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Hakelberg, Lukas P.
The Hypocritical Hegemon: How the United States Shapes Global Rules against Tax Evasion and Avoidance.


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1. CHANGE AND STABILITY IN GLOBAL TAX POLICY

1. Investors may use secrecy jurisdictions for purposes other than tax evasion. Instead of hiding assets from the tax office, investors may hide assets from spouses to frustrate requests for alimony in case of divorce, or from creditors to avoid the repayment of debt. Whatever the main motive, however, it is likely to concur with tax evasion, since declaring assets to the tax office is most likely to also bring them within the reach of spouses and creditors.

2. Interview with former Austrian minister of finance, July 10, 2014.


4. Bank secrecy had existed in Switzerland long before Adolf Hitler was elected Reich chancellor in 1933. The Swiss Bankers Association spun this narrative only once the Allies began to investigate its financing activities for the Axis powers toward the end of World War II (Guex 2000).

5. Interviews with European Commission official on June 13, 2018 and with two academic experts on EU tax policy on August 23, 2018.


7. Interview with partner in US tax law firm on April 17, 2015.


10. Interview on April 13, 2015.

11. A Nexis search for “Qualified Intermediary Program” in all English-language news retrieved six articles between August 2006, when the first PSI report was released, and December 2007. A Nexis search for “Qualified Intermediary Program” in all English-language news retrieved forty-one articles between July 2008, when the second PSI report was released, and December 2008, but only three articles between January and June of the same year.

12. Alex Cobham is the current director of the Tax Justice Network, a nongovernmental organization (NGO) advocating for tougher international rules against tax evasion and avoidance.

13. According to the benefits principle, a source country is entitled to tax the active business income of a permanent establishment under its jurisdiction. The royalties, dividends, and interest this permanent establishment pays to its parent company, however, are in principle taxable in the latter’s country of residence. According to the OECD’s model tax treaty, source countries retain the right to levy limited withholding taxes on dividend and interest payments but not on royalty payments (OECD 2014d, Art. 10, 11, & 12). Moreover, the United States strikes bilateral tax treaties with foreign countries that reduce withholding taxes on interest paid to US firms to zero (US Treasury 2016, Art. 11).
2. POWER IN INTERNATIONAL TAX POLITICS

1. Tax evaders invest offshore to strip their capital income of its tax burden. As a result, offshore wealth grows faster than onshore wealth (Alstadsæter, Johannesen, and Zucman 2017a; Harrington 2016). Yet this possibility exists only as long as an individual who is in principle liable to tax on her worldwide income manages to hide her offshore account from her local tax office. Therefore, the level of financial secrecy has a direct effect on the after-tax return to offshore portfolio investment.

2. Since the 1920s, when member states of the League of Nations created the current international tax system, the prevention of double taxation, which requires reconciliation of the source and residence principles, has been the main purpose of international tax law. The OECD’s Model Tax Convention provides governments with two reconciliation methods: residence countries can exempt their residents’ foreign income from taxation altogether or credit foreign taxes against the domestic tax. The credit method is most widespread but applies only once companies repatriate their foreign profits in the form of dividends, interest, or royalties. Therefore, companies can defer tax payments by hoarding profits offshore for an indefinite amount of time or until the government grants them a repatriation tax holiday (Rixen 2008, 57–60; Pinkernell 2012).

3. The EU has been identified as a single actor with great power status in the regulation of finance, trade, and many other areas of economic governance (Bach and Newman 2007; Drezner 2008; Meunier and Nicolaïdis 2006; Posner 2009).

4. The OECD Model Agreement links source country status to the presence of a PE. A PE is a place of effective management or production. This may also include an Internet server wholly owned or controlled by a foreign company that is used to process product sales and payments. Yet tax authorities have to determine in every case whether the automatic processing of sales and payments is a core element of corporate activity. Source-country status in e-commerce therefore remains a contested issue (Pinkernell 2014, 28–30).

5. FATCA also obliges participating institutions to levy a withholding tax on pass-through payments from the United States to nonparticipating institutions. This requirement is meant to reduce the attractiveness of business with nonparticipating institutions and to extend the reach of FATCA beyond financial institutions with business in the United States (Grinberg 2012).

6. Decisions on administrative assistance in tax matters are decided by unanimity in the Council of Ministers. The directive introducing the AEI in the EU does not provide for sanctions against third states not applying this standard in their relations with member states. Moreover, any mandate for negotiations with third states on an AEI agreement also has to be granted by unanimity (cf. European Union 2014b).

7. According to data from the US Bureau of Labor Statistics (2017), all private households and service providers catering directly to households create about as much employment in the United States as half of the manufacturing sector.

8. The steps are as follows: (1) formation of government preferences at the domestic level, (2) interaction of government preferences in determining great power strategy, (3) great power strategy producing the outcome.

3. COUNTERING HARMFUL TAX PRACTICES

1. Searches of LexisNexis and HeinOnline using various combinations of the keywords “OECD,” “harmful tax,” “bankers,” “finance,” “American,” “Florida,” and “Texas” do not retrieve any documents suggesting that banking associations from Florida or Texas openly opposed the HTC project. In this context, criticism is always directed against new domestic reporting requirements.
2. In any event, the CFA had first decided to postpone sanctions against uncooperative tax havens to 2001, and later even extended the deadline for full cooperation by tax havens to 2005.

3. Interviews with lobbyist for US multinationals on April 23, 2015, and with partner in tax law firm on June 22, 2015.

4. For further tax planning strategies using hybrids to circumvent subpart F see Office of Tax Policy (2000); IRS (1998b); West (2005).

5. IRS Notice 98–35 revokes Notice 98–11 and corresponding temporary regulations. Notice 98–35 also presents a new set of regulations. However, these were placed under a moratorium until 2000, when Congress expected to have finished its analysis of subpart F (Cooper and Torgersen 1998).


4. THE SWIFT RETURN OF TAX COMPETITION

1. The Bush team’s calculations apparently relied on an overly optimistic projection of GDP growth at an average 2.7 percent over the following ten years.

2. The group included Nobel Prize winners Milton Friedman, Robert Lucas, James Buchanan, Gary Becker, and Robert Mundell. For the crucial role these economists have played in the “neoliberal thought collective” see Mirowski (2013).

3. Hacker and Pierson argue that Republican representatives in the House are more vulnerable to campaigns by anti-tax lobby groups such as the Club for Growth or Americans for Tax Reform than incumbent senators, which is the reason Republican representatives almost unanimously accede to requests from these groups.

4. The split Senate extended the cuts by two years in 2010, so the cuts eventually expired on January 1, 2013.

5. Interviews with former US Treasury officials on April 15 and 17, 2015.

6. Testifying at a Senate hearing on tax haven abuse, O’Neill was eager to dispel allegations that he was turning a blind eye on breaches of US tax law (cf. O’Neill 2001b).

7. According to Mirowski (2013), the Mont Peléron Society and George Mason University are key players in what he describes as the “neoliberal thought collective.”

8. Interview with former US Treasury official on April 15, 2015.

5. THE EMERGENCE OF MULTILATERAL AEI

1. A Nexis search for “Qualified Intermediary Program” in all English-language news retrieved six articles between August 2006, when the PSI report was released, and December 2007.

2. A Nexis search for “Qualified Intermediary Program” in all English-language news retrieved forty-one articles between July and December 2008, but only three articles between January and June 2008.

3. Interview on March 6, 2014.

4. Interviews with OECD diplomat for large member state on March 6, 2014; member of German parliament on November 14, 2014; and former undersecretary of state in German ministry of finance on January 28, 2015.


7. Interviews with senior French tax official on March 14, 2014; former undersecretary of state in German ministry of finance on January 28, 2015; and senior German tax official on March 3, 2015.

8. Interview with former US Treasury official on April 15, 2015.

9. Interviews with members of German parliament on October 8 and 16, 2014, and on November 14, 2014.
10. Interviews with former undersecretary of state in German ministry of finance on January 28, 2015, and senior German tax official on March 3, 2015.
15. Interview on April 15, 2015.
16. According to an OECD tax official interviewed on March 6, 2014, this wording was understood as obliging signatories to cooperate with the OECD in establishing multilateral AEI.
17. Interviews with member of the German parliament on October 15, 2014; with former undersecretary in German ministry of finance on January 28, 2014; and with senior German tax official on March 3, 2015.
18. Interviews with members of the German parliament on October 8 and 16, 2014, and on November 14, 2014.
19. Interview with member of the German parliament on October 16, 2014.
20. Research by academics and journalists later revealed that Swiss and Luxembourgian wealth managers had created or purchased a massive number of mostly Panamanian corporations on behalf of their clients just after the Savings Directive and Agreement entered into force in 2005 (cf. Johannesen 2014; Obermayer et al. 2015).
23. Translation from Luxembourgish by the author.
25. Interviews with OECD diplomat for small member state on March 5, 2014; with OECD diplomat for small member state on March 7, 2014; with senior French tax official on March 14, 2014; with European Commission tax official on March 28, 2014; and with senior German tax official on March 3, 2015.
27. Interview on March 3, 2015. Translation from German by the author.
28. Translation from German by the author
29. Interview on March 6, 2014.
30. Interviews with OECD ambassador for small member state on March 4, 2014, and with OECD diplomat for large member state on March 6, 2014.
31. Interview on April 15, 2015.
32. Interview on April 13, 2015.
33. Interviews with former Treasury officials on April 13 and 15, 2015.
34. Interview with partner and manager of Austrian tax law firm on July 7, 2014.
35. Interview on April 15, 2015.
36. Interview on January 28, 2015. Translation from German by the author.
37. Interview on March 3, 2015. Translation from German by the author.
38. Interview on April 17, 2015.

6. THE BEPS PROJECT

1. Interview with tax adviser to the German finance ministry on June 22, 2015.
2. Interview with senior German tax official on March 3, 2015.
3. Interviews with tax adviser to the German finance ministry on June 22, 2015, and partner in US tax law firm on April 17, 2015.
4. Interview with senior German tax official on March 3, 2015. Translation from German by the author.
5. Interview on April 21, 2015.
6. Translation from German by the author.
9. The author served as senior adviser to the OECD in the elaboration of the BEPS project.
10. Out of a total of 9,316 pages received by the OECD during public consultations on the BEPS project, 3,014 are devoted to transfer pricing; 1,177 to CbCR; and merely 577 to CFC rules.
11. Submissions from the Silicon Valley Tax Directors Group (SVTDG 2015) and the United States Council on International Business (USCIB 2015) also included in the compendium of public comments convey the same points of criticism.
12. This statement matches the key points of criticism expressed by PwC (2015), another big four accounting firm, in its submission to the OECD.
15. Special measures were sometimes interpreted as CFC rules, but they do not appear in the corresponding final BEPS report (cf. OECD 2015b).
16. Interview with tax adviser to the German government on June 22, 2015.
17. The author also shows that Amazon has begun to change its tax structure in Europe so as to unambiguously subject itself to taxation at source.
18. That is, a source country wishing to apply the new definition to corporations residing in the US, Luxembourg, or Ireland faces the difficult task of renegotiating the corresponding bilateral tax treaties and convincing its treaty partners to abandon their general reservation in the process. At present, this result seems highly unlikely, especially when the US government is the treaty partner.
19. The twenty-five countries include Andorra, Australia, Austria, Belgium, Canada, Fiji, Finland, France, Germany, Greece, Ireland, Italy, Japan, Liechtenstein, Luxembourg, Malta, the Netherlands, New Zealand, Portugal, Singapore, Slovenia, Spain, Sweden, Switzerland, and the United Kingdom.
20. The authors show that the diffusion of bilateral tax treaties is in part driven by the competitive advantages such agreements afford corporations interested in investing abroad.
21. With the adoption of the Interest and Royalties Directive in 2003, withholding taxes on interest and royalty payments between related firms of different member states were abolished.
22. Yet the Alliance of Liberals and Democrats for Europe (ALDE) managed to introduce a safeguard clause protecting multinationals against the release of sensitive information (Amendment 82). Deputies on the left fear this will allow many companies to circumvent public reporting (cf. De Masi 2017).
23. According to the draft directive, public CbCR would apply to all firms with a PE in the common market that earn more than €750 million in annual revenue. In contrast to the BEPS recommendations, this provision implies that firms that are not headquartered in the EU would also be obliged to publish information. Therefore, were the United States to withhold information received from parent companies, this would not make much of a difference. Accordingly, alternative sanction mechanisms, including the application of
section 891 of the US tax code through which taxes on companies from a country that is considered to impose discriminatory taxes on US multinationals could be doubled, are currently being debated (cf. Grinberg 2016b).

24. Although the measure was clearly conceived to respond to public concern over tax avoidance, the measure fit in neatly with the conservative government’s tax-cut-cum-base-broadening strategy. While the diverted profits tax limits profit shifting out of the United Kingdom, the parallel introduction of a tax break for multinationals’ overseas financing activities provides an additional incentive for shifting profits toward the United Kingdom. In addition, the Tories also reduced the statutory corporate tax rate from 26 to 19 percent and introduced another tax break for research and development activity. Overall, the United Kingdom intensified international tax competition instead of limiting it (cf. Hakelberg and Rixen 2017).

25. The term “joint decision trap” was coined by Fritz W. Scharpf (1988) to describe deadlock in decision-making processes that are marked by a unanimity requirement and divergent interests among involved actors.

26. According to Gerda Falkner (2011, 12) “unsettling” and “pressurizing” are two strategies through which the Commission can change member states’ opportunity structures and thereby find an exit from the EU’s joint decision trap.

7. FROM HEGEMONY TO TRANSATLANTIC TAX BATTLE?

1. Translated from German by the author.
2. Interview on March 3, 2015. Translated from German by the author.
5. In common law countries, the beneficiary of a trust is taxed only once she receives distributions. Civil law countries do not recognize trusts. Therefore, a resident beneficiary of an Anglo-Saxon trust would be taxed currently on the trust’s earnings. For this reason, residents of continental Europe must keep their trust arrangements secret from the tax office to reap the fiscal benefits of these arrangements.