Are Tax Avoidance 'Havens' a Bad Thing? Part I

Nicolas Véron explains why low-tax havens in Europe like Ireland and Luxembourg are a legitimate business model and will be hard to suppress.

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Steve Weisman: The United States is in something of a political furor over multinational corporations, especially Apple, supposedly evading taxes by shifting their operations and their intellectual property rights overseas to places like Ireland and Luxembourg. In Europe, there's also a controversy, especially in Britain, over the same thing, and also over individuals having secret bank accounts. This is Steve Weisman at the Peterson Institute for International Economics, with Nicolas Veron a visiting fellow here, also from Bruegel, to talk about the scene in Europe. Nicolas, Europe looks at this situation differently as a tax set of issues, but also banking issues.

Nicolas Véron: In Europe, each country has a slightly different debate on this, but I think almost every country in Europe has a debate about tax evasion. It happens not to be, necessarily, the same kind of tax. And in particular, on the continent, I think the emphasis recently has been more on individual income tax, especially by wealthy individuals or public figures such as Jerome Cahuzac, a former budget minister in France, or as a head of a football club, soccer club in Munich, in Germany.

Writers and large multinational corporations such as Apple, or Google, or Starbucks have been more the case in the UK and the US, but there is a lot of debate everywhere about tax evasion. Personally, I think it's entirely connected to the fact that most countries are under pressure to consolidate their fiscal situation, and therefore there is more sensitivity to tax evasion, because the screws are being turned on most stakeholders.

Steve Weisman: The United States saw some of that in the presidential election in 2012, with Governor Romney's tax returns.

Nicolas Véron: By the way, sorry for interrupting, it's also an issue outside of the North Atlantic. I mean in India, you have a huge debate about this evasion of domestic tax, and people putting their money in Mauritius, or wherever it is, I mean wealthy individuals, not unlike what you see in continental Europe.

Steve Weisman: Let's go back to these notorious tax havens, many of them in Europe. We saw that setting up a low tax rate and a low regulatory system, and even to some degree, a secretive one, was kind of a business model. First, for Cyprus, and after Cyprus there's talk of other countries in the crosshairs: Ireland, Luxembourg, Monaco, other places. How do the Europeans see that?

Nicolas Véron: Well, different things here. First, this debate is dominated by the cliché of the small country tax haven. I think, frankly, this is unfair to small countries in general, if only for the reasons that a lot of large countries have very attractive tax niches, and compete on tax like on everything else. Countries compete on tax. Governments have to raise revenue, and they want to attract as many taxable factors to their territorial base, so that they can raise more revenue. And this is true of small countries; this is true of large countries, only the equation is not the same for small and large countries. And we are in a world of sovereign states, where this tax competition in principle is allowed and acknowledged.

Now, it happens that many of the decision-making committees and bodies at the international level, starting with the G20, are dominated by large countries, or even only composed of large countries, in the case of the G20. Therefore it's easy for them to find an agreement by bashing the small ones, which are not part of the committee. But there is a fundamental element of unfairness in this cliché, even though there are a lot of deplorable and highly condemnable practices in some small countries. But I think having this distorted factor in mind is very important.

Steve Weisman: How do big countries with ostensibly high tax rates like Germany, or I guess France, compete with "niche" tax rates?

Nicolas Véron: Because different countries tax different things. If you want to escape capital gains tax, you go to Belgium. If you want to escape income tax, you go to a different country. If you want to escape gasoline tax, for some reason, you go to the U.S.

Steve Weisman: Well, you can't drive to the U.S. from Europe.

Nicolas Véron: But I'm sure actually there is some arbitrage of this, even though probably not on a huge scale. But just to say that the UK has maintained, for example, this extraordinarily favorable system for a very long time for non-domiciled residents—so-called non-domiciled individuals in the city of London, that allow wealthy individuals from Russia, India, or wherever in the world, to live in London and pay very little tax. It only is attractive if you are extremely wealthy, because you have to pay the minimum amount of tax, which is much more than you and I would pay.

But still, if you are extremely wealthy, it's incredibly attractive, so this idea that the low tax regimes are only in small countries is just entirely wrong. It's not the world we live in.

Steve Weisman: And speaking of the UK…

Nicolas Véron: The Netherlands, by the way, is not a very small country, and has an extremely favorable tax regime for multinationals, which has given rise to the famous Dutch sandwich, which is now receiving some international recognition together with its sidekick the Double Irish. And for tax lawyers, this is a familiar combination of the Double Irish and the Dutch Sandwich, which is one of the techniques used by Google and other multinationals to evade corporate income tax.

Steve Weisman: Let's stop there for part II.

Nicolas Véron: Thank you, Steve.