

# TRACING CORPORATE FORM ACROSS SECTORS

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## INTRODUCTION

The purpose of the working paper is to showcase our comparative knowledge of a series of cases from the WP4 Corporate Form package in the COFFERS project. Our aim has been to trace corporate forms through the application of a typology, Global Wealth Chains. The typology of Global Wealth Chain types, and their combination, allows us to see how sectoral differences relate to different “transacted forms of capital operating multi-jurisdictionally for the purposes of wealth creation and protection” in the international political economy (Seabrooke and Wigan 2017: 2). We have justified the use of typologies rather than explicit causal theories earlier in the project (see the working paper COFFERS D4.3). This follows on two ambitions. The first is to provide a means to obtain new information about cases that permits knowledge from accounting, law, political science, sociology, and management studies to all be included in the building of cases, rather than to hold disciplinary assumptions for the purpose of theory testing. In this manner typology is deliberately an attempt to hold an artificial construct up against an empirical reality to see where things do and do not fit, and adjust accordingly (Weber 1978; Swedberg 2018). The second ambition is to trace corporate form knowing that the firm and the corporation are conceptually and legally distinct. While the firm is the ongoing concern, the corporation is the legal structure created to protect the firm (Robé 2011; Biondi 2017). As such tracing corporate form through typology is not about knowing the firm’s strategies but providing insights into how corporate structure is articulated. This includes the kind of relationships between clients, suppliers, and regulators, including whether they are functional and transactional or social, how complex they are, and what power dynamics are present between the entities involved.

As clarified in earlier COFFERS work, the Global Wealth Chains typology deliberately mirrors the Global Value Chains typology that has greatly influenced work in international political economy, management studies, and economic geography (Gereffi, Humphrey and Sturgeon 2005), as well as international organizations. This framework focuses on the complexity of transactions, the ability to codify information in the value chain, and the capacity of suppliers. The wealth chains typology follows this logic but changes the assessment of the ability to codify transactions into an assessment of regulatory liability involved in transactions, that is the chance of regulators intervening. The capacity of suppliers is then tied to assisting wealth creation and protection in a way that mitigates challenges posed by regulators (Seabrooke and Wigan 2017: 12-13). Both global value chains and global wealth chains share five types: Market, Modular, Relational, Captive, and Hierarchy. For wealth chains, these can be summarized as:

1. *Market* linkages occur through arm's length relationships with low complexity in established legal regimes. Products can be accessed from multiple suppliers who compete on price and capacity.

2. *Modular* wealth chains offer more bespoke services and products within well-established financial and legal environments that restrict the supplier and client flexibility. Products involve complex information but can be exchanged with little explicit coordination.
3. *Relational* wealth chains involve the exchange of complex tacit information, requiring high levels of explicit coordination. Strong trust relationships managed by prestige and status interactions make switching costs high.
4. *Captive* wealth chains occur when lead suppliers dominate smaller suppliers by dominating the legal apparatus and financial technology.
5. *Hierarchy* wealth chains are vertically integrated. A high degree of control is exercised by senior management. Clients and suppliers are highly integrated and coordinate on complex transactions.

As others have recently commented, the global wealth chain typology is important in understanding how “the ‘onward journey’ of value-added that accrues to firms across different tax regimes and jurisdictions is critical to understanding the socially and spatially uneven development impacts of global production networks” (Coe and Yeung 2019: 786). We contend that wealth chains are not only important post-production but in how firms and corporate structures organize both value and wealth creation processes. Here we apply the global wealth chains typology to a series of cases developed by the COFFERS team in the Corporate Form work package. The cases have been selected to provide variation in sectors and where change from the immediate post-global financial crisis period until now is evident, or where stability also provides us with information on dynamics in the international political economy. Within the Global Wealth Chains framework information asymmetries exist between Clients (*C*), Suppliers (*S*), and Regulators (*R*). The length of the information ties between these actors (*C-S*, *S-R*, *R-C*) create triangles of information asymmetries, with greater distance between the actors representing a greater lack of information or opacity (Seabrooke and Wigan 2017). Given COFFERS’ focus on empowering regulators our cases focus on the importance of rule change and regulatory initiatives that may have modified how wealth chains are articulated, as well as changes in information asymmetries between the regulator and the clients and suppliers involved in the wealth chain. Table 1 provides a summary of the cases and key findings presented in this working paper:

**Table 1 - Summary of cases and key findings**

Case	2009 GWC Type	2019 GWC Type	Rule Change	Information Asymmetries
Transfer Pricing Industry	Captive	Captive-Hierarchy	BEPS has introduced stronger documentation requirements	Some reduction in asymmetry and consequent increase in regulatory traction

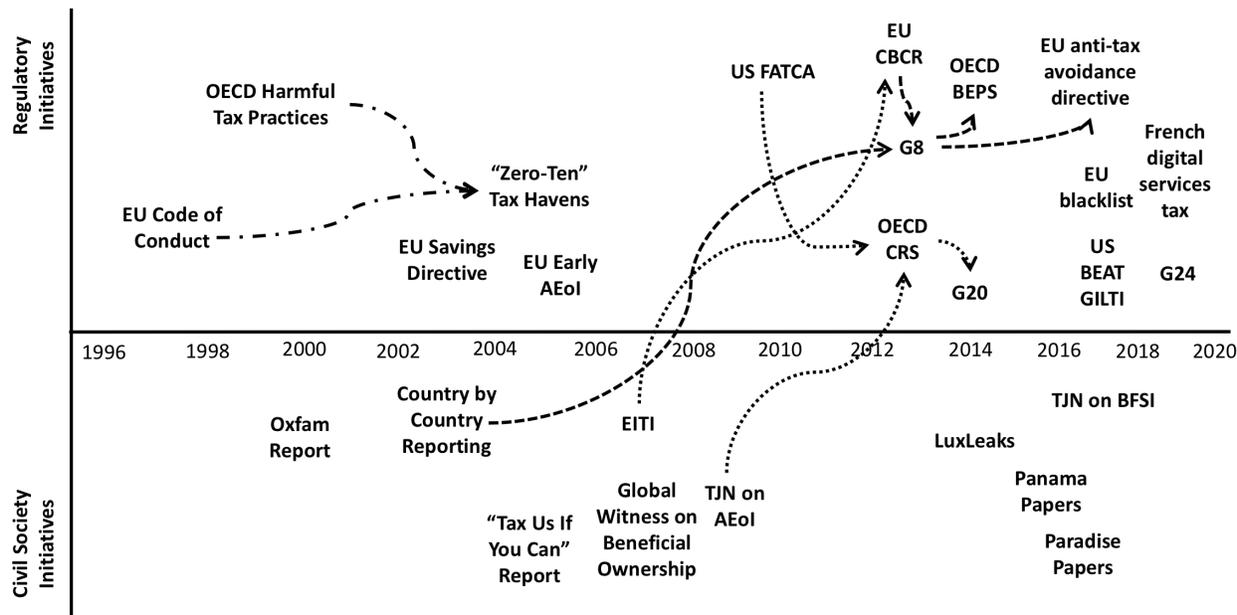
Cum Ex	Captive	Captive	Prosecution and establishment of warning system	Improved coordination through iterative experiences of fiscal exploitation.
Art Freeports	Relational	Relational-Modular	AMLD5 encompasses freeports, albeit only as obligated non-financial institutions that are not held to AEOI.	Regulators have little information. 'Fishing' in information from non-financial entities is expressly prohibited.
Mining	Relational-Hierarchy	Relational-Hierarchy	EITI initiatives, Dodd-Frank, EU Accounting Directive 2013 all placing some pressure	CBCR growing but regulators have little information on profit shifting practices (transfer pricing)

This working paper first introduces the context for change from the 2009 to 2019 period and then delves into the respective cases before providing a discussion on what lessons from comparative knowledge can be gained. Following the presentation of the cases we discuss how changes in wealth chain types can be identified, their sectoral characteristics, and what lessons there are for regulators seeking to combat fiscal fraud and evasion.

**CHANGES IN THE TAX ENVIRONMENT AFFECTING GLOBAL WEALTH CHAINS**

The years from 2009 to 2019 constitute an era of unprecedented change in international taxation (Christensen & Hearson, 2019). In order to assess how corporate forms have changed between 2009 and 2019, we need to account for the contextual environment for regulatory and corporate actors, and how it has been transformed as civil society activists, media, policy-makers and corporations themselves have actively reshaped the international tax landscape. Figure 1, provides an overview of the major changes to the international tax environment in recent years, some tracing back before the turn of the century. Overall, the figure illustrates the substantial ramp-up of regulatory and civil society initiatives since the global financial crisis, following a period of relative quiet with only sparse EU and OECD reforms in the late 1990s and early 2000s (Radaelli, 1997; Sharman, 2006). We can think of this transformation of the tax agenda as movement from a slow to a fast burning crisis (Seabrooke & Tsingou, 2018). Below, we discuss key developments (and summarize them in Table 2).

**Figure 1. Changes in the tax ecosystem**



Source: Authors

A significant area of development is in the European Union’s fiscal regime. For most of its history, the development of the EU fiscal regime was limited by the absence of “political will”, insufficient Member State consensus, weak institutional capacity and divergent tax competition strategies between member states (Genschel & Jachtenfuchs, 2011; Kemmerling & Seils, 2009; Radaelli, 1999, Wigan, 2014). In contrast, the EU has been central to the recent prominence of political innovations and compression of the policy development, implementation and impact cycle, taking a clear lead internationally (Christensen, 2019a). This includes areas like tax transparency, where the EU’s Accounting and Transparency Directives and Capital Requirements Directive, adopted in 2013, were the first to introduce mandatory public country-by-country reporting - detailed, geographically segmented tax and economic activity data - for European extractive and financial industry firms. Furthermore, on the issue of tax havens, after years of political stalemate and discussions, primarily at the OECD level, EU Member States in 2017 agreed to a common list of ‘non-cooperative tax jurisdictions’ to identify and sanction countries that did not ‘play fair’ on international tax matters. Most recently, the European Union has become a primary driver of the global tax agenda to revolutionise the way the digital economy is taxed, with proposals for special taxes on large digital firms (Lips, 2019).

Frustrated by a perceived lack of ‘tax fairness’, EU institutions have also utilized unusual policy tools in trying to rework the international tax system. Notably, the European Commission has mobilised its anti-trust/competition laws to pursue the ‘unfair’ tax practices of multinationals. The most high-profile development has been the Commission’s case against Apple. In 2016, the Commission found Apple’s tax arrangements in Ireland amounted to illegal state aid, totalling €13bn, to be repaid to the

Irish government - a much-publicised and -criticised finding that Apple has appealed to the European courts (Avi-Yonah & Mazzoni, 2016; Che, 2018; Jaeger, 2017). Elsewhere in the European system, the European Parliament has used a number of new means to spotlight the issues of tax avoidance and evasion, for example ‘grilling’ of politicians and corporates involved in international tax affairs, innovative activism in legislative processes, and scathing reports highlighting a range of problems in the current international tax order (Christensen, 2019a).

At the OECD level, similarly, political discussions have come a long way from the late-90s initiatives on Harmful Tax Competition. These initiatives attracted heavy criticism from small island economies and eventually failed following withdrawal of support by the US “Bush administration” (Sharman, 2006). The area that has seen the fastest transformations is arguably on the information exchange front. Here, the OECD developed and diffused its global standard for automatic exchange of tax information, the Common Reporting Standard (CRS), in 2013. This followed from heavy civil society pressure, and political developments elsewhere - notably the EU Savings Tax Directive, and the US’ introduction of FATCA. FATCA, adopted in 2010, in the immediate wake of the global financial crisis, mandated all foreign financial institutions operating in the US market to automatically report financial account information of US citizens to the US authorities, under heavy withholding tax sanctions (Palan & Wigan, 2014).

The OECD built on the US unilateral model to improve its information exchange regime, and generated significant momentum, with more than 100 countries globally now committed to the CRS (Ahrens & Bothner, 2019; Hakelberg, 2016; Lips, 2018). The automatic exchange of information on financial accounts held by “natural persons” and other entities known to be used for avoidance, evasion and illicit activities, represents a major step forward in tackling the information opacity that has traditionally hampered regulators. In comparison to the preceding norm, the exchange of information only on request, this amounts to a radical transformation in the international tax system.

The OECD has also moved on corporate tax transparency, albeit less rapidly. Like the area of exchange of information, the tax transparency agenda has been marked by building civil society activism since the early 2000s. Notably, the Tax Justice Network - a civil society network launched in 2003, focused on international tax issues - has been aggressive and influential in pushing forward the idea of Country-by-Country Reporting (CBCR) (Seabrooke & Wigan, 2015, 2016). Before the global financial crisis, the idea, developed in 2003 by TJN founding member Richard Murphy, largely fell on deaf ears (Baden & Wigan, 2017). However, when the issue of corporate tax abuse became a hot political issue, and under pressure from the G8, the OECD included CBCR in its Base Erosion and Profit Shifting (BEPS) initiative. This normalisation of CBCR and its adoption onto the established global political agenda is an apt illustration of the evolutionary patterns of policy development, from slow to fast and cold to hot, that is the starting point for our analysis here.

The last decade has featured a number of large-scale tax haven ‘leaks’, globally coordinated and publicised, featuring secret and confidential documents shedding light

on the tax-related practices and structures of some of the world's largest corporations, wealthy individuals, political leaders, and celebrities. This illustrates how the international taxation agenda has witnessed an increased mobilization and influence of non-state actors. Where the EU and civil society actors offer two prominent examples, as above, the list also includes media, alternative political champions and funders (Forstater & Christensen, 2017). LuxLeaks, in 2014, was a major, internationally coordinated, news story published by the International Consortium for Investigative Journalists (ICIJ), "leaking" the 'sweetheart' tax agreements between Luxembourg and large corporates. The second major leak by ICIJ was the Panama Papers in 2016, containing data from Panama-based offshore service provider Mossack Fonseca, implicating many wealthy individuals and world celebrities. The third major leak was the Paradise Papers, also by ICIJ, in 2017, this time from the offshore service provider Appleby, and included secret documents on the tax affairs of Apple, Nike, wealthy individuals and world celebrities. These leaks have been important contributors to political attention, issue salience, and consequent political momentum and initiative in the international tax space (Berg & Davidson, 2017; Dover, 2016; Oei & Ring, 2018).

Finally, geopolitical shifts mean that emerging and developing countries are finding an increasingly powerful voice in international tax affairs (Christensen & Hearson, 2019; Lesage, Lips, & Vermeiren, 2019). Established theories about the need for the United States to take the lead on international tax policy are now in doubt and require revisiting (Eccleston, 2013). At the same time, unilateral action by the United States has been characterised as catalytic for international tax politics. FATCA, as discussed above, remains the preeminent example, enabling coordinated global action on information exchange at the OECD level. More recent unilateral reforms have been discussed in similar terms, most notably the Trump administration's "Tax Cut and Jobs Act" (TCJA) in 2017. The reform initiative includes a significant cut to the headline US corporate tax rate and a move towards a territorial corporate tax system, and an end to the much-criticised 'deferral' system allowing US corporations to accumulate untaxed profits outside the US. It also included key provisions aimed at combating corporate tax avoidance using intangibles (GILTI) and deductible payments (BEAT), which have become core points of inspiration for ongoing global tax reform discussions at the OECD and the G-20 (OECD, 2018, 2019).

In short: Propelled by a shift from a slow-burning and cold policy environment to a fast-burning and hot policy environment, the EU and international tax regimes have undergone a remarkably rapid and significant evolution. In table 2 we summarize the main events in the global tax environment from 2009 onwards. With this context in mind, we next delve into four specific cases investigating corporate forms using the Global Wealth Chains typology, tracing changes from 2009 to 2019.

**Table 2. Major international tax events in the last decade**

<b>Event and year</b>	<b>Implications</b>
Foreign Accounts Tax Compliance Act (2010)	Introduced unilaterally, FATCA mandates all foreign financial institutions operating in the US market to automatically report financial account information of US citizens to the US authorities, under heavy withholding tax sanctions.
OECD Common Reporting Standard (2013)	Following FATCA, the OECD designed a global Common Reporting Standard (CRS) for automatic exchange of foreign accounting information, with more than 100 countries now committed to the standard.
OECD/G-20 Base Erosion and Profit Shifting project (2013)	BEPS is a comprehensive project to reform the global corporate tax system, encompassing 15 action points aimed at combating tax avoidance and shoring up international tax rules.
European Union Accounting and Transparency Directives (2013)	The EU directives introduced mandatory public country-by-country reporting - detailed, geographically segmented tax and economic activity data - for European extractive and financial industry firms.
LuxLeaks (2014)	The first major 'tax haven' leak published by the International Consortium for Investigative Journalists (ICIJ), putting the media spotlight heavily on 'sweetheart' tax agreements between Luxembourg and large corporates.
European Commission decision on illegal state aid for Apple (2016)	The European Commission's DG Competition found Apple's tax structure in Ireland amounted to illegal state aid, totalling €13bn, to be repaid to the Irish government.
Panama Papers (2016)	The second major leak by ICIJ, containing data from Panama-based offshore service provider Mossack Fonseca, implicating many wealthy individuals and world celebrities.
Paradise Papers (2017)	The third major leak by ICIJ, this time from the offshore service provider Appleby, included secret documents on the tax affairs of Apple, Nike, wealthy individuals and world celebrities.
United States Tax Cut and Jobs Act (2017)	TCJA includes a significant cut to the headline US corporate tax rate, a move towards a territorial corporate tax system, and an end to the much-criticised 'deferral' system allowing US corporations to accumulate untaxed profits outside the US. It also included key provisions aimed at combating corporate tax avoidance using intangibles and deductible payments, which provided inspiration for global tax reform discussions.
European Union list of non-cooperative tax jurisdictions (2017)	After years of political stalemate, EU Member States agreed to a common list of 'tax havens' (or non-cooperative tax jurisdictions) to identify and sanction countries that did not 'play fair' on international tax matters.

## **TRANSFER PRICING**

Transfer pricing is the practice of the pricing transactions between related corporate entities – for instance, between subsidiaries within a multinational group (Wittendorff, 2010). This activity might not seem so important, but over the past century, it has grown from a minor technical inconvenience to being at the heart of the modern multinational corporation (MNC), and of corporate tax practice. Upwards of a third of global trade today is conducted not between unrelated parties on an open market but between related parties, ‘inside’ MNCs, and thus subject to transfer pricing practice (Lakatos & Ohnsorge, 2017). The transfer pricing choices made by MNCs have substantial implications, as they decide the allocation of profits and thus taxable income between corporate subsidiaries and between countries (Picciotto, 1992). Yet very few MNCs have significant in-house expertise in transfer pricing. Instead, the highest concentration of transfer pricing expertise is in the transfer pricing advisory sector, dominated by global professional services firms (Christensen, 2018). These advisors span the boundary between tax authorities and corporate taxpayers, operating as intermediaries, scoping out unique knowledge and economic propositions by assisting MNCs in understanding and managing regulation, administrative practices and norms (Hasseldine et al., 2011).

From the wealth chain perspective, the transfer pricing industry predominantly expresses *captive* corporate structures. The *complexity* of transfer pricing practices and principles is high. The determination of appropriate pricing for related-party transactions is not a simple, formulaic exercise, but rather a highly intricate and intangible endeavor. As Richard Collier and Joe Andrus note, “at virtually every step in a typical transfer pricing analysis, rather than applying mechanical rules, taxpayers and governments alike need to exercise independent judgement regarding factors that may materially affect the outcome of the transfer pricing analysis. Use of discretion and judgement will be necessary (...)” (2017, p. 4.70). Because of this complexity, the *capabilities* of advisors are requisitely high. Their expertise is broadly perceived as unique and unparalleled (Hasseldine et al., 2011). As Radcliffe and colleagues note: “Decisions about what is a ‘right amount’ of tax to pay or what is ‘acceptable’ in the context of public opinion cannot be made without recourse to the highly specialized knowledge base and shared meaning system that tax professionals as a whole are privy to” (Radcliffe, Spence, Stein, & Wilkinson, 2018, p. 9). In turn, the *regulatory liability* of certain transfer pricing practices, such as those associated with intellectual property, may be low (Büttner & Thiemann, 2017). In general, however, regulators – tax authorities – have automatic access to standardized information on transfer pricing practice (PwC, 2013).

However, transfer pricing wealth chains are changing. As outlined above, there has been a surge of transparency-related initiatives from national and international regulators, civil society and MNCs themselves, aimed at corporate tax and transfer pricing practices (Christensen & Hearson, 2019; Lesage & Kacar, 2013). These initiatives have followed in the wake of rising dissatisfaction with the practices of corporations and advisors minimizing tax payments around the world (Berg & Davidson, 2017; Dover, 2016). By increasing the scope and depth of information available to tax authorities and other outsiders (media, politicians, NGOs), these initiatives have created

unprecedented pressure and risk for the transfer pricing industry through increased regulatory liability (Christensen, 2019b). In response, the industry has reacted by reshaping wealth chains towards the hierarchy model, mitigating uncertainty by bringing transfer pricing practices and policies closer to the center of power in global corporations. Advisors are increasingly positioning transfer pricing as being part of a comprehensive corporate strategy, rather than a disparate practical practice (Hearson, 2019). Moreover, tax and transfer pricing professionals themselves have gained power and prestige in the wake of regulatory attention, gaining access to executives, boards and other decision-making institutions inside MNCs (Radcliffe et al., 2018).

Another dimension of change in these wealth chains is legitimation. In the wake of transparency requirements and political attention to the industry, some clients and suppliers are distancing themselves from the 'old ways', emphasizing instead an increased capacity to develop a 'tax honest' approach, founded on a culture of compliance (Lagarden, 2019). We can trace this shift through the rhetoric used by global professional service firms in presenting their tax and transfer pricing advisory services. Specifically, analyzing the web pages of the 'Big Four' firms (Deloitte, EY, KPMG, PwC) over time, we can see that the rhetoric has shifted from being explicitly focused on tax *minimization*, to being more conscious about *transparency* and *compliance* (Murphy, Seabrooke, & Stausholm, 2019). Particularly in the era after the global financial crisis, the web pages have stopped mentioning lower taxes altogether, a particular point of critique by wealth chain 'outsiders'. This is far removed from, for instance, 1998, when KPMG presented their services as follows: "Our aim is to ensure that each client pays no more tax than the law requires." Contemporary formulations, in contrast, are increasingly less direct on minimizing taxes, and increasingly vaguer, and more broadly concerned with tax planning.

These changes may well represent attempts to mitigate rising regulatory liability. Political attention as well as further transparency requirements present a challenge to transfer pricing wealth chains. At the minimum, this surge in regulatory liability increases the costs associated with the services supplied throughout the wealth chain, in terms of raw compliance and administrative costs, but potentially also reputational costs (Dyrenge, Hoopes, & Wilde, 2016). Moreover, transparency enables regulatory intervention, such as in the form of audits or sanctions. In this context, more explicit coordination and a closer relationship between advisors (suppliers) and corporate taxpayers (clients), as well as an emphasis on 'legitimate' framing of activities, within transfer pricing wealth chains, may well serve to counter-act increasing regulatory liability.

## CUM EX

Cum-Cum and Cum-Ex are trading schemes for 'tax extraction' that rely on the time-sensitive transfer of ownership between corporate entities within or across jurisdictions to claim undue tax rebates on dividends. In 2017, the schemes were publicised in a large-scale European media collaboration coordinated by the German non-profit investigative reporting centre, CORRECTIV. The so-called 'Cum-Ex Files' exposed a

total tax loss across Europe of more than €50bn<sup>1</sup>, and was described as ‘the biggest tax robbery in European history’ (Deutsche Welle, 2018). The schemes rely on exploiting ownership in order to extract undue dividend tax rebates from authorities unable to sufficiently track, verify or assess ownership for tax purposes. Yet the schemes are also characterized by a highly complex context, involving varied corporate networks, jurisdictional arbitrage, deep professional expertise, and elaborate chains of financial transactions. These dimensions are central to the story of why cum-cum and cum-ex ‘tax extraction markets’ provided huge gains for perpetrators throughout the 2000s and 2010s and without effective regulatory intervention. The failure to intervene was despite regulators having knowledge of the schemes as early as 2007 (Bundestag, 2017).

The cum-ex schemes about which we have most information originate from Germany. Here, the most prevalent type of cum-ex takes advantage of a delay in the date of a share sale and its official settlement. Just before a dividend payout is due from a company, a share sale is executed. The seller remains the legal owner (in the not-yet-updated formal settlement records), accruing both the dividend and an associated tax refund claim. The buyer (with the share sale documentation) receives a compensation exactly equal to the dividend, which the buyer’s financial institution cannot distinguish from the actual dividend, and will thus make another claim for the associated tax refund on this basis. Other types of cum-ex schemes have also been exposed, where the arbitrage occurs due to ambivalent share ownership on the dividend payout day itself. In other countries, cum-ex schemes have been tailored to the specific national rules and context. In cases from Denmark, for instance, share ownership documentation was outright forged, exploiting lax of regulatory oversight and control in verification. Cum-Cum schemes involve the transfer of share ownership to an entity or individual that has a legal right to receive a rebate on dividend taxation, when the transferee does not (Fastrup and Svaneborg, 2019).

Using our typology, these early cum-ex schemes can be characterised as ‘captive’ wealth chains. The design, in most cases, was by dominant ‘lead suppliers’, able to enlist the support - some knowing, some unknowing - of investors, banks, brokers, various financial institutions, and large corporates, all involved in centrally-coordinated transaction chains. (One example of a key figure here is British businessman Sanjay Shah, suspected of being the key figure in the cum-ex schemes in Denmark.) These organized leaders, with a grand idea, utilised deep expertise in law, finance, tax, and administration to develop and carry out the highly complex schemes. For instance, specialised expertise on the legal implications of the schemes are central; formal legal views, based on requisite knowledge, certifying transactions offers a facade of due diligence, and enables later claims of deniability, should regulatory inquest occur. In the case of Denmark, in-depth knowledge of tax authorities’ procedures were central, enabling fraudulent claims of share ownership to pass inspection without detection.

Yet high scheme complexity and supplier capability is just one side of the cum-ex story. Another important one is the regulatory liability, or the ease of regulatory intervention in

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<sup>1</sup> <https://cumex-files.com/en/>

the schemes. In the early years of cum-ex, regulatory liability was relatively low. There was substantial information asymmetries towards authorities, who had insufficient information, knowledge and understanding of the schemes, lacked coordination, and were thus largely unable to intervene effectively. Notably, a lack of cross-institutional coordination both within and across countries contributed to a lack of regulatory interventions. In the German case, the Federal Financial Supervisory Authority (BaFin), which might have had the requisite expertise to intervene, deemed the cum-ex cases were beyond its purview, as it related to taxation (Schick, 2018). In Denmark, successive political reforms had reduced human resource and shifted the identity of the tax authority away from control and towards customer service, leaving those responsible for verifying dividend tax refund claims with few resources and little oversight (Andersen et al., 2018). Moreover, even when German officials initially became aware of the cum-ex schemes in 2007, it took years for them to relay that information to other European countries' authorities, delaying effective regulatory intervention.

Once the gravity of the situation became clear, European regulators did intervene proactively, revamping the context of cum-ex transactions. Following the release of the Cum-Ex Files, and various other tax- and finance related scandals, political attention helped to change the system. First, there has been a surge to enhance transparency of beneficial ownership - the actual beneficiaries of corporate assets and shares (European Council, 2015). This could potentially go some way to increase regulatory liability in the cum-ex cases, where the opacity of ownership is central. In a report under the COFFERS programme published in 2018, researchers identified that more than 40 jurisdictions had implemented or committed to new beneficial ownership regulation (Knobel et al. 2018:12). There has also been a momentum to close various loopholes or issues in national legislation. For instance, we have seen a move against bearer shares - anonymous shares that are difficult to impossible for regulators to track. In 2015, the Danish government for instance moved to ban the issuance of future bearer shares. Institutionally, reforms to overcome coordination problems have been high on the agenda. Internationally, administrative cooperation and exchange of information has been radically strengthened. Within countries, there have been institutional reforms too. Germany, for instance, has centralized the organisation of dividend payouts and asset ownership certification. Finally, the cum-ex scandals have led to a raft of national legal cases, with authorities pursuing prosecutions for multiple actors involved in the schemes (O'Donnell and Sims 2018).

These changes on the regulatory side have significantly changed the regulatory context of cum-ex wealth chains. On the client-supplier side, the features remain largely the same, 'captive' wealth chains in our typology. But regulatory liability has been increased. Coordination amongst authorities - within and across countries - has been significantly improved, prosecutions have been pursued and new legislation enacted. This has increased the prospect of regulatory intervention, ostensibly curtailing the proliferation and scale of use of cum-ex schemes.

## **ART FREEPORTS**

Over the last few years a novel form of offshore storage spaces, where art and other luxury goods can be deposited for unlimited periods of time and traded without tax or duty payments, has been spreading around the globe, including to three locations in Europe (Geneva, Luxembourg, Monaco) (Zarobell 2017; Adam 2018; Weeks 2018). Where traditional freeports, which serve as temporary tax- and duty-free storage for commercial goods in transit, can be key to the operation of global value chains (GVCs), these new “luxury freeports” are more likely to act as links in global wealth chains, permanently storing wealth for corporations and high net worth individuals. Indeed, over the last few years, luxury freeports have explicitly positioned themselves as part and parcel of the wealth management industry (Deloitte Art and Finance Report 2017; see Harrington 2012 for more on trust and estate planning for families). While there are no reliable measures of the wealth stored in luxury freeports, we know that this business model has been growing rapidly: In 2010, luxury freeports offered 46,722 m<sup>2</sup> of dedicated storage, compared to over 178,800 m<sup>2</sup> today.

While growing economic inequality, an international post-crisis turn to quantitative easing and low yields on traditional financial assets are necessary preconditions for the rise of luxury freeports (Horowitz 2011; Goetzmann, Renneboog and Spaenjers 2011; Schragger 2015), they do not suffice to explain why this particular kind of offshore has been spreading. In fact, art, a key asset class stored in luxury offshores, has traditionally been considered a notoriously risky investment and unreliable store of value (Velthuis 2005; Baumol 1986). Yet, Deloitte estimates that US\$1.62 trillion of HNWI wealth was allocated to art and collectibles in 2016 and projects that this figure will reach US\$2.7 trillion by 2026 (Deloitte Art & Finance report 2017)<sup>2</sup>. What explains this trend?

A likely explanation of the art market boom (Horowitz 2011; Zarobell 2017; Fillitz 2014; Adam 2014, 2017) is the growing intensity of regulatory initiatives and interventions to crack down on traditional offshores and the secrecy practices that sustain them (Zucman 2015). As FATCA, CRS and DAC make it more difficult for individuals to escape taxation on proceeds of funds held in bank accounts, there is new demand for investment alternatives, including in tangible goods like art, wine, gold and precious stones (EPRS 2018). Tangibles, by their very nature, must then be stored somewhere. One way to conceptualize the growth of luxury freeports is therefore as an observable implication of changing investment practices in response to regulatory crackdowns. In this sense, the appearance of luxury freeports speaks to the entanglement and interdependence of various kinds of wealth chains and their sensitivity to regulatory shifts.

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<sup>2</sup> Since the bulk of art transactions are not publicly reported, any estimate of the overall value of the art market should be taken with a grain of salt. Clare McAndrew, until recently an economist for the European Fine Art Fair, estimates that art market transactions were \$64bn in 2017 alone (McAndrew 2017). Regardless of the estimates, all agree that the overall growth trend is indisputable.

Crucially, however, trade in and storage of tangible luxury goods is markedly different from that of more standardized intangibles or financial assets, which are more likely to take the form of market wealth chain based on transparent, simple, open and legal arm's length relationships. By contrast, the commercial relationships that center on luxury freeports are more likely to be *relational* in nature. These are deeply sociological interactions, thriving on the transaction of tacit information, requiring high levels of explicit coordination and ultimately founded on trust relationships. In an illustration of this, the price of the services that luxury freeports offer cannot be readily accessed. Instead, public communication stresses that luxury freeports offer “a large spectrum of services and expertise” that are “customizable” and “turnkey,” tailored to individual needs, and available upon request only<sup>3</sup>. While these services stand to become more modular as they become more routinized, the relation aspect remains paramount.

Relational interactions are further anchored in claims to prestige and status. Indeed, fearing further regulatory crackdowns, luxury freeports have actively exploited the special nature of the assets they store, capitalizing on the halo-effect of the high-end art world. For example, the 2014 official opening of Le Freeport in Luxembourg was a glamorous cultural occasion, officiated by the Grand Duke of Luxembourg. Also in attendance were the Prime Minister, the Ministers of Finance and Culture, art dealers, auctioneers, collectors and bankers from around Europe and the Luxembourg Philharmonic played a ‘Freeport’ overture, composed for the occasion as part of the opening (Adam 2018). This is closer to what one might expect at the launch of a prestigious museum or gallery than a storage facility with special legal exemptions. Taking a further step in this direction, the Luxembourg Freeport has also begun hosting an annual “open day” during which members of the public can visit the Freeport and view some of the treasures held there, ranging “from Banksy to Picasso”<sup>4</sup>.

While regulators have limited information about luxury freeports, fear of regulatory action that might impact them is not without basis. Inventory requirements are now becoming standard for luxury freeports as the EU’s fifth Anti-Money Laundering Directive (AMLD5) broadens the scope of earlier directives to include a number of new actors, including freeports and art traders. Crucially, however, these art market actors are defined as “non-financial institutions” that are not held to AEOI. ‘Fishing’ in information from non-financial entities is expressly prohibited and information is therefore only exchanged upon request and where there is prior suspicion of misdeeds. Since confidentiality and discretion is key to the art trade, the effects of AMLD5 on the freeport business may therefore be very limited in practice (EPRS 2018).

## MINING

The mobility of capital enables multinational corporations to depend on transactions and transformations of assets to create and protect wealth, and has challenged

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<sup>3</sup> E.g. <https://www.lefreeport.lu/>; <https://geneva-freeports.ch/en/>

<sup>4</sup> <https://today.rtl.lu/culture/exhibitions-and-history/a/1328180.html>

governments to compete for investment through the tax code. Mobility being key to these processes it is hard not to wonder how this plays out in an industry where immobility of the underlying asset is a fundamental constraint: the mining of minerals does not provide the same opportunities for global investment, as minerals are as fixed to a geographical location as is possible. This contrasts with manufacturing to some degree, and starkly contrasts to firms the value of which is accounted for by a high proportion of with a high proportion of intangible assets (Bryan et al., 2017). Though the source of the wealth is fixed, the multijurisdictional nature of multinational mining firms still enables them to engage in wealth chains. Strategies for profit shifting occur for these global firms, where the mining rights are strategically held by firms in jurisdictions chosen for that purpose rather than due to the location of the minerals. Finér and Ylönen (2017) describe how firms in the Finnish mining sector employ a wide range of tax minimization strategies, all based on strategic choices of intra-group relationships that constitute a hierarchical global wealth chain, showcasing that the fixed position and tangible quality of the underlying assets is not enough to ensure fixed geographic treatment in terms of taxation.

The challenge of taxing mineral wealth goes beyond profit shifting opportunities. The fiscal regime of a mining project consists on the legal side of the combined law within a country as it comes to tax code, investment code and mining code. On top of this, the specific fiscal regime for each project is often negotiated directly in the mining contract where the license to extract natural resources is granted. This enables companies to negotiate directly with the government for lower rates or other concessions (IGF and OECD 2018). A review of contracts across countries shows that this is indeed widespread, and that contracts do provide fiscal regimes that vary from (and are more generous than) the law on several points. It varies from land tax exemptions or tariff reductions to lower corporate income tax rates, lower royalties and tax holidays. The most widespread concession is a tax stability agreement, wherein the government concedes their ability to change any of the applicable tax rules for a period of time ranging from a few years to, often, the entire length of the mining project (IGF 2019).

While the government gives these concessions readily, they do so under circumstances of imperfect information and bounded rationality (Poulsen 2015). Mining a resource requires large scale investment, but the uncertainty regarding the size of the deposit as well as future commodity prices does introduce significant uncertainty regarding the profitability of the project. Imperfect knowledge regarding the actual value of the resource as well as the eventual cost of extracting, bolsters government perceptions of a risk of losing investment and jobs if the tax regime sets the cost above the break-even point for a possible investor. The tax concession itself is also shrouded in uncertainty as the cost of the concession is unknowable without knowing the value of the resource. This uncertainty can make it seem like an inexpensive way to incentivize investment. The provision of a concession does not yield an immediate cost to the government. It yields an indirect cost realized at a unknown future point in time (Wells et al 2001, Bolnick 2004, James 2009).

Mining firms in these negotiations have an advantage over the government in their internal expertise on estimating the deposit, in their ability to hire specialized consultants to estimate this, and in their ability to hire external legal and negotiations expertise to ensure a favorable contract. Thereby the mining firm is able to ensure asymmetric information between the government and the firm, even if neither can overcome the imperfect information problem completely. The use of external consultants in estimating the deposit and negotiating contracts constitutes a relational global wealth chain where suppliers engage in close relationships where information with high complexity is shared, but is combined with the internal expertise and knowledge existing within a larger mining firm. The firm is thereby able to have more knowledge than the government which enables them to obtain a higher degree of tax concessions.

The central asymmetry of information in the mining industry is the question of the value of the mining project, which is unknown at the time of negotiation of the fiscal regime covering it. It is in principle unknown to both the government and the firm. However, both internal expertise and experience as well as coordination with external valuation experts provides the firm with a better estimate of both the costs and potential value of the project. Further large multinational mining corporations might be better positioned than governments to evaluate the projects comparatively to other possible investments in other countries. This enables corporations to pressure the government to give concessions on the fiscal regime such as lower tax and royalty rates and other exemptions, as the government might hold relatively more imperfect information about the profitability of the project. This constitutes a relational wealth chain where the exchange of complex information on different levels - between supplier and client, as well as between client and regulator - determines the final fiscal regime that will cover the project through the contract.

The granting of tax concessions in contracts and the strategic use of multiple jurisdictions and holding companies are different strategies but used in an integrated way by mining companies. An example of how overlapping these two strategies are is the contract between the government of Guinea and Global Alumina. In the annex to the contract it is stated that the company will have a “two-tiered, tax haven structure very commonly accepted by investors worldwide as a more flexible, tax-efficient and sensible means of investing their capital into major, cross-border infrastructure investments”. It goes on to describe a structure in which the Canadian public company fully owns a holding company in BVI, which owns another BVI investment entity which owns the Guinean entity which will carry out the work. The use of BVI means that income in the owning entity is not subject to corporate income tax or withholding tax, and can be repatriated to Canada without being taxed. The agreement with the government therefore provides in one document both generous tax concessions such as a 15 year

tax holiday, as well as grants the company permission to use a “tax-efficient tax haven structure”.<sup>5</sup>

Mining sector actors are able to overcome the fiscal regime surrounding the minerals through a combination of relational and hierarchical global wealth chains. Close coordination with suppliers of expertise in estimation of the value of the deposit enables them to limit their exposure to imperfect information and create information asymmetry on the value of the assets between the firm and the government. This asymmetry provides the bounds of the bounded rationality in which firms are able to persuade governments to grant tax concessions. On top of these relational global wealth chains firms are able to use multijurisdictional strategies of ownership and transaction of capital in a centrally arranged, vertically integrated, hierarchical way.

The major change to the mining industry over last decade in terms of tax has been the rise of the Extractive Industries Transparency Initiative (EITI) initiative and the formal implementations in the US and EU of the transparency requirements coming from this initiative. After the multistakeholder EITI had committed an increasing number of governments and firms to transparency of tax payments in the industry, the G8 endorsed the approach of voluntary standards in 2011. In the following years, the Dodd-Frank act in the US and the 2013 European Accounting Directive made the disclosure of tax payments on a country by country basis a legally mandated part of accounting standards in extractive industries. The latter required country by country reporting of tax payments on a firm and project level from all extractives industry firms (regulated by EU). The reporting requirement even goes beyond taxes and includes royalties, dividends, fees and a range of other payments (Cobham, Gray & Murphy 2017).

As such, the extractives sector has been one of the first sectors subject to country by country reporting on tax matters. However, the implementation of CBCR is remarkably different from, for example, the OECD BEPS standards. It requires transparency on the payments to government reported both from the firm and the government. The misalignment it can be used to track is therefore not tax avoidance but rather corruption. It is designed to detect whether sums go missing in the transaction. The increased transparency might have decreased corruption, acting as a deterrent for governments to obtain rents from the extractive industry. However, it has not been made easier to track the tax payments in proportion to the value creation (or value extraction) of extractive companies. It does not provide any transparency into the value of the extraction done. CBCR works for tax avoidance mitigation purposes only if it can be used to track misalignments between where profit is reported and where value is created. This is also the key of the CBCR rules implemented in the CRDIV directive as well as the OECD BEPS process. The extractives industry is only required to report tax paid. With no

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<sup>5</sup> Basic Agreement between the Republic of Guinea and Guinea Alumina Corporation LTD, 2004, available from ResourceContracts.org. Natural Resource Governance Institute, the World Bank, and the Columbia Center on Sustainable Investment. Available at <https://resourcecontracts.org/contract/ocds-591adf-0616817020/view#/pdf>

measure of the value of their operations, civil society or governments are not able to detect whether the total taxes paid were a proportional amount.

For listed companies, it is possible of course to also find the information on the profitability of mines and thereby get closer to estimating the effective tax rate the company has paid. However a low effective tax rate does not necessarily indicate tax avoidance. It can just as well be the result of lenient tax policies granting generous tax incentives.

Transparency in the extractives sector had not come so far when it comes to tax, even though it was the first sector to be subject to CBCR. If there has been a switch in the propensity of firms in the mining industry to negotiate or plan their way out of higher taxes, then this change has not come from the new legislation. The global wealth chains of the mining industry continue to be characterized by asymmetries of information which enable both widespread tax concessions, and use of low-tax jurisdictions to avoid taxes. The combination between relational and hierarchical global wealth chains in addition breeds corruption, further undermining the development policy and the construction of stronger institutions in developing countries (OECD 2017).

## CONCLUSION AND LESSONS

This working paper maps corporate form across sectors through the application of a typology, Global Wealth Chains. The purpose of this typology is to apply abstracted ideal relationships against real empirical phenomena to reveal trends and highlight how change is happening. The changes in GWC structures across the four cases indicate that the changes in corporate forms have been toward increasingly more complex forms of global wealth chain governance, where information is more closely coordinated within more elaborate corporate forms and where tax avoidance is seeking to exploit legal loopholes. In some cases we have also seen important regulatory advances where the 'length' of information asymmetries has been shortened and political will significantly bolstered.

The most important regulatory changes affecting the *transfer pricing* industry have been the increase in the scope and depth of information available to tax authorities and the public, increasing risk and regulatory liability. In response, the industry has reacted by reshaping wealth chains towards the hierarchy model, mitigating uncertainty by bringing transfer pricing practices and policies closer to the center of power in global corporations. The *cum-ex* tax extraction markets were enabled by a lack of regulatory power, information and resources, contrasting with the expertise and closely connected networks of the involved financial actors. The case of *cum-ex* developed as a captive global wealth chain but has now been constrained by prosecution and regulation. AMLD5 broadens the scope of earlier directives to encompass both *art freeports* and art dealers. However, for now, at least, these art market actors are defined as 'non-financial' entities that are not held to AEOI so the impact on the freeport business may be very limited in practice. As art freeports have benefited enormously from the

clampdown on financial secrecy practices and the resulting turn to investment in tangibles, they have shifted from relational to relational-modular practices. Only the case of *mining* has been immune to change, maintaining Relational-Hierarchy types of wealth chains throughout the period, with little change in how contracts are designed and managed within mining conglomerates and their relationship to developing countries. The complex information asymmetries associated with the beginning of mining projects enable a relational type of global wealth chain between mining corporations and governments. The information asymmetry between corporations and governments is hard to reconcile. To date efforts to empower regulators with more transparent contracts and greater knowledge of underlying value have not proven effective.

Taken together these changes are indicative both of the effectiveness of recent regulatory intervention *and* of regulators' need to remain vigilant to the inevitable downstream effects of such interventions. Thus, in some cases, the revelations and regulatory shifts of the last decade have had a constraining impact on the cases examined (transfer pricing, cum ex). Other cases, meanwhile, seem to have benefitted from the clampdown, as investment practices shift to new asset classes in response to new regulation (art freeports).

Notably, the direction of travel seems to be away from more complex tax avoidance schemes and towards simpler contractual ones that rely on special legal exemptions (art freeports) or *ad hoc* agreements with sovereign states (mining). Ironically, less complexity in the schemes however does not necessarily mean that they are easier to combat. The least complex scheme conceivable is a tax deal between a government and a corporation. However, these are politically very hard to roll back once they have been established. As long as states are willing to set up freeports, special economic zones, lower their taxes and grant discretionary benefits, it is difficult to enforce the restriction of these spaces through international rules.

The initiatives taken by governments and international bodies against tax avoidance and criminal tax extraction (as in cum-ex) across our cases have primarily been focused on the misalignment of paper versus "real" activity. The theory behind country by country reporting is that tax should be paid where value is created, and that if activities and tax payment is reported across locations, the misalignment can be tracked. This effort has had some effect on the transfer pricing industry whose lucrative profession it has been to help multinational corporations manipulate their taxable profits in different jurisdictions. In response to the decrease in information asymmetry between "clients" and "regulators" in this industry, the "suppliers" have converted their strategies toward more hierarchical wealth chain governance modes. In the mining industry however, the increased information has not been a catalyst for change. This is partly because the standard for CBCR in this industry is far from comprehensive. Partly, it is because the close coordination between firms and governments combined with tax competition for investment is what provides the advantageous fiscal regimes for mining firms. Closer coordination between resource rich countries could therefore be needed to empower regulators against the pressure from mining corporations.

Here, problems of valuation and discrepancies in access to expert advice also have a bearing. In mining, the gap between the amount and quality of the expertise that corporations and governments have can lead states to commit to disadvantageous contracts. Similarly, the subjective valuation of art makes it difficult to assess how art should be taxed when it does leave tax-free zones.

Nevertheless, the repercussions of the shift in political will are apparent across the cases. Industry efforts to reify, legitimize and defend the use of tax optimizing practices, whether through declaring a new commitment to 'tax honest' accounting, appealing to the need for 'competitive' taxation levels or imbuing art storage spaces with the halo effect of the high-end art world, are a testimony to this political watershed.

## NOTES

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