

**Equity, Transparency, Cooperation
and the Taxation of High Net Worth Individuals***

by

Vito Tanzi**

*Paper written for presentation at the Fourth International Tax Dialogue Global Conference on “Tax and Equality”, New Delhi, India, December 7-9, 2011.

**Honorary President of the International Institute of Public Finance; former Director, Fiscal Affairs Department, IMF; and former Undersecretary for Economy and Finance, Italian Government.

“An Imbalance between rich and poor is the oldest and most fatal ailment of all republics”

Plutarch

I. Introduction

In The Wealth of Nations, published in 1776, Adam Smith described the characteristics that a good tax, or a good tax system, should have. These were: certainty, convenience, economy, and equity. By equity he meant mostly *horizontal* equity. Smith maintained that, when any of these characteristics is missing, a tax, or a tax system, could not be considered good.

Writing in the pre-industrial revolution and pre-globalization era, Adam Smith could not have been concerned with modern tax issues such as progressivity, transparency, complexity and international tax evasion, because these issues were largely absent at that time. The world has changed a great deal since 1776 and the pace of change has accelerated in recent decades. Tax levels have increased significantly, raising the question as to how the high tax burdens should be shared among individuals belonging to different income classes, especially when: (a) before -tax incomes are distributed very unevenly; (b) tax rates are much higher than in the past; (c) taxes have become more complex; (d) some individuals and capital have become highly mobile; and (e) the globalization of economic activities and of the capital market have created opportunities, for evading taxes that had not existed in the past.

These developments were taking place at a time when the governments' perceived need for additional public revenue was growing. The governments of

both rich and poor countries have been forced to rely on loans to finance their public spending. This has led to worrisome growth in public debts, and to potential fiscal crises. The need for higher tax revenue in future years will continue to be acute in developed countries, to help them get out of their current fiscal difficulties and to finance their fast-growing future needs, and in developing and emerging markets, to allow governments to promote policies for growth, and for raising the living standards of poorer sections of the population.

II. On High Net Worth Individuals and their Income Levels

“Ability to pay” has been an important guiding principle of taxation for at least a century. The view that people with high income, or high net worth individuals (HNWIs), should pay more taxes than their less fortunate compatriots has, over the years, received much support from tax experts, citizens at large, and most governments. While there has been some academic and political debate on the merits of this principle, a debate that continues today especially in the United States, the principle has not been widely challenged.

Some political observers have maintained that the HNWIs are the creators of jobs and the promoters of economic growth. Therefore, their incomes ought to be protected. Those who strongly hold this view, as for example the members of the Tea Party in the USA, tend to assign little importance to the role that governments play or can play in the growth process. They think that governmental activities are inherently unproductive. On the other hand, those who tend to assign greater importance to what governments do, or can do, argue that

governments can play their growth-promoting or socially important role, only if they have the needed financial resources, for building infrastructure, for educational spending, and for other growth-promoting or socially important functions. An area where tax resources can be found is, obviously, in the high net worth individuals.

Before dealing more directly with tax questions, in a conference that deals with “Tax and Equality”, let us briefly review the evolution over time of top incomes, to get a better quantitative idea of how much taxable capacity exists, or can be assumed to exist, among them. In countries with relatively even income distributions before tax (those whose markets produce low Gini coefficients), by definition, the HNWIs receive modest shares of the countries’ total income. However, when the before-tax, Gini coefficients are high, the HNWIs receive higher shares of total income and , consequently, have a higher taxable capacity.

In addressing the question of the taxation of the HNWIs, we need to start with some definition of what makes an individual belong to the HNWIs. Such a definition cannot be based on the absolute income of the taxpayers but must be related to the per capita incomes of the countries. In low -income countries, the HNWIs may have *absolute* income, that would make them part of the middle class of richer countries. For this reason, the definition of the HNWIs must be country specific.

According to a recent study, prepared by a Singapore-based research and advisory firm (Wealth-X), reported by Blumberg News (on September 1, 2011), there are 62960 *ultra*-high-net-worth individuals in North America, 54325 in

Europe, and 42525 in the Asia-Pacific region. These are individuals each with a net worth of at least US \$30 million. India was reported to have 8200 such individuals, and Indonesia 725. The report stated that “US wealth managers [hire] hundreds of advisers to handle the[ir] assets ...”. Many of these “advisers” are “tax planners”. Presumably the *ultra* HNWIs of other countries do the same.

The above data refer to *ultra* HNWIs. However, one does not need to have a net worth of over \$30 million to be considered rich and to be able to pay higher taxes than the rest of the population. In recent years, some academic literature has focused on the incomes of individuals at the top one percent or, in some cases, at the top one per thousand of the population, or of the taxpayers. In relative terms these individuals must be considered rich, within the countries in which they have residence. See Piketty and Saez, 2006; and Atkinson, Piketty, and Saez, 2011. This literature has traced, over the years and through tax data, the trends in the share of total income received by these lucky individuals.

Obviously, the reliance on tax data is likely to bias downward the income estimates of the richest one percent (or one per thousand), especially for recent decades when the countries’ economies were more open, the financial market more global, the tax consultants more active and alert, and the possibility available to rich individuals for avoiding taxes were more easily available. The “tax advisers” were at times paid, for their “advice”, on how to save taxes to those who hired them, on the basis of the taxes actually “saved”. The existence of many *tax havens* and *off shore centers* was of great help. It should also be kept in mind that the capital gains that had not been realized were not reported to the tax

authorities. These capital gains are likely to be concentrated at the top and in a period of growth can be significant.

The academic studies have reported that the shares of total taxable income attributed to the top incomes dropped dramatically in the first part of the 20th century, until the late 1960s or early 1970s, because of two Great Wars and of the Great Depression, events that lowered the returns to capital incomes, or that destroyed much privately- owned capital. Also, during this period, the tax rates on capital incomes were sharply increased and, especially in the period during World War II and in the years immediately after, they became very high. In the mid-1960s these taxes became so high that they even inspired a Beatles’ song, called “The taxman”. Its lyrics were: “I will tell you how it will be, one for you, nineteen for me, ‘cause I’m the taxman”. The marginal tax rate at that time exceeded 90 percent in the UK, where the Beatles paid their taxes. So there was no exaggeration in their counting.

For the USA, an American think tank (The Tax Foundation) has estimated the effective tax rate, for heads of households that had earnings equivalent of \$1 million for the 1913-2010 period, at 2010 prices. See Table 1. The rise and fall of these rates over the period is evident.

Table 1
Effective Tax Rates on Millionaires in the USA
(Percent)

Year	Tax Rate
1913	1.6

1929	13.4
1945	66.4
1965	55.3
1982	47.7
2000	36.4
2010	32.4

Source: Tax Foundation

After the election of Margaret Thatcher, in the UK, and of Ronald Reagan, in the USA, views about taxes started to be influenced by what came to be called “supply-side revolution”, accompanied by its popular expression, the “Laffer curve”. The impact on policy was a progressive lowering of statutory tax rates in those two countries that soon spread to other countries, during the late 1980s and afterward. See Tanzi, 1987. All tax rates, but especially those on capital incomes, were significantly reduced. At the same time other developments (globalization of economic activities, the creation of a *global* financial market, the growing international mobility of goods, capital, and high-skilled individuals) contributed to the increase in the shares of the total personal income that was received by the top income earners. In those years, while the tax rates went significantly down, the *pre-tax* income shares of the HNWIs were going dramatically up. These trends continued in recent years at least until the financial crisis.

The increase in the share of total income received by the top income earners was much greater in English-speaking countries, and in India and China, than in European countries, and in Japan. An interesting aspect of this change was that the increase in those income shares, in Anglo-Saxon countries, was caused by sharp increases in labor compensation (*wages*), that included the compensation received by managers.

Over the past three decades, the compensation packages of managers and of other top income earners rose dramatically, compared to the wages of workers with average incomes that largely stagnated. Capital incomes (passive returns to the investments of savers) grew much less. Those who *manage* wealth have done much better than those who *generate* savings.

There has been a heated debate about why this has occurred. The net result has been that there is now a larger share of what can be broadly called “wage income” in the total income of the top income earners, lending itself more easily to the argument, made by some politicians or even some conservative economists, that high tax rates would have disincentive effects if they were levied on high-level taxpayers.

In the United States, the income of those in the top ten percent rose from about 35 percent of total income, in 1970, to 50 percent in 2007. That of the top one percent rose from about 10 percent in the 1960s and 1970s to close to 25 percent in 2007 according to data issued by the Congressional Budget Office (October 2011). The latest (US) IRS data indicate that the pool of taxpayers with an adjusted gross income of \$10 million or more fell by 55 percent between 2007

and 2009 as a consequence of the financial crisis. These individuals combined income fell from \$561,6 billion in 2007 to \$240.1 billion in 2009. In 2009 81.9 percent of taxpayers with an adjusted gross income of more than \$10 million earned a salary or wage, down from 85.4 in 2000.

With some differences, the behavior in the trend of the top income earners (the top one percent) in the United States was replicated in Canada, Ireland, United Kingdom, Australia and New Zealand. See Atkinson et al., p. 41. However, it was not replicated in France, the Netherlands, Japan, Germany and Switzerland, where the share of the top one percent had fallen significantly until World War II and continued to fall, but at a very slow pace, after World War II, until the present. This difference raises the inevitable question of whether the attitudes, or the norms, of the population of the Anglo Saxon countries, vis-à-vis income distribution and vis-à-vis the role of the state in the economy, are different from those of the countries in continental Europe and Japan. There have been statements about “winner take all” attitudes in Anglo-Saxon countries, attitudes that are criticized in continental European countries.

The compensations of bankers and other participants in the financial market, such as hedge fund managers, (the *allocators* of financial capital) have attracted a lot of negative attention in recent years especially in the USA and in The UK, where large bonuses were paid to many of them in the middle of the financial crisis and often to the same individuals that had created the crisis and had driven their banks to the point where they had to be rescued by huge amounts

of taxpayers' money. See, many recent books including, Sinn, 2010, and Suskind, 2011.

Many complex tax preferences and compensation packages have made possible for financial managers to get huge incomes even when those incomes were clearly not merited and when they were so large that they attracted a lot of critical comments. As an author put it: "...handsomely paid lawyers and accountants ... made sure [that] every practice could be defended as legal..." Suskind, p. 236. So the legal problems were controlled but the ethical ones remained and became more acute and annoying to people not benefiting from this bonanza.

Broadly similar results to those of the non-Anglo-Saxon group of countries reported above were reported for countries from the North of Europe (Sweden, Finland and Norway) and from the South of Europe (Spain, Portugal, and Italy). For these countries there was some increase, since the 1980s, in the share of income received by the top one percent of the population. However, with the exception of Norway, in all the above non Anglo-Saxon countries, the share of the total income going to the top one percent remained near 10 percent. This compares with the significantly higher percentage, for recent years, in the USA and in some other Anglo-Saxon countries. See Table 2 below.

These differences in income shares have stimulated an intense debate, during and after the financial crisis, between those who favor greater income redistribution, especially through higher taxes on high -income earners, and those who oppose such policies as interference in the work of the market. These

arguments have become particularly heated in the United States where they have contributed, on one side, to the creation of a so-called Tea Party, and, on the other side, to a growing number of sit-ins and demonstrations. The realization that some individuals, who receive very high incomes (hedge fund managers, bankers, CEOs, and others), have accumulated huge assets while paying very little taxes (often paying taxes on their incomes that were lower percentages than those paid by their drivers or secretaries) has led to strong popular reactions. These reactions have been particularly intense especially when the incomes have not been seen as merited, or have not been seen as clearly contributing real value to the economy. On the conservative side, there have been complaints that the critics were engaging in what was described as “class warfare” and advocating populist and anti market attitudes.

The arguments *against* collecting higher taxes from HNWIs can be *political*---high taxes reduce the liberty of individuals who, in a market economy, can be assumed to “get what they deserve”, through their greater ability, hard work, and better effort, a view attributed by Ron Suskind to Larry Summers (in Suskind, 2011, p.231)--- or *economic*---high taxes affect negatively the incentives and the economic performance of the very individuals who are assumed to be the main agents of economic growth.

The validity of the economic arguments have been dismissed, or minimized, over the years by some prominent economists (including Samuelson, Atkinson and others) and have been given much weight by conservative economists and politicians, especially in the United States. It has also been argued

that, when there is social mobility in a country, there are no reasons, and less calls, for having highly- progressive taxes. Over the years this latter argument was made when comparing Europe, with its low, upward, social mobility, with the USA, with presumably -high mobility. However, recent information has indicated that social mobility has become less common in the United States, so that the poor tend to remain poor more frequently than in the past, an outcome that had been attributed to Europe.

The arguments *for* more income redistributions, presumably though higher tax rates on the incomes of the HNWIs, have often been made by economists in international organizations and by some academic economists, including Nobel Prize winners, Amartya Sen, and Paul Krugman. Sen has argued that an individual's capacity to choose (a measure of economic liberty) depends on his/her standard of living. When the standard of living is very low, economic liberty is much reduced and political liberty becomes less important. To a person who does not have enough to eat, the right to vote is likely to lose much of its appeal. Governments can increase the economic liberty of individuals, and maintain their attachment to democratic institutions, by increasing their economic opportunities. To be able to do so, they need revenue and the tax revenue can be obtained from those who have taxable capacity. Significant ability to pay, or significant taxable capacity, in many countries, is concentrated among the HNWIs.

A different and perhaps novel argument can be made in support of higher tax rates on the HNWIs. This argument challenges the view, attributed to

Summers but widely shared by mainstream economists, that in market economies “people get [the incomes that] they deserve”. It could be argued that, the HNWIs owe significant shares of their wealth to the particular institutions and arrangements that have been created, or that have been allowed, by governments, in the societies in which the HNWIs live. In other words, large shares of many, though not all, of the high incomes can be assumed to be rents. They are not *genuine* and *deserved incomes* in the economic definition of the term. As a consequence, these high net wealth, or high -income individuals, have some obligations towards the other individuals of the society in which they live. It is this society that has made it possible for them to receive their incomes. Less lucky individuals, who benefit less from these institutions and arrangements, do not have the same tax obligations.

The incomes received by the HNWIs have not been earned in a Robinson Crusoe’s, isolated economic environment. They have been earned in an environment in which particular institutions, rules, and specific governmental actions, or, at times, inactions, have made it possible, for many of these individuals, to earn very high incomes. Just think of the actions taken by many governments, during the 2008-2009 financial crisis, to save the financial systems, and thus to protect the incomes (and the bonuses) of bankers and many others operating in the financial market, including hedge fund managers. Or think of the role that patents, copyrights, trademarks, limited liability rules, restrictions to entry in some professions, import duties, monopolies, monopolistic practices, tax incentives, “too big to fail” conditions, and other institutions, promoted or

allowed by governments, play in generating the very high incomes. Without the existence of these institutions or rules and actions, it would be very difficult for many HNWIs to receive the high incomes that they receive.

The existence of this kind of, what could be called, government -created *institutional capital* makes it possible for many lucky, or well -placed and well -connected, individuals, to become HNWIs. In a truly free economic environment, one characterized by “perfect competition”, these incomes would not exist and the income distribution would be much more even, requiring a less redistributive role on the part of the government.

An additional and totally different argument, for justifying high tax rates on HNWIs, can be based on the impact, or lack of, of high tax rates on the incentives of *very high* -income individuals. Many of the very HNWIs, (CEOs of large corporations, famous athletes, famous artists, hedge fund managers, and so on), by the time they become HNWIs, they have acquired a social status or a social position that they would want to maintain and to defend regardless of their tax rates. A top athlete, a top artist, or the CEO of a large corporation, is not likely to reduce his or her effort to remain at the top position acquired only because he or she is being taxed at a higher rate. This reaction must be true for many *very* HNWIs. For them the presumed negative impact on incentives from higher tax rates is doubtful.

While taxes may create disincentives *on the way to the top* (at levels of income and of prestige when the income is of overwhelming importance), their disincentive impact is likely to weaken *once one has reached the top*, and has

acquired a social status or position, that gives a lot of fame or prestige and thus merits to be defended. For many HNWI's the social position may become more important than the income that accompanies it. If this argument has merit, it would justify the use of higher tax rates at *only very high income levels*, say at the level of the *very* HNWI's income. This would be a kind of millionaires' tax rate. For lower incomes, the disincentives that high tax rates create could be more damaging, because the individuals have not yet achieved the high social statuses, (that provide the important, additional, "psychic income" to individuals). For lower income individuals, the financial compensation is the total compensation (both financial and psychic).

The above argument would acquire even more weight when it is assumed that some of the top income earners have not contributed, or are not contributing, something of real value to society. Some economists have made this point with respect of the activities of the high income earners who have been operating in a financial market characterized by excessive financial engineering, that, some have maintained, has transformed it in a "Casino Capitalism". See Sinn, 2010, and, also, Tanzi, 2011. However, this additional argument would require making distinctions among very HNWI's, a distinction impossible to make in practice.

The economic and the political powers of individuals tend to be correlated in many countries; in some more than in others. This might be seen as a further reason to tax very HNWI's at higher rates. More income and more wealth give individuals more political power. That relation is enhanced by the increasing complexity of laws and regulations, that has become common in many countries

and that allows rich individuals to better exploit, to their advantage, the existing laws, regulations, and institutions that constitute the “institutional capital” mentioned earlier.

In recent decades some financial instruments and some forms of compensation, such as differed -stock distributions, have been created explicitly to get around existing taxes. Globalization has facilitated this objective. High-income individuals have the financial means to hire, able and specialized individuals (lawyers, tax experts, accountants, lobbyists, and others) that, for their clients, can search for loopholes and for exploitable ambiguities in the complex tax laws and regulations. If the individuals are really rich, they can also hire lobbyists who, in the words of a famous Washington lobbyist, know “...the Byzantine legislative process and how to make it work for clients”, to change some of those laws or regulations. See Abramoff, 2011.

Some of these individuals, and especially those who operate as lobbyists and who are both experts and have good political connections, can more easily access the civil servants, the high level bureaucrats, and the politicians who have some power of interpretation over the rules and the laws. This implies that the state should make every effort (a) to make the economic system as competitive as possible; (b) to make the laws and the rules as transparent as possible; and (c) to remove (at least some of) the factors that provide rents to the HNWIs. When this is not possible, higher tax rates on higher income individuals could become more justifiable.

Table 2 provides some estimates of the shares of taxable income received by the top 0.1 percent, the top one percent, and the top five percent of taxpayers. These are different definitions of HNWI's. The table shows large differences among countries and especially the large shares of total income going to the HNWI's in the United States, the United Kingdom, and Argentina. It should be recalled that these estimates have been derived from tax data. They are likely to underestimate the true, economic, incomes of these groups. For example, they do not include unrealized capital gains and non -reported incomes. For the USA, recently released data from the Congressional Budget Office (October 2011) have reported shares of total income, for the top one percent of the population, that are significantly higher than those in the table and that exceed 20 percent of total income, for 2007.

The data in Table 2 are, mostly, for developed countries. Data on income distribution, as measured by Gini coefficients, can also be helpful in assessing the importance of tax equity especially in developing countries where tax data are very deficient. They are shown, for different *regions*, in Table 3. Data for specific countries, both developing and developed, are easily available from several sources such as the World Bank, the (US) CIA, and the UN..

Table 2
Comparative Top Income Shares
(Around 2005)

Country	Top 0.1%	Top 1%	Next 4%	Top 5%
---------	----------	--------	---------	--------

Argentina	7.02	16.75	--	--
Ireland	--	10.30	--	--
Netherlands	1.08	5.38	11.79 (1999)	17.08
India	3.64	8.95	--	--
Germany	4.40	11.10	13.1 (1998)	24.2
United Kingdom	5.19	14.26	14.5	28.7
Australia	2.68	8.79	11.2 (2002)	20.0
USA	7.70	17.42	15.2	32.6
Canada	5.23	13.56	15.4 (2000)	29.0
Singapore	4.29	13.28	14.6	27.9
New Zealand	2.51	8.76	12.7	21.5
Switzerland	2.67	7.76	11.5 (1955)	19.3
France	2.48	8.73	13.0	21.7
Norway	5.59	11.82	11.3	23.1
Japan	2.40	9.20	16.1	25.3
Finland	2.65	7.08	9.5 (2004)	16.1
Sweden	1.91	6.28	11.1	17.4
Spain	2.62	8.79	13.4	22.2
Portugal	2.26	9.13	15.4 (2003)	24.5
Italy	2.55	9.03	12.3 (2004)	21.3
China	1.20	5.87	11.9 (2003)	17.8

Source: Adopted from tables in Atkinson et al, 2011

Table 3
Gini Indexes and Poverty by Region
(Ginis for 2004; poverty for 2005)

Country	Ginis	Poverty*
Developed Countries	32.2	n.a
Eastern Europe Central Asia	33.6	12.9
South Asia	38.9	84.4
Middle East and North Africa	38.9	28.4
East Asia and Pacific	39.1	50.7
Sub Saharan Africa	44.7	80.5
Latin America and Caribbean	52.2	22.1

*Less than \$2.5 dollars a day

Source: Adapted from Lustig (2010); and Chen and Ravallion (2008)

The data in these two tables, together with data on world income inequality, available from the World Bank's World Development Index, that provide also shares of total income going to the lowest 20 percent of the population, indicate the clear need to pay attention to the taxation of HNWIs.

If the emphasis were not on income but on the net wealth of the top one percent of the population, that one percent would be seen in the USA to appropriate 34.6 percent of the total, compared with only 15 percent of the total wealth owned by the bottom 80 percent of the citizens. For financial wealth the percentages are 42.7 percent of the total for the top one percent and 7 percent for the bottom 80 percent. The data for net wealth are from G. William Dumhoff. The

share of total wealth held by the top one percent, fell from 44.2 percent in 1929 to 19.9 percent in 1974. It increased sharply after the 1970s, and reached 38.5 percent in 1995 before falling a little to 34.6 percent in 2007. For several other countries the data on wealth distribution indicate equally high degrees of unevenness.

III. The Government's Role in Reducing Income Inequality

At least since the decade of 1880s, when Adolf Wagner, a famous, German economist, advocated that governments should play a role in making the income distributions more even in countries with a market economy, (a role that was different from the one advocated by socialist economists, who had no use for a market economy, and no respect for property rights), citizens have expected their governments to ensure that the income distribution does not become excessively uneven and becoming the “most fatal ailment of...republics”, as Plutarch wrote 2000 years ago.

Governments can play such a role:

(a) by improving the working of the market, because a well-working, market economy is less likely to produce excessively uneven income distributions. Therefore, the government should go forcefully after all monopolies, after all rents of particular categories of citizens and acts of corruption, and after other market failures, or abuses. As argued earlier, the “institutional capital” that establishes itself in a country must not be allowed to create unusual advantages for particular groups. In such a country there must be no role for “crony capitalism”, for “too big to fail” institutions, for politically

powerful lobbies, and for corrupt practices that allow some individuals to become rich at the expense of others;

(b) by enhancing the productive capacity of poorer groups of citizens, with good, basic education and training, with needed infrastructures, with essential, basic medical assistance, and, when possible and necessary, even with some distribution of assets. However, the government must make sure that the public programs are not accompanied by inefficiency, by corrupt practices, or even by rents, on the part of the providers or the beneficiaries of these programs. When inefficiency, rent seeking and corruption are allowed to prevail in public programs, they provide a ready and convenient justification on the part of some observers to oppose any government role in income distribution. Obviously government programs require resources that, in most countries, must come mainly from taxes;

(c) by the intelligent use of the tax system. That system must (i) provide adequate levels of revenue to allow governments to perform their essential roles at an adequate and efficient level; (ii) must do so with taxes that respect both “horizontal equity” and “vertical equity”. In other words the taxes must be as horizontally neutral as possible, and as vertically progressive as is economically feasible, with statutory tax rates that do not create significant disincentive effects; (iii) by paying special attention to individuals with high net worth, to make sure that these individuals, who have more taxable capacity, contribute their fair share of tax revenue, without being overburdened with punitive tax rates or excessive compliance costs.

The balance between the need for revenue, on one hand, and the danger of creating significant disincentive effects, or strong pressures on the taxpayers to look for escape clauses from the high taxes through tax evasion, on the other, must receive careful and sustained attention. The issues in this section have received a lot of attention by tax experts over the years so that they will not be discussed further in this paper. Having argued in favor of the need to collect more taxes from HNWIs, the following section will focus on some of the difficulties in making them contribute adequately to tax revenue.

IV. The Taxation of HNWIs.

By definition, the HNWIs have more wealth, more income, better social connections, better tax advisers, better access to the “institutional capital” of countries, and, increasingly, more activities that are global in scope. They operate in a more open world, a world where tax rates are high in some countries and low, or even zero, in others, in the so-called tax havens. This difference allows them to search for some tax arbitrage. among countries.

Complexity in tax systems, lack of transparency or, even, of objectivity in accounting procedures, limited administrative capability and limited resources on the part of the tax administrations of some countries, corrupt tax administrators, and a culture that may tend to condone tax evasion in some countries, are likely to facilitate, for the HNWIs the non-reporting to their tax authorities of some, or all of their incomes. Accounting tricks may also be used to report the incomes in countries in which tax rates are low, or to transform normal compensations for

individuals into lower-taxed capital gains. For various examples of ways in which HNWIs can evade taxes, see, Grevelle, 2009.

For enterprises, the use of “transfer prices”, the (arbitrary) valuation of the cost of borrowed capital, use of loans channeled from “tax havens”, the manipulation of the cost of using patents, trademarks, and copyrights, or even the manipulation of insurance costs for goods transported, can all provide possibilities of reducing, at times to zero, the taxes paid to specific countries on incomes earned.

Some direct “estimates” of the size of tax evasion at the global level are available. For example, Guttentag and Avi-Yonah, 2005, have estimated that the revenue loss to the United States, due to international tax evasion by HNWIs, is \$50 billions, a figure that has been challenged by other tax experts. The Tax Justice Network has estimated a worldwide revenue loss of \$255 for all countries for similar activities by individuals. While these estimates can be challenged, there is a lot of indirect evidence on international tax evasion. The direct “estimates” often are more “guesses” than genuine “estimates”, because, generally something that cannot be fully observed or controlled cannot be properly measured.

The Tax Justice Network, a think tank that aims to promote justice in taxation, has reported that the assets held offshore, “beyond the reach of effective taxation” are “about a third of total global assets”. This is an enormous figure. For sure, there are a lot of assets held in off-shore centers and in tax havens as statistics indicate. The Tax Justice Network has estimated that “the amount of

funds held offshore by individuals [in addition to those held by corporations] is about \$11.5 trillion”. As a consequence of these large funds held offshore, large amounts of tax revenue are likely to be lost every year, by the countries where the owners of these funds have their legal residences. The beneficiaries from this tax evasion are mostly HNWIs. One should add the non -payment of taxes because of the funds held offshore and not distributed by corporations. Estimates made, by Global Financial Integrity (GFI), of the global proceeds from criminal activities and from major acts of corruption, amount to U.S.\$1-1.6 trillion per year. These have also tax implications. Alex Cobham, at St. Anne’s college at Oxford, has estimated that developing countries lose US \$ 385 billion annually in tax revenue mostly because of international tax evasion.

There is now a large literature that has described the way in which “tax planning”, by both individuals and corporations, can lead to tax avoidance and tax evasion. It would require too much space to review this literature. The manipulation of input and output prices, in the operation of enterprises, plays a significant role. For individuals, secrecy is especially significant. There are many jurisdictions that allow depositors banking and other kinds of secrecy, on grounds of respecting the privacy rights of individuals from aggressive governments. There is clearly some merit to this argument. However, it should not be sufficient to prevent the fair taxation of HNWIs and of corporations.. It should be mentioned that some of these jurisdictions now have the highest per capita incomes in the world. This indicates that the provision of secrecy to foreign taxpayers can be a lucrative activity for tax havens. It is easy to appreciate their

reluctance to exchange information with the countries in which the taxpayers reside.

As the Tax Justice Network has stated, “secrecy comes in various different flavors”: “banking secrecy”; “trusts”; vehicles such as “foundations” and “Anstalt” (establishment); “offshore companies”; and “other corporate vehicles”; the use of borrowed “nominees” behind the real owners; the “refusal of jurisdictions to provide information”; “their refusal to collect relevant data”; and in other ways. A recent, major study by the World Bank, The Puppet Masters, has studied the related problem of “how the corrupt use legal structures to hide stolen assets”. This is another aspect with large revenue implications for particular countries.

Some data, reported by Grevelle, 2009, are indicative of the scope of the problem as seen, for example, from the point of view of the United States. The share of US company profits, relative to the GDP of the countries where the profits were reported, was 645.7 percent in Bermuda, 546.7 percent in the Cayman Islands, and similarly large shares in other small islands listed in tax havens lists. The shares were also fairly large in some countries not listed as tax havens. For example they were 18.2 percent of the GDP of Luxembourg, 9.8 percent of that of Cyprus, and 7.6 percent of the GDP of Ireland. As long as these profits are kept abroad, US tax laws do not tax them. It is obvious that large losses in tax revenue occur to the USA because of these reallocations of profits.

A world in which the “world’s tax base” (the potential taxable income of the whole world estimated on the basis of the existing laws) is fractured into

hundreds of jurisdictions, and in which the taxes on personal income are imposed nationally (generally following the residence -based principle, that requires that taxes be paid to the country, or the jurisdiction, of residence of those who receive the incomes), cannot lead to a fair outcome, unless, somehow, there is full transparency in the tax arrangements, and unless all the jurisdictions fully cooperate in exchanging information, use efficiently the information obtained, and help one another prevent tax avoidance and tax evasion. Unfortunately, there is often neither transparency in the actions of taxpayers, nor full cooperation on the part of the jurisdictions. It is also an open question whether the information obtained is efficiently used. See Tanzi and Zee, 2001.

Tax planners, who are often well paid and clever individuals, are continually probing the defensive walls of the tax systems and creating new schemes to facilitate tax avoidance, especially by HNWIs. Furthermore, the tax jurisdictions engage in tax competition to attract to them investments, that might have gone to other countries, and profits, earned in other countries that might have been reported elsewhere. By doing so they derive some economic advantages. The incentives that are introduced by the competing countries tend to create frictions, between the countries that lose tax revenue and those that benefit from the tax competition, or from the tax avoiding activities of the taxpayers. The “world’s tax base” tends to become a “commons” that can be exploited by the less scrupulous jurisdictions. The facility with which income can now move across jurisdictions facilitates tax avoidance by clever, but less law-abiding individuals at times assisted by corrupt national tax administrators.

In past writings the author of the present paper argued that a World Tax Organization-- an organization that would represent the global interests, (in the same way as the World Trade Organization does it with trade issues), that would hopefully have the resources necessary, and that would focus exclusively on tax matters, exercising a surveillance activities over the tax behavior of individual countries--could help deal more effectively with some of the difficulties mentioned above. See Tanzi, 1995, 1999, and 2008. Until the time when the need for such an organization is widely recognized and leads to its creation, the countries must continue the fight against international tax evasion using the tools available. That fight is now assisted by offices within existing international organizations that have main mandates that directly related to taxes, and by activities including those of the International Tax Dialogue.

It is important to stress that the fight against tax evasion must start at home, in the countries themselves. No outside help will ever be sufficient for dealing with the growing problem of domestic and global tax evasion. At the national level the fight must start by making the tax systems *more transparent and less complex* than they have become, because tax avoidance problems often begin at home, by exploiting existing complexity. Complexity has become a problem in the tax systems of most countries and has created growing possibilities for tax planning and tax evasion, both domestically or globally. See Tanzi, 2010, and 2011.

It is distressing to read that there are, today, reportedly more than 70 thousand pages, in laws and regulations, for the US income taxes. The situation in

many other countries is not much better and complaints about tax complexity are common. This complexity is clearly affecting the cost of compliance and the equity of tax systems. For example, the Internal Revenue Service of the United States has recently reported that the average tax rate on the incomes reported by the 400 individuals with the highest adjusted gross incomes fell from 30 percent in 1995 to 18 percent in 2008. Much of the fall was not due to statutory rate reduction but presumably to reclassification of income sources.

Transparency and genuine tax equity cannot be achieved when the conditions reported above prevail. Without more tax simplicity at the *national* level, the HNWIs will continue to have an easy time in reducing their tax liabilities, regardless of international actions. The pressures of lobbies and of other special interests groups, and the desire on the part of policymakers to accommodate many perceived, personal or corporate, special needs, with special tax treatments, tax incentives, tax expenditures, and so on, make the tax systems opaque, opening possibilities of reinterpretations of laws. Complexity ends up making the systems unfair both horizontally and vertically.

In several countries, including the United States, there has been continuous talk over the years about the need for tax simplification. However the talk has not been followed by action and complexity has continued to grow year after year because complexity is a cumulative process.. The result has been the “erosion” of taxable bases, for both personal and corporate income taxes but also for other taxes. The differences between the economically defined tax bases and

the bases that are actually taxed have become large, especially for the incomes of the HNWIs.

At the international level, the fight against tax evasion is being fought with (a) political pressures and threats on tax havens on the part of some powerful governments, such as those of the United States and Germany, (b) with bilateral agreements on exchange of information, of which there are now more than 700, and (c) with declarations for greater cooperation, made at G8, G20 and at other high -level, political meetings, as for example the one issued at Cannes on November 4, 2011. Tax treaties are expensive to negotiate, take a lot of time and effort, and often put officials from highly sophisticated countries, who have the assistance of top tax experts, against much less sophisticated and poorly paid officials and experts from poorer countries, leaving the impression that their results are not always fair. There is much skepticism about the usefulness of these treaties and whether they justify their cost. There are now some 700 such treaties.

In negotiating these treaties, the principles are similar to those that arise in bilateral trade negotiations. It would be better to develop a single standard, a template, one that would guide the behavior of all countries, dispensing with the need for bilateral treaties. That standard should reflect the interests of all the countries and not mainly those of particular countries. A World Tax Organization, if it existed, might find it easier to promote such a single standard. The OECD and the Council of Europe have developed a Protocol for all countries to follow on transparency and on exchange of information. However, the limited membership

of these organizations is likely to reduce the impact or the acceptability of this Protocol.

Pressures on tax havens, and on other jurisdictions that make it easier for HNWIs to evade taxes, should be intensified. In recent years these pressures seem to have generated some positive results. They have also elicited some promises at deeper collaboration. However, much more needs to be done. The results of these attempts have been published in reports by the OECD and by other groups. See, for example, the Tax Transparency 2011: Report on Progress by OECD (Paris: 2011).

V. Concluding Comments

It is not easy to quantify the progress made so far in the areas discussed in this paper. While the attempts made, and the official, but still too general, backing that international tax cooperation has received from countries' leaders who attend global Meetings (G8 and G20) are helpful, it is difficult to ascertain whether tax evasion, an activity that increasingly involves cross-countries actions, is going up or down. The impression that one gets, and it is just an impression, is that tax evasion, often in the less clear form of tax avoidance, may still be going up. As long as tax levels, tax rates, tax structures, and the incentives continue to diverge across countries, promoting and facilitating tax competition, the fair taxation of HNWIs and, more broadly, tax equity will remain distant and difficult -to -reach

objectives and without equity both market economies and democracies will face future dangers by losing some of their legitimacy and attraction.

It must be repeated that, while the promotion of tax equity requires greater international cooperation, it requires also specific national actions by all countries, and especially by the larger ones. It may be naïve to expect that the solution to the difficulties discussed will come from outside. Ongoing economic developments in the world are not likely to make the promotion of the tax equity objective any less difficult with the passing of time.

Finally, it is important to stress that the use to which tax revenue is put is also of great importance in reducing the validity of arguments, made by some observers, that while high taxes always produce some disincentives effects and other costs, they rarely generate clearly identifiable benefits for citizens.

It needs to be reaffirmed that tax revenue, if it is used to support efficiently- provided and clearly needed public services and if they are collected with reasonable rates and with equity, remain a most important tool in the actions of governments. But, obviously, taxes can be not only too low but also too high.

REFERENCES

Albi, Emilio and Jorge Martinez-Vazques, 2011, The Elgar Guide to Tax Systems (Edward Elgar Publishing)

Atkinson, Anthony B., Thomas Piketty, and Emmanuel Saez, 2011, “Top Incomes in the Long Run of History”, Journal of Economic Literature, 49:1, 3-71.

- Bloomquist, Kim M., 2003, "Tax Evasion, Income Inequality and Opportunity Cost of Compliance", Paper presented at the 96th Annual Conference of the National Tax Association, Chicago, IL (November).
- Chen, Shaohua and Martin Ravallion, 2008, "The developing world is poorer than we thought, but no less successful in the fight against poverty". Policy Research working Paper 4703 (World Bank).
- CIAT, Inter-American Center of Tax Administration, 2011, "Taxation and Tax Administration: Latin America", Comparative Series, No. 1 (March).
- Clausing, Kimberly A. and Reuven S. Avi-Yonah, 2007, "Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formula Apportionment", Discussion Paper 2007-08, The Brookings Institution (June).
- Congressional Budget Office, USA, 2011, "Trends in the Distribution of Household Income Between 1979 and 2007" (October).
- Dumhoff, G. William, 2011, "Wealth, Income, and Power" in Who rules America? (University of Santa Cruz).
- Gravelle, Jane G., 2009, "Tax Havens: International Tax Avoidance and Evasion", CRS Report for Congress, 7-5700 (July 9).
- Guttentag, Joseph and Reuven Avi-Yonah, 2005, "Closing the International Tax Gap", in Max B. Sawicky, editor, Addressing the Crisis in Federal Tax Administration (Washington, D.C., Economic Policy Institute).
- Lustig, Nora, 2010, "Latin America Social report Card: A Scorecard of Governments' Commitment to Social Equity" (January).
- Milanovic, Branko, 2006, "Global Income Inequality: What It is and Why It Matters", DESA Working Paper No. 26.
- OECD, 2011, Tax Transparency 2011: Report on Progress (OECD: Paris).
- Piketty Thomas and Emmanuel Saez, 2006, "The Evolution of Top Incomes: A Historical and International Perspective" " AEA Papers and Proceedings, Vol. 96, NO. 3 (May) 2000-2005.
- Sinn, Hans-Werner, 2010, Casino Capitalism (Oxford University Press).
- Suskind, Ron , 2011, Confidence Men (HarperCollinsPublishers).

Tanzi Vito, 1995, Taxation in an Integrating World (Washington: The Brookings Institution).

-----, 1987, "The Response of Other industrial Countries to the U.S. Tax Reform Act", National Tax Journal, Vol. XL, No. 3 (September) 339-355.

-----, 2010, "Complexity in Taxation: Origin and Consequences" (mimeo, December 18). Paper presented at a Conference at the Law School of Getulio Vargas Foundation, Sao Paulo, Brazil.

_____, 2011, "The Entitlement State, Demography and Constitutional Stability", Paper presented at the "Fifth Annual Conference: Constitutionalism in Crisis", Transatlantic Law Forum, Bucerius Law School, Hamburg (Germany), October 28-29.

_____, 2011, "Tax Systems in the OECD: Recent Evolution, Competition and Convergence", in Albi and Martinez, Vasquez, editors.

-----, 2011, Government versus Markets: The Economic Role of the State (Cambridge University Press).

Wikipedia, "List of countries by income equality".

_____, "Income Inequality in the United States".

World Bank, 2011, The Puppet Masters (Washington, D.C.).

_____, 2007, World Development Index (Washington, D.C.).