ProQuest

Tax and terrorism: a new partnership?

M. Michelle Gallant. **Journal of Financial Crime**. London: 2007. Vol. 14, Iss. 4; pg. 453

Abstract (Summary)

Purpose - This paper has the purpose of being a preliminary exploration of the link between taxation and the contemporary assault on the financial aspect of terrorism. Design/methodology/approach - This is a discussion paper. Findings - Locating the origins of the link in the terrorist attacks of September 2001, it considers the ramifications of the fusion of taxation and international tax havens with terrorist finance. Originality/value- The paper considers the link between taxation and the financial aspect of terrorism. [PUBLICATION ABSTRACT]

Full Text (3652 words)

The global chase for terrorist assets has shed light on a link between tax and terrorism. Tax havens have been associated with terrorist finance, identified as potential centres for filtrating terrorist assets and for enabling the cross-border movement of the resources destined for terrorist enterprises[1] . Complex multi-jurisdictional financial transactions have become the venues for the merger of terrorist finance with other mobile capital, its criminally ordained purpose hidden midst the convolutions of international tax and related transactions.

To many the mechanics of tax is an inaccessible subject. It consists of a complex matrix of laws best left to the professional few who choose to play within its increasingly intricate confines. Adding the gyrations of international tax dealings to the mix multiples the complexities. And when tax converges with terrorist finance, a domain previously reasonably ignored by international criminal law policy suddenly comes under scrutiny as part of the global anti-terrorism initiative. In illuminating this fusion of two discrete disciplines, this paper tentatively explores the contours of the emerging relationship between taxation and terrorist finance.

Taxation and terrorist finance

The realm of taxation remained relatively resistant to the onslaught of anti-criminal finance strategies that have arisen over the course of the past few decades[2] . Anti-money laundering laws and confiscation regimes, the core of national and international efforts to curb criminal pursuits by targeting their financial underpinnings, paid little heed to taxation. In its legislative regime implementing anti-money laundering norms, confiscation laws and forfeiture regimes, English law introduced the discrete power to levy a tax on unlawful earnings [1] Mumford and Alldridge (2002)[3] . In most jurisdictions, the unlawful origin of revenue does not preclude the imposition of a tax because tax law ordinarily draws no distinction between lawful and unlawful revenues: revenues, of any source, are liable to be taxed[4] . The forfeiture of criminal earnings, the products of criminal pursuits, is sometimes loosely justified as an exercise in taxation although this is a complete misnomer. Forfeiture or confiscation laws generally entail the forfeiture of all moneys derived from criminal pursuits. Tax laws normally only take a percentage of earnings, at times a substantial piece, but never the full amounts earned. And of course, since illicit transactions fall outside the field of lawful market transactions, no consumption tax, a tax attaching at the point of the sale of goods, applies to the sale of goods such as illegal drugs or arms.

In the domain of international taxation, the existence of tax havens, have always been a peculiar blight on the ability of states to levy and collect taxes. Characteristically identified with lower tax rates, these havens create intense competition for revenues in search of the cheapest global residence. Other attributes of tax havens such as stringent confidentiality rules attract venom as shelters for revenues of criminal origin, the attempt to track the global trail of dollars thwarted by numbered accounts, an inability to identity legal and beneficial owners, and the lack of any systemic scrutiny of financial activity ([2] Oxfam, 2000)[5] .

The linkage between taxation and terrorism began to achieve prominence with the events of September 2001.

Derelict tax jurisdictions which had previously suffered some modest association with global-criminal enterprises climbed into focus as centres for the circulation of terrorist finance ([3] Costello, 2005; [4] Weintraub, 2002)[6] . Largely, this identification was the product of the concerted international response to terrorism and its focus on terrorist finance, the abrupt pointing of fingers at money as the fuel for terrorist activity. Moreover, the international mobility of funds facilitated the internationalization of terrorism. Attacks could be hatched in one jurisdiction and carried out in another with a series of intermediate jurisdictions allowing the essential funding to flow with the act to its final culmination.

Tax crimes and crimes of terrorism

Tax crimes and dubious related international tax manoeuvres rarely invoke the scathing response that greets terrorism although like terrorism national imperatives and the claim that "is it not our problem" tends to inform particular national responses. September 2001 made terrorism an international imperative, particularly since the voices that heavily shape international norms, the USA, were the primary victims. Equally, the scale of the devastation and its real-time televised nature contributed to the congealing of international sentiment over the need to vigorously attend to terrorism's evil power.

Apart from a few notorious cases, tax crimes never attract much attention nor muster significant political will to counteract their occurrence[7] . Criminal breaches of national taxation codes, known as tax evasion or tax fraud, involve the theft of public resources. Appreciations to economic spending power, whether of business origins, employment origins or some species of taxable wealth accumulation (wealth taxes or inheritance taxes) are usually subject to taxation. When financial affairs are knowingly arranged to evade the payment of tax, most jurisdictions acknowledge that this constitutes a criminal offence[8] . The offensive quality of the act does not emerge, as it does for terrorism, from the source of the earnings or from their ultimate destination. Rather, it arises from the knowing failure to disclose those earnings and thus evade paying the dues owed to the state.

In part, tax offences fail to generate much interest because there is a failure to perceive and fully appreciate the consequences. The commission of tax crimes deprives the state of the moneys needed to fund the state infra-structure. Unlike terrorist offences, the costs or public harm are not acutely visible. Equally, they are not animated by a culture of fear, the concern that we might be terror's next arbitrary victim. The harm is simply a loss of revenues, public revenues, not privately-held revenues: the victim is just the state, and the injury is merely a financial loss. But the harm of tax offences is very real. Denied its resources, the state loses some of its capacity to fund public goods - social services, education, the military who might have a role to play in intervening in states that sanction terrorism and the national police forces charged with the task of terrorist detection and prevention. Moreover, other taxpayers endure the financial burden of tax crimes. The easiest way to make up for the stolen revenues is to increase the taxes paid by the other taxpayers.

In part, too the evasion of taxes enjoys a level of tacit public approval that terrorism does not. While societies quibble over the distinction between freedom fighters and legitimate resistance movements, and terrorists, and seek to distance themselves from the latter, few defend the arbitrary slaughter of their citizens or their property. Most, however, resist the payment of taxes and use many legitimate tax avoidance strategies to minimize their tax burdens [9] . Tax offenders merely ventured one step further.

The nascent attack on terrorist assets causes the convergence of tax offences and terrorist finance. The same strategies and tactics used to evade the payment of taxes are identified as the methods used to move terrorist finance. Whatever tolerance there may have been for tax crimes is no longer sustainable if the dollars once thought to be the product of tax crimes might equally be dollars destined for terrorism.

Tax havens and terrorist finance

With the increased interest in confronting terrorism, tax havens are coming under increasing scrutiny as the demons of terrorist finance, the sanctuaries and the conduits for the movement of blood money. Classically, these entities were principally criticized for depriving states of tax revenues, not for their possible function in facilitating terrorist finance. Terrorism helps to re-cast the tax havens as terrorist finance havens and serves to amplify the condemnations.

But perspective is keenly relevant, for the tax inquiry, to the question of the designation of a jurisdiction as an illegitimate haven. For developed countries, countries rich in natural resources, educated human capital, technology and thriving business, trade and investment sectors, tax havens constitute illegitimate venues through which taxable earnings are unlawfully exported. In a transnational business climate, this export can be achieved through a variety of mechanisms. Many jurisdictions tax on the basis of residency or source or some combination of these two. Shifting residency from one jurisdiction to another is one way to avoid taxation. Developed countries counter this trend through various devices, including through source-based taxation, the taxation of non-residents and the negotiation of international tax treaties. Once earnings move to a tax haven, however, even if the developed country has some legitimate claim to a portion of those earnings, it is difficult to enforce that entitlement since the moneys are, at that point, beyond national reach. The conflicts of laws principle that denies the recognition and enforcement of foreign tax judgements exacerbates this problem[10] .

Transnational business practices that plague developed countries are tactics that enable the profit of an enterprise to be located in a jurisdiction of choice, usually a country with a low tax rate. When a business operates, or has related-affiliates, in different countries, a common technique is to organize financial affairs so that profit, the sum total of its revenues minus its expenses, occurs in the jurisdiction with the lowest tax rates. For example, a company located in a developed country, country A, may purchase (expense) goods used in the production process in country A from a related-company in a tax haven, country B, at prices that are excessive or that exceed fair-market value ([5] OECD, 1995)[11] . The commodities are subsequently sold (revenues) in country A. The bulk of the taxable profit accrues in country B because the artificially high expense leaves little money in country A. Of course, an incredible profit arises in country B but, because the tax rate is low to non-existent, this consequence appeals to the transnational business. Framed in this manner, for a developed country tax havens are illegitimate quests to secure the export of resources that rightfully belong, from a tax-perspective, in the state coffers of the developed country.

For the tax havens jurisdictions, the portrait is not quite so dire. Tax havens predominantly emerge in jurisdictions that are less developed than their counterparts ([6] OECD, 2000; [7] Financial Action Task Force, 2000)[12] . Some lack economic resources or a well-developed public infra-structure. A history of colonial exploitation may be part of their past. They may have been excluded from the prosperity of an early protectionist era that allowed developed countries to accumulate capital and hone their infra-structure leaving the less-developed simply unable to compete in an age dominated by freer global trade and investment norms. Rejecting the label of tax haven, it is a financial service industry that develops in these jurisdictions. The services offered, including tax advantages, require little capital investment and few, to no, natural resources. Rather, they use legal norms to cultivate an investment climate that is eminently appealing to global capitalists. Historically, the jurisdictions rely on competitive tax rates, stringent financial privacy rules and creative financial products to charm potential clients. And tax revenues are not usually the countries' primary source of public funds. Bank licensing costs and other service fees generate the bulk of state revenues ([8] Brittain-Catlin, 2006). For the tax haven countries, their motivations for the creation of a tax-friendly and financial services jurisdiction are a legitimate attempt to compete with other financial centres for global dollars.

To depict the tax haven discourse as a fight between developed and less-developed countries tends towards oversimplification. Jurisdictions which have none of the attributes of less-developed countries, Switzerland and Liechtenstein, for example, have notorious haven pedigrees. The very institutions that choose to establish offices and branches in tax havens are the same institutions that operate in virtually all developed countries, semi-expatriots who seek to avoid the taxation regimes of the countries within which they are well-established. Even within developed countries, it is not only its financial institutions but equally its wealthiest class which can lay claim to the advantage that tax havens present. While the public voice of the countries witnessing the export of dollars decries the existence of havens, its private sector, principally its wealthier private sector, claims the benefits. The life-blood of the tax-planning professional, typically the agent of those with more than a few dollars to spare, is the quest to defer or otherwise avoid the payment of taxes. Creative tax planning, at times reliant on tax havens, allows this to occur. To the extent that there is a clash in the tax haven discourse between states, it is also a clash within states, with private citizens seeking the advantages of the tax shelters which their state opposes.

Into this existing discourse terrorism adds a new twist. Previously, the arguments about the putative tax-haven status of certain jurisdictions evolved around tensions between economic interests, competing claims of rights to taxable dollars. The fact that the mobile dollars are now potentially terrorist moneys changes the rules of the game. Terrorism trumps economic arguments. Whether the creation of a financial haven produces local economic benefits or not when those benefits pre-empt the pursuit of terrorist finance, they fall on the sword.

The consequences of merging terrorism and tax run much deeper than this. International financial transactions, whether linked to tax evasion or to terrorist finance, are complicated affairs. Canadian taxation law, complete with inter-jurisdictional tax treaties, occupies thousands of pages of text[13] . Terrorist financing laws, in most countries, are increasing in length and complexity. The movement of terrorist money and the movement of taxation moneys usually involves multiple incidents of corporate law, international commercial law, international trade and investment law, each a complex entity onto itself ([9] Financial Action Task Force, 2006)[14] . Since, a dollar or some other representative financial instrument does not, on its own, reveal its origins or intended purpose, it is the trail that must be unwound, opened and followed. When the trail is cluttered with intermediate transactions, corporate entities, jurisdictions and laws, the task before the hound is immense. He must be familiar with tax law and practice, with terrorist financing laws and tactics, with corporate law and practice as well as with the wealth of intersecting international norms.

For those disposed to acknowledge the evils of tax offences, there is an obvious benefit to any tax and terrorist finance link. Whether moneys are destined for terrorism or are the product of tax offences, both are criminal offences. If the pursuit of terrorism exposes, dirty tax dollars, so much the better.

And this may be the unspoken advantage of linking these two. Years of pursuing criminal earnings around the globe, of harmonizing national laws with respect to anti-money laundering laws and confiscation regimes, of imposing increasingly harsh obligations on the agents of international financial transactions to report any suspicious financial activity, have meet with resistance. It may be that the task of separating the clean dollars from the dirty is simply too difficult to accomplish. However, with the risk that the dirty dollars may be destined for terrorist activity, there may be more incentive to fully investigate the international financial sphere and to develop concrete and acceptable strategies which will facilitate the disclosure of the terrorist and tax dollar alike.

[Footnote]

1. Tax haven is one of a cluster of euphemisms. It tends to be synonymous with "off-shore" financial centres and jurisdictions described as having "harmful tax practices".

2. The genesis of the strategies is the 1988 United Nations Convention which sought to harmonize national norms respecting the concealment of earnings linked to drug offences (money laundering) and the forfeiture (confiscation) of drug revenues. At the international level, money laundering laws and proceeds of crime provisions now pepper international crime control devices. Domestically, states began to extend the reach of money laundering and confiscation laws to capture financial products linked to any criminal offences. Some extended the strategy beyond the traditional confines of the criminal law (the right to forfeit criminal proceeds dependant upon a criminal conviction) to reliance on civil processes. For example, see generally, United Nations Convention Against Illegal Traffic in Narcotic Drugs and Psychotropic Substances, 1988; United Nations Convention Against Transnational Organized Crime, 2003; Proceeds of Crime (Money Laundering) and Terrorist Financing Act, 2000, c. 17 (Canada); Civil Remedies Against Organized Crime Act, 2002, C.C.S.M. c. C107 (Manitoba, Canada).

3. Proceeds of Crime Act, 2002, (UK), Part 6.

4. In the Canadian context, see, for example, [10] *R.* v *Poynton* , [1972] wherein the proceeds of fraud were subject to taxation.

5. Numerous reports identify the ingredients of tax havens; Tax Haven Criteria, OECD, www.oecd.org

6. An examination of the literature reveals a market tendency to couple taxation and tax havens with terrorist financing in the post-2001 period: see, for example, USA Patriot Act, 2001, section 302 (finding link between off-shore financial jurisdiction and the circulation of terrorist finance); Harmful Tax Practices, OECD Council at the Ministerial Level, 15-16 May 2002, www.oecd.org at paragraph 6; (stating "Excessive bank secrecy can be used to cover money-laundering and terrorist financing as well as tax evasion".) "Terrorism Financing and Financial System Vulnerabilities: Issues and Challenges" (2006) 3 International Threat Assessment Centre, at 9 (noting "A second source of vulnerability in the financial system is the existence of offshore financial centres (OFCs) with lax regulations, where there are greater risks that terrorism transactions can be hidden ... they represent a loss of tex revenue for countries around the world, as individuals and firms hide their income in these 'tax havens'."). Although beyond the scope of this paper, another tax angle introduced by terrorism is the relationship between terrorist finance and charitable organizations. Charities have come under attack for their putative role in funnelling terrorist finance and risk losing their preferential tax status. For a summary of these issues, see Charities in the International Context, Canadian Revenue Agency, www.cra.gc.ca/tax/charities/international

7. The case of Alphonse Capone, also known as Scarface, is the infamous exception. Capone was a notorious Chicago crime king of the 1920s. Although well-known for his role in diverse criminal enterprises including several execution-style murders, it was the mundane offence of tax evasion that eventually brought about the demise of his empire.

8. Income Tax Act, RSC 1985 (Canada), Sections 238 and 239.

9. Tax avoidance, as opposed to tax evasion or tax fraud, is not a criminal offence. Everyone is entitled to arrange his affairs so to reduce his tax liability. Refusing to work, for example, is the most banal form of tax avoidance. Since, there is no taxable income such as employment income, the tax is avoided. More sophisticated tax avoidance strategies include the transformation of fully taxable income into other forms of non-taxable income or income that attracts lower tax rates. The transformation of business earnings into capital gains is a common tax planning strategy since, under Canadian tax law, capital gains are taxed at a lower rate than business income. The distinction between lawful tax avoidance and illegal tax evasion is fraught with controversy.

10. Standard case saying conflict precludes tax judgment.

11. This is traditional transfer pricing. International regulations attempts to establish rules for discerning when the transfer

pricing is legitimate and when it is not.

12. In 2000, counties listed by the OECD found to meet its tax haven criteria included Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Bahrain, Barbados, Belize, British Virgin Islands, Cooks Islands, Dominica, Gibraltar, Grenada, Guernsey, Isle of Man, Jersey, Liberia, Liechtenstein, Maldives, Marshall Islands, Monaco, Montserrat, Nauru, Panama, Samoa, Seychelles, St Lucia, St Kitts and Nevis, St Vincent and the Grenadines, Tonga, Turks and Caicos, US Virgin Islands, Vanuatua. There is a telling parallel between the countries listed by the OECD and the countries listed by its sister organization, the Financial Action Task Force, in the same year as failing to comply with international efforts to combat money laundering. The later reports lists Antigua and Barbuda, Bahamas, Belize, Bermuda, British Virgin Islands, Cayman Island, Cook Islands, Cyprus, Dominica, Gibraltar, Guernsey, Isle of Man, Jersey, Israel, Lebanon, Liechtenstein, Malta, Marshall Islands, Mauritius, Monaco, Naura, Niue, Panama, Philippines, Russia, Samoa, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines.

13. The Canadian Income Tax occupies several hundred pages of text. An annotated version, complete with attendant schedules, regulations, and tax treaties, occupies several thousand: see Stikeman Income Tax Act Annotated, 38th edition, Carswell, Toronto.

14. Adding to the complexity, in 2006 the Financial Action Task Force identified international trade as a forum for money laundering. It is worth nothing that the laundering techniques identified - over- and under-invoicing of goods and services, multiple invoicing of goods and services, over- and under-shipments of goods and services and falsely described goods and services - resemble, in species, the tactics which have long been associated with money laundering by organized criminal groups. It is the international component which sets trade based laundering apart.

[Reference]

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10. *R.* v *Poynton* (1972), CTC 411.

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[Illustration]

Indexing (document details)

Subjects:	Studies, Terrorism, Tax havens, Crime, Finance
Classification Codes	9130, 1210, 4200, 8100, 4300
Author(s):	M. Michelle Gallant
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Document types:	Feature
Document features:	References
Publication title:	Journal of Financial Crime. London: 2007. Vol. 14, Iss. 4; pg. 453
Source type:	Periodical
ISSN:	13590790
ProQuest document ID:	1347259291
Text Word Count	3652
DOI:	10.1108/13590790710828163
Document URL:	http://proquest.umi.com/pqdweb?did=1347259291&Fmt=3&clientId=8631&RQT=309&VName=PQD