to as 'net household wealth', others are intended to protect future or potential income-generating titles. The academic literature on the subject seems long on the former and short on the latter. Protection schemes for future or potential income are usually only mentioned in the context of what are described in the trade as 'sophisticated' schemes, where the objectives of both types of wealth protection are mixed together.

The intangible dimension of wealth looms even larger. That is because conventional classifications of tangible and intangible assets are conceptually misleading. A number of tangible assets commonly conceived as part of wealth-already-accumulated, such as stock, shares and even bonds, contain in fact an inherent degree of futurity value. As Palan () notes in a different context, even the seemingly tangible assets of real estate are regularly valued as claims on future income streams. In other words, the current value of those assets factors in future profits. As their value is based largely on projections of future profits, those seemingly tangible assets would deserve inclusion in corporate accounts as part of their goodwill.

Contrary to common impression, therefore, it is reasonable to conclude that most 'wealth' is made up of non-tangible assets that represent claims on future income streams. However, by their intangible nature, claims on future income streams are nomadic, and their place of registration – and taxation – is easy to manipulate.

4.1. Goodwill and Tax Havens

Let us briefly consider goodwill management with reference to individual wealth. There is little doubt that a renowned footballer of the likes of David Beckham, for instance, will have accumulated a great stock of wealth in his lifetime on the back of his many professional achievements. What is often neglected, however, is that his profile and visibility will have also earned him a commensurate amount of goodwill among the public. Though intangible, goodwill is a considerable addition to the footballer's personal wealth because, qua promise of future profit, it constitutes an asset for sale. Commercial establishments will seek to obtain this asset – his 'endorsement', in this context – in order to associate his goodwill to their products, thereby attracting potential customers and increasing sales. Companies are therefore prepared to purchase Beckham's goodwill at a price. They purchase the right to use his image, or words attributed to him (both under strict conditions), to endorse their products. David Beckham, to pursue the example further, can therefore be said to be in the business of selling his goodwill, which he can also do to more than one company at a time. There are a few restrictions; for example, he may only be allowed to support, say, one brand of fizzy drink at any one time. That is because a goodwill persona is for all intents and purposes a business proposition and, as such, goes by a different set of rules to the person itself. In our example, 'goodwill Beckham' is not allowed to indulge in both Coca Cola and Pepsi Cola at the same time, whereas 'real Beckham' may well enjoy both (or neither).

This intangible side to personal wealth lays itself wide open to tax minimisation schemes. Spotting an opportunity in the management of celebrity goodwill, for instance, the island of Guernsey has recently introduced a new law, the Image Rights (Bailiwick of Guernsey) Ordinance 2012, that enables the registration of personalities and images associated to them. The advantage of a Guernsey registration is twofold. First, as a UK jurisdiction, Guernsey can project its laws overseas and hence ensure (to an as yet untested degree) the maintenance of such rights throughout the world. Second, Guernsey corporate taxation is 20% as opposed to the 50% that top earners, such as David Beckham, would pay in the UK. Hence, by the simple provision of registering image rights in Guernsey, a well-known celebrity can already reduce tax liabilities to 20%. As we will see later, that 20% can be chipped further away.

Celebrities like David Beckham are not alone in selling their goodwill; in principle, we all do. When an academic lecturer, such as the authors of this chapter, signs a contract with a University, the University is purchasing something about the future accomplishment and services of said academics, typically based on projections of past performances. In that sense, not only do we all 'own' something that may generate future income, but the potential for future income may also be valuable in itself. Insofar as both sides to the contract make promises to the future, these contracts are essentially futures.

What mainstream accounts of 'net household wealth' or HNWI leave out of their calculations, however, are two variables: (a) estimates of aggregate potential earnings accruing from individual goodwill, and (b) potential for future gains that may or may not materialise. This analysis therefore alerts us to the existence of three types of personal wealth:

1. Wealth that has already been accumulated;
2. Income streams generated against personal goodwill;
3. Future income streams that may be generated against personal goodwill.

4.2. Real Estate and Tax Havens

That most wealth is largely intangible, and hence nomadic, may appear counter-intuitive. Let us take the example of what has a good claim to be the least mobile of assets, real estate – also known, appropriately enough, as 'immovable property'. The vast majority of household 'net' wealth is residential and commercial real estate, which is subject to various layers of taxation during the ownership cycle as well as at point of sale. There is a business case, therefore, to find ways of grabbing income from real estate without the claiming direct ownership. Different tax planning strategies can be used to achieve this, such as through financial derivatives (which cannot be explored at sufficient length here) or through schemes that prevent the registration of the sales of real estate in a taxing country. In all these cases, multi-jurisdictional arrangements are necessary, preferably through tax havens.

Let us take the example of a London property. In the UK, realised appreciation in the value of properties is subject to capital gain tax, currently standing at 18%. In addition, the UK imposes a 7% stamp duty on assets worth more than £2 million, the value of a small flat in central London. The figure for properties owned by companies goes up to 15%. Duties on the sales of such

properties can therefore reach up to 33% of the value of the sale. How can taxes be avoided on such sales? These are, after all, immobile assets.

Let us consider the following scenario:

1. London Property A is owned by a Spanish Company B. Company B has only one asset, the London property.
2. Company B is owned by Company C, registered in the Cayman Islands.
3. Company C is owned by Company D, registered in Bermuda.
4. A legal person wishes to purchase London property A. To do so, they set up a company in Luxembourg (Company E).

The scheme can work in a number of ways. For instance, Company C sells Company B to Company E registered in Luxembourg. Alternatively, Company D sells Company C to Company E. In both of these cases, as far as the UK is concerned, no sale took place: Property A is still owned by company B, and hence there are no tax issues arising from this sale. Taxation on sales of companies in the Cayman Islands or Bermuda is minimal. In fact, the sale may have no tax implications at all (known in the trade as 'tax neutral' transaction).

At face value, each company in the above scenario appears innocuous; these are entirely legitimate Spanish, Caymanian, Bermudan and Luxembourgish companies. Furthermore, in this scenario, each of the jurisdictions involved may be internally highly regulated, as they increasingly pride themselves to be. But what is the scope of isolated regulation in the midst of these intangible transactions? It is only in combination that the true purpose of the scheme comes to light. In fact, the sole objective of this multi-jurisdictional arrangement is to remove the location of the sale of a property from the location of the property itself, so as to avoid the sales tax in the original location of the property. It is difficult to see any other purpose to these arrangements.

The net results of these multi-jurisdictional schemes is that the brunt of property tax and stamp duties is borne by the worse-off and the middle classes, whereas the better-off and large corporations have the privilege of avoiding those taxes if they so wish. These are, in other words, wealth concentration devices. Tax havens have an added 'advantage' to these schemes in that they create purposefully exploitable loopholes that serve such schemes.

To take another example, in 2010 Luxembourg, under pressure from the EU, withdrew its 1929 Holding Company Legislation. These types of holding companies were used pervasively for tax avoidance purposes because they were exempt from corporate income tax and could withhold tax on dividends and certain other Luxembourg tax. As the backbone of many corporate tax minimisation techniques, they had come in for widespread condemnation. On the face of it, Luxembourg appeared to have bowed to criticisms by terminating the 1929 Holding Company Legislation. In reality, in anticipation of the withdrawal, Luxembourg had already innovated a number of new structures to replace it. Among them are the Private Asset Management Company (SPF) introduced in 2007. The Luxembourg Consulting Group helpfully lists the tax liabilities of these types of companies as follows:

- A one-off registration tax of 75 EUR which is payable at the formation of a SPF and when the articles of association are amended;
- Subscription tax of 0.25% annually on the deposited capital (+ issuing bonuses);
- No DBA authorisation; (Data Base authorisation, i.e. data provided by the company is taken at face value);
- No VAT registration;
- Complete exemption from corporate income tax, excise tax, and assets tax;
- No withholding tax on interest payments (restrictions apply to individuals);
- No withholding tax on dividend payments (non-residents);
- No taxation of capital profit arising from the sale of SPF shares (non-residents);
- No taxation of liquidation revenues from the SPF (non-residents).

(source: <http://www.lcg-luxembourg.com/Family-operated-private-asse.472+M52087573ab0.0.htm> accessed 16/05/2014)

One can see how SPFs can support what the same document, perhaps unadvisedly, refers to as 'opportunistic real estate investment'. The specific recommendation of the Luxembourg Consulting Group is for individuals and companies to set up SPFs 'just in case'. SPFs are considered legal and above board. Indeed, Luxembourg is considered a highly regulated financial environment. But it is

difficult to deny that SPFs, and a few other provisions like it, are intended to perpetrate tax avoidance schemes routed through Luxembourg.

The scenario presented above also tells us that the data on assets registered offshore is highly dubious for two related reasons. First, there is no inherent reason why any of the holding companies, of whatever type or denomination, should revise asset values as they rise and fall. In the case of the Luxembourgish SPFs, which is rather typical, there is an implicit promise on the part of the Luxembourgish authorities not to relinquish the data provided by the SPFs to the national authorities. Most likely, declared asset values in such entities count as business propositions, and may be subject to considerations of taxation, leverage, collaterals and the like. Second, we do not know whether there is any occurrence of double, triple or quadruple accounting, as some assets are linked together in chains of ownership running across different jurisdictions. Each of these jurisdictions is keen to boast the aggregate value of all the registered assets. Indeed, the practice is to create at least one or two additional shell companies in different locations, ‘just in case’ a future sale scenario would benefit from a slightly different organisation of the chain.

4.3. The Firm and Tax Havens

The intangible dimension of wealth is perhaps expressed to the fullest in the context of business companies. A surprising amount of business assets fall under the rubric of goodwill, and companies take full advantage of this flexibility for tax minimisation purposes. Let us start with some clarification about the nature of the firm and corporations. As succinctly put by Jean-Phillipe Robé, the firm is conventionally believed to be build around:

the notions of agency, property rights and contracts. The common view is that the shareholders are the owners of the firm and that the managers, as their agents, must manage the firm in their interest. That’s the micro, private, part of the analysis. The prevailing theory is also part of a broader, macro, societal view. Firms are assumed to be operating within perfect legal and political environments internalizing all externalities within the firms’ production prices. All interests affected by the firm’s activities (other than those of the shareholders’) are assumed to be adequately protected by contracts and laws. Maximizing the shareholders’ interests in the management of the firm is then presented as the only form of management to be socially beneficial (Robé, 2011, 1).

The conventional view, however, conflates the ownership structures of assets (the capital) with

institutions (such as multinational corporations) and furthermore it furthermore conflates legal institutions (corporations) with economic units (firms). The corporation is a legal entity that is licensed by a sovereign entity and can only operate within the bounds of one national space at a time.¹ The firm, in contrast, is an economic entity. Firms often control strings of legal entities or corporations – at times numbering in the thousands – and in that sense can operate in many jurisdictions. The firm, on the other hand, lacks legal existence. In other words, legally speaking, there is no such thing as a ‘multinational corporation’.

In this context, tax minimisation techniques exploit the differences between the economic control of firms and the legal foundations of territorially bounded companies. All legal companies are bound by national rules and regulations that, if duly observed, are sufficient to raise companies above legal suspicions, as in the case of Luxembourg's SPFs described above. Firms, on the other hand, are organisations put together by accountants, such as the Big Four accounting firms (Deloitte, PwC, Ernst and Young, KPMG). They typically span a number of territories and are used to link companies from different jurisdictions in such a way as to minimise their overall tax footprint.

4.3.1. Russian Dolls

A telling example of firm's tax minimisation techniques has recently been furnished by Emily Yiolitis, Partner at Harneys, Cyprus. She describes a deal organised by her firm for a proposed \$US 500 million restructuring of a Russian individual shareholding with the view ‘of maximising the tax efficiency of the corporate structure and with a view to a prospective sale of part of the operations’ (2012). Harneys proposed the following steps:

Step one: The Russian company (RI) sets up a Cypriot holding company (CY). In order to access double tax treaty network with Cyprus, the company had to be a Cypriot tax resident. That meant that the management and control of the company had to take place in Cyprus. To do so, the Russian investor sets up an office in Limassol, moves three management representatives from Russia to Cyprus, and hires two administrative staff.

Step two: The Russian shareholder contributes 100 per cent per cent of the shares of their Russian corporation (RusCo) to the CY in return for further shares in CY. Stamp duty (otherwise applicable

1 ‘Corporations are apart among the legal instruments used to legally structure firms. The reason for this is that they are treated by the legal systems as if they were “real” persons (with some adaptations), i.e. they can participate in the legal systems through the phenomenon of “juridical personality”. They can own property, have debts, contract, sue and be sued in courts, get bankrupt, etc. –i.e. they can “function” in the economy like human beings because they are treated by the legal system as if they were “persons”.’ (Robé, 2011, 11)

at 0.2 per cent per cent of the value of the transaction) is exempted in such qualifying re-organisations. Hence the exchange of shares is carried out with no tax implication and no stamp duty levy. As a result RI becomes the shareholder of an increased number of shares in CY, and CY becomes the shareholder of RusCo. Profits derived by the manufacturing operations of RusCo were to be sent as dividends to the sole shareholder, CY. In accordance with the double tax treaty between Cyprus and Russia, dividends payable from Russia to Cyprus are subject to five per cent per cent withholding tax in Russia provided the investment exceeds €100,000.

As RusCo was engaged in active manufacturing operations, according to Cyprus law CY was not subject to any tax in Cyprus. Hence, Cyprus does not levy any withholding tax on CY. Cyprus Income Tax law provides for a tax exemption from profits realised by Cyprus companies upon the sale of securities. Therefore the sale by CY of 30% of its shares in RusCo to a purchaser situated in the British Virgin Islands (BVI) did not attract any income tax in Cyprus as a trading gain. As Cyprus does not tax capital gains, there was no incidence of capital gains tax in the sale of 30% of RusCo by CY.

Here we have a case of a deal that operates through three different jurisdictions, taking advantage of tax loopholes in each to ensure that only the minimal amount of tax is paid. Cyprus is therefore used by the Russian individual to minimise his tax footprint in Russia.

4.3.2. Of Apples and Cars

Another common way the intangible assets of a firm can be exploited for tax minimisation purposes is by recourse to the futurity value of all the intangibles formally recognised in English Common Law as 'goodwill'. These include all the usual business assets that are valued on the basis of the firm's future earning capacity, such as trademarks and brand names as well as the organisational and managerial business structure.

One way firms can utilise these assets in multi-jurisdictional tax minimisation schemes is by separating the tangible sources of income, such as the sale of hardware, from the intangible sources of income therein embedded, such as the sale of patent rights or intellectual property rights associated with the hardware. The different sources of income can be subsequently apportioned to different companies. A large company of the size of BMW, for example, could hypothetically set up a string of offshore entities, each with a claim to different portions of a car: one owning the rights of income from the use of the label, another owning the rights of income from the sale of physical assets, and yet another owning the rights of income from the patents embedded in the cars.

In this model, BMW car sales would have to pay royalties to each of those separate companies. Since they are legally separated, they are each treated as separate entities for tax purposes. Needless to say, those companies will be registered in different jurisdictions, chosen largely for tax purposes.

Let us take the example of Apple. The following is taken from a detailed study of the Levin Congressional Committee. It appears that Apple Inc. has created three offshore corporations which receive tens of billions of dollars in income, but which have no tax residence – neither in Ireland, where they are incorporated, nor in the U.S., where the Apple executives who run them are located. 'Apple has arranged matters so that it can claim that these ghost companies, for tax purposes, exist nowhere. One has paid no corporate income tax to any nation for the last 5 years; another pays tax to Ireland equivalent to a tiny fraction of 1 percent of its total income' (p.3).

One of Apple's shell companies is Apple Operations International (AOI). AOI directly or indirectly owns most of Apple's other offshore entities. Under Irish law, only companies that are managed and controlled in Ireland are considered Irish residents for tax purposes. Since AOI is only incorporated, but not managed or controlled, in Ireland, it does not count as an Irish tax resident. Under U.S. law, on the other hand, a company is generally taxed on the basis of where it is incorporated, not where it is managed and controlled. Since AOI is not incorporated in the U.S., it is not tax resident in the US either. AOI, therefore, is tax resident nowhere. In fact, AOI has no employees either.

The second corporate shell set up by Apple in Ireland is Apple Sales International (ASI). ASI holds the economic rights to Apple intellectual property rights outside of the U.S. From 2009 to 2012, its sales income amounted to \$74 billion. Similarly to AOI, the company is incorporated in Ireland but operated from the US. ASI only paid a minimal amount of tax to Ireland. For example, in 2011 it paid \$10 million against \$US 22 billion in revenue. Apple's third subsidiary, Apple Operations Europe (AOE), sits between ASI and AOI. It, too, has not tax home.

Not unlike many firms of its kind, Apple is taking advantage, in other words, of discrepancies in incorporation and tax residency rules between different countries. Compared with more sophisticated techniques used by other household name firms, this is one of the simplest schemes of tax minimisation, but one that makes full use of multi-jurisdictional tax arbitrage. Needless to say, it is all legal.

5. Troublesome Tax Havens: Agglomerations and Niche Seeking Strategies

The cases mentioned above offer a flavour of how multi-jurisdictionality works in practise. It is a world that relies heavily on financial services, the big Four accounting firms, as well as a myriad smaller law, banking and financial firms. A UK parliamentary committee estimates that this industry generates about US\$ 55 billion of annual income.

One interesting question that arise from this discussion is whether those countries known colloquially as tax havens are actively encouraging the development of tax avoidance strategies or whether, as it's claimed, they have developed their own taxation rules independently and are just being exploited by scrupulous accounting firms.

There are two possible answers to these questions. One is based on the theory of the captured state or captured elites. This theory suggests that lacking the necessary manpower and tertiary education facilities, many small island jurisdictions and their governments are not capable of developing successful offshore financial centres (OFCs) on their own. They are effectively 'captured' by powerful foreign finance and legal firms who write the laws of these countries which they then exploit. There is good evidence to this effect. The other theory suggests that tax havens evolved in jurisdictions that were traditionally outward looking and dominated by commercial and trading interests. Many tax havens, such as Switzerland or Singapore, were originally known as entrepôt centres for regional trading activities. Their local elites were therefore strongly predisposed to develop OFCs. The two theories are not incompatible. Indeed, the second may add nuance to the first.

The latter theory points to the historical evolution of two broad types of tax haven agglomerations. This argument is founded on an analysis of the Bank of International Settlement's (BIS) locational statistics on international lending and borrowing data. The data reveals that one agglomeration of tax havens has a distinct British Imperial flavour. It consists, first and foremost, of the City of London, and includes, in addition, the British Crown dependencies of Jersey, Guernsey and the Isle of Man; a few British Overseas Territories, including the Cayman Islands, Bermuda, British Virgin Islands, Turks and Caicos, and Gibraltar; and recently independent British colonies such as Hong Kong, Singapore, the Bahamas, Cyprus, Bahrain, and Dubai.² The British imperial pole accounted

² Bermuda, the largest captive insurance centre in the world in spite of its relatively small banking centre, can be included too, and so can Cyprus and the numerous but less significant former British colonies in the Pacific. For a

for a combined average of 38.3% of all outstanding international loans and deposits by March 2010.

The other, far looser agglomeration consists of a string of mid-size Western European states known for an odd coupling of welfare and tax haven provisions. They include the Benelux countries, Belgium, Netherlands and Luxembourg, as well as Ireland and Switzerland. The European agglomeration accounted for a combined 14.9% of all outstanding international loans and deposits by March 2010, exactly the same as the entire U.S.³

What explains the emergence of these two agglomerations of international financial centres? Why do so many of the world's leading international financial centres have a British imperial link? The root cause behind this differentiation is found in the distinction, operated since the legal establishment of futurity valuation in the late 19th century, between two types of incorporeal properties, financial instruments and goodwill instruments (or intangibles).

London's rise took place in the midst of the City's attempt to survive the period of imperial decline. The tax haven agglomeration linked to it evolved as a group of centres designed to trade in incorporeal assets and therefore geared to operate as one gigantic offshore financial centre with the City of London at its core. The subsequent re-emergence of the City of London as the world's premier financial centre was in no small part due to the emergence of the Euromarket in London in 1957 (Burn 2005). According to this theory, the Bank of England came to an informal agreement with London merchant banks that it would treat certain types of financial transactions, those between non-resident parties and those denominated in foreign currencies, as if they did not take place in London. In doing so, the bank effectively created a new regulatory space outside of its own jurisdiction – as well as a new concept, that of offshore finance. As the transactions taking place in London were deemed by the Bank of England to be taking place elsewhere, they ended up under no regulation at all, and therefore 'offshore'. This new, unregulated locus of transaction came to known as the Euromarket, or offshore financial market (Burn 2005).

The Euromarket remained small and practically unknown for three or four years until American banks discovered it in the early 1960s. They quickly developed branch networks so that they could avoid restrictive domestic regulations through their London subsidiaries. Once the facilities of the Euromarket were discovered, corporate clients also began to bypass the banks and to tap directly

discussion of Bermuda's financial centre, see Crombie 2008. For a discussion of the Pacific offshore centres and their relationship to the UK, see Sharman and Mistry 2008.

³ The U.S., in contrast, accounted for 12.4% and 12.9% of all outstanding international loans and deposits, while Japan accounted for 4.5% and 3.8% respectively in March 2009. The European havens were about 2% higher only a year before. The U.S. appears to be the only large net gainer during the crisis of 2007 up to this day.

into the offshore financial market to earn higher rates of interest while their clients, too, learnt to tap in the Euromarket to fund their operations (Burn 2005; Sylla 2002).

London emerged as an offshore financial market as a result of what could be seen as an administrative accident. All other areas under the jurisdiction of the UK at the time, including Hong Kong, the Channel Islands, the Cayman Islands and other British Caribbean Islands, happened to enjoy the same legal provisions, and spontaneously developed as offshore centres as a result. It did not take long, of course, for banks and other financial institutions to appreciate the useful synergies between tax havens and OFCs, particularly if located in the same place. In dual status tax havens/OFCs, banks and other financial institutions could not only circumvent stringent financial regulations, but also find 'tax neutral' ways of conducting their business. This is in fact what drove some tax havens to develop as OFCs.

Some smaller North-American, U.S. and Canadian banks, faced with the high infrastructural costs of a London base, 'realized that the Caribbean OFCs offered a cheaper and equally attractive regulatory environment – free of exchange controls, reserve requirements and interest rate ceilings, and in the same time zone as New York' (Hudson 1998: 541). According to various reports (Sylla 2002), the early spill-over of OFCs activities into the Bahamas and Cayman was motivated, like the London Euromarket, not by tax advantages, but by the cheaper transaction costs of setting up branches there.

The London Euromarket, while effectively unregulated, was still heavily taxed. However, as tax was levied at point of maturation, it became common practice to register syndicated loans and, later on, many other financial activities in commensurate offshore centres in British dependencies (although for reasons that go beyond the scope of this chapter, until 1974, Euromarket operations could develop only in British overseas territories and not in the three Channel Islands). Due to its historical roots, the British Imperial pole of tax havens came to specialise in financial affairs, such as syndicated loans, derivatives, forex, insurance hedge funds, and 'off the shelf' companies.

The European agglomeration, on the other hand, preceded the British one. A recent study by Christophe Farquet (Farquet, 2013) demonstrates that unambiguous concern with Swiss and Belgian support for tax avoidance and evasion strategies was clearly expressed as early as in the 1920s, and then extended to Luxembourg in the 1930s.

European centres, primarily the Benelux countries and Ireland, and to a lesser extent Switzerland, developed primarily as harvesters of international income from intangible assets for tax purposes.

They developed rules and regulations aimed at attracting holding companies that serve as repositories of international incomes from logos, goodwill, trademarks and brand names. Analysis of German inbound and outbound Foreign Direct Investment (FDI), for instance, shows that the Netherlands and Switzerland were the two leading conduit jurisdictions used by German businesses in the past twenty years. The study also found that, typically for cases of this type, British-linked tax havens, such as Barbados, Bermuda, and the Caymans, played no significant role in hosting German conduit entities (Weichenrieder and Mintz 2007).

Whatever their different historical origins, the Imperial and European agglomerations combined accounted for approximately 53.3% of all international banking assets and liabilities by March 2010.

6. Conclusion

There is no denying that taking every opportunity to reduce the tax burden makes good business sense. To be sure, businesses, as economists are fond of repeating, are by their nature profit oriented. What plain economic accounts tend to overlook, however, is the extent to which profit orientation varies along two conceptual and logistical boundaries: profit before and after taxes, and profit within and without national borders. In fact, the very logic of profit orientation is consistent with the notion that cross-border differences in tax structures necessarily create an incentive for individuals and corporations to minimise the tax burden as much and as prudently as possible. Equally consistent with this logic, however, is the notion that, to escape legal or moral obloquy, the same incentive would also drive some of them to go to such great lengths to minimise the tax burden that concealing the footprints becomes a matter, not of prudence, but necessity. It is therefore rather surprising that, for all its impact on this cross-border traffic of wealth, the multi-jurisdictional tax-avoidance incentives created by national and regulatory boundaries are seldom given adequate political attention.

Bib

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