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“Students of equity have to be aware that trusts are often vehicles for tax evasion and tax avoidance. A critical understanding of this problem means taking account of the political, social and moral contexts in which trusts operate.”

Introduction and Aim of Paper

When undertaking a study in equity, the use of trusts is often at the forefront of the discussions as a tool by which equity can be achieved.¹ It is noted in this paper, however, that trusts have increasingly been viewed as a mechanism by which rules and regulations—in this case, in relation to taxation—can be avoided and by which individuals can look to avoid or minimise an otherwise valid tax bill. The purpose of this paper is to consider this proposition by focusing on the perceived problems of trusts being used as a mechanism for tax evasion and tax avoidance schemes with particular reference to offshore tax trusts. These will be considered not only from a legal perspective, but also in relation to the political, moral and social context in which they operate. The paper will firstly look at the way that trusts are potentially used for tax evasion to get an understanding of the core principles before then going on to consider in more detail the way this results in offshore secrecy, looking at practical examples. It then aims to consider the pros and cons of the use of trusts in this way, recognising that trusts can provide a positive impact as well as being a negative force, before finally offering suggested improvements and a conclusion as to the influence that factors outside of the black letter of the law can have on the area of equity and trusts.

Trusts as a Focus for Tax Evasion

Trusts are, in their basic form, a relationship where one party allows another party to hold assets for the benefit of a third party, who is referred to as a beneficiary. These are used in multiple different scenarios—for example, a trust allows for the management of assets so that they are treated differently for tax purposes and for day to day management. It may be that this is done for basic reasons, such as the fact that the beneficiary is unable to undertake the management of the assets, perhaps because they are a minor or for some other reason. More commonly, however—and the subject of the case here—is that trusts are used as a mechanism to gain greater tax efficiency for the parties.²

Trusts allow for the parties to gain financial secrecy in whatever jurisdiction they are or wherever they choose to operate. Interestingly, the whole concept of the trust was established back in medieval times, where knights would give their property to a friend or confidante to

¹ Ambrosanio, M. F., & Caroppo, M. S. (2005). Eliminating harmful tax practices in tax havens: Defensive measures by major EU countries and tax haven reforms. *Canadian Tax Journal*, 53(3), 685.

² Braithwaite, J. (2005) Globalization, redistribution and tax avoidance. *Public Policy Research*, 12(2), 85–92.

look after for a period. The underlying position of this remains relevant today, with trusts being used as a mechanism to hide wealth, whether it be for tax purposes or some other potentially more sinister purpose such as money laundering. Although the focus of the discussion here is going to be on offshore tax trusts, trusts are commonly seen in the area of inheritance tax.³ Where trusts are utilised in the area of inheritance tax, it could be argued that this increases the level of wealth inequality that is experienced across the region with the wealthy being able to afford to put in place these tax arrangements and the less wealthy not being able to.⁴ This remains a core argument when it comes to the impact of trusts and offshore trusts on the wider social, political and economic context.

Offshore Secrecy: A Product of Tax Trusts?

The question here requires consideration of the political, social and economic issues that emerge when trusts are used in order to avoid tax. Each of these three elements will be discussed here to gain a greater understanding of the arguments both for and against the use of trusts in this way.⁵

Offshore trusts are established primarily with the purpose of avoiding the tax position that would be faced were it resident in the UK. This means that an offshore tax trust would be considered to be resident outside of the UK for tax purposes.⁶ Crucially, the residency of the trust is independent of the residency of the individual beneficiaries; this offers opportunities for individuals resident in the UK to enjoy a preferential tax regime by being captured under the tax regime of an offshore jurisdiction.⁷

Political

From a political point of view, tax evasion or avoidance can be problematic as it raises core issues associated with jurisdiction as well as the issues of concentration of wealth in certain regions and democracy being distorted. One of the core arguments presented in this debate is that of Richard Murphy⁸ on tax, where he argues that by allowing the wealthy to utilise

³ Johannesen, N., & Zucman, G. (2014). The end of bank secrecy? An evaluation of the G20 tax haven crackdown. *American Economic Journal: Economic Policy*, 6(1), 65–91.

⁴ Palan, R., Murphy, R., & Chavagneux, C. (2013). *Tax havens: How globalization really works*. Cornell University Press.

⁵ Christensen, J. (2011). The looting continues: Tax havens and corruption. *Critical Perspectives on International Business*, 7(2), 177–196.

⁶ Income Tax (Trading and Other Income) Act 2005

⁷ Desai, M. A., Foley, C. F., & Hines Jr, J. R. (2006). The demand for tax haven operations. *Journal of Public Economics*, 90(3), 513–531.

⁸ Murphy, R. (2017). *Dirty secrets: How tax havens destroy the economy*. London: Verso, pp. 29–51.

offshore trusts and to effectively shop around for the best taxation arrangement, this creates a position where the wealthy become wealthier and power is held by a relative few, creating a real challenge for democracy.

An alternative view that is presented in this regard is that property rights are present regardless of political desire and conventions, and that individuals have a right to retain their monies or income whether this be through income or inheritance. In this paper, it is argued that the position taken by Murphy must be pursued at least in part. To have an entirely free system where the government is not able to interfere with the individual's right to retain all of their income or inheritance would leave the government with a funding dilemma. The government and democracy rely upon the charging of taxes and the legal system would not exist without the government. This necessarily presents a robust argument that trusts which deprive the government of all tax in their jurisdiction and encourage the concentration of wealth in several offshore jurisdictions do so in opposition to democratic behaviour.

A further argument which holds reasonable merit here in the opinion of the author is that put forward by Knobel,⁹ who argued that wealthier countries such as the UK will often look to place substantial restrictions on illegal activity such as drugs trafficking and kidnapping, etc., whereas they seem to actively encourage, or at least turn a blind eye to, activities that are unlawful activities but in a more economic arena such as tax evasion and corruption. The two are intertwined, and it would seem politically unacceptable to have two very different approaches to illegal activity. It could even be argued, as was the case by Knobel, that by encouraging these offshore trusts, the offshore jurisdiction finds itself experiencing a real wealth divide, where those involved in the provision of these trusts become the elite and are effectively protected from their own society.

Economic

The next area that comes under scrutiny is the impact that the use of offshore trusts has on the economic position of a region or country, or even the global economic position. Crucially for this discussion, and distinct from the points raised politically, is that from a strict economic position the distinction between tax evasion and tax avoidance is minimal. Tax avoidance refers to schemes and arrangements that are within the law, whereas tax evasion is outside of

⁹ Knobel, A. (2017). Trusts: Weapons of mass injustice. *Tax Justice Network*. Retrieved from <http://www.taxjustice.net/wpcontent/uploads/2017/02/Trusts-Weapons-of-Mass-Injustice-Final-12-FEB-2017.pdf>

the law and is criminal activity. Offshore trusts are considered as tax avoidance when following the parameters set down by the relevant tax authority.

However, from an economic point of view, the two are largely similar in that the aim of the activity is to reduce the taxation that would otherwise be chargeable. The economic position remains the same in that it results in less money being made available to the government for general spending and can ultimately result in resources not being allocated correctly. Where an individual tax payer gains a tax benefit, they do not necessarily confer this to others and effectively create a deadweight loss.¹⁰ Despite this reasonably robust argument, it is contended here that tax havens and the ability to arrange tax affairs through trusts can have a good economic benefit in that it encourages competitive behaviour from governments, as being too aggressive with the taxation will simply encourage more people to look to offshore structures. It could also be argued that by allowing the wealthy to retain their wealth, ultimately this will be re-invested or spent within the economy where the beneficiary is located, which is beneficial for the home country—in this case, the UK.¹¹

Social/Moral

Finally, there is the social and moral argument against allowing trusts of this nature to be established with a view to minimising tax. A core text presenting this argument is Prebble and Prebble in 2010.¹² When considering the moral position, the distinction between evasion and avoidance is much more pertinent: evasion is illegal, whereas avoidance is not, and this very distinction offers an argument that it is a moral right for individuals to be able to utilise arrangements that are considered to be avoidance so as to protect their income. This is heavily linked to the political arguments that are presented both in favour and against the use of tax trusts.

It would seem that the arguments here are centred on the debate as to whether or not these taxation arrangements are considered to be harmful. Is it the case that allowing these tax trusts in tax havens is harmless to society in general and therefore presents no real threat and should be allowed to continue? It is argued here that the arguments for and against the use of tax trusts are in fact much more rooted in social and moral discussions and the willingness to accept, or otherwise, the wealthy remaining wealthy and being able to protect their wealth in

¹⁰ Christensen, J. (2011). The looting continues: Tax havens and corruption. *Critical Perspectives on International Business*, 7(2), 177–196.

¹¹ Dharmapala, D. (2008). What problems and opportunities are created by tax havens? *Oxford Review of Economic Policy*, 24(4), 661–679.

¹² Prebble, Z., & Prebble, J. (2010). The morality of tax avoidance. *Creighton Law Review*, 43(3), 693–746.

a way that would not then allow it to be distributed to those within the less wealthy categories.¹³

Suggested Improvements, Analysis and Conclusions

Referring back to the point under discussion here, which requires the consideration of the wider impact of the use of trusts to engage in tax schemes or arrangements, which may be considered avoidance or evasion depending on its nature, it is suggested that the area of offshore tax trusts should be rightly put under review.

It is argued here that the key issue is that of secrecy and the potential opportunities that are presented to those that are seen as having greater wealth so as to effectively minimise their tax position. The moral argument that this is a right for all is strong, and it is therefore argued here that the focus should be on preventing behaviour that would be seen as evasion and preventing secrecy that goes beyond allowing individuals the freedom to manage their financial affairs as they choose. Politically, it is noted that the availability of tax havens and the use of tax trusts places a constraint on the UK government to behave in a way that is not unnecessarily greedy, as it is more than aware that the wealthier individuals have alternative options. This type of moderation of behaviour is useful and would be lost in the event that trusts were not to be used in this way.

Despite this, it remains the position of the author here that there should be greater transparency and that this could be achieved through a need to register trusts and to allow for information to be transferred amongst countries. This is an area that has already been identified as critical by the EU with its directive in 2003¹⁴ that required information to be widely available to tax administrators across the EU in relation to private savings. This was further supported in the case of the EU rules in 2015, which are now before government in the form of the Finance Bill 2017.¹⁵ It is suggested that this regime be extended to focus more on the trusts and to ensure that beneficial interests are understood: it is here that the focus should be, and not on the prevention of the trust mechanism for tax planning purposes.

¹³ Bramall, R. (2016). Tax justice in austerity: new formations. *Journal of Culture/Theory/Politics*, 87, 29–46.

¹⁴ Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments.

¹⁵ House of Commons. (2018). Briefing Paper: Tax avoidance recent developments. Retrieved from <http://researchbriefings.files.parliament.uk/documents/CBP-7948/CBP-7948.pdf>

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