



Canadians for Tax Fairness
Canadiens pour une fiscalité équitable

Presentation to the House of Commons Finance Committee
Re: Tax Evasion and the Use of Tax Havens
From: Dennis Howlett, Canadians for Tax Fairness
Date: February 14, 2013

Thank you for the opportunity to address the Finance Committee. We appreciate that the Finance Committee agreed to take up this study as it is a major and growing problem that needs to be addressed.

Canadians for Tax Fairness is a non-profit association which promotes fair taxation. We support a tax system -- based on ability to pay -- to fund the comprehensive, high-quality public services and programs required to meet our social, economic and environmental needs in the 21st century. Canadians for Tax Fairness is a member of the Tax Justice Network.

Last October we launched the Tackle Tax Havens Campaign, which aims to raise awareness and advocate for action on the growing problem of tax havens. The Campaign calls federal government leadership in tackling tax havens by:

- Publicizing an official estimate of the size of the tax evasion and avoidance problem. This estimate should include domestic practices and the impact of tax havens. It should report on the cost to federal and provincial treasuries.
- Increasing the resources of the international tax audit program of the Canada Revenue Agency so they can do more to catch tax cheats.
- Pushing for stronger action against tax havens at the G8, G20 and the United Nations.
- Implementing a “publish what they pay” protocol for corporations. This would be designed to provide information about taxes paid on a country by country basis.
- Promoting automatic tax information exchange as a way to facilitate more efficient sharing of information and timely collection of revenue.

Today I would like to make five points:

1. The size of the tax havens problem is much bigger than you might think and it is growing. We are recommending that the federal government publish an official estimate of the size of the tax evasion and avoidance problem because we feel that if policy makers and political leaders realize how grave the situation is, it will spur them to take more decisive action.

I acknowledge that this is not an easy thing to do and as Finance Canada witness, Mr. Ernewein said last week in response to questioning from Peggy Nash, there are many unknowns and many assumptions that would have to be made.

However, let us look at some of the information that is available:

A World Bank Policy Research Working Paper #5356 from July 2010 by Friedrich Schneider, Andreas Buehn and Claudio Montenegro titled **Shadow Economies All over the World** estimated that the weighted average of the shadow economy of 162 countries was 17.2% of official GDP.ⁱ According to this study Canada had a shadow economy of 15.7% of GDP, which is right in the middle of pack of the group of OECD countries.

Using figures from this World Bank study, the Tax Justice Network calculated that Canada's shadow economy was \$247 billion and applying the over-all tax rate for Canada of 32.2% they got an estimate of total tax revenue lost (to all levels of government) of \$79 billion a year.ⁱⁱ This figure is not limited just to tax havens, though they play a key role in facilitating tax evasion.

The Tax Justice Network published an exhaustive study last July by James Henry, titled **The Price of Offshore Revisited**, that put the estimate of wealth hidden in tax havens at between \$21 trillion to \$32 trillion.ⁱⁱⁱ Assuming, conservatively, that global offshore financial wealth earns a total return of just 3 percent a year, and would have faced an average marginal tax rate of 30 percent in the home country, this unrecorded wealth might have generated tax revenues of \$189 to \$280 billion per year – more than twice, and possibly three times the \$86 billion that OECD countries as a whole are now spending on all overseas development assistance. Given that Canada's economy is 2.8% of the global economy we can estimate that Canada may be losing between \$5.3 to \$7.8 billion a year to tax havens.

Statistics Canada figures confirm that tax havens are a huge and growing problem for Canada. A report on Canadian direct investment abroad by country^{iv} shows that 24% of Canadian direct investment overseas in 2011 went to the top twelve tax havens, up from 10% in 1987. This totals more than \$170 billion. In fact, tax havens of the Barbados, Cayman Islands, Ireland, Luxembourg and Bermuda were five of the top eight national destinations of total Canadian investment abroad, with the US, UK and Australia the only countries not considered tax havens in this group. While some of the direct foreign investment in tax havens may be legitimate investments, such as in resorts or operating businesses, much of it, we can assume, is going there to avoid taxes. While there could be a debate about what this might translate into in terms of tax revenue lost, there is no question that it would amount to billions of dollars.

2. Tax havens and secrecy jurisdictions facilitate crime, impoverish developing countries and undermine the integrity of the tax system.

The problem with tax havens is not limited just to the loss of Canadian tax revenue.

Tax havens play a key role in facilitating organized crime, the illegal arms trade, bribery and corruption and the financing of terrorism. It is the secrecy of tax havens, not just the low tax regime, that is the main problem in terms of crime. Banking secrecy rules in many of the tax haven countries allow criminals to set up accounts without having to declare the beneficial owner and move huge sums of cash in and out without any scrutiny. This is a perfect system for money laundering. And we have learned that many of the large banks are complicit in this criminal enterprise. If the government is serious about its tough on crime agenda it needs to take much stronger action to curb the use of tax havens. Jailing the street-level drug dealer for more years will do nothing to curb the drug trade if tax havens are free to help ensure that crime pays (at least for the king pins).

Tax havens are also impoverishing developing countries. It is estimated that tax havens have facilitated

illegal capital flight from developing country elites totaling \$7.3 to \$9.3 trillion of unrecorded offshore wealth in 2010. The same source countries had aggregate gross external debt of \$4.08 trillion in 2010 but if wealth hidden abroad by their elites is taken into account they would be creditor, not debtor countries.^v A Christian Aid study^{vi} estimated that poor countries were also losing \$160 billion a year of corporate taxes from transfer mis-pricing and false invoicing.

By making it easier for large corporations and wealthy individuals to avoid paying their fair share of taxes, tax havens also undermine the integrity of the tax system itself, which relies on the principles of voluntary compliance and everyone paying their fair share of taxes. They also create an unfair advantage for large multinational corporations over medium and smaller businesses who don't have the same capacity to take advantage of tax havens.

3. The Capacity of CRA to go after tax cheats using tax havens needs to be increased significantly.

While tackling tax havens will require a concerted international effort, there is much more that Canada could be doing itself. While Mr. McAuley from the Canada Revenue Agency in his testimony last week claimed that the hundreds of CRA staff layoffs from last year's federal budget cutbacks did not affect the capacity of the CRA to go after international tax avoidance and evasion, it is not clear whether any new staff resources have been applied to international enforcement efforts in recent years, despite the fact that the amount of Canadian money going to tax havens is at an all-time high.

We do have evidence that when additional resources are invested in enforcement, there is a very good return on investment. When the previous Liberal government increased the capacity of the CRA to combat Aggressive International Tax Planning by \$30 million in 2005, an additional \$2.5 billion in revenue was recovered over 4 years, according to an official response to an Order Paper question from Senator Percy Downe. The tax collection system can pay for itself. Stronger enforcement capabilities will also boost voluntary compliance rates as more companies and individuals will be afraid of getting caught.

In 2006 the Australian government launched Project Wickenby, a cross-agency task force dedicated to fighting tax evasion, avoidance and crime, particularly those using tax havens. By September of 2012 this initiative had recouped \$675 million.^{vii} Other countries, including the UK, US and France have stepped up tax compliance efforts related to tax havens and are beginning to get results.

But Canadian tax enforcement efforts fall short of what is needed. A CRA internal audit document revealed that “tax practitioners believe the CRA is not doing enough to catch or prosecute tax evaders” and that “those engaging in non-compliant behaviour believe that the risk of getting caught for evading taxes is remote.”^{viii}

I expect we will learn more about what the real CRA capacity situation is from the upcoming Auditor General's review of CRA.

4. Bilateral Tax Information Exchange Agreements are ineffective. Canada should push for automatic information exchange.

Much is being made about the number of bilateral tax information exchange agreements

Canada has signed and is negotiating with other countries. But it is questionable how much they will actually help to collect taxes that are owed. There are a number of serious flaws with these agreements. Most importantly, as Mr. Ernewein, from Finance Canada acknowledged before this committee last week, data is only supplied on request. Canada needs to supply details of an individual or company under suspicion and their bank accounts before they get the information from a tax haven. And the secrecy of tax havens makes it very difficult to get this information in the first place. I would be interested to know how many Canadian cases of tax evasion have been resolved by using information obtained from tax information exchange agreements. The information on Canadians hiding wealth in secret bank accounts in Liechtenstein and Switzerland did not come from these agreements but from whistle-blowers.

Mr. Ernewein did agree that automatic information exchange agreements which are now under discussion in the OECD and at the G20 would be “the next step”. A number of OECD countries already exchange tax information automatically with countries with whom they have tax treaties, and Canada does this with the United States, but most developing countries do not have the capacity to negotiate such tax treaties bilaterally.

Automatic information exchange would require governments to collect data from financial institutions on income, gains, and property paid to non-resident individuals, corporations, and trusts and that this data automatically be provided to the governments where the non-resident entity is located. It would greatly improve the effectiveness of tax collection from secrecy jurisdictions.

5. Canada should support upgrading the United Nations Tax Committee to an inter-governmental body and be provided with adequate resources.

To date, Canada has been pursuing international cooperation on tax matters primarily through the OECD. But the OECD membership is comprised of developed countries only. The tax policies and protocols promoted by the OECD have not taken the needs and interests of developing countries into account. Even though the G20 charged the OECD with taking leadership in reigning in tax havens, to date, their record has been very disappointing.

The United Nations has a Tax Committee of Experts that has made a valuable contribution on issues like transfer pricing, and model tax conventions. Canada has opposed upgrading this Committee to an intergovernmental body and has not supported providing it with adequate resources. The UN Tax Committee is a more representative forum than the OECD and Canada should support giving it a larger role in international tax cooperation.

6. Conclusion

Tax havens are a serious problem for Canada and the global community. The Canadian government can and should be doing much more to tackle tax havens. It is an encouraging sign that this committee has taken up this study. We trust that the Finance Committee will make some strong recommendations for action. And we hope that the government will take those recommendations seriously.

- i Friedrich Schneider, Andreas Buehn and Claudio Montenegro, **Shadow Economies All over the World**, World Bank Policy Research Working Paper #5356, July 2010.
http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2010/10/14/000158349_20101014160704/Rendered/IN/DEX/WPS5356.txt
- ii Tax Justice Network, **The Cost of Tax Abuse**, November 2011,
http://www.tackletaxhavens.com/Cost_of_Tax_Abuse_TJN_Research_23rd_Nov_2011.pdf
- iii James Henry, **The Price of Offshore Revisited**, Tax Justice Network, July 2012.
http://tjn-usa.org/storage/documents/The_Price_of_Offshore_Revisited_-_22-07-2012.pdf
- iv Statistics Canada Table 376-0051, International investment position, Canadian direct investment abroad and foreign direct investment in Canada, by country
[http://www5.statcan.gc.ca/cansim/a26?lang=eng&retrLang=eng&id=3760051&pattern=376-0054&tabMode=dataTable&srchLan=-1&p1=-1&p2=31](http://www5.statcan.gc.ca/cansim/a26?lang=eng&retrLang=eng&id=3760051&pattern=376-0051..376-0054&tabMode=dataTable&srchLan=-1&p1=-1&p2=31)
- v James Henry, Ibid. p. 5.
- vi Christian Aid, False Profits, Robbing the poor to keep the rich tax-free, 2009.
<http://www.christianaid.org.uk/Images/false-profits.pdf>
- vii Government of Australia, Project Wickenby Report, <http://www.ato.gov.au/corporate/content.aspx?menuid=0&doc=/content/00220075.htm&page=1&H1>
- viii CRA Enforcement and Disclosures Program Evaluation, October 2010 Section 5.2.2 . http://www.cra-arc.gc.ca/gncy/ntrnl/2011/nfrcmntdelsprgms2011-eng.html#_Toc274142204