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Global tax evasion: the good and the bad news

Targeting tax fraud has improved, but the urgency to prevent the rich from benefiting disproportionately from the system remains

The many ways in which rich people and global companies can avoid tax have been quite widely known for some time. Periodically, information from leaks, such as the Panama Papers, creates public outrage and some (albeit often halfhearted) attempts by tax authorities to deal with at least some of the disclosures. But the full extent of such evasion and its global spread have been hard to assess, given its insidious nature, due to a lack of data.

Though, matters have recently improved, with more information becoming available and more researchers willing to sift carefully through it. A landmark new *Global Tax Evasion* report from the European Union Tax Observatory encapsulates work by more than 100 researchers all over the world, often in partnership with tax administrations.

The report covers some clearly illegal practices, such as concealing income from offshore bank accounts, as well as grey-zone tax-saving practices, such as profit-shifting to foreign shell companies and creating holding companies or trusts to manage personal wealth and avoid individual income taxes. It affords great insight into the extent and fashion of illicit financial flows and tax evasion and is essential reading for concerned citizens in all countries.

Small, but important steps forward

There is some good news, for sure. Simple sharing of information across countries has been a breakthrough, stemming from two sources. The United States' Foreign Account Tax Compliance Act, implemented in 2014, requires all banks everywhere to report on the account holdings of US taxpayers, under threat of penalties. And the Common Reporting Standard of the Organisation for Economic Co-operation and Development (OECD), which began in 2017-18 and includes more than

110 jurisdictions, involves automatic exchange of banking information.

It is as a result much harder for very wealthy individuals to avoid reporting offshore financial wealth, and this form of evasion has greatly reduced. In 2022 alone, around $12.6 trillion in offshore wealth was reported to foreign tax authorities through this mechanism. (Of course, it is then up to national tax authorities to make use of the knowledge — and this depends on the domestic political economy.)

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Even so, offshore tax evasion has not disappeared. The report estimates that about 25 per cent of global offshore financial wealth remains untaxed. Not all offshore financial institutions comply with the reporting requirements — and the US, which contains several tax-haven states, does not participate in the OECD exchange. Also, the very rich can choose to hold non-financial assets, such as property (in Dubai, for example, foreign owners hold 27 per cent of property). But this still shows that international co-operation can achieve, in a relatively short time, what was previously thought impossible.

The loopholes for tax evasion *within* countries, however, remain large. The report suggests that global billionaires have effective tax rates equivalent to as little as 0–0.5 per cent of their wealth, largely because they use shell companies to avoid income taxation. The obvious remedy is to institute a wealth tax only on dollar billionaires. Even a relatively low tax rate of 2 per cent (barely noticeable for those who hold such enormous wealth) would generate significant tax revenues — close to $250 bn annually from fewer than 3,000 people!

The emergence of new forms of tax competition

Meanwhile, another OECD initiative, on 'base erosion and profit-shifting' (BEPS), to control tax avoidance by multinational companies shifting their profits to low-tax or no-tax jurisdictions, has not been as successful. A major result of the associated negotiations over seven years was the agreement in 2021 to enforce a minimum corporate-tax rate. The rate finally agreed upon was only 15 per cent — much lower than the 25 per cent median of global rates and close to that in some tax havens. Nevertheless, the principle was important.

Even this minimum rate has not, however, had the expected effect, because of carve-outs subsequently introduced. These include showing 'economic substance', which has enabled multinationals to continue to benefit from reporting profits in tax havens by investing some capital and hiring some workers there.

As a result, the gains from this measure have been very limited, adding only 3 per cent to global corporate-tax revenue rather than the projected 9 per cent. And profit-shifting has continued unabated: the country-by-country reporting of profits by multinationals shows that about 35 per cent of foreign profits, amounting to $1 trillion, were shifted to tax havens in 2022 — around the same as before.

Even as these existing strategies of tax evasion need to be blocked, new forms of tax competition are emerging.

Obviously, corporate lobbying had the desired effect, in what was a rather opaque negotiation process at the OECD. But this is still an important opportunity: proper implementation of a 20 per cent minimum corporate-tax rate, were that to be introduced – without loopholes – would also generate an estimated $250 bn a year.

Even as these existing strategies of tax evasion need to be blocked, new forms of tax competition are emerging. A growing number of countries seek to attract residents with lower tax rates on incomes earned abroad.

Remote workers and digital nomads provide only one element of the revenue losses, since many of these regimes are targeted at rich people who can choose to shift their primary residence to a low-tax jurisdiction. This reduces global tax collection and adds to inequality. For companies, meanwhile, new industrial policies in the advanced economies are providing subsidies (essentially negative taxes) for 'green' investment, which are likely to more than offset the limited gains from the minimum corporate-tax rate.

Clearly, there is a lot still to be done to fix our tax systems. But at least we have more knowledge of what is taking place — and so more practical ideas about how to change it.

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