The direct tax cost of tax havens to the UK

Richard Murphy FCA

Tax Research LLP

Introduction

This paper makes an estimate of the tax loss to the UK arising from the tax haven activities of those who are subject to UK tax upon their income, or who would be if the UK's HM Revenue and Customs knew about them.

The resulting annual tax losses are estimated to be £8.5 billion by high net worth individuals (HNWIs) resident in the UK, £3 billion by large UK companies and £7 billion as a result of tax evasion and related activities, or a total of not less than £18.5 billion per annum.

In calculating this cost it is assumed that the actions of HNWIs and large companies constitutes legal tax avoidance. Most of the £7 billion loss is the result of illegal tax evasion.

HNWIs

Tax Research and the Tax Justice Network published a report in 2005 entitled 'The Price of Offshore'[1]. Based on data from Boston Consulting Group, McKinsey's, Merrill Lynch/Cap Gemini and the Bank for International Settlements, this document estimated that the world's High Net Worth Individuals (HNWIs) held around $11.5 trillion of assets offshore, which would generate a return of about $860 billion a year at a 7.5% rate of return, and a consequent tax loss of about $250 billion as a result of it being held offshore.

This figure was considered extremely conservative: it did not include tax losses arising from tax competition or trade mispricing; the surveys on which the data was based excluded holdings of individuals with liquid assets below

[1] http://www.globalpolicy.org/nations/launder/haven/2005/Price_of_Offshore.pdf

$1 million, and corporations, which reportedly pass more money through tax havens than individuals.

In 2007 according to the Cap Gemini / Merrill Lynch World Wealth Report[2] there were 10.1 million HNWIs[3].

Of these they reported that 495,000 HNWIs were resident in the UK. Some of these were, no doubt, non-domiciled under UK tax law.

Assuming that UK resident HNWIs have similar wealth distributions to average HNWIs[4] then it is likely that the UK tax loss from HNWI activity offshore amounts to £8.5 billion per annum[5].

This is likely to understate the loss. UK HNWIs are widely believed to have above average wealth due to abuse of the domicile rule. They are also widely believed to pay little tax. For example, the Sunday Times[6] has reported that the 54 identified billionaires living in the UK:

> *paid income tax totalling just £14.7m on their £126 billion combined fortunes, and only a handful paid any capital gains tax. At least 32 of the individual billionaires or family groupings are calculated not to have paid any personal taxes on their fortunes, although they are liable for VAT and council tax.*

If that fortune yielded a return of 7.5% (reasonable in 2006) the income would have been £9.45 billion and tax paid should have been, at 40%, £3.78 billion by this group alone. This figure would be included in the £8.5 billion of loss making that figure for the tax loss appear credible, and almost certainly understated, as a result.

The loss of £8.5 billion also includes the loss of £4.3 billion arising from use of the domicile rule referred to in the TUC report The Missing Billions[7] prepared by the author of this paper in February 2008, and as such this loss cannot be counted again.

The other losses relating to personal direct tax noted in that TUC report resulted from the use of onshore mechanisms and as such cannot be included here.

---

[2] http://www.ml.com/media/100472.pdf
[3] An increase of 25% since 2003
[4] This is a modest assumption: due to the presence of many oligarchs they are much more likely to be very wealthy than average
[5] $255 billion x 495,000 / 10,100,000 = $12.5 billion which at £1 = $1.475 = £8.5 billion.
[6] http://www.timesonline.co.uk/article/0,,2087-2483988,00.html and http://www.taxresearch.org.uk/Blog/2006/12/04/im-rich-ill-pay-income-tax-at-014/
[7] http://www.tuc.org.uk/touchstone/Missingbillions/1missingbillions.pdf

Tax Research

UK large companies

The TUC report The Missing Billions noted that:

> *In 2006–07, HM Revenue & Customs raised £44.3 billion in corporation tax, of which £23.8 billion came from those [700] businesses within the Large Business Service.*
>
> *In 2006 the companies … survey[ed] declared UK current tax liabilities of £11.5 billion, or just under half the total tax managed by th[at] unit.[This report suggests that a] tax gap of £5.7 billion might arise from these companies.*
>
> *If th[is] estimated loss is extrapolated across all of these 700 companies then the total corporation tax expectation gap might be some £11.8 billion.*
>
> *This is an increase from £9.2 billion, which was the estimate made the last time a similar exercise to that undertaken here was completed, relating to the period to 2004.*

It would be quite unrealistic to attribute all this tax loss to tax haven activities. The companies themselves claim most is lost as a result of legitimate tax claims for capital expenditure. However, it is also notable that almost none refer to any benefit arising from the use of tax havens, or from lower overseas tax rates, or any associated issues such as the relocation of profits out of the UK by the transfer of intellectual property rights to such places.

There is, however, considerable evidence that these activities take place. The whole dispute about foreign profits that resulted in several companies leaving the UK in 2008 arose from this issue: the companies in question wanted to continue to secure the benefit of the low rates of tax they enjoy outside of the UK. Such is the significance of the matter to them that they have lobbied extensively for change in UK tax law so that foreign earned profits of UK multinational companies cannot fall within the UK tax net if remitted to the UK. This lobbying would not have arisen unless the amounts involved were substantial.

In addition, it is well known from international evidence that multinational corporations of the type surveyed take advantage of transfer pricing and other mechanisms for the reallocation of profits out of the UK. The largest study on illicit financial flows of this sort (a mispriced transaction being considered illicit for this purpose) which used trade statistics as the basis for its calculations was published by Global Financial Integrity in January 2009 [8] and estimated total world wide illicit flows of between $850 billion and $1 trillion per annum, of which 17% flowed to Europe. The tax loss on this is

[8] http://www.gfip.org/storage/gfip/executive%20-%20final%20version%201-5-09.pdf

obviously somewhat lower, but would at the OECD average 25% corporate tax rate exceed $230 billion using a midpoint, of which $39 billion (at least) would arise in Europe. The UK is one of the largest financial centres in Europe. It is reasonable to think at least 10% of this sum might flow to London given its importance as a financial market and headquarters location i.e. at current exchange rates at least £2.65 billion.

It is important to note that GFI estimate that at least two thirds of illicit financial flows arise in the course of commercial trade[9].

As the report also notes, this is bound to underestimate the losses as trade statistics cannot identify all forms of abuse. As such the estimate might reasonably be rounded up to the nearest billion and still remain cautious at £3 billion.

The sum is approximately 25% of the loss reported in the TUC report. This is considered entirely plausible, and justification for the considerable lobbying on the taxation of foreign profits that business has undertaken.

Tax evasion

It is well known that tax evasion by UK resident individuals takes place through tax havens. In the 2007 UK 'tax amnesty' approximately 120,000 customers of the five leading UK banks were identified as being UK resident but having bank accounts in the UK Crown Dependencies and some (but not all) overseas territories. 45,000 made a settlement in 2007 [10]. About £400 million was paid to HM Revenue & Customs as a result. The remaining cases are under investigation. In addition, HM Revenue & Customs is seeking to extend the enquiry to more than 100 additional banks in a wider range of jurisdictions.

It is important to note that even so this enquiry will only capture those who are naive enough to place their offshore funds in their own names. Those who use trusts and companies will not be caught; as such this exercise will only capture the small-fry tax evaders. The larger ones will not be in this group. They may however be in the HNWI category noted above, a group who do not however, it should be noted, usually evade their tax since they can afford to set up the structures to avoid and not evade their obligations. As such they are to be considered a separate grouping from the issue being considered here.

The smaller evaders will, however, be included in the total estimates of tax lost to tax evasion in the UK. The UK's HM Revenue & Customs estimate tax

[9] http://www.taxjustice.net/cms/front_content.php?idcat=103
[10] http://www.timesonline.co.uk/tol/money/tax/article3008168.ece

lost to tax havens by UK individuals is up to £1.5 billion a year[11]. This does, however assume that UK resident holdings in tax havens are just £80 billion.

Sterling deposits in Jersey alone in 2008 were, however, £68 billion[12]. Martin Sullivan of Tax Notes in the USA suggested in a report on Jersey published in 2007 [13] that at the end of 2006 there were $491.6 billion of assets in the Jersey financial sector beneficially owned by non-Jersey individuals who were likely to be illegally avoiding tax on income derived from those assets in their home jurisdictions. He used an exchange rate of £1 = $1.82. Of the illegal assets he noted $182 billion were in cash (37% of the total). This he estimated as 49% of all cash on deposit in the island.

Sterling deposits in Jersey are likely to be held either by UK residents or expatriates. The latter may well not be evading their taxes and might as a result be in the category of those Sullivan considers to be holding legitimate funds in that location. If 49% of the sterling deposits in Jersey in 2008 were held illegally by UK residents as a result then £33.3 billion would be held in Jersey alone by those likely to be UK resident.

Cash represents 37% of all financial assets held in Jersey. Assuming that UK residents who hold cash in Jersey on which they do not declare the income also hold other assets in Jersey, and in the same ratio as for the Jersey market as a whole (and the analysis of offshore portfolios in reports like the World Wealth Report suggests this is likely) then the £33.3 billion of cash they hold represents 37% of their total Jersey holdings, meaning their total holdings are likely to be £90 billion (33.3% of the Jersey total).

We know that Sullivan's estimates of assets held for illegal purposes in the Isle of Man and Guernsey are $150 billion and $293 billion respectively (£243 billion in total) of which the UK part is therefore likely to be about £80 billion.

Added to the Jersey total of £90 billion the total comes to £170 billion. This suggests that the HMRC estimate for these three locations of £48 billion based on Datamonitor information is far too low[14]. So too, therefore, will be the estimate of tax lost. Instead of being in a range of £900 million to £1.5 billion per annum it should be in the range £3.2 billion to £5.3 billion. A mid-point of £4.3 billion of tax evaded will be used here.

[11] http://www.taxresearch.org.uk/Blog/2008/03/14/uk-tax-gap-can-only-exist-with-the-knowledge-of-accountants/

[12] http://www.jerseyfinance.je/_support/uploadedFiles/Quarterly%20report%20for%20period%20ended%2030th%20September%202008.pdf

[13] http://www.taxanalysts.com/www/features.nsf/Articles/3ACC6C4D1B6B00218525738A006716E4?OpenDocument

[14] http://www.hmrc.gov.uk/research/direct-tax-gaps.pdf page 50

There are however other tax losses from the use of tax havens. VAT carousel fraud has been undertaken almost entirely using offshore bank accounts. In 2005-6, the Commons Public Accounts Committee said the cash loss amounted to £2bn to £3bn[15]. A figure of £2.5 billion will be used here.

And there will be other losses as well. For example, the sale of DVDs and other products from Channel Island web sites is expected to cost the UK Exchequer at least £90 million a year[16] - a figure many consider understated by a considerable margin, and whilst this may not be evasion it is typical of the use of these places for abuse.

A modest estimate of total losses of £7 billion is used here as a result, safe in the knowledge that this is bound to underestimate the impact of these locations on the UK tax yield.

Conclusion

This data suggests tax losses might be £8.5 billion from UK resident high net worth individuals[17], £3 billion by large UK companies and £7 billion as a result of tax evasion and related activities, or a total of not less than £18.5 billion per annum.

This is enough to take 4.5p of the basic rate of UK income tax[18] – reducing it to less than 16% if that were done.

Alternatively it could fund substantial and essential public expenditure, helping fund for example the creation of the vital green energy infrastructure the UK needs.

Either way what is clear is that tax havens, those who use them, and those who promote their services within them, impose a considerable cost on the UK Exchequer and urgent action is needed to stop this abuse.

---

[15] http://www.independent.co.uk/news/business/news/carousel-fraud-has-cost-uk-up-to-16316bn-458771.html
[16] http://www.guardian.co.uk/business/2008/jul/19/hmvgroupbusiness.retail
[17] A figure greater than that for abuse of the domicile rule alone, it should be noted – and a figure that is logical in being so because the loss is caused by the actions of more than those who can make use of that rule
[18] http://www.hmrc.gov.uk/stats/tax_expenditures/table1-6.pdf