Funding the Future

The Tax Justice Network's new estimates of tax lost to ...

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Over the last few months a lot of my time has been devoted to work in the national debt. The result of much of that labour has yet to be published because answers to some quite critical questions are only now becoming apparentï¿¼. ï¿¼The blog that I published yesterday on quantitative easing is, however, one of the outcomesï¿¼. The effort has been worth it, but sometimes I have been distracted from other issues.

One such issue was the new Tax Justice Network report on the cost of international tax abuse.

The report claims two things. The first is that international tax abuse by companies shifting profits out of the countries where it should be paid amounts to $245 billion (££188 bn) a year. All figures are in US dollars.

The second is that the cost of personal tax evasion using tax havens is $182 billion (£140 billion) a year.

Total losses are $425 billion (£327 billion) as a result.

In a UK context the first category is stated to be $10 billion (£7.7 billion) and personal tax evasion is said to cost $29 billion (£22.3 billion). These figures are compared with a U.K. tax take said to be $740 billion (£570 billion).

I was not part of the advisory group for this report but did see the data in advance of publication and advised of my reservations, because I have them.

First, let's deal with the basic error. The UK budgeted tax income for 2019/20 was was £755.8 billion. That is very hard to equate to the TJN claim for total UK tax of $740 billion, which translates to £570 billion at the official exchange rate in March 2020 of £1 = $1.295. This type of error does not help.

Second, I acknowledge that the worldwide corporate tax loss is faded on OECD data from country-by-country reporting information published by the OECD, and I welcome that. But the losses have been extrapolated at average effective tax rates paid according to the same OECD reports in the countries in question and I am baffled by that. The shifted profit is marginal, and not average income lost. It is very unlikely that more allowances and reliefs that reduce an effective tax rate in a country will be available because headline profit is shifted from a country. The right tax rate to use to estimate the loss is, then, the headline rate for a country. I know I am not alone in pointing this out. TJN has in that case seriously understated corporate tax losses as a result. I am aware that overstatement is never a good idea, but this seems like an error to me.

The result is that the U.K. figure also looks to be understated. The TJN figure, translated to pounds £7.7 billion. This can be compared with recent reports that HMRC thinks corporate tax abuse, much of it related to the issues TJN concerns itself with, should yield it more than £13 billion on investigation. Much of that estimate will also be based on country-by-country reporting data. I know that which HMRC has is more granulated than the OECD data, but I strongly suspect the tax rate error by TJN explains much if this difference. This must be the first case when tax campaigners are claiming abuse is less than a tax authority estimate.

I also question the personal tax loss estimates. The quantum of offshore money, at $10.5 trillion is remarkably close to an estimate I prepared in 2005 when I was working with TJN of $11.5 trillion. The link has now gone from the TJN web site but it is referred to here. On a consistent basis with the current report the 2005 estimate was about $9 trillion. The current report excludes all non-financial assets. I can live with that, and with inflation allowed for it might indicate small progress since then.

But I do have a problem with the calculation of the loss. The 2005 report assumed a portfolio return rate of 7%, which was hardly ambitious at the time. In 2020 the assumption is a 5% return rate. Given that much of the illicit offshore funds will be held in cash to reduce the chance of multiple scrutiny within the financial services sector, and because cash holdings dominate many offshore portfolios from the countries TJN says is losing most, I find that current rate of return very unlikely. A quick check suggests shares have yielded 7.6% in the last decade, bonds 3.6% and cash a lot less. I think 50% cash holdings likely in these portfolios was on wealth reports from major banks, at least. The return, and so tax loss estimate is too high for this reason.

On the other hand, it seems like the tax lost on the capital illicitly moved from source countries is ignored, as if it is assumed that there is now a static offshore capital stock. That loss on capital shifted could be much higher, of course. The estimate appears understated for this reason.

I welcome all reports that suggest offshore remains a problem. But this one is very curious, overall appearing to significantly understate the potential issue whilst including basic errors. I will not be using it as a benchmark as a result. TJN says this exercise will be repeated annually now. I hope opportunity is taken to improve it.