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Thesis title:

International Financial Regulation and Offshore Financial Centers: The Rise of Soft Law

and The Dichotomy Between The Anglo-Saxon Vision and The Continental European Approach

PhD in International Law and Economics

Cycle 28

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International Financial Regulation and Offshore Financial Centers: The Rise of Soft Law and The Dichotomy Between The Anglo-Saxon Vision and The Continental European Approach.

A Thesis
Submitted to the Faculty
in fulfillment of the requirements for the
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by

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Università Commerciale Luigi Bocconi - Italy
Université Paris I Panthéon-Sorbonne - France
2017

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ABSTRACT

How does the lack of shared economic interests among OECD member countries weaken new international laws—which are based on soft law—that aim to contribute to the fight against the financial and fiscal opacity of offshore financial centers?

Tax optimization involves using the rules of law to legally reduce a tax burden. But the line that separates tax optimization and tax evasion is tenuous and one could even say porous at best. Increasingly, it indeed appears that the issues of tax optimization and tax fraud are becoming one, as the rules of law can be easily circumvented and the limits easily crossed. This phenomenon is particularly evident in the field of international taxation.

This thesis deals precisely with the issue of difficulties of Soft Law in regulating offshore financial centers. Indeed, the absence of common economic interests is blatant between the Anglo-Saxon countries and continental Europe on this issue, thus finding a common interest (that could be economic, cultural, environmental or security-related) appears to be key to the success of legislation based on Soft Law internationally.

The common interest seems unattainable when it comes to combating tax optimization, since the main aim is to protect the social model of the welfare state in continental European countries. A dichotomy of size at the time when the Anglo-Saxon countries are increasingly lacking in such a model.

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ABSTRACT

En quoi l'absence d'intérêts économiques communs entre les pays membres de l'OCDE affaiblit-elle les nouvelles législations internationales basées sur le Soft Law en vue de lutter contre l'opacité financière et fiscale des centres financiers offshore ?

L'optimisation fiscale consiste à utiliser les règles de droit pour réduire en toute légalité sa charge fiscale. Mais la frontière entre l'optimisation fiscale et l'évasion fiscale est ténue pour ne pas dire perméable.

De plus en plus, les notions d'optimisation fiscale et de fraude fiscale ne font plus qu'une, tant les règles de droit sont facilement contournables et ses limites aisément franchissables. Ce phénomène est tout particulièrement avéré sur le plan de la fiscalité internationale.

La problématique de cette thèse met en lumière les difficultés du Soft Law à réguler les centres financiers offshore, tant l'absence d'intérêts (économiques) communs semble flagrante entre les pays anglo-saxons et l'Europe continentale sur la question. Or l'intérêt commun (qu'il soit économique, culturel, sécuritaire, environnemental) constitue la clef de voute du succès d'une législation basée sur le Soft Law à l'international.

L'intérêt commun paraît inexistant voire inaccessible en matière de lutte contre l'optimisation fiscale, dès lors que celle-ci vise principalement à protéger le modèle social de l'état providence des pays d'Europe continentale. Une dichotomie de taille à l'heure où les pays anglo-saxons s'en écartent toujours plus.

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Nomenclature

Acronyms / Abbreviations

AEF	Afrique Équatoriale Française
AEOI	Automatic Exchange of Information
AFME	Association of European Financial Markets
AIFM	Directive for Alternative Investment Fund Managers
ALM	Arm's Length Method
AMF	Autorité des Marchés Financiers in France
AOF	Afrique Occidentale Française
ASCM	Agreement on Subsidies and Countervailing Measures
BCBS	Basel Committee on Banking Supervision
BEPS	Base Erosion and Profit Shifting
BIS	Bank for International Settlements
BRICS	Brazil, Russia, India, China and South Africa
BTA	Border Tax Adjustment
CAA	Competent Authority Agreements
CCCTB	Common Consolidated Corporate Tax Base
CGP	Commissariat Général au Plan
CMU	Capital Markets Union
CONSO	Commissione Nazionale per le Società e la Borsa in Italy
CPIS	Coordinated Portfolio Investment Survey
CRA	Credit Rating Agencies
CRD IV	Capital Requirements Regulation and Directive IV
CRS	Common Reporting Standard
CTC	United Nations Security Council Counter-Terrorism Committee
DISC	Domestic International Sales Corporations

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DSB	Dispute Settlement Body
DTA	Double Taxation Avoidance agreements
EBA	European Banking Authority
EEA	European Economic Area
EEC	European Economic Community
EIOPA	European Insurance and Occupational Pensions Authority
EMIR	European Markets Infrastructure Regulation
ESFS	European System of Financial Supervision
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
ETI	Extraterritorial Income
EU	European Union
FAFT	Financial Action Task Force
FATCA	Foreign Account Tax Compliance Act
FDFA	Federal Department of Foreign Affairs
FFI	Foreign Financial Institution
FinCEN	Financial Crimes Enforcement Network
FSC	Foreign Service Corporations
GAFA	Google, Apple, Facebook and Amazon
GATT	General Agreement on Tariffs and Trade
GCD	Great Circle Distance
GDP	Gross Domestic Product
GFI	Global Financial Integrity
HDI	Human Development Index
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
IFIs	International Financial Institutions

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IGA	Inter-Governmental Agreements
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IRS	Internal Revenue Service (In the United States)
ISA	International Standards on Auditing
MCAA	Mutual Competent Authority Agreement
MFN	Most Favored Nation
MR	Main Rate
NCAs	National Competent Authorities
OECD	Organization for Economic Co-operation and Development
OEEC	Organization for European Economic Co-operation
OFCs	Offshore Financial Centers
OLS	Ordinary Least Squares
OWS	Occupy Wall Street
PE	Permanent Establishment
R&D	Research and Development
RCAP	Regulatory Consistency Assessment Program
RWA	Risk Weighted Assets
SIEs	Small Island Economies
SPR	Small Profits Rate
SPS	Sanitary and Phytosanitary Measures
TBT	Technical Barriers to Trade
TIEA	Tax Information Exchange Agreement
TIN	Tax Identification Number
TRACFIN	Traitement du Renseignement et Action contre les Circuits Financiers Clandestins
TRIPS	Trade-Related Aspects of Intellectual Property Rights Agreement
TTIP	Transatlantic Trade and Investment Partnership

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UCITS	Undertakings for the Collective Investment of Transferable Securities
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
USVI	US Virgin Islands
VAT	Value Added Tax
WEF	World Economic Forum
WTO	World Trade Organization

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Introduction

How does the lack of shared economic interests among OECD member countries weaken new international laws—which are based on soft law—that aim to contribute to the fight against the financial and fiscal opacity of offshore financial centers?

Tax optimization involves using the rules of law to legally reduce a tax burden. But the line that separates tax optimization and tax evasion is tenuous and one could even say porous at best. Increasingly, it indeed appears that the issues of tax optimization and tax fraud are becoming one, as the rules of law can be easily circumvented and the limits easily crossed. This phenomenon is particularly evident in the field of international taxation.

International tax law is inadequate and incomplete. The loopholes are numerous and allow multinationals to easily cross this line between tax optimization and tax avoidance—most of the time legally. Is tax evasion a legal form of tax fraud? How can one defraud if the law does not prohibit it? Is anything not prohibited therefore considered to be legal? The questions of law melt into questions of morality.

While the principle of abuse of law has developed in most countries of the world in order to counteract the abusive optimization of tax rules, tax authorities now seem to be overwhelmed by the scale of the phenomenon. The proliferation of complexity is growing with the development of patents, intellectual property and the digital technology in increasingly globalized economies.

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At the heart of this phenomenon is transfer pricing which makes it possible to legally transfer part of revenues (and therefore profits) from one country to another according to the costs linked to the production of a multinational, which are often self-defined. While the costs of manufacturing high-consumption goods were readily quantifiable in the 1990s, it is now almost impossible to calculate the actual cost of manufacturing a new generation iPhone or a sophisticated cancer treatment. The debate on the price of anti-cancer treatment Keytruda sold in 2016 at 100,000 euros per patient per year in France highlights an inflation of the valuation of the costs of research and development of a product. This increase in costs is rarely justified and is difficult to assess accurately in terms of R & D costs by the tax administrations of developed countries.

These two examples from the outset cited in this introduction may seem trivial but they reflect crucial problems.

R & D costs are at the heart of transfer pricing practices, even though the main legal weapon, the abuse of rights, seems incapable of fighting companies that are increasingly valuing their intangible assets as being tied to intellectual property. Companies internationally have understood this perfectly, placing the ownership of these patents in subsidiaries located in tax havens, thereby allowing these law-tax countries to be the tax residence of a significant portion of their profits.

International tax evasion would thus involve companies in the new technology sector wishing to optimize their taxation, countries with low tax rates and limited fiscal and banking transparency—the famous tax havens—and developed countries with static tax legislation that are helpless in the face of multinationals that are increasingly clever about distributing their costs across the different jurisdictions in which they operate.

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The reality that this leads to is dark, however. Despite increasingly stringent tax regulations in developed countries, tax evasion remains massive and involves most multinationals to varying degrees.

Developing countries are not spared and would even be the first to be affected, as a result of weak tax administrations and higher growth of (and dependence on) international trade than developed countries.

It is this growth in trade and the absence of a binding international legal framework that fuels the development of tax havens, the very definition of which is difficult and open to debate, as the concept brings together different and varied realities.
The Organization for Economic Co-operation and Development (OECD) considers that a tax haven should be characterized by the following criteria: non-existent or insignificant taxes, lack of fiscal and banking transparency, legislation that does not permit the exchange of information with administrations of third party countries and finally tolerance towards shell companies with fictitious activities (OECD, 2009).

Yet such a definition is restrictive because it is too precise in its terms and too imprecise regarding broader outcomes. Indeed, the official announcement in June 2006 that no more countries appear on the lists of tax havens as defined by the OECD does not mean that no tax havens exist.
The definition of a tax haven is also sometimes simplified to the extreme and is then referred to as an Offshore Financial Center (OFC), a territory in which the financial sector has taken a preponderant and often disproportionate place in the economy.

Switzerland, a historical tax haven in Europe, has been partly threatened by the deregulation of London and New York since the 1980s. Around these new

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financial centers, there is an ecosystem of tax havens where OFCs each have a specialty and certain specific capacities. But all share a common objective: to pay dividends and interest on securities domiciled in their territories without paying tax and this in total opacity. And indeed New York and London themselves can be considered tax havens today.

While Switzerland had invented the numbered bank account, the OFCs spread around the world have created the equivalent of numbered shell companies, going thus from "account #123456 to Company ABCDEF" (Zucman, 2015). The principle is the same, only the method changes.

While the OECD, the G20, the European Union and the international community as a whole seem to struggle against the financial and fiscal opacity of the OFCs, the results are disappointing.

Between 2009, the date of the establishment of the automatic exchange of information at the request of the OECD and 2013, the amount of assets managed in Switzerland increased by almost 14%, while at the level of OFCs in the world as a whole the average increase in funds managed would be up by almost 25% (Zucman, 2015). The exchange of information at the request of the OECD has even led to counterproductive effects—part of the money placed in offshore centers that signed exchange agreements has been moved to even more secret jurisdictions. Places such as Hong Kong or Singapore, historically tied to the UK but today in the realm of influence of China, have earned between 4 and 5% of the total offshore assets managed on the planet. Conversely, Jersey saw its assets under management collapse. Less compensation for European regulators and the OECD and a resounding failure for the institution which was to put down the offshore financial centers operating on the basis of banking secrecy.

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In the global context of the fight against the fiscal and financial opacity of tax havens, how does the lack of shared economic interests weaken international legislation based on Soft Law?

This thesis deals precisely with the issue of difficulties of Soft Law in regulating offshore financial centers. Indeed, the absence of common economic interests is blatant between the Anglo-Saxon countries and continental Europe on this issue, thus finding a common interest (that could be economic, cultural, environmental or security-related) appears to be key to the success of legislation based on Soft Law internationally.

One possible example to follow is provided by the successful case of the fight against the financing of international terrorism. The FAFT and the UN Security Council resolutions were made possible thanks to the common interest of UN member states united in their desire to fight terrorism. Thus a security interest became a common interest, prompting states to establish efficient regulation based on Soft Law and then Hard Law.

The recent signing in Paris of the global climate agreement in 2016 marks the renewal and realization of the global fight against global warming. The common interest in environmental matters has also led to the emergence of a rule commonly accepted by all.

The fight against the opacity of offshore financial centers must also be based on a common interest in financial transparency at the global level, in order to be commonly accepted and put in place by all, either through Soft Law or in fine by Hard Law.

However, while the common interest has emerged on the security front, it has taken decades to take shape in terms of the environment, even though this state

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of affairs seems once again to be called into question by the future Republican American administration.

In such a context where shared interests are difficult to make emerge following the diversification and multipolarization of international actors, can the fight against tax havens today be based on a shared economic interest?

The dichotomy between the Anglo-Saxon economies and continental Europe on the subject suggests that a common interest is unattainable presently. Furthermore, the continued divergence of interests between those that have something to gain (the Offshore Financial Centers and their clients) and those that have something to lose (states whose citizens and companies use OFCs and who therefore have a weakened tax base) will maintain a challenge for any efforts to reduce the use of OFCs worldwide. Only a global approach that would take effect in all areas at a time would be truly effective, since otherwise money can flow from one area to another with ease. However, this very approach, based as it would be on Soft Law would have inherent weaknesses.

The aim of this dissertation is to unveil a dichotomy between countries of Anglo-Saxon culture and continental Europe on questions of regulation of international taxation. The European Union, the United Kingdom and the United States each have different economic interests linked to the weight of the financial sector in their economy, their economic culture and their cultural or colonial heritage.

This dichotomy, although historical and well known, should be compared with the weak progress in the fight against the financial opacity of the tax havens that will be referred to here as OFCs. The successive failures of international regulations, in particular those of the OECD, are largely due to this dichotomy in the way developed economies perceive OFCs.

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As they are reviled by continental Europe whose public finances have (in part) been weakened by massive tax evasion by multinationals and large fortunes on the continent, the European Union has been the spearhead of a massive regulation of OFCs considered to be detrimental to the proper functioning of the European economy and its common market.

Conversely, OFCs are sometimes considered essential for the functioning of globalized economies and the prevailing economic culture of the UK and the US see free markets as positive for the society as a whole. Facilitating the mobility of capital, OFCs would thus make it possible to streamline the workings of cross-border capitalism.

The United States and the United Kingdom, historically and culturally very connected to a myriad of OFCs around the world, see them as a means of extending their capitalist and cultural influence beyond traditional channels. Their banks and multinationals present in all four corners of the globe can find cheap financing and relay areas with low taxes to store their profits. This all leads to a cost for US and UK in terms of public finances but one that at least on the surface is explained by the benefits gained from the conquest of export markets, the favorable dynamics of the mergers and acquisitions market, and ultimately employment and growth in these countries.

These two visions, somewhat caricatured but clearly discordant, partly explain the slow speed at the international level of the fight against banking and the fiscal opacity of the OFCs, despite the OECD's stated intention to put an end to certain practices that they and other actors would like to belong to the past, without necessarily having the means to undertake such a major project.

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The choice of soft law to legislate on this issue—the importance of which is growing in international law regardless of the sector concerned—appears debatable both due to the lack of sanctions that is inherent to soft law and on the question of the lack of common interests among key stakeholders.

Soft law is limited by its own weaknesses, leaving open the development of offshore financial activity which is progressing at an ever more unbridled pace. Why, then, should we continue to advocate soft law on these international issues when a hard law model would be more able to effectively resolve the issue through the signing of treaties and the establishment of sanctions associated with a dispute settlement body ?

The lack of shared economic interests amply explains the choice of such a legal architecture. Faced with the rise of emerging countries and multilateralism, the United States has progressively pushed for alternative methods to hard law and soft law is still an option outside of the hard law path. Soft law also allows the US to maintain its two-faced role as permissive in terms of tax optimization domestically and still a regulator on the international stage, part of the OECD negotiations to adjust the fiscal structure of the future.
Does the combination of soft law and the absence of common economic interests, owing to the unavoidable interconnection between the United States on one side and the United Kingdom on another to many OFCs, mark an unavoidable failure of the fight against optimization in the international tax system?

Many options remain unexplored to date, such as changing the role of the WTO in order to incorporate an explicit mandate on tax issues, since they are contrary to the principle of free competition in a market where subsidies may be the subject of disputes in the WTO. The many conflicts between the European Union

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and the United States on taxation issues for export (DISC, FSC, ETI) show that the WTO is already addressing issues closely linked to tax optimization via OFCs.

Yet the WTO is also divided today by a growing divergence of economic interests among its member states, to such an extent that its model of Hard Law seems to be called into question. If one considers that a rise of the Soft Law is indeed a weakness, it presents the possibility of further undermining the WTO on the questions of taxation. And this even though the priority seems to be the setting up of a Hard Law-type architecture.

The very recent establishment of the Automatic Exchange of Information (AEOI) set up by the OECD could thus benefit from the creation of a World Financial Registry under the aegis of the IMF (Zucman, 2015). Holders of every share and obligation in the world would thus be transcribed in this registry, thus overcoming the problem of shell companies established in the OFCs.

The European Commission's plan to set up a Common Consolidated Corporate Tax Base (CCCTB) for all EU countries by 2021 should allow an end to the abuses related to transfer pricing. A revolutionary measure on a European scale, this could be imitated on a global scale for all companies with a turnover of more than 100 million dollars.

The fight against international tax evasion via OFCs is therefore not short of possibilities, as many regulatory options remain hitherto unexplored.

Soft law could find its place because an inherent function of soft law is to prepare the emergence of a coercive rule, hard law, that would be accepted by all due to the consensual elaboration of soft law.

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A relevant example of soft law having led to the development of a coercive rule that is accepted by all today as the norm is the fight against terrorist financing.

The awareness of the international community and the establishment of rapid sanctions in case of non-respect of the obligations imposed by the United Nations provides a ray of hope in the fight against the financial opacity of the OFCs. Awareness of all the participating countries and the umbrella of a global regulation under the aegis of the UN, the WTO or the IMF could enable the fight against the opacity of the OFCs to know the same success as the fight against the financing of terrorism.

Nevertheless, a key component of the success of anti-terrorist financing legislation would have to emerge: an interest that is not security-related, but economic. The emergence of a shared economic interest remains for the time — and this thesis will underline this point—beyond the reach of the international community due to the lack of a supreme body that would impose a soft law from above and therefore make all countries even in their confrontation with the competition for revenues.

Yet the absence of shared economic interests denotes the impossibility of a structure of the Hard Law type, and instead favors the Soft Law approach even if Soft Law will not succeed in being applied due to this very lack of a shared interest.

This paradox makes it impossible to efficiently legislate offshore financial centers.

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I - Soft law as a tool for more efficient and effective international financial regulation

While soft law is a relatively recent arrival in France, it has been present on the international scene for some time. It is generally accepted that the emergence of soft or semisoft law in international law occurred after the Second World War, dating specifically to December 10, 1948 when the member states of the United Nations signed the Universal Declaration of Human Rights. This text sets out essential principles without, however, sanctioning signatory states that do not respect the Declaration. The enunciation of a rule without a sanction is the first criterion of a rule of law qualified to be soft law (Cazala, 1992).

After 1945, the role of soft law continued to take on importance at the international level, under the impetus of the United States and the Western world enamored with multilateralism. Indeed, in international law, soft law allows for flexibility in international relations between states. The European Union also increasingly applied soft law as an alternative to hard law.

France resisted the tide of an international community captivated by soft law for some time with the French Council of State long criticizing this approach before gradually integrating soft law through various analyses that emphasize the evolution of Semisoft law (*Droit mou*) towards Soft law (*Droit souple*). As early as 1991, in its public report "On legal security" (*De la sécurité juridique*), the French Council of State declared that a proliferation of texts and their heterogeneity could only undermine legal certainty. Legal certainty is intended to protect citizens and litigants from the negative effects of the law, due to its complexity,

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contradictions, inconsistencies or successive amendments (French Council of State, 1991).

Indeed, the French Council of State had very decisively derogated this legal proliferation by calling it semisoft law (*droit mou*), fuzzy law (*droit flou*) and even gaseous law (*droit gazeux*)!

The Constitutional Council rejected rules without a normative or binding force in its decision n° 2005-512 DC of April 21, 2005, distinguishing semi-soft law from soft law but reaffirming emphatically the need for laws to establish a clear, precise and coercive regulatory framework. The degree of coercion must also be clearly defined and not left undetermined (Mathieu, 2007).

Yet as the years have passed, soft law seems to have become a rule of law in its own right in France. In its annual study of 2013, the Council of State re-qualified and finally integrated soft law into a range of standards by defining the three criteria of soft law:

- the provisions laid down must be designed to alter or direct the conduct of the person to whom it is addressed;
- the provisions create neither a right nor coercion in respect of and against their addressee; and
- the formalism of these provisions is similar to the rules of law.

In this same study, the Council of State analyzes the four functions or purposes of soft law:

- soft law can substitute for hard law when the application of the latter is difficult;
- soft law can act as a law that is preparatory to hard law for emerging subjects;
- soft law may accompany hard law; and

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- soft law and hard law may function alternatively leading to greater overall autonomy.

Faced with the increasing emergence of norms that lay down a rule without an accompanying sanction, the French Council of State consecrated soft law and recognizes it as a useful tool in the face of increasing quantities of standards.

In March 2016, the French Council of State determined that Soft Law rules adopted by regulatory authorities (including the AMF) could, from that date forward, be the subject of an action for repeal before the Administrative Court.1 The administrative judge would thus be able to establish the relevance of Soft Law acts developed by regulatory authorities with regard to their mandate, and the consequences "in particular of an economic nature, or intended to have a significant influence on the behavior of the persons to whom they are addressed.2

This new jurisprudence thus aims to strengthen Soft law and remains in the continuity of the 2013 report, Soft law being once again enshrined by the Council of State.

This position is widely shared internationally, particularly with regard to the regulation of the financial sector, fiscal and banking transparency and the fight against the financing of terrorism. All of these issues the international community has had to confront for 20 years while the very question of legal and fiscal sovereignty seemed untouchable in many countries and in many OFCs.

This chapter, devoted to soft law and the development of international banking, financial and tax standards, will deal initially with the emergence of soft law and

1 As declared in Decision No. 390023 of 21 March 2016.
2 Decision No. 388150 of 13 July 2016 concerning the Acts adopted by the AMF and the Commission for Energy Regulation.

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the numerous criticisms it faces including non-binding rules, a possibility of inefficiency, and a risky mixture of lobbying and regulation.

Secondly, the example of the new OECD standards for the exchange of banking and tax information across the world will be discussed in detail in order to better understand the ins and outs of the implementation of soft law-type standards internationally including those that are applied at the national level.

The example of the successful transposition of the FAFT recommendations in the fight against the financing of terrorism internationally will be discussed in order to closely consider the possible rapid and concrete paths of soft law application with regard to financial and banking regulation internationally, including a very large number of players, including all the member states of the United Nations.

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A) The role of soft law in international law in the era of a globalized economy

1) The origins of soft law and customary law

In order to better understand the emergence of soft law and its growing importance in international law today, one must go back to the sources of international law and its evolution under the influence of Anglo-Saxon law and Common Law.

The sources of public international law refer to Article 38 of the Statute of the International Court of Justice (ICJ) which states:

> 1. The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:
>   a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;
>   b. international custom, as evidence of a general practice accepted as law;
>   c. the general principles of law recognized by civilized nations;
>   d. subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.
> 2. This provision shall not prejudice the power of the Court to decide a case *ex aequo et bono*, if the parties agree thereto.

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This article of the ICJ text takes up the formulation of a statute of its predecessor, the Permanent Court of International Justice, dating from 1920. The International Court of Justice succeeded the Permanent Court in 1945. Hence, some obsolete or unusual expressions are used such as "civilized nations" or "the most qualified publicists", terms that are representative of a way of thinking that has long been criticized by emerging countries. Western customary law was seen as being imposed upon them, and, in spite of their recently acquired independence in 1945, these countries were unable to contribute to the further elaboration of the latter.

This article is essential when the members of the United Nations are subject to the statutes of the ICJ. It confirms and enshrines written law while placing customary law in second place.

This relative importance of customary law in international law will favor the emergence of soft law which tends to resemble it. Customary law is criticized by many emerging countries, however, because it is considered anti-democratic since these new nations did not take part in its elaboration (Carreau and Marrella, 2012).

The aforementioned article of the ICJ does not refer specifically to soft law, but soft rules are apparent here and impose themselves. Soft law appears at the international summits at which the emerging countries are represented, allowing them to add their stone to the edifice of international law that is in the course of development.

The multiplication of non-binding resolutions at the UN or of international standards, because of the accumulation of these texts on a given subject, can

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ultimately become "a general *opinio juris* and thus constitute a norm of customary international law" (Dillard 1975).

The customary character of an accumulation of non-binding norms may be disputed internationally, while others insist on the constructive and inclusive nature of the increased quantity of these standards in order to create a renewed international customary law based on consensus.

The peculiarity of soft law is that it is a law of adherence *(droit d'adhésion)* which presupposes little or no sanction and which allows, above all, an adaptability to circumstances and to state actors. The adherence of a state to a norm entails a loss of sovereignty. Any loss of sovereignty must always be compensated by the flexibility of the rule, without any sanction being attached to this rule. Soft law, unlike hard law or binding law, imposes a transfer of sovereignty due to this constraint.

It should be kept in mind that soft law can have very diverse forms: the relationship between hard and soft law is more complex than it might appear. The report of the French Council of State discussed in the introduction is a good reminder of this.

Soft law also allows the development of laws that depend upon a bottom-up approach (as does customary law) while maintaining a certain flexibility appreciated by private sector players and national authorities overwhelmed by the rapid evolution of the international environment.

Soft law's sparse and rapid solution to the need for a legal framework also makes it possible to adapt to technological developments in sectors covered by the new regulations while keeping costs relatively low (in terms of time and negotiations) to reach an agreement between the different countries.

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The difficulties of reaching a coercive agreement within the framework of international treaties in a multipolar and globalized world are today highlighted by the example of the WTO which has serious difficulties in reforming due to its foundations based on its historic GATT model.

Obtaining an agreement on the basis of soft law on the other hand is all the more easy and rapid as states know full well that the legal constraint is ultimately limited due to the absence of sanctions.

In this international context, very different from that of the post-war period, the United States took into account the evolution of politico-financial relations between countries and continents and was the first to defend the development of international regulatory frameworks that are more supple and simplified and which adapt and evolve rapidly. These regulatory frameworks should have an application that is as broad as possible and not lead to sanctions.

2) Soft law encouraged by Anglo-Saxon influence on the international scene

By opening up to the possibility of soft law, the US had taken into account both the constant evolution of the increasingly multipolar world—in which often criticized customary law had been too rigid and entirely incapable of adapting rapidly to changes in society—and the evolution of politico-financial relations between countries and continents. Indeed, the changes in legal governance encouraged by the US mirrored the experience of England, five centuries after the UK had launched the Equity Reform of Common Law that had also proven itself unable to adjust to the upheavals of society and economic progress.

The French model on the other hand is distinct from the American and British system, with its written code and a very limited part for custom. France, given its

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history, its legislative model and its legal milieu *(la doctrine)* resistant to the appearance of soft law both internationally and nationally remained for some time apart from this movement.

According to Abi-Saab, a professor of international law at the Graduate Institute of International and Development Studies in Geneva, the issue of Soft law must be seen in the light of multilateral normative co-operation, where results count less than the availability and implementation of means. It is these obligations of means which are at the heart of "collective action in the pursuit of a common goal" (Abi-Saab, 1993). We thus find here the notion of common interest with the establishment of collective means to achieve them without obligation of result. The international community will thus judge the parties (countries) on the absence of the establishment of the necessary means required for the common cause (interest) rather than on the results obtained.

René Jean Dupuy considers Soft Law to be Green Law, since Soft Law is a law in perpetual evolution, "growing" and having the vocation to propagate or to develop towards harder law (Dupuy, 1973). The temporal notion implied by the characteristic evolution of Soft Law as pre-law is thus a key element in its very definition.

This favorable view of Soft Law by Dupuy and many others provoked a chain reaction in the academic world in the 1970s and 1980s. French administrative law theory, of which Prosper Weil was one of the spearheads, was much more cautious with regards to Soft Law and moved away from this movement in 1982, considering Soft Law not as pre-law, but as a legal tool with reduced normativity (Weak Law), which in his view, would have no legal value (Weil, 1982).

In reaction to this rejection of the notion of pre-law, Alain Pellet entered humorously into the academic debate with his article referring to the expression

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"separating the wheat from the chaff" entitled "'Good law' and the chaff: Advocacy for the Chaff" (*Le "bon droit" et l'ivraie: Plaidoyer pour l'ivraie*) in which he speaks of Soft Law as a "normative process" with "normative milestones"—stating that there is a normative purpose that is deferred in time (Pellet, 1984).

In this context, soft law was almost exclusively on the rise thanks to the activism of the United States that resulted in its expansion in 1970s and 1980s, as it was seen as a solution to the repeated blockages on the questions of international regulation via more traditional structures such as treaties. Thus the difficulties encountered in developing common standards in the financial sector have led to the creation of forums such as the International Organization of Securities Commissions (IOSCO), the International Accounting Standards Board (IASB) or the Basel Committee supported by the US Treasury that promotes an alternative model that is soft law.

Thus American regulators belonging to these international working groups have been instructed by the US Treasury to do their utmost to set up "less formal approaches to solving increasingly globalized problems"—in other words, non-binding rules (Galbraith and Zaring, 2014).

States and economic and financial actors are therefore confronted with American pressure. They seek to contribute to the construction of a norm and a rule in order to standardize a globalizing financial world and to adhere to this norm or rule without losing the power of decision and sovereignty to a third state—in most cases the United States.

The corollary of this simplified rule is the danger of interpretation and the lack of recourse against the rule and its application, especially since the elaboration of the rule is often in a context which therefore has a binding force from a political

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point of view without having a legal point of view. The rule is, however, developed and thus imposes itself in the given domain.

The United States logically uses the standards developed by soft law internationally in the process of setting up their domestic policy, largely dominated by administrative law with agencies of the Federal government that have expanded powers for the application of regulations adopted internationally. Sometimes, however, the United States can ignore the transcription of norms adopted internationally in their national law. The example of FACTA and the adoption of the OECD's Common Reporting Standard (CSR) is symptomatic of an ambiguous relationship, if not an à la carte choice of applications of soft law.

3) Useful soft law with multiple functions including that of preparing the hard law of tomorrow

For over thirty years, academia and legal experts (la doctrine) have been debating the evolution of soft law and its insertion into a codified system. One thing is certain however: soft law inspires hard law, it is one of the primary meanings of soft law to play the role of “pre-law”.

Soft law is made up of numerous and different components with little or no binding character, the gradation of which can go from a simple resolution to a convention adopted between states. The development of this soft law is considered by many to be pre-law, as is the case in the formation of a new customary international law—which leads one to suppose that this pre-law could become a law that could be binding in the end.

The Anglo-Saxon doctrine is more flexible on this subject, which it has also treated for many years. Richard Baxter, the late law professor from Harvard University,

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considered as early as 1980 that international law has an "infinite variety" of legal tools and that Soft Law occupies a prominent place. On the other hand, Roessler, Schachter and Bothe refute this hypothesis, considering that Soft Law only includes norms of an extra-legal nature, and thus exclude the idea of graduated normative law from a series of legal tools. Nevertheless, over the years, the Anglo-Saxon doctrine quickly made its place in Soft Law, incorporating the idea of a scale of gradual norms as it has been highlighted by Abbot or Keohane.

Through working groups where soft law has increasingly taken up its place, private institutions participate in the elaboration of soft law—theses standards are non-binding at present but will potentially become binding in the future. The establishment of universally accepted standards is a factor of legal certainty once it allows soft law to fulfill its pre-law functions more easily, subsequently reinforcing the acceptance of the binding norm.

But it has to be said that this is not the case in one domain: binding law has not yet found its place in financial regulation. On the other hand, soft law has begun to take its place at the national level in France, as evident in the growing interest of the French Council of State for soft law that had been considered until very recently "fuzzy", "gaseous" law without rigor that is potentially dangerous.

Indeed, according to Jean-Jacques Rousseau, law only has meaning if it lays down defined legal obligations "obedience to a law that we know is prescribed is freedom" (Rousseau, 1762). This historical conception of law, which is typically European, could partly explain the reluctant position of continental Europe to embrace soft law regulations more recently.

The uncertain legal ramifications of soft law as well as its excessive proliferation and invasiveness (sometimes duplicating standards already in place) had discredited it in the eyes of the highest French courts, as they saw in it a factor of

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legal instability arising from the proliferation of texts and the overabundance of entities that have the capacity to produce soft law. In the face of such an abundance of non-binding texts, those in the field of law *(la doctrine)* were in a position to question the relevance of the use of soft law as it could present the risk of seeing States and private organizations turn away from soft law due to its weakness and therefore respect only hard law.

Yet soft law continued to gain ground in the 1990s and 2000s, finding new legitimacy in European Community bodies that skillfully combine hard law and soft law, thereby requiring European states and lawyers not to turn away from it. On the contrary, the EU was one of the first to integrate soft law into its legislation, citing the qualities of simplified procedures for the development of soft law that allow for easier adoption of these laws while allowing rules to be laid down within a reasonable time.

The EU applies treaties and directives that are binding and can be characterized as hard law. Associated with these binding regulations are a set of recommendations, communications and opinions that form another arsenal that can be described as soft law. This arsenal of soft law-type is indeed not binding, it does not have a compulsory character.

There are a number of sectors subject to these new requirements, including energy and competition law—sectors that are bombarded with these European recommendations. The Directorate General for Competition regularly publishes guidelines on market concentration, coupled with the recommendations of the European Commission on mergers and the publication of guidelines in the controversial domain of anti-trust.

However, even without being binding, soft law produces effects from a legal point of view (characteristic of pre-law), sometimes resulting in binding European

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directives that are themselves adopted by national authorities that use them as inspiration for their domestic legislation.

At the international level, given the rapid evolution of societies and the globalization of commercial and financial exchanges throughout the world, soft law is emerging more and more as an all-encompassing solution to a legislative environment that must adapt to an increasingly dynamic economic environment.

Another example of the successful transposition of soft law (FAFT Recommendations) into hard law (Resolution 1373 of UN Security Council) is the legislation of the UN to combat the financing of international terrorism.

This pre-law function, which seems to have become characteristic of soft law, suggests that international financial regulation that has taken place since the end of the 1980s will eventually move from soft law to hard law. The proliferation of international forums dealing with financial, banking and fiscal standards must go through this prior stage of soft law in order to bring about a commonly accepted and potentially binding regime thereafter.

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B) The importance of soft law in the development of banking and financial standards

1) A dichotomy between trade law and financial law also explains the appearance of soft law.

The financial crisis of 2008 forced Western governments to speak out in favor of further financial regulation at the international level, without, however, changing the very nature of these regulations based on a soft law-type of architecture developed in the 1980s and 1990s. As we have seen above, the Anglo-Saxon world and the United States in particular, have always pushed for this type of soft regulation without sanctions, a solution widely supported by banks and their lobbies.

Beyond this link between Anglo-Saxon legal culture and soft law, the question arises as to whether international finance has become such an arena for soft law rules, while international trade law appears in the more classical context of the WTO and thus has historically been linked to hard law.

The two sectors, both impacted by an increasing globalization of trade, nevertheless have to deal with profoundly different economic and structural environments that have influenced the mode of regulation which it seemed appropriate to build in each instance.

However, this dichotomy in the development of standards has tended to fade since the early 2000s with the digital revolution and the digital economy.

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The WTO, a historical institution of international trade law based on numerous international agreements, is a symbol of a hard law-like architecture in an international organization, that has incorporated a Dispute Settlement Body.

The WTO could continue to rely on a hard-law model because of the stability of the market sectors that the institution oversees. Agriculture, raw materials, automobiles and the industrial sector have been relatively stable and are perfectly comfortable with hard law-based legislations at a time when soft law was only a purely theoretical concept.

However, this dichotomy between international financial law and international trade law has tended to fade with the rise of new technologies and electronics based on increased technological competition between market actors (patent wars) and planned obsolescence requiring a rapid renewal of equipment, a change that has profoundly affected the WTO regulatory landscape. The next chapter on the WTO will further explore this subject.

The financial sector is increasingly the target of more recent regulation in contrast to the regulatory model of international trade law. While financial regulation emerged in the 1980s, the regulation of international trade dates back to the 1950s, a significant difference in eras on the time scale of international law.

Thus the financial sector—through these relatively new soft law regulations—includes varied elements such as best practices (via the Basel Committees, IOSCO, etc.), study reports and advisory opinions. To a lesser extent there are also co-operation conventions on the exchange of banking and tax information within the framework of Memorandums of Understanding. These conventions express the desire for common guidelines and mutual understanding such as, for example, the signing of a Tax Information Exchange Agreement (TIEA) of the OECD that have

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recently been replaced by the Common Reporting Standard and the Automatic Exchange of Tax Information (AEOI).

The close ties between soft law and the financial sector are not new. Because of its complexity, technical nature and rapid evolution linked to the evolution of information technology and communications, States have long been led to develop a soft, rapidly adaptable standard. The development of regulations and supervision of this sector is delegated to working groups composed of experts. Thus, at the national level, central banks and financial market authorities have the role of delegated regulator in many countries. The autonomy of these independent administrations gives them a better ability to adapt to rapid changes in technology and the way in which the financial sector evolves. The *Autorité des Marchés Financiers* (AMF) in France, the *Commissione Nazionale per le Società e la Borsa* (CONSOB) in Italy, and the Securities and Exchange Commission in the United States are autonomous administrative agencies that have the capacity to sign bilateral agreements— politicians do not always have the technical skills necessary to understand the texts that must be adopted.

This flexibility and independence so appreciated at the national level have been used as a model in the framework of the development of international standards through the creation of committees such as the one in Basel.

2) The Basel Committee, a symbol of soft international capital regulation

The 2008-2009 financial crisis has led to increased coordination among forums of regulatory authorities rather than through formal international financial organizations. Through the action of the G20, many forums decided to develop stricter standards and increase the scope of intervention of existing international forums such as the Basel Committee. The focus is mainly concentrated on the importance of financial risks on a systemic scale, as opposed to the more

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microeconomic approach that national regulators might have. As voluntary standards produced by international firms to govern themselves, they mainly produce pro-cyclical prudential rules for large and complex financial institutions – i.e. major banks and insurance companies. They try to build a framework for cross-border crisis management and, in particular, the liquidation of International Financial Institutions (IFIs).

The development of soft law in the field of international finance has been driven by the establishment of the Bank for International Settlements (BIS) in 1975 in Basel, Switzerland. The Bank for International Settlements is an international organization created in 1930 to facilitate the settlement of war reparations imposed on Germany after the First World War, it became a forum for cooperation and coordination of European central banks in the ensuing years.

The Basel Committee on Banking Supervision (BCBS) was created at the end of 1974, after the first oil shock of 1973, by the Group of 10 (G10) which brought together central bankers from major Western economies and Japan. The Basel Committee on Banking Supervision was supposed to produce an annual report addressed to the governor of each member's central bank. The Basel Committee developed banking and accounting standards in order to improve banking hegemony between the countries belonging to the committee. In the beginning of the 1990s, the Basel Committee "embraced a methodology in the international harmonization of standards that involved close consultation with the private sector". [1]

This very innovative approach "was driven both by the increasing complexity of banking and finance and by the belief that clumsily formulated standards

[1] Wood, Duncan R. *Governing Global Banking: The Basel Committee and the Politics of Financial Globalization.* Aldershot, Hants, England: Ashgate, 2005.

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threatened the profitability of banks and the stability of national and international banking systems[1]. "

The First Agreement: Basel I

In 1988, the Basel Committee introduced a capital measurement system called Basel Capital Ratio for Western Banks, also known as Basel I. Its goal was to reduce systemic risks and ensure banking stability around the world through a clear focus on credit risk. Its main proposal was to define “capital and structure of risk weights” for financial institutions—particularly banks. The capital requirement was fixed at a minimum level of 8% of risk weighted assets (RWA), known as the Cooke ratio. RWA considers assets with different risk profiles, from low to moderate, excluding high risk assets. An asset backed by collateral would carry lower risks than corporate loans, which have no collateral and represent too much risk to be considered in the bank’s capital requirement. The idea is to ensure that risks are low and diversified when included in banks’ capital requirements.

The Second Agreement: Basel II

The Second Basel Agreements, called Basel II, established a new capital framework for the international banking system in 2004.

This new framework is built around three main principles: (1) a minimum capital requirement for banks in order to cover credit risk and operational risk; and a (2) supervisory review process combined with strong market discipline (3).

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[1] Wood, Duncan R. *Governing Global Banking: The Basel Committee and the Politics of Financial Globalization.* Aldershot, Hants, England: Ashgate, 2005.

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This framework was not revolutionary as it did not deeply modify the previous international agreement (Basel I). Indeed the capital ratio of 8% had been mentioned in the first Basel Agreement and was maintained in Basel II, though new risk weights to the capital ratio are defined.

Banks are requested to review their internal risk monitoring methodology, with new recommendations to ensure proper risk monitoring at each financial institution and a more accurate assessment of the quality of their assets.

The measurement of capital became more precise for capital requirements, in particular with the integration of operational risk and the notion of Tier One capital: hard capital that is assessed to be the least risky. The ratio of capital required was renamed the McDonough ratio with Basel II.

Basel II is organized into three main pillars:
- Shareholders' equity,
- Risk monitoring, and
- Transparency.

In 2006, the European Union transposed the recommendations of the Basel Committee into Community law through Directives 2006/48/EC and 2006/49/EC, which began to apply to the Member States of the EU on January 1, 2007 .

The Third Agreement: Basel III

In 2010, following the shock wave of the collapse of the American commercial bank, the Lehman Brothers, the Basel Committee decided to validate a third part

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of its prudential recommendations as Basel III. The objective is to improve and strengthen the ability of banks to resist shocks on the financial markets[1].

In view of the systemic nature of risks linked to the growing interdependence of banks on international financial markets, the Basel III agreements propose to substantially increase the quality of equity capital, the level of which had remained unchanged since 1988 with Tiers 1 capital to move to from 2% to 4.5% by 2013. Ultimately, the equity ratio would increase from 8% in 2015 to 10.5% in 2019.

Standards on liquidity risk were also introduced by Basel III, banks are recommended to select assets that can be easily traded without loss of value in order to supply liquidity in case of difficulty due to mass withdrawals by customers (bank runs and flight-to-liquidity) or the drying up of the interbank market (credit crunch).

Banks are also asked to weigh their assets according to the quality of the risk, therefore increasing counterparty risk or the development of market activities that will have to be offset by more equity.

Basel committees have no supranational authority, and in order to be implemented, the standards they propose must be endorsed and incorporated into national legislation (or European Law in the case of Europe). This is a perfect example of the use of soft law as pre-law at the international level. Basel Committee standards however have little chance to impact the banking industry and protect international financial markets from systemic crisis, as it had no coercive power outside of Europe.

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[1] Angelini, P. *BASEL III: Long-term Impact on Economic Performance and Fluctuations*. Basel, Switzerland: Bank for International Settlements, Monetary and Economic Dept., 2011.

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Moreover, beyond the question of the non-binding measures recommended by the Basel Committee, the very organization of the forum and the way in which its standards emerge has been criticized by a part of the international community. Many experts are afraid of the growing power of the banking and financial lobbies that are very present in these international forums. Some going as far as to refer to the privatization of regulation of the international financial system as "creepy" (Eatwell and Milgate, 2011).

3) A technical financial sector where the influential role of lobbies is contested

The complexity and increasingly technical nature of the world of finance and financial markets, as well as its operating methods and its ever more specific tools has led to a shift from the supervision of these markets to dedicated regulatory authorities. This transfer has strengthened the power of professionals both in their relations with States and in the elaboration of the rules to which they will subsequently be subjected.

Whereas initially financial activities were generally localized in a given economy (with the notion of territory) in which specific rules of law applied, globalization upset this balance, presenting the possibility of reduced costs with the development of digital and information technologies that also presented the instantaneous flow of financial exchanges on a global scale at an increasingly low cost. Thus there has been the creation of an immense world market of finance composed of national financial markets that are interconnected to rules of law that are often diverse and varied.

These developments in international markets and the legal vacuum that surrounded them have led financial institutions—mainly banks—to expand their

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activities globally. They take advantage of market opportunities country-by-country but also optimize regulatory opportunities in certain jurisdictions depending on their more or less restrictive nature, and move or relocate some of their financial activities in accordance to all of these parameters.

The laws of the country of origin, as an element for decision-making therefore lost its importance as of the 1980s. The rules and sanctions of the law of the country of origin have lost their effectiveness in the context of the internationalization of activities that are difficult to identify for national authorities in the absence of uniform legal, accounting and financial rules.

Aware of this asymmetry between financial activities whose complexity and internationalization exceeded their own capacities, public authorities quickly decided to set up international committees such as the Basel Committee. Nevertheless, decision-making and the resulting issues that arise are changing the balance of power between regulators, supervisors and those being regulated (banks). This new balance of power in the elaboration of international standards is contested but nevertheless inevitable.

The elaboration of the law remains highly technical in relation to the subject matter of the proposed regulation or deregulation. Parliamentarians are politicians, rarely technicians, so they do not necessarily have the competencies required by parliamentary committees. As part of their mandate, parliamentarians come together in specialized committees, assisted by troupes of technicians and experts. The question arises of the autonomy remaining to parliamentarians in the face of the complexity of the issue at hand. Again the lobbies and experts in the field have a growing power, which can lead to conflicts of interest. Another outcome is a form of self-regulation by economic actors in question, since the political actors have in a sense renounced their power or lost this power de facto because of a lack of mastery of the subject.

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We will discuss this issue in more detail in a subsequent chapter in the framework of the institutional obstacles at the level of the US Congress and the transposition into national law of the OECD CRS recommendations. The power of the lobbies is then determinant in terms of the position taken by the republican group to defend national economic interests.

This capturing of the development of legal rules by non-political actors raises a question of the legitimacy of the rule of law, whether of soft law or hard law type. The American legislative system is thus considered captive by Wall Street on the issues of financial regulations.

The popular movement Occupy Wall Street (OWS or "Occupy") that started spontaneously in 2011 in the United States denounces the growing power of banking interests in the elaboration of the law and in the domination of the economy. The movement was even supported by a part of the American intellectual elite, including a Nobel laureate in Economics, Joseph Stiglitz, who took part in some marches in New York and declared that the American financial system was corroding the American democratic system, creating at the same time "a distorted economy" far from the ideals of a market economy (Lopez, 2011).

Self-regulation and lobbying thus seems to be a brake on the development of a sound and stable market economy for some economists, contrary to the objective sought by the legislator through an integration of all stakeholders at the negotiating table.

And yet legislators, regulators and stakeholders tend to become categories of individuals that overlap today. Since the permeability between these organisms is greater in proportion to the fact that an adapted regulation emerges and as competencies are exchanged alternately between regulators and regulated.

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Examples abound, from the former Minister of Economy, Emmanuel Macron, who had been an official and Inspector of Finances and partner in the Rothschild business bank and Minister under the Holland Presidency. Or José Manuel Barroso who presided over the European Commission for ten years until 2014 before becoming Senior Advisor at the US investment bank Goldman Sachs.

Beyond these high-profile individuals who crossed government and private sector borders, which can be considered controversial, there is a movement of exchange of skills between regulators and those regulated (through these forums, and through cross-recruitment at the intermediate level of management and not just top management). On the upside, these interconnections can improve understanding of two universes that must be understood and respected with commonly accepted and more efficient standards.

The development of these standards is evolving, and co-operation now seems to be the standard that is required in financial regulation as it will likely emerge tomorrow in international trade law.

The work of the OECD in the fight against tax optimization and for better supervision and transparency of OFCs on the principle is based on a principle of increased cooperation between actors and stakeholders. The OECD appears to have successfully built a set of international standards to strengthen the national legislative arsenals against financial opacity enjoyed by multinationals and large banks in many jurisdictions including OFCs.

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C) The OECD and the Fight Against Tax Evasion Through OFCs.

After World War II, under the auspices of the Marshall Plan, European countries came together to create what was then called the Organization for European Economic Co-operation (OEEC) with the aim of rebuilding the countries of Europe with the help of funding from the United States. In 1961, the OEEC was superseded by the OECD (Organization for Economic Co-operation and Development). The activities of its Member States consist in promoting and exchanging experiences and knowledge both on politics and economics and coordinating their respective actions on the various issues of interest to them.

To date, the institution whose headquarters is located in Paris, has 35 member countries dedicated to democracy and a free market. The OECD has many experts who work on the drafting and publication of studies, statistics and analyses on economic and political issues in each of its member countries.

Tax issues are regularly examined within the framework of the mandate of the OECD. Thus in 2000, a Global Forum addressed in detail the issue of tax havens and the risk of tax compliance.

In this context, the Global Forum on Transparency and Exchange of Information for Tax Purposes was created to continue the efforts of the first meeting. This Forum aims to lay down rules for transparency and exchange of information, notably within bilateral exchange agreements in this area.

The OECD is also known for its advocacy on this subject and in particular for its publication of its ratings and lists of non-cooperative countries in the framework of international cooperation for the exchange of tax and banking information. In

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2000, the OECD published its first Black List of Uncooperative Tax Havens comprising 35 countries or territories. In 2002, only seven territories remained on the list after many others had promised to improve cooperation, these were: Andorra, Liberia, Liechtenstein, the Marshall Islands, Monaco, Nauru and Vanuatu. As of May 2009, there are no more territories on this list.

The 2008 crisis strengthened and changed the role of the Global Forum on Transparency and Exchange of Tax Information. As of 2009, the Forum began to analyze and assess bilateral treaties between states, including tax havens—treaties relating to the exchange of tax information. It also relaunched the signatures of agreements by updating what is known as Tax Information Exchange Agreements or TIEAs.

In 2015, faced with the lack of concrete results following an evaluation of the efficiency of the conventions signed, the Forum established a new standard for the Automatic Exchange of Information (AEOI) that has been rapidly taken up by all countries of the world except the United States.

As of 2016, the Forum includes 123 Member States, far more than the 35 members of the OECD hosting it, which strengthens its credibility internationally, especially with emerging countries which often have little or no representation in organizations founded after World War II.

1) OECD and on-demand information exchange TIEAs

(A) Agreements Re-designed for Increased Efficiency

Tax Information Exchange Agreements (TIEAs) mark a new chapter in the fight against tax evasion and the opacity of OFCs in the world. Until now, the

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international community has been carrying out work on the elaboration of conventions in order to avoid double taxation in the framework of the implementation of Double Taxation Avoidance agreements (DTA).

The willingness to include an exchange of information is a major step forward and an innovative breakthrough capable of combating tax evasion that has hitherto been reinforced by the growing opacity of the OFCs, which have used confidentiality as an important argument allowing them to attract international capital.

The functioning of a TIEA is fairly simple. Each country that is a signatory to the TIEA can send a request to the tax administration of the co-signatory country. In practice, the official request is sent by the requesting country via a digital and postal channel. This request has supporting documents attached and is sent to the partner country from which information is requested.

The country from which the tax information is requested then has, in theory, a maximum period of 90 days to provide a detailed reply to the requesting tax administration. Beyond this period, the tax administration to which the request is addressed must justify any delay. In practice, many OFCs have to go beyond this 90-day deadline, arguing that there are difficulties in collecting data within their countries, or stating that the provision of this information is not compulsory.

Requests for information that are not supported by tax elements justifying the transfer of tax information are often rejected by the destination tax administrations on the grounds that an application must be specific and linked to concrete and detailed tax evasion suspicions based on the opening of a bank account or the establishment of a company in their territories. The OFCs thus avoid the risk of their local administrations being overwhelmed with requests

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and eventually jeopardizing their economic model based on the confidentiality of the financial assets held on their territory.

The OECD, aware of the fact that many delays could result from the recipient tax administrations' (often OFCs') slow responses to OECD member countries' requests, has set up a rating system for each country on the basis of the speed of the processing of applications received each year. Like the gray or black lists of tax havens, this rating tool aims to be the indicator of the reputation of a signatory country in the fight against tax avoidance and opacity.

In theory, if the request for information concerns a bank account, the requesting administration must disclose the name of the bank concerned and the details of the banking information concerned. The request shall be forwarded by the receiving administration to the bank concerned by the request. The financial institution then has 60 days to process the request, within which time it can challenge the legal basis before the competent judicial authority in the country of destination.

In practice, either the file is processed within the time limit, or it receives an objection of inadmissibility and is not forwarded to the tax administration to which it is addressed and is not the subject of a challenge before the competent court.

If the file is deemed acceptable by the bank and the latter consents to transmit the requested documents, it shall communicate all the information to which it has access relative to the bank account concerned: bank account movements and balances, user names for e-banking services if these are available, the bank card numbers linked to the accounts, and the movements and the location of the payments related to the bank card if this is available, etc. (Lang, Pistone, Rust,

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Schuch, Staringer, and Storck, 2015). However, the request will not be cross-checked to reveal other bank accounts held by the same client in the same bank.

In theory, if the request for information concerns one or several companies established in the country of destination, the requesting administration must communicate the names of all the companies concerned. The request is forwarded by the receiving administration to the statutory agent responsible for managing the legal and fiscal interests of the company in the country. The statutory agent (often a law firm or legal adviser) then has 60 days to process the request, within which time they can challenge the legal basis of the request before the competent judicial authority in the country (the procedure is identical to that for bank accounts and financial institutions).

In practice, the transmission of data is not always an evident process. Indeed, the countries receiving applications often have different legislation and a strong culture of secrecy, and the information transmitted is often of low quality. The widespread use of trusts and foundations in OFCs often does not allow for the identification of beneficial owners (shareholders, boards of directors, etc.) and their tax residence.

The OECD is undertaking a peer review of the Member States of the Global Forum on Transparency and Exchange of Tax Information rating their ability to pursue a policy of optimal cooperation in tax matters. This action aims to help limit obstacles in accessing information which would in the end render certain agreements practically null and void by not allowing for the exchange of information of sufficient relevance or quality to allow for a step forward on the transparency front and an optimum effectiveness of the exchange of information.

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2) Reviews of the Effectiveness of the Conventions by the Member States of the Forum (Peer Reviews).

The primary objective of the peer reviews among states is to encourage better understanding of each country and to incite participating states to collect the kinds and qualities of information that will be considered crucial for the international exchange of information. Foremost among the requirements for a participating state to succeed is the ability of a tax administration to lift banking secrecy or to gain access to the identity of direct shareholders of companies domiciled on its territory (OECD, 2010).

These reviews conducted under the auspices of the Forum depend on ten technical criteria falling into three main categories: (1) availability of information (on the identity of shareholders and company accounting), (2) access to information by relevant authorities (availability of confidential information, for example) and, finally, (3) the rapidity of the exchange of information with the requesting administrations (OECD, 2010).

The objectives of the Global Forum of the OECD are to identify progress in information exchange, to identify states that are potentially falling short of meeting commitments and finally to recommend measures to improve their capacity to meet the requirements of the exchange agreements.

As we have seen previously, there is a lag between the theoretical and practical phases in the information-exchange procedures before results are seen. The OECD, aware of this state of affairs, therefore included in its evaluation a theoretical compliance phase (Phase 1) in the legal framework of countries to respond to exchange requests and a phase of compliance in practice (Phase 2) to validate the level of effectiveness in information exchange.

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As part of the Phase 1 review, a team of experts composed of two Global Forum evaluators ensures compliance with the "legal and regulatory frameworks in force" and the compatibility with the regulatory framework of the model convention of the OECD (on the basis of the three main categories mentioned above including the ten essential elements, each of which is further broken down into 31 specific sub-elements).

As part of the Phase 2 review, experts at the Global Forum focus on the effectiveness and reliability of the implementation in practice of the Forum's recommendations.

The Phase 2 review ultimately yields an annual report that rates countries as compliant, largely compliant, partially compliant and non-compliant according to their level of compliance with Forum standards. To move from Phase 1 to Phase 2, a country has to fulfill the criteria of Phase 1. Otherwise, the country never accedes to Phase 2, which leads to re-establishing a list of non-compliant countries (similar to the OECD gray lists).

3) Difficult implementation in the face of heterogeneous regulatory frameworks

The OECD prides itself on an ambitious plan to combat tax evasion, with recovered tax revenues on the order of €520 million in 2012, €745 million in 2013 and €667 million in 2014 according to a Global Forum survey of some 30 jurisdictions among its member countries (Global Forum, 2015). The difficulties of implementing the TIEAs remain numerous and this is one of the main obstacles to the development of these bilateral agreements issued by the OECD.

France, in a report analyzing the public policies of 2014, thus identifies significant problems that prevent a smooth application of these bilateral agreements. The specific case of the British Virgin Islands and Bermuda is

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discussed in this report. Due to different tax and accounting legal architecture, France had difficulty obtaining the information requested under the signed agreements. These bilateral agreements do not require the signatory countries to reform their internal fiscal and administrative practices in order to collect all the information requested by the partner countries. The report thus found examples in the British Virgin Islands and in Bermuda where local administrations transmitted to France the corporate accounts of businesses that were either incomplete or not certified under French standards.

Other countries that are also signatories of bilateral agreements for the exchange of tax information with France try to obstruct the demands of the French administration. The French request can be considered unjustified by the partner countries. The island of Jersey, for example, put forward numerous objections, considering that French requests for information were "constitutive of fishing for information" (PLF, 2014).

Due to the difficulties in using TIEAs correctly and the cost and the slowness of these procedures that often have a very uncertain or unsatisfying result, the tax administrations of OECD member countries have tended to reserve these procedures for the most important cases. Controls are therefore usually limited to large structures or individuals who are the most at risk.

Aware of the limitations of these bilateral agreements and the imperfections in these manual exchanges of information, the OECD is rapidly introducing a new form of the project to standardize (via the Common Reporting Standard) and automate the exchange of tax information based on the FATCA model in the United States. The signature of this Mutual Competent Authority Agreement (MCAA) can lead directly to the establishment of an Automatic Exchange of Information (AEOI).

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D) Creating a standard for Automatic Exchanges of Information - The Common Reporting Standard (CRS)

The entry into force of this new system in 2017, should, according to the most optimistic experts, mark the end of the tax and banking opacity of many OFCs, the exchange of information becoming standardized and automatically targeting trusts, foundations and all shell companies.

The entry into force of this new system follows the request of the G20 meeting in St. Petersburg, Russia in 2013 to establish a model convention for the automatic exchange of tax information. The OECD then embarked on this task and presented a new framework that was endorsed by the G20 Finance Ministers in Australia in 2014.

The OECD and the Global Forum, taking note of the G20's political will to move forward quickly, met and validated the Automatic Exchange of Information through a Common Reporting Standard (CRS), which imposes common standards on all signatory countries based on the American FATCA model.

As of November 2, 2016, more than one hundred countries had signed bilateral agreements of automatic exchange of information representing more than a thousand signed agreements[1]. In addition, 87 countries have signed a multilateral exchange agreement –MCAA– with an effective date between 2017 and 2018 (OECD, 2016).

[1] See Annex XXX for the list of countries which have signed a multilateral agreement as of November 2, 2016.

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1) The new CRS standard - A model close to the American FATCA

The United States—in order to fight tax evasion of US citizens more effectively—launched the Foreign Account Tax Compliance Act (FATCA) in 2010, which is supposed to better identify and control the holding of financial assets of US citizens or relatives. The US also imposed its new rules on most countries in the world that have a banking system linked to the United States.

In order to respond to the problems arising from the heterogeneity of the quality of the information transmitted within the TIEA framework, the OECD decided to create the Common Reporting Standard (CRS). This framework establishing a common standard has the goal of assisting all signatory countries of the MCAA to obtain the identical quality of information without each country being able to oppose the specificity of its tax or legal model. A major example of this standardization of the collection of tax and banking information is the will to impose a Tax Identification Number (TIN) on all the signatory countries of the MCAA. Each individual or legal entity must have a TIN to open a bank account and thus be listed by national administrations. The equivalent in France for companies is the SIREN (*Système Informatique du Répertoire des Entreprises*), or the Registration Number (RN) in the United States. While many European states already have a TIN, this is a novelty for most OFCs around the world.

Financial institutions subjected to this reporting obligation obviously include banks. This also includes brokerage firms, insurance companies and UCITS.

The countries that are signatories to the agreement have the responsibility of ensuring compliance with these declarations and as regards to the information collected by financial institutions.

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- For natural persons, the name, address, date and place of birth, together with the tax identification number must be collected.

- For legal persons, the company name, the registered office, and all information relating to that company, including the tax identification number, must be collected. The information requested for natural persons is also collected for the directors of legal entities or those who have control over them.

- This information should also include details of the assets held by the non-resident client and, finally, details of financial income.

Accounts held by the natural persons are involved but also the accounts of any entity, such as a foundation, or trust and all types of legal arrangements such as shell companies as well as all natural persons "behind" these structures.

The financial information to be collected and transmitted is listed below[1]:

- the name and identification number of the financial institution;
- the bank account number, the balance,
- the number of a life insurance contract, its balance, and its redemption value,
- the financial income of the financial assets of the account, depending on the nature of the account including dividends, interest, life insurance income etc.

These new CRS tax standards allow for the implementation of a model of automatic tax information exchange conventions. When these are conducted on a bilateral basis they are called Competent Authority Agreements (CAA). The

[1] See annex XXX for an example from French bank BNP Paribas of the new forms requested since the beginning of 2016 for the opening of a bank account.

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OECD also has put forward the Common Reporting Standards Multilateral Competent Authority Agreement (CRS MCAA) for signatures.

2) Automatic Exchange models CAA/MCAA

The rule that are to be established include that the country in which revenue and financial products are generated must regularly and systematically inform the country of the taxpayer in question of the income or dividends that the taxpayer is receiving.

Any country wishing to accede to this exchange of information must be a signatory either of a bilateral agreement with another country or of a multilateral agreement.

- The bilateral agreement: Competent Authority Agreement or CAA. This type of agreement is signed directly between the two countries that wish to exchange information.

- The multilateral agreement: Multilateral Competent Authority Agreement or MCAA. This agreement is obviously more complex to put in place. The signature of this agreement does not imply that each country will immediately communicate the information at its disposal.

A first phase that could be described as the approach phase will aim to analyze the mode of exchange and communication of information in each country, adapting in particular to the legislative constraints of each country and respecting the prevailing rules of confidentiality.

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The second phase will not take place before 2017, which is already a very short time horizon in view of the changes and constraints that this entails in tax regulation.

The MCAA is part of a framework agreement (Multilateral Convention on Mutual Administrative Assistance in Tax Matters) defining a mode of operation but not creating reciprocal obligations between all the signatories.

Indeed, at this stage, the signature of the MCAA does not bind the new signatory to disseminate the information concerned to all the other members of this agreement. Each signatory country is free to determine with which other signatory country it wishes to establish this exchange of information. In a sense there are agreements within agreements, with the multilateral agreement being further subdivided into bilateral and cross-sectional sub-agreements.

Each signatory country retains full freedom and chooses the country or countries with which it wants to exchange financial information. But once the countries have come together under these agreements, the taxpayers and the financial income concerned are defined globally by these agreements.

The taxpayers concerned are natural persons and legal persons, including certain trusts. In the case of legal entities, the financial institution in which the account is opened must communicate this information not only to the country of the registered office of the entity but also to the country of residence of the shareholders who are the beneficial owners of these revenues.

The information relating to such accounts that is to be disclosed shall cover all income from investments, such as proceeds from sales of shares, sales of bonds, life insurance, interest payments, dividends and the balance of all the accounts opened within these institutions.

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Financial reporting institutions, such as banks and credit institutions, but also intermediaries such as brokerage and investment institutions, are subject to this reporting and disclosure requirement. This does not apply to insurance brokers domiciled in the country.

This reporting requirement may however pose a number of logistical problems in the processing of information and cross-referencing of data at the level of certain tax administrations at the country level. In fact, the multiplication of tax structures abroad risks jeopardizing an automatic exchange of information as the complexity could cause a breakdown in these systems that are not prepared for these demands in the face of a mass of information to be processed—this could affect the relevance or veracity of the information transmitted and will surely complicate the work of tax administrations.

The tax administrations of each country will also be confronted with different problems depending on the origin and the flow of information provided. For example, in the case of information requested that concerns only a single taxpayer, with data from one state and one institution, there may be no difficulty in analyzing and processing this request. But the analysis and processing of information becomes much more complicated when it comes from several states or from several institutions and covers groups of companies with subsidiaries, parent or sister companies in several countries, bank accounts in yet other countries and directors or shareholders domiciled in yet other countries. Receiving and collecting this data will cause problems of simultaneity, overlap, duplication, and especially deficiency, making analysis less efficient, erroneous or even ineffective.

It is not certain that tax administrations have the tools to manage this flow of information. Added to this question of capacity is the question of legality as the

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treatment of this information must respect the laws of each country and respect the confidentiality inherent in this matter and the professionals dealing with said material.

E) A notable step forward: The DAC2 Directive from the European Union

These regulatory developments, in which the European Union is actively participating at the level of the OECD, are being rapidly transposed into European law at the European Community level. European countries are thus among the first to implement the CRS standards and the new AEOI starting in 2017—with one member, Austria, that will come into conformity as of September 2018[1]. The European Union is thus updating the Convention on Mutual Administrative Assistance in Tax Matters that it had created in partnership with the OECD on January 25, 1988, a convention that entered into force on April 1, 1995 when the minimum of five signatory states had been reached.

Prior to this convention, in 1977, the European Economic Community had adopted the first tools in the field of taxation, consisting of assistance and cooperation between the competent tax authorities of each country in the field of the collection of direct taxes (Directive of December 19, 1977, 1977/799/EEC).

In 2003, the European Union adopted a tool allowing the exchange of information that would permit the taxation of income from savings. According to Directive 2003/48/EC, the members of the European Union have agreed on the automatic transmission of banking data. The information in question was interest on savings income. But not all states have agreed to implement the provisions of this Directive. Under cover of banking protection, Austria,

[1] See Annex XXX for a list of signatory countries.

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Luxembourg and Belgium have refused to transmit the banking data. For these three countries, tax administrations withheld tax on the income in question, with part of the tax returning to the country of origin of the taxpayer. It is interesting to note that these three countries are sometimes considered to be jurisdictions that have characteristics of certain OFCs.

Directive 2003/48/EC will be amended by Directive 2006/98/EC on account of the accession of Bulgaria and Romania. In parallel to the provisions of Directive 2003/48/EC, another provision dating from 2011 will apply and be articulated with this directive. On February 15, 2011 the European Union had decided to replace the Directive of December 19, 1977 with a view to improving the procedures and exchanges between the tax authorities of each country and making them more efficient. Council Directive 2011/16/EU states in the introduction:

> In a globalized era […] there is a tremendous development of the mobility of taxpayers, of the number of cross-border transactions and of the internationalization of financial instruments, which makes it difficult for Member States to assess taxes due properly. This increasing difficulty affects the functioning of taxation systems and entails double taxation, which itself incites to tax fraud and tax evasion, while the powers of controls remain at national level. It thus jeopardizes the functioning of the internal market.

Conscious of the urgency of the situation in a world where capital is moving more and more freely, Directive 2011/16/EU thus provides for five categories of income to be included in the information exchanged:

- Professional income,

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- Directors' fees,
- Life insurance products not covered by the EU Savings Directive,
- Pensions,
- Income from real estate.

Three years later, Directive 2014/107/EU of December 9, 2014 amended Directive 2011/16 EU in order to extend the list of revenue concerned to include:

- Dividends,
- Capital gains,
- Other financial income,
- The balance of the accounts.

This Directive, by extending the domain of information that is to be included, is in line with the new OECD CRS standards, which are themselves inspired by the American FATCA, aiming to harmonize the procedures for the communication of this data, both by defining these data and institutions.

Also in 2014 and concomitantly, Directive 2003/48/EC will be amended by Directive 2014/48/EU. It appears from the debates of the Council of the European Union, the opinion of the European Parliament and the European Social and Economic Committee that the 2003 Directive was no longer up to date concerning the financial instruments that are covered therein since these evolved considerably during the 2000s.

The absence of a tax identification number or equivalent makes it difficult to identify the actual beneficiaries of the financial income arising from these products. The debate on the question of the identification of beneficiaries

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(natural persons) of this financial income is particularly important as Directive 2003/48/EC covered only persons residing in the European Union.

A legal structure located in a jurisdiction outside the European Union thus escaped any identification verification with regard to that directive. This notion of transparency is at the heart of the reforms carried out by the OECD.

Directive 2003/48/EC on the taxation of savings income will subsequently be repealed by Directive 2015/2060/EU, which will only be applied when Directive 2014/107/EU is itself applied. The last country to put this directive into place, Austria, still benefits from a postponement.

France has undertaken to carry out the automatic exchange and collection of information covered by Directive 2014/107/EU as of December 9, 2014. France has therefore undertaken to transmit this information concerning the year 2016 as of the year 2017.

The application of this Directive is subject to the multilateral agreement accepted by two countries.

Each country must relate their country's information for five annexes in advance:

- List of countries without reciprocity agreements,
- Methodology for the transmission of information
- Desired rules for the protection of personal data,
- Description of confidentiality rules,
- List of countries that wish to be involved in an automatic exchange of information agreement.

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The agreement becomes effective when both countries have notified the OECD of all of these elements.

A symbol of these fundamental reforms in the European Union and among its partners is the end of "numbered accounts" for the countries that have signed an agreement. Thus in Switzerland, this ban becomes effective for non-tax residents from 2018, ending two centuries of banking secrecy.

F) The OECD and the Base Erosion and Profit Shifting (BEPS) program

The OECD, beyond the tax treaties which have been at the heart of its action in recent years, has maintained an active policy on the issue of transfer pricing, which is an integral part of the tax optimization techniques of multinationals.

Transfer pricing is defined by the OECD as the use of prices at which a business transfers tangible property, intangible assets, or services from or to one of its subsidiaries.

The four giants of the new globalized digital economy, now commonly called GAFA (Google, Apple, Facebook and Amazon) make extensive use of tax optimization techniques including the massive or even abusive use of transfer pricing. The GAFA are the repeated target of the attacks from Brussels, the OECD and the Member States of the European Union for their lack of respect of the tax rules of the countries in which they carry out business activities.

The G20 once again took up the problem and asked the OECD in 2013 to put in place an action plan to cover transfer pricing policies in the world, since tax administrations today are globally dispersed and not harmonized.

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On October 5, 2015, the OECD announced a package under the name of Base Erosion and Profit Shifting or BEPS (OECD, 2015) to eradicate transfer pricing that is considered abusive. The primary objective of this new package is to thoroughly reform national regulatory environments in order to put an end to harmful tax practices. The angle of attack, instead of being focused on companies, is a concentrated effort on those states that have long had practices that distort the international transfer pricing environment through, for example, the establishment of a "patent box" or "intellectual property box", a special tax regime that aims to tax revenues on intellectual property or patents differently than other commercial revenues. While the primary objective of this type of tax regime had been to boost the research sector in some countries (i.e. France and the United Kingdom), other jurisdictions have abused the model in the framework of transfer pricing (Ireland, the Netherlands).

It is indeed difficult for a third country to assess the cost of research/innovation for a high-tech product or in the medicines sector, thus allowing income transfers to these famous jurisdictions that offer the patent box, which is especially attractive since their corporate tax rate is generally low (as in Ireland where it peaks at 12.5%).

The OECD plan breaks down into 15 relatively precise actions grouped into three distinct categories the fight against double tax exemptions, transfer pricing and transparency.

1) Combating double tax exemptions and the BEPS

The fight against dual tax exemptions is based on three main actions within the BEPS: the neutralization of the effects of Hybrid Mismatch Arrangements (Action 2), the design of new rules to redefine the concept of Controlled Foreign

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Companies or CFCs (Action 3) and the reframing of the notion of Permanent Establishment status (Action 7).

Action 2 thus seeks to put an end to double tax deductions, making it possible to arrive at a difference or an asymmetry of tax treatment due to an expense or a revenue depending on the country. The hybrid structures target in particular the asymmetries between investment and debt when investments are financed by borrowing between two different countries. The case of redeemable shares and their tax treatment in Luxembourg is regularly cited. The aim of this action is to propose country-by-country recommendations to amend their national legislation or to propose, when signing tax treaties, annexes dealing with specific cases of fiscal asymmetry for a given country.

Action 3 on CFCs includes measures to transfer part of profits to a specific jurisdiction, while benefiting from a long-term carry-over of tax in the country of the parent company. The United States and many OFCs are thus targeted by the measures that have developed significantly since the 1960s, despite US legislation in the Internal Revenue Code, Subpart F, developed in 1962 to regulate transfers of profits to countries with low taxation. Indeed, the development of fiscal arrangements of the FSC, DISC and ETI type in the United States for thirty years have largely abused the use of CFCs in OFCs. This problem that the OECD aims to cover was the subject of a dispute between the European Union and the United States for nearly twenty years at the WTO, a problem that will be discussed in the next chapter.

Action number 7 reframes the notion of Permanent Establishment (PE) for foreign companies that avoid double taxation when PE is established in a country that has signed a tax treaty with the partner country in which the parent company is a tax resident. The aim here is for the OECD to redefine what PE is

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and the definition given to PE here is reflected in the new models of tax treaties of the OECD in Article 5.

2) Transfer pricing and BEPS

The second major category covered by this OECD BEPS plan is the question of transfer pricing frameworks through new methods of calculation (value creation), in order to limit the tax optimization of the GAFAs. This category is organized around five main actions: the reform of the ownership of an intangible asset that can be represented by patents or intellectual property (Action 8) coupled with the reform of the geographical location of capital and management (Action 9) and in particular the treatment for financial sector players (Action 10). The requirements for documentation to be provided in order to justify the methods for evaluating transfer pricing are reformed (Action 13) and the establishment of a model multilateral convention between states (Action 15) after the model of the OECD exchange of information is treated.

Action 8, addressing patents and the issue of intellectual property in the practice of transfer pricing is fundamental and central to the BEPS plan. The idea is thus to calculate transfer prices on the basis of the value actually created and not on the basis that is commonly accepted by tax administrations of the arm's length principle as enacted by the OECD in 1979, in 1995 and 2010 in Article 9 of the various models of fiscal conventions of the organization.

This notion of perfect competition is difficult at the present time when many giants of new technologies are in a quasi-monopoly position in certain markets, capable of influencing administrations that are trying to attract their investments to their territory. These are again the GAFA which are the subject of numerous appeals from the European Commission: Google in search engines,

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Apple in high-end telephones, Facebook in social networks and Amazon on online commerce.

The objective is therefore to re-allocate the profits of the companies country by country, according to the value created by the entity present in each country. An entity specializing in research and innovation in Ireland (imposed at 12.5%) will thus not be able to reallocate all the profits of the subsidiaries located in the different countries of the European Union, even though these subsidiaries concentrate the bulk of the turnover of the parent company, which is established in the United States.

Action 8, by addressing intangible assets that are difficult to evaluate in an unequal competitive environment, considers that the mere fact of possessing this intangible asset does not entitle the holder to compensation equal to the value of that asset. The entire economic chain that led to the creation of this asset must be considered. In the case of a parent company in the United States, it will not be able to leave all profits at the subsidiary level in Ireland on the pretext that it has ownership of intangible assets that can certainly be considered the wealth of the company. The parent company in the United States must therefore be obliged to receive a proportion of the Irish profits corresponding to the reality of the value created by the US entity. This principle of the proportion of profits with regard to the size of the economic activity of each structure (which is one of the means of determining the value creation of each structure) is relatively innovative in comparison with previous methods of evaluating transfer pricing.

This method of value creation not only reduces the distribution of profits for intangible assets but also addresses the question of the remuneration of venture capital (Action 9) or the question of the high-risk re-invoicing of certain intra-group services such as management fees, head office costs, etc. (Action 10).

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3) Increased transparency at the international level

The issue of documentation relating to the valuation by the company of these transfer prices is included in Action 13 of the BEPS plan. It includes all the standards to be complied with in the calculation of this creation value, coupled with declaration forms, jurisdiction by jurisdiction, so that the tax administrations concerned have the accounting elements on a country by country basis to determine the creation value and ultimately the valuation of the transfer prices charged.

As a result, large companies with a turnover in excess of $750 million must comply with a three-step process that includes the communication of a master file, evaluation of the transfer prices for each country (local file), and the country-by-country balance sheet for each of their subsidiaries (country-by-country reports).

Action 15 thus proposes the establishment of a multilateral convention between the states concerned by such an approach in order to thoroughly reform the bilateral tax treaties signed so far. It is proposed that an additional forum within the OECD be established in order to make the implementation of this convention effective, in the model of the Global Forum.

4) Eliminating “cash boxes”: one aim of BEPS

The primary objective of these measures is therefore to limit the creation of what the OECD calls "cash boxes" internationally as they allow large groups to store significant amounts of money in safeguarded jurisdictions away from the tax administration of their country of origin. This practice is very common in the United States and is partly legal and aimed at fostering the weight of American

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companies in the mergers and acquisitions market. This issue will be addressed in-depth in the chapter on US taxation.

The United States, incidentally, did little to support the BEPS project, which was not found to be in the American interest, as their primary objective is not to recover public revenue as is the case in Europe. In June 2015, the US Deputy Assistant Secretary of the Treasury, Robert Stacks, announced his fears about the implementation of the BEPS package by the OECD regarding the negative impact it could have on US multinationals despite the favorable US position on a moderate reform of transfer pricing. The idea that the European Union can use BEPS reforms to benefit from some of the profits of US companies so far stored in OFCs strongly displeased the US administration. The recent action by Margrethe Vestager, the European Commissioner for Competition, on the untaxed profits of Apple in Ireland has ruffled feathers in an extremely tense environment related to the issues of international taxation. If indirectly the issue of transfer pricing is not at stake, Ireland, via tax rebates, has given Apple a comparative advantage comparable to public subsidies on the order of 13 billion euros. Thus Apple's recent condemnation in Ireland echoes an alarming situation in terms of tax competition in Europe, a subject on which the Commission is very active while the United States applies the same methods to foreign banks[1] in an idea of extra-territoriality often misunderstood.

5) The European Union and the implementation of the BEPS measures

Following the publication of the OECD BEPS, the European Union is adopting a new road map to more effectively combat tax avoidance strategies via transfer

[1] See BNP Paribas' case in 2014, with a US fine of 9 billion dollars and a threat of banking license withdrawal. However, the non-extra-territoriality of the law supposed that the French Bank had complied with its obligations under French and international law.

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pricing: the Anti-Tax Avoidance Package of January 2016. This includes the Anti-Tax Avoidance Directive, the Recommendation on Tax Treaties and the Revised Administrative Cooperation Directive.

On June 20, 2016, the Council adopted the Anti-Tax Avoidance Directive (EU) 2016/1164, which largely incorporates the measures and actions advocated by the BEPS package. Member States must comply with the new Directive as of January 1, 2019.

In addition, the European Union reorganized the assessment of transfer prices for the EU by taking up Actions 13 and 15 from the framework of the Revised Administrative Cooperation Directive of December 8, 2015 (Directive 2011/16 / EU).

The European Commission Recommendation on Tax Treaties of January 28, 2016 by Pierre Moscovici, European Commissioner for Economic and Financial Affairs, Taxation and Customs, deals with Actions 6 and 7 of the OECD BEPS on the question of redefining physical establishment. The document takes up and cites the BEPS as an example[1]. The European Union therefore perfectly aligned itself with the recommendations made by the BEPS project in record time, demonstrating the will of a Europe concerned to put an end to harmful tax practices for many of its Member States.

The question nevertheless arises as to the distortions of competition that could occur after the rapid application of the BEPS plan in Europe via the aforementioned European Directives, while many other countries around the world may be slow to apply these new standards. The question of imposing these norms in a coercive manner arises, therefore, when a dichotomy in the application of the rules on the international level risks being prejudicial to a

[1] See Annex XXX for the text of the Recommendation.

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certain number of states, the same ones that are today the first impacted by the tax avoidance strategies of multinationals.

The idea of building a global and coercive framework seems difficult, but not impossible, in the image of the FAFT measures in the fight against money laundering and the financing of terrorism that the United Nations has made a priority. In just a few years, the implementation of the recommendations of the FAFT, which is part of the OECD, was made possible by the adoption of resolution 1373 by the UN Security Council.

G) The FAFT and Common Security Interests

The fight against money laundering was for a long time framed by soft law standards and recommendations. The proliferation of terrorist acts throughout the world since the beginning of the 1990s and the almost universal desire to put an end to the financing of terrorism globally have made it possible to move from soft law to hard law in two decades with the some of the most comprehensive and stringent laws in the world, even though a definition of terrorism can still be debated today (Sorel, 2002).

The definition of an act of terrorism is open to debate as some can be perceived as an act of terrorism at one instant and then as a heroic act only a few years later (and vice versa). The acts committed by Bin Laden or Nelson Mandela were thus seen differently according to the country or individual's perspective and the time scale in question. The perception of the act itself (terrorist or heroic) may then be politically reversible (Sorel, 2003)

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The Financial Action Task Force (FAFT), whose G7 mandate is to combat money laundering in the international financial system has gradually seen its role in the fight against specific financing of terrorism develop from the 1990s onwards to include more traditional and legal channels such as financing through individuals and industry or trade in legal goods and services abroad.

Following the terrorist attacks in the United States on September 11, 2001, the international community took on the obligation to strengthen the legislative arsenal against the financing of terrorism. In October 2001, the FAFT adopted eight additional resolutions specifically addressing the financing of terrorism, supplemented by a ninth resolution in 2004.

The FAFT was the first organization to establish a normative framework to oversee the issue of financing of terrorism, establishing international standards of reference in this area. These so-called 40 + 9 standards, referring to the first 40 recommendations adopted in 1990 and then the nine additional ones following the attacks of September 11, 2001, set standards of good practice (such as the OECD recommendations on the exchange of information in order to undermine the financing of terrorism at the international level and not only among the Member States of the organization.

These standards included recommendations such as the freezing and confiscation of assets related to the financing of terrorism, an increased duty of vigilance for banks and financial institutions to ensure the origin of their clients' funds and the reporting of transactions to their national authorities.

These recommendations are therefore quite broad and enumerate principles of good practice more than specific and detailed technical measures. The FAFT regularly publishes studies on the topic of terrorist financing through working groups and also publishes technical notes to clarify the practicality of certain

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recommendations on the ground (Sorel, 2009). In this context, we are talking about guidelines or directives that deal with sectors as varied as real estate, law, notarial agents and even casinos.

In the field and among its member countries, the FAFT also produces an annual evaluation questionnaire on the proper implementation of its recommendations, in addition to the preparation of an annual report by its experts who audit each country on the basis of an analysis of 25 evaluation criteria determined by the organization.

States and private organizations (banks and financial institutions) are meant to respect the standards laid down by the FAFT. Nevertheless, like other issues dealt with by the OECD, these norms or standards are not binding. Only a suspension of the accession of a member country to the FAFT can be envisaged internally, the other countries can be added to a list of non-compliant countries. The method is therefore similar to that of the OECD, the use of Major soft law, with limited impact in practice.

1) Post 9-11, an evolution of soft law towards a coercive regulatory framework

a) The International Convention for the Suppression of the Financing of Terrorism

The adoption of the International Convention for the Suppression of the Financing of Terrorism made it possible on December 9, 1999 for the United Nations to equip itself with the necessary tools for its ambitions, ensuring that its Member States take all necessary measures to combat all forms of terrorist financing.

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This normative incentive framework, comprising 28 articles, is the main UN tool in this area. Given the international reticence on the very notion of defining the concept of terrorism with precision—Lebanon and the United States for instance do not have the same view of the question—the Convention refrains from any definition, simply referring to the term "terrorism". It thus allows each member state the opportunity to interpret the definition of terrorism "in various ways" (Sorel, 2003).

Like the recommendations of the FAFT that strongly inspired the convention resolutions, Member States must identify and freeze all funds tied to or available to be used for the financing of terrorism. Co-operation in this area is reinforced by the prohibition of a State to avail itself of bank secrecy in the context of a request for mutual assistance by a third State.

Actively supported by the United States and France, the adoption of this Convention follows the multiplication of attacks throughout the world during the 1990s and in particular the attacks of Paris of 1995 and the American embassy in Kenya in 1998.

This global awareness of the financing issue allowed the UN Security Council to obtain the means to compel Member States of the UN to apply the International Convention for the Suppression of the Financing of Terrorism.

b) A strengthened legislative arsenal for a coercive regulatory framework

Under Article 24 of the UN Charter, the objective of the Security Council is to act in order to maintain international peace and security. Under Article 25, the UN Member States must respect and implement the resolutions adopted by the Security Council.

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Under Article 39 and Chapter 7 of the Charter, the Security Council is in a position to take coercive measures against its Member States in order to enforce resolutions. Sanctions such as embargoes on military equipment, travel bans or financial or diplomatic retaliation can be envisaged to complete packages of economic and trade sanctions, as was the case on the Iranian nuclear issue between 2006 and 2015.

On the question of the financing of terrorism, the UN Security Council first tackled the question of the financing of the Taliban in Afghanistan (resolution 1267) in the late 1990s, to which it applied an arms embargo, a freezing of international funds and travel bans.

In 2001, following the September 11 attacks in New York City, the identification and dismantling of networks became the priority of the post 9-11 Bush administration. The work of the FAFT appeared to the international community to be paramount. Urgent multilateral action on the basis of the work of the FAFT became the credo of the anti-terrorist speeches at the UN which was mandated to act as quickly as possible to drain the financial resources and channels of transmission of these resources to terrorist organizations.

The adoption of resolution 1373 on September 28, 2001, two weeks after the terrorist attacks in New York, marked a major turning point in the fight against terrorism and its international financing. Resolution 1373 defines international terrorism as a factor of instability, threatening international peace and security, allowing de facto the UN Security Council to use Chapter VII of the UN Charter to enforce Resolution 1373 by all means at its disposal (Sorel, 2009). The bridges between Resolution 1373 and the International Convention for the Suppression of the Financing of Terrorism are numerous, and the measures to combat such financing are generally taken up again in the latter.

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While only four states had ratified the International Convention for the Suppression of the Financing of Terrorism, a major international treaty as of 2001, Resolution 1373 greatly accelerated the process of ratification and implementation of its measures (identification, infraction of the financing of terrorism and the obligation to bring to justice the legal entities financing terrorism), making a large part of the Convention binding on all UN Member States.

In order to ensure the implementation of resolution 1373, the Security Council set up the UN Security Council Counter-Terrorism Committee (CTC). Thanks to this international activism coupled with a coercive regulatory framework by 2016 no fewer than 173 states had ratified the convention according to the Counter-Terrorism Committee (UN, 2016).

2) An evolution of the regulatory framework difficult to duplicate to OFCs

A perfect demonstration of the principle that soft law must ultimately evolve towards the development of more coercive law (hard law) is thus this fight against terrorism financing.

Indeed, the four functions and purposes of soft law defined by the French Council of State in its annual study of 2013 can be returned to in order to support this position. One is to consider that soft law can act as a preparatory law for hard law in relation to new, emerging topics. The other three functions or purposes defined by the Council of the State were as follows: (1) Soft law can substitute for hard law when the application of the latter is difficult; (2) Soft law can accompany hard law; and (3) Soft law and hard law can function alternatively, allowing for greater autonomy.

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The FAFT, by putting in place recommendations that can be used to prepare legal texts, paved the way for the United Nations and the Security Council to put in place a coercive framework (an international treaty, a Security Council resolution and a Monitoring Committee supported by the Sanctions Committee) and it was therefore better able to meet the needs of an international community in a hurry to achieve its stated security objectives.

This international activism was made possible by the support and sustained follow-up of the United States, which adopted the US Patriot Act at the end of 2001, aimed at redesigning the American anti-terrorist fight, in particular on financing issues. The Financial Crimes Enforcement Network (FinCEN) created in 1970 by the Bank Secrecy Act (BSA) which, like the French TRACFIN controls and supervises suspect financial flows on its territory, saw its mission extended within the framework of the USA Patriot Act to include the fight against financing of terrorism and money laundering (Sorel, 2009).

In 2002, the United States adopted "The Suppression of Financing of Terrorism Convention Implementation Act" in order to implement the International Convention for the Suppression of the Financing of Terrorism of which France was the instigator.

Across the Atlantic, France updated its legislation on November 15, 2001, also following the attacks of 9-11, notably concerning the offense of financing terrorist activities via article 421-2-2 of the Criminal Code, which had already been amended in 1996 (via article 421-2-1) concerning the offense of association of criminals in connection with a terrorist enterprise following the Paris bombings in 1995.

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France, through TRACFIN created in 1990 following the 15th G7 annual summit in order to better control suspicious financial flows on its territory, modernized its legislative arsenal against money laundering in January 2006 in order to comply fully with the resolutions of the UN Security Council as regards the freezing of assets.

The role and central position of the UN, although sometimes criticized, on this issue of combating the financing of terrorism has made possible comprehensive, rapid and efficient action. This action served as a relay to other international organizations having the capacity to intervene on such subjects closely linked to the supervision of the financial sector. The IMF and the World Bank rapidly added to the list of their mandates the fight against the financing of tax havens as of 2002, following the publication of the FAFT's special resolutions (Sorel, 2009).

By integrating the FAFT's recommendations into their financial systems' evaluation processes in countries under surveillance (through the Financial Sector Assessment Program-FSAP) in 2004, the IMF and the World Bank developed a national assessment for rapid identification of deficiencies or vulnerabilities of some States in the implementation of FAFT recommendations.

However, it is difficult to imagine a similar solution for the question of the supervision and transparency of OFCs and the fight against harmful tax strategies, of which the OECD is the spearhead. While the issue has been the subject of soft law recommendations and standards for 15 years, it is hard to imagine applying and duplicating a coercive model similar to that used in the fight against the financing of terrorism.

The disagreements between the OECD countries on issues of fiscal transparency, highlighted in particular by the FATCA paradox in the United States, make it

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impossible to imagine the development of a global regulatory framework on this subject.

And yet it is urgent to move forward. During a speech on November 8, 2008, Pascal Lamy, then Director General of the World Trade Organization (WTO) said: "There are global organizations for trade, health, environment, telecommunications and food. There are however, two black holes in the world's global governance, international finance [...] and human migration."

It would indeed be entirely possible to integrate coercive regulation, not into the United Nations but into the WTO, as their competence in this field is proven in instances when the organization can influence the problems of fiscal excesses of its Member States.

The United States and the European Union have opposed one another on numerous occasions at the WTO, notably in terms of fiscal issues and the Dispute Settlement Body was created for this purpose.

The European Union has long and strongly criticized a number of tax provisions favorable to American companies as part of their export activities. These criticisms have allowed the WTO to rule on the European Union's claims by settling disputes essentially relating to taxation, which have been up to now exclusively matters for the states.

The WTO, as guarantor of its founding principles—free trade and pure and perfect competition—has censored these tax regimes by determining them to be equivalent to illegal subsidies. The WTO should therefore be in a position to renegotiate treaties currently in effect thereby integrating into its mandate an area of intervention extended to tax issues in the context of a globalization of trade.

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Nevertheless, in the current political context, it is difficult to imagine reforming the WTO in depth, as the Republican candidate, Donald Trump, recently elected President of the United States of America, promises in his economic program the exit of the United States from the WTO and the reintroduction of tariffs of around 40% against Chinese imports. The rapid implementation of the OECD BEPS Package is certainly not on the agenda of the future Republican administration.

This economic program, for which the United States must prepare, runs counter to the free-market ideas that shaped today's WTO, making it even more difficult for the next round of negotiations to open up at the WTO, which could have included major tax reforms.

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II - The WTO and Diverging Economic Interests : the Rising Importance of Soft Law and Fiscal Issues internationally

This chapter aims to elucidate recent developments on the international stage that the World Trade Organization (WTO) is currently confronting that will lead to a move from a hard-law model to a soft-law model. Various possible scenarios in terms of better regulation of international tax issues and offshore financial centers will be considered in turn.

The WTO has encountered serious setbacks since its inception, particularly since the famous Doha Development Act that was to promote greater internationalization of world consumer good markets. However this negotiation cycle, which started in 2001, has gone on interminably. The negotiations have been painstakingly slow, so much so that Pascal Lamy, the former Director General of the WTO, declared the negotiations "suspended" in 2006, before starting them up again in 2013. Indeed, the WTO seems increasingly unable to adapt to sectors such as agriculture and to the new complexities of global trade. One can also consider, for example, their difficulty in facing the evolutions of intellectual property in the field of medical patents or in new technologies.

What then does this difficult situation indicate for an international institution long regarded as a model to be followed? Could it be that the historical model used for the WTO is no longer able to provide answers for questions of international trade law? Is its very structure, based on Hard Law, out of touch with new realities, or is it even the Hard Law model itself that is obsolete in light of the evolution of world trade?

These questions seem inseparable from recent regulatory developments in the world of international finance. Is there an influence of one on the other?

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Could the diversity of international law, whether in trade or in finance, give way to a "continuum" of Soft Law?

International tax law must take international trade law into account and hence this chapter, divided into two parts, will consider these two intertwined subjects in turn.

The first part of the chapter is dedicated to a brief analysis of recent developments in regulation and international trade due to a rebalancing of power between stakeholders first in GATT and later in the WTO. This analysis will further show us whether or not the linking of financial and trade regulations is pertinent. The WTO could thus be at the heart of the construction of efficient international financial regulation and a legal model that imposes itself within a complicated international context: Soft Law.

The second part of the chapter is subdivided into four sections. The first deals with limitations of the WTO's scope due to the "most favored nation" status which limits the WTO as the institution cannot assert itself directly in areas related to international taxation, which the OECD does attempt to do on the world stage in order to present itself as the eliminator of tax abuses by multinationals from its member states.

The major trade agreements that exist within the WTO, will lead us to reconsider the way the institution can impact the issues of fiscal excesses of its member states in the ensuing sections of the chapter. There have been many trade disputes between the United States and the European Union that have included significant tax-related dimensions. The claims of the European Union on the tax status of Domestic International Sales Corporations (DISC), Foreign Service Corporations (FSC) and Extraterritorial Income (ETI) have allowed the WTO to pronounce judgments in disputes based almost exclusively on points of

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disagreement within the taxation field that are intimately related to the legal and tax sovereignty of states.

The reclassification of these tax statuses as illegal subsidies by the WTO was possible in order to uphold the founding principles from the agreements of the institution: free trade and pure and perfect competition. In time, the WTO could eventually rework its treaties to arrive at a broader, reaffirmed scope on taxation. This possibility could arise with the integration of specific chapters on offshore financial centers and international tax schemes within already existing trade agreements.

If the political will of its member states were to be in favor of such a step, the WTO could eventually undertake an in-depth process of reform to adapt to the changing economic and business world of tomorrow, while expanding its scope of influence to include finance and international taxation, in accordance with the statutes and agreements signed within it.

A) The WTO confronting Soft Law pressures

Previously a symbol of all-powerful international trade law and based on a Hard Law legal structure, the WTO today is facing many challenges, as much in relation to the current economic climate as to its very structure. The model of the WTO, which for is considered out of date by some, must evolve in order to avoid losing influence. Soft Law is one possible means to such an end, as is the broadening of competences, particularly in reference to tax issues.

Nonetheless, currently the WTO remains one of the greater successes in terms of international trade regulation, becoming the world point of reference on the subject and managing to impose a model of a "rule-oriented international trading order instead of power trading oriented international order" (Matsushita,

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2014). This model is slow, at the moment, in imposing itself in terms of financial regulation globally.

This first part of the chapter deals with the limits of the regulatory apparatus of GATT and the establishment of the WTO and its possible evolution towards a more open model that would remain just as structuring.

1) The limits of GATT and its regulatory function

Established on January 1, 1995, the World Trade Organization (WTO) was a natural step forward in the international trade landscape following the adoption of the Marrakesh Agreement on April 15, 1994. It is the successor to the General Agreement on Tariffs and Trade (GATT), which was ratified after World War II.

The current multilateral trading system is the result of eight rounds of trade negotiations: the last round (the Uruguay Round) led to the creation of the WTO. At the Doha Ministerial Conference in November 2001, the organization's members decided to launch a ninth round of negotiations that is still on-going today.

The WTO, in contrast to many institutions of the postwar period such as the IMF, has no independent executive body that yields broad powers. Thus, the WTO Secretariat has no authority to develop its own activities and to issue recommendations to its members on economic policy, as do the IMF or the OECD. Its main role is therefore to enforce trade agreements, ratified by member countries, among its members.

To do so, each WTO member is generally required to observe:

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- Multilateral trade agreements, including the Marrakesh Agreement that established the World Trade Organization, as well as 20 Annex agreements.

- Tariffs ceilings for consumer, agricultural and nonagricultural goods to which each country has committed. These rights are called "consolidated" and are recorded in tariff schedules;

- Domestic support ceilings and export subsidies for agricultural products that countries have committed to. These ceilings are listed in commitment schedules;

- Commitments made, country by country, in terms of market access and national treatment in the field of services trade for GATS. (Three schedules of Specific Commitments for all WTO member countries amount to an impressive 35,000 pages (French Treasury, 2014).

WTO members are also required to comply with the legislation of the international institution, regularly issued by panelists in panel reports and the Appellate Body. Since its inception, the WTO has recorded more than 430 complaints, published nearly 160 panel reports and 110 Appellate Body reports, totaling more than 60,000 pages.

Upon the signature of the GATT agreement, the rules of international law, as such, could be directly imposed on States. As of 1947, a possibility of monitoring the compliance of Member States to their obligations existed. Article XXII "Consultation" and Article XXIII "Nullification or Impairment" provides the right for states to consultation between Member States if they consider that they are being harmed by the non-compliance to GATT of a third-party state, also a signatory of the agreement.

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Compliance with the rules laid down by Articles XXII and XXIII of GATT was rapidly understood to be "voluntary", since the failure to comply with these articles brought about no sanction that a member state could accept.

The first goal was therefore to determine a mutually satisfactory solution, usually through consultations. In the instance where no satisfactory solution for each of the member states could be found, proposals and recommendations must come from all members of GATT leading to sanctions as a last resort. In practice, an amicable solution was always preferred to avoid any such sanctions. Contentious negotiations took place, leading in most cases to minimum agreements or solutions. This historical practice of "negotiated dispute settlement" explains that often today, many claim that WTO law is "negotiated", an idea that is partially inherited from the bad reputation of dispute settlement under the aegis of the GATT until 1995.

William Davy, now Chair Emeritus at the College of Law in Illinois, described the situation as such in the late 1980s:

> Perceptions of the system's effectiveness and usefulness have varied widely over the years. It was generally viewed as effective during the first decade of GATT's existence, but during the ensuing twenty years, its reputation declined significantly. […] During this second period, the reputation of the dispute settlement system also declined. It was perceived to be ineffective, a conclusion buttressed by the major case of the 1970s, the so-called *DISC* case, in which the EC alleged that certain U.S. tax legislation amounted to an export subsidy. In response, the United States counterclaimed that several EC member state tax systems were also operated as export subsidies.
>
> The conduct of the combined cases epitomized the shortcomings of the dispute settlement system; it took almost three years to appoint the panel and, when the panel upheld both claims in 1976, many felt that it had reached the wrong result. Furthermore, implementation of the decision was unsatisfactory.

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> The panel report was not adopted by the Council until 1981 and then only subject to qualifications. The European tax systems remained in place, although the U.S. DISC legislation was effectively replaced in 1984 (Davey, 1987).

The slowness of the GATT dispute settlement system, involved in ongoing negotiations and games of influences between the Member States concerned, represented the main grievances against this dispute settlement system. The conflict around the US legislation of the DISC (Domestic International Sales Corporations) is the most blatant example of the limitations and dysfunctions of the GATT dispute settlement system. The case of the US DISC will be discussed in the second part of this chapter.

Faced with the poor reputation of the Dispute Settlement system under GATT, particular care was brought to the institution of the Dispute Settlement Body (DSB) granting it compulsory jurisdiction within the WTO. The rulings of the DSB are able to lead to economic sanctions imposed against the State in question, minimizing delays in the system and external pressures.

Henri Culot of the Catholic University of Louvain writes:

> That States do not correctly fulfill all their obligations and that international institutions are not always able to compel them to do so does not deprive their rules of their binding nature. That is why WTO law has long been and continues to be considered Hard Law, with the DSB there to ensure this. But the DSB requires the court to justify its decisions on the basis of the texts of treaties and correspondingly forbids the court from acting as amiable compositeur. The DSB respectfully submits to this requirement, at least in its formal aspect (Culot, 2005).

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2) The WTO and Soft Law confront the evolution of economic interests.

The idea here is not, however, to discuss the binding force of the DSB, its impact on decisions on domestic law of the European Union for example, or the perception that the Court of Justice of the European Union, which sometimes calls into question the mandatory and binding force of WTO law.[1]

Similarly, the examination of the treatment of certain *soft law* standards in the Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary Measures (SPS) Agreements (health protection Measures such as additives in food labeling or of composition / quality requirements) can mitigate the compulsory nature of WTO law[2].

Historically, the WTO could rely on a Hard Law model because of the stability of the market sectors that the WTO regulated. Thus agriculture, commodities, automobiles, and industry are relatively stable, they adapted themselves perfectly to Hard Law-based legislation. However, the rise of new technologies and electronics based on increased technological competition between market players and a planned obsolescence allowing rapid renewal of appliances, have profoundly impacted a portion of the WTO regulatory landscape.

Faced with the rise of the patent war, especially in China, South Korea and the United States, a number of WTO rules appear to be ineffective. This is particularly the case of the TRIPS Agreement (Trade-Related Aspects of Intellectual Property Rights Agreement) adopted in 1994 and put forward by the United States to strengthen the WTO's body of legislation on copyrights and patents. Despite its adoption and the entry of China into the WTO in 2001, the

[1] C.J.E.U., December 12, 1972, *International Fruit Company Case*. 1972.
[2] Ibid.

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TRIPS Agreement has been little respected by this country, despite repeated efforts by the WTO, with the support of the United States, to try to apply the text.

Why does China not respect the TRIPS Agreement? Explanations abound. The first of two main reasons is economic interest, with China benefitting (for now) from the relative non-enforcement of patents (in 2011 the non-enforcement of patents internationally cost close to $600 billion to companies worldwide (Bitton, 2012), the US and European industry being the most affected, while Chinese industries were the primary beneficiaries). Secondly, lawyers cannot deny the existence of a cultural gap. China does not share the strict view of intellectual property held by Western countries that previously dominated the WTO.

Nevertheless, the questioning of the TRIPS Agreement on intellectual property and patents, including medicines, is not ta question for China alone. Many developing countries have requested a profound change in this Agreement which, in their view, protects the interests of Western firms and hinders innovation and technological development in Asian and Latin American countries. The failure of the Cancun summit in 2003 is a direct result of the impasse of negotiations concerning the relaxation of the TRIPS Agreement, especially for the pharmaceutical sector where the objective is to facilitate access to new drugs for middle-income countries.

We must accept the idea that the problems facing the WTO do not all stem from the structural change in international trade. The evolution of international trade, the rise of new technologies and changes in the global market for patents are important factors that will ultimately push the WTO from a Hard Law model towards a Soft Law model. However these factors taken together are not enough to promote Soft Law in an international institution deeply rooted in a more traditional legal architecture. The rebalancing of economic power of WTO

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member countries will probably ultimately be the decisive element in a relaxation of WTO law.

3) Multi-polarization of the international players imposes an overhaul of the WTO

Difficulties for the WTO in implementing new policies or modify existing agreements in the last rounds often arise due to a growing multipolarity of the international economic world. When the WTO was created, developed countries controlled the major international institutions, including the WTO. But the rise of emerging countries as regional economic powers has weakened the influence of developed countries in Asia and Latin America, particularly in terms of the governance of international organizations. Thus the failure of negotiation rounds in Seattle in the United States in 1999, Cancun in Mexico in 2003 and Hong Kong in 2005 could be attributed to the multi-polarization of the world's wealth, to the end of the dominance of Western powers on trade regulation, and more generally in terms of economic regulation.

Thus, according to Mitsuo "The BRICS and the developed countries (the USA and the European Union) face each other in a confrontational way at the WTO trade negotiations and compromises have become extremely difficult. Neither of those groups is powerful enough to overwhelm the others and this has led to an inevitable stalemate and bottleneck. Also the number of WTO Members increased tremendously in recent years and this has added difficulty to achieving any consensus."

We are witnessing a challenge to the governance of the IMF and a weakening of the legitimacy of the World Bank in some areas of the world. A very current example is the willingness of China to make the Asian Infrastructure Investment Bank compete with the Asian Development Bank and the World Bank in Asia.

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This shift or rebalancing of trade and wealth from the West to Asia, coupled with the explosion in the number of WTO members have therefore undermined the principle of consensus decision advocated by the WTO. In addition, for trade, the multilateralism that was advocated since the 1980s, seems to have come to a standstill.

The rise of regional economic powers has moved international trade law towards forms of regionalism where bilateral agreements are developed like the proposed Trans-Atlantic Trade Agreement between the United States and Europe, and the potential EU-Japan Free Trade Agreement. Established outside the WTO and in a purely regionalized framework, these agreements show the profound changes that the WTO must face. It has also become the biggest challenge of the WTO today and many experts wonder how the institution will manage to reform in order to adapt to competition from such trade agreements.

One hypothesis put forward is a profound change in the role and objectives of the institution, whose model is outdated, even obsolete, at the time of a multipolar world facing a proliferation of regional agreements. This is not new however. In the 1980s, the GATT also appeared threatened by the creation and rise in power of the European Economic Community and its internal institutions[1]. Yet far from disappearing and triumphing over the most pessimistic forecasts, the GATT was able to adapt to these structural and regional developments in international trade. In 1995, following the Marrakech agreements, this organization became the WTO that we know today.

[1] According to William J. Davey: "The U.S. Congress was often ill-disposed toward GATT, and there was much uncertainty over how the formation of the European Economic Community would affect GATT. In those years it was not so unthinkable that GATT could collapse-or more likely gradually fade from the scene-particularly if the United States and the EEC (and later Japan) decided to deal with trade matters outside its framework. Of course, GATT did not collapse or fade away, and it is arguably less likely to do so now than at any time in its history." Dispute Settlement in GATT. *Fordham International Law Journal*. 1987. Volume 11 Issue 1 Article 2.

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Thus the WTO could also adapt and decide to coordinate the various free trade agreements -FTAs- gradually appearing in the world in order to maintain some regulatory coherence in global trade levels. We would move from a centralized model with an enforcement body to a decentralized but coordinated model where the WTO would accompany and advise its member states. This option seems somewhat idealistic, but necessary according to Mitsuo, who fears that we would take a step back where the "Mega-FTAs may be counterproductive to the development of the world trading system at large."

Conclusion

The WTO still appears today as one of the pioneer organizations in international trade law, in that it has managed to impose a set of rules among its members, with the binding Dispute Settlement Body (DSB). Yet the evolution of the WTO model to a Soft Law model appears as an inevitable and profound process. The changing regulatory landscape, the very structure of international trade and multi-polarization of world economies seems indeed to push the institution in that direction.

In this sense, the WTO joins a mainstream current in international law, these legal developments affecting many sectors, including the financial sector where prudential rules are gradually becoming the norm (i.e. Basel III, Solvency II). Moreover, coordination issues and international tax regulation are directly linked to these developments. Faced with a progressive easing of the WTO regime, we will try to rule on the relevance or lack thereof for the institution to deal with tax issues, including the case of offshore financial centers and tax evasion of which large international companies are adepts.

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B) The WTO in its role as Monitor of International Business

The WTO in its role as Monitor of International Business, currently has insufficient tools to conduct any fight against tax evasion at the international level.

Faced with the possible gradual relaxation of the legal regime of the WTO, we will try to rule on the relevance or lack thereof of the institution in dealing with tax issues, and imagine the integration of specific measures to establish an international legal framework for offshore financial centers and the international tax schemes they facilitate.

Through the Most Favored Nation clauses, the WTO appears limited in its field of action, and can thus not follow the position that the OECD has been trying to take in recent years as the opponent of the excesses of offshore finance. Yet thanks to the major trade agreements already existing within the institution, the WTO may indirectly influence the issues of tax abuses. This was the case with the United States and the European Union in the case of the longest trade dispute in the institution's history. The DISC, FSC and the ETI status allowed the WTO to rule on a dispute over tax issues that are traditionally under the sovereignty of the states. The United States in this case.

The impacts of these tax statuses on international trade, free trade and the principles of perfect competition were enough for the WTO to take up the matter. In this, the institution could ultimately "fine tune" its treaties to give it a wider scope on tax issues.

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1) The WTO and the limits of the MFN clause in the fight against OFCs

The question of the principle of non-discrimination under the WTO has been the subject of numerous research articles, including the principle of equal treatment with the Most Favored Nation (MFN) status, by which each State signatory of an agreement or international treaty undertakes to grant any benefits it may grant to a third country to all countries, as also defined by Article 1.1 of the GATT and the interpretation thereof by the Members states of the institution (Sadowsky, 2013). In this matter, each country is free to set tax rules as they please according to the concept of fiscal sovereignty. Differences arise in the acceptance of the principle of non-discrimination in the WTO and its exceptions (61 exception lists are included in the Marrakech Accords).[1] In the name of a certain flexibility of this principle, many states adapt their interpretation to their own will. Thus the objective of WTO member States is to establish a complex balance between, on the one side, the external benefits they get from the principle of tax non-discrimination while trying, on the other side and in parallel, to push the limits of this "flexible" principle to temporarily resort to measures that may be discriminatory in the eyes of the WTO.

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[1] See: *General Agreement on Trade in Services.* WTO. Article XIV: General Exceptions.
"Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures: (a) necessary to protect public morals or to maintain public order;(5) (b) necessary to protect human, animal or plant life or health; (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to: (i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts; (ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts; (iii) safety; (d) inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective(6) imposition or collection of direct taxes in respect of services or service suppliers of other Members; (e) inconsistent with Article II, provided that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound."

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The European Union is widely beneficiary of these exceptions, particularly in the road transport sector and financial services(Sadowsky, 2013). On the other hand, there are many exceptions in tax matters under Article XIV of the General Agreement on Trade in Services (GATS), mainly since bilateral agreements regarding specific tax regimes to avoid double taxation were signed between two WTO member states. In this specific case, the bilateral agreement signed between the two parties will override Article XIV.

The Most Favored Nation status further limits the WTO in a potential fight against the tax excesses of its Member States, as the MFN status prevents the institution from acting against offshore financial centers due to the current status of its trade agreements. Indeed, as long as tax havens comply with this clause in terms of taxation (where they have sovereignty), the WTO cannot intervene.

Worse, if a Member State were to decide unilaterally upon sanctions upon a tax haven in order to "restore" some equity in the tax treatment of a company established in both countries, the tax haven in question would be entitled to open a dispute with the WTO to enforce the "Most Favored Nation" status for discriminatory and arbitrary tax treatment. This would require the Member State to compile a list of common sanctions for all tax havens based on the OECD list for example to avoid the discriminating character and thus does not fall within the scope of the MFN clause.

This would be politically very strong and legally essential from the point of view of WTO law, however it would be diplomatically much more complex to implement as discussed in the last chapter of this thesis. Furthermore, as the OECD list often varies and is today reduced to a "trickle", the hypothesis of global sanctions on the basis of this list is not feasible in practice.

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The WTO, whose role is to encourage and streamline international trade is thus faced with problems that seem to exceed the objectives initially set by the Institute at its inception. But can the WTO ignore the growing tax abuses that we are witnessing today? The mobilization of the OECD in recent years could have been a solution if both institutions had mingled their efforts to link an international list of tax havens to the legal firepower of the MFN clause of the WTO. Now, however, as we have just seen, the OECD has significantly reduced the number of countries on the OFC lists making such a line of work impossible for the WTO.

Yet it appears to be important for many Western and developing countries to end the abuses of tax havens. These tax exceptions result directly from international trade and the increased competition that offshore financial centers indulge in to attract the multinational financial windfall. Considering that international trade in goods and services is the main cause (through transfer pricing) of the development of tax havens, it appears legitimate to analyze the ins and outs of the role that the WTO might be led to play.

The main framework agreements (GATT, GATS, and the ASCM) of the WTO superficially deal with tax matters that its members may face (MFN clause and subsidies disguised as tax manipulations). Writing special Chapters that deal specifically with tax and legal issues related to offshore financial centers could be a long-term global response to an international problem.

This is the path that Pascal Lamy, WTO Director General, seemed to be advocating in 2009, by campaigning for the formation of an international consensus such as in the form of a multilateral treaty within the WTO for example. The idea was to dispense with all bilateral agreements between States advocated by the OECD, through a legally binding multilateral treaty.

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Indeed, now most of the WTO agreements include articles protecting the signatory countries from discriminatory measures through directives on VAT and taxes on goods and services. The current treaties in no way directly target corporate taxes and derogatory tax regimes to which they can be subject.

However, and indirectly, the WTO invited itself onto the world stage of international financial regulation, particularly in terms of taxation for export. One of the most studied and widely known examples is the dispute that opposed the European Union and the United States for over thirty years in the WTO concerning tax benefits of American exporting corporations.

2) Border Tax Adjustment (BTA) and the role of the WTO in the face of complexities of the US tax system.

The WTO has never been able to ignore tax issues affecting its member States, particularly the fiscal impacts arising from trade that takes place between them. The dispute which opposed the European Economic Community and the European Union and the United States on qualified tax benefits considered to be illegal subsidies by the EU that benefit American companies, is the most blatant example of the undeniable importance of the role of the WTO in dealing with these issues.

To better understand the different tax statuses granted by the United States to their exporting companies, it is first necessary to understand the reasons that have led the United States to act in such a way.

Indeed as of the late 1960s, the US was facing two parallel trends. First, economic globalization was becoming an economic reality, increasing in importance since the end of World War II. Second, the largest US companies

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were becoming multinationals with a growing share of their output being produced for export.

Fiscal questions arose quickly, even though the 1960 GATT agreements clearly defined guidelines with respect to taxes and duties. Direct taxes are paid in the place that a good is produced while indirect taxes are paid in the place of receipt or (resale) of the manufactured good. This is the Border Tax Adjustment (BTA) principle defining tax rules according to place of origin and destination of production and subsidiaries.

This BTA model quickly showed its limits. It is founded on a very unrealistic principle: that industrialized and globalized economies use a similar fiscal architecture based on a uniform distribution of direct and indirect tax ratios.

But taxation is one of the many dichotomies between the United States and Western Europe. Europe, and primarily France, have a 2 to 1 ratio between direct and indirect taxes (Gros, 1998), while this is 3 to 1 for the United States. The explanation lies in the massive introduction of valued-added taxes in European countries at relatively high rates(PWC, 2013). VAT rates thus vary from 15% in Spain to over 30% in Denmark as of June 2013, with a European average of about 22% according to a PWC study. In the United States by contrast, no VAT rate is imposed at the federal level, leaving the possibility for states to freely set their own rates. Five states including New Hampshire have no sales tax (VAT), while Tennessee has a combined sales tax of 9.25%, the highest in the United States (Drenkard, 2014).

The indirect tax burden appears much lower in the United States, penalizing the US compared to the European Union in the framework of the BTA that almost exclusively models indirect taxes upon their destination. Other countries

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face similar challenges such as Japan where the VAT rate has long been very low, and appears likely to stay low.

The US, by contrast, has a double handicap in terms of taxes upon export. Besides a generally very low VAT rates that are unevenly distributed across the territory, the US practice what is called the residence regime for the taxation of companies.

Two major company taxation schemes exist in the world, the residency regime and the territorial regime. In the case of the territorial regime, only the income stream from the country where the company is based is taxed, while income flows from abroad are taxed abroad and not in the destination country, or under very favorable conditions or a dividend regime. France and 25 other OECD[1] countries use the territorial tax system.

Under the residency regime, all domestic and international income streams are taxes along with all income earned abroad. The United States and seven other countries of the OECD[2] adopted this tax system. In 2009, the United Kingdom and Japan abandoned the residency regime to adopt the territoriality regime with the aim of simplifying taxes and also to repatriate dormant capital from abroad.

Faced with a crippling fiscal architecture for US exporters, the US federal government quickly proposed tax exemptions for exporting companies in order to facilitate the emergence of exporting US multinationals. US taxation is divided into two broad categories. The first category corresponds to US subsidiaries

[1] Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Estonia, Finland, Germany, Hungary, Iceland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, and the United Kingdom according to the IMF in April 2011.

[2] Chile, Greece, Ireland, Israel, Korea, Mexico, and Poland according to the IMF in April 2011.

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abroad producing manufactured goods that are not destined to be sold on the US market.

The second category is that of American companies on American soil producing and exporting its production abroad. It is this second category that interests us in the following cases. The first category can indeed indefinitely postpone the payment of taxes as long as earnings are not repatriated to the United States. This postponement comes under criticism by European Union countries, but no dispute is on the verge of being registered due to the lack of legal criterion. However, the second category enters entirely under Article 16 of the GATT framework and it is this second category that we will study here to see how the WTO could eventually deal with similar issues between its member States. These cases were quickly defined by the European Economic Community as amounting to export subsidies and thus considered to be illegal under the agreements signed within the GATT. The EEC brought the dispute before the GATT dispute settlement body in order to obtain a judgment its favor.

3) The dispute over Domestic International Sales Corporations (DISC) in the WTO

President Nixon introduced the status of "Domestic International Sales Corporations" (DSIC), the same president who ended the Bretton Woods system and reduced taxes for businesses and the wealthy.

This new tax status was adopted in 1971 as part of the "New Economic Policy", the spearhead of Nixon's economic program. The primary objective of this major law was to revive the US economy and create jobs. The new tax status of US companies producing on US soil but exporting their production, falls under this desire to restore competitiveness to the US economy in its confrontation with the EEC and Japan.

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The principle is simple; a US company exporting part of its production abroad can therefore create a subsidiary whose mandate will be exclusively linked to the export of the production of the parent company. This subsidiary therefore enjoys the status of DISC and will be treated as a foreign company or subsidiary. The company will also be able to defer a large portion of its taxes as long as the dividends are not distributed but reinvested on US soil.

This tax status is therefore situated midway between the US corporate tax system and the special status granted to foreign subsidiaries operating abroad and exporting abroad who can indefinitely defer taxes as long as their income is not repatriated.

The EC was not to be fooled however, and immediately challenged the DISC status before the GATT authorities. The EEC based its arguments on Article 16 of the GATT agreement which considers that if export prices are lower than prices on national markets, the products have benefited from export subsidies. Naturally, tax rebates (VAT) practiced upon borders are excluded from the scope of its grants. The United States are heavily penalized, as VAT is negligible in terms of direct taxes in the country, and therefore has a low impact on prices of US products destined for export. In contrast, European products fully benefit from the agreements due to the high VAT rates in Western Europe. Moreover, as the US practices the residency regime, export products are at the same price as those charged. The United States are thus negatively impacted and the country is therefore less competitive in terms of price than the countries of the European Union. This is what justifies, in their eyes, the establishment of such a tax system aiming to reduce unequal treatment of the BTA.

The verdict of the GATT authorities would nevertheless be very clear: the tax status granted to these US subsidiaries is illegal and may be considered

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equivalent to a grant from the US with the objective of promoting exports. This status therefore does not follow the principle of free competition advocated by the GATT agreements.

Below are presented parts of the conclusions of the GATT judgment, Report of the Panel presented to the Council of Representatives on 12 November 1976 (GATT, 1976) :

> 67. The Panel started by examining the effects of the DISC legislation in economic terms. The Panel concluded that it conferred a **tax benefit and that this benefit was essentially related to exports.** The Panel considered that if the corporation income tax was reduced with respect to export related activities and was unchanged with respect to domestic activities for the internal market this would tend to lead to an expansion of export activity. Therefore the DISC would result in more resources being attracted to export activities than would have occurred in the absence of such benefits for exports.
>
> 68. The Panel noted that the United States Treasury had acknowledged that exports had increased as a result of the DISC legislation and the Panel considered that the fact that so many DISCs had been created was evidence that **DISC status conferred a substantial benefit**.
>
> 69. The Panel noted that the DISC legislation was intended, in its own terms, to increase United States exports and concluded that, as its benefits arose as a function of profits from exports, **it should be regarded as an export subsidy.**
>
> 78. While the Panel noted that primary product exports were eligible for DISC benefits and had been traded substantially through DISCs, it did not examine whether the benefits would result in the United States obtaining a disproportionate share of the world market in terms of Article XVI:3.
>
> 79. The Panel noted the United States argument that it had introduced the **DISC legislation to correct an existing distortion created by tax practices of certain other contracting parties**. However, the **Panel did not accept that one distortion could be justified by the existence of another one** and considered that, if the United States had considered that other contracting parties were violating the

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> General Agreement, it could have had recourse to the remedies which the General Agreement offered."

The findings of the GATT panel are very interesting. They reinforce the Europeans in their position and consider that the tax status of DISC can be considered an export subsidy. The report even criticizes the intentions of the US tax status, arguing that its objective of rectifying distortions introduced by the European VAT is not admissible but is a tax distortion not justifying the creation of a new proportional distortion to the advantage of the United States.

But it was not until 1984 and the new Deficit Reduction Act (DEFRA) that the GATT decision was more or less applied. But American officials do not give up the idea of creating a competitive advantage for US companies exporting their production. A new tax status was therefore created.

4) The FSC status and the increased use of Offshore Financial Centers (OFCs)

In response to the GATT decision, the United States thus created a new favorable tax status for US exporters. This status will be called a Foreign Sales Corporation (FSC). The principle is similar to the previous fiscal status of DISC, however the US counter attacked by "relocating" the tax system overseas. Indeed, the FSC will no longer operate in the US as did the DISC. Here it will be a question of subsidiaries operating abroad, enjoying all the tax benefits as were found in the previous regime and therefore tax benefits for exports. Now, however, it is a DISC relocated into a foreign jurisdiction, often an offshore financial center offering accommodative legislation and taxation.

The WTO defines this construct as such: "A FSC is a corporation created, organized, and maintained in a qualified foreign country or US possession outside the customs territory of the United States under the specific

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requirements of Sections 921-927 of the US Internal Revenue Code. A FSC obtains a US tax exemption on a portion of its earnings ("foreign trade income"), which means clustering the gross income of a FSC attributable to "foreign trading gross receipts." Foreign trading gross receipts means the gross receipts of any FSC that are generated by qualifying transactions, which generally involve the sale or lease of "export property" (WTO, 1999).

It should be added that repatriated profits as dividends of these FSC to the parent company situated in the US that are partially deductible from their taxable income.

The idea here is to facilitate the production and export of US production, by optimizing, and massively so, the use of transfer pricing. The US authorities therefore create two new techniques for calculating transfer prices for this new tax status, in addition to the classic method of arm's length pricing mentioned for this purpose in Section 482 of the Internal Revenue Code.

The FSC can thus use two "administrative" methods allowing their parent company to deduct between 15 and 30% of total revenues from their exports that pass through their FSC from their total taxable income (Congressional Research Service, 2000).

Administrative method a)

The parent company may deduct from its taxable income: 1.83% of its gross export revenue (to a maximum of 46% of total taxable income of the parent company) multiplied by 15/23 of the total revenues of the FSC.

Administrative method b)

The parent company may deduct from its taxable income: 23% of its taxable income related to exports (within the limit of 46% of total taxable

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income of the parent company) multiplied by 15/23 of the total revenues of the FSC.

In both cases, tax exemption is a maximum of 30% of export revenues or 46%x 15/23 = 0.30.

Traditional Arm's Length Method (ALM):

The most classic Arm's Length methods are much less advantageous. Although the revenue ceilings of the FSC are eligible for tax deductions for the parent company equal to 30% (just as with the administrative methods), implementation is complex. While administrative methods are almost automatic in their application, ALM have the disadvantage of being subjective in their application. Over time, tax deductions by this method are, in practice, less than 15% of export revenues. This therefore makes ALM much less interesting to companies than the option of administrative methods available whose deduction rates have a ceiling of 30% as do the ALM, but in practice the administrative methods remain at 30% or twice the rates of the ALM. The administrative methods have the further advantage of rates fixed in advance.

Understandably, US companies that previously enjoyed the favorable tax status of DISC, turned towards the new status of FSC. They also rapidly opted for the administrative methods of transfer pricing. Thus the tax impact for US multinational exporters will be almost zero in the transition from DISC to FSC status.

The United States thus allowed companies from many sectors (electrical and non-electrical machinery, chemicals, aerospace, agriculture etc.) to relocate part of their profits arising from exports into tax structures abroad, additionally this was done in all legality.

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The European Union, far from being taken in, understood that the issue was far from settled. As shown in the graph on the functioning of FSC relative to DISC, the United States had simply relocated their tax strategy to offshore financial centers in order to comply with the GATT decision, while maintaining the tax benefits of US exporting companies.

Although the FSC enjoy a respite under GATT, the implementation of the DSB of the WTO allows the EU to counterattack. The EU requested consultations in 1997, without necessarily expecting a rapid response. The following year, the EU required the organization of an arbitration panel in order to speed up the process, this action being based on the Agreement on Subsidies and Countervailing Measures, whose Article 3.1.a prohibits tax export subsidies and condemns the non-respect of ALM methods recognized internationally.

The United States clearly not in compliance with Article 3.1.a by "granting subsidies in law contingent upon export performance", the arbitration panel formed at the request of the European Union ordered them to change their legislation to achieve compliance with the Agreement on Subsidies and Countervailing Measures. It would be argued that the US was acting deliberately by reducing the taxes of US exporting companies to make them more competitive internationally.

The WTO Appellate Body in March 2000 confirmed the conclusions of the report of the Panel that the FSC regime is an export subsidy prohibited under the Agreement on Subsidies and Countervailing Measures. Additionally, the Appellate Body confirmed that this scheme is also considered a prohibited export subsidy under the Agreement on Agriculture.

Here is an excerpt from the decision of the Appellate Body of the WTO dated February 24, 2000:

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> The Appellate Body *recommends* that the DSB request the United States to bring the FSC measure that has been found, in this Report and in the Panel Report as modified by this Report, to be inconsistent with its obligations under Articles 3.1 (a) and 3.2 of the *SCM Agreement* and under Articles 10.1 and 8 of the *Agreement on Agriculture*, into conformity with its obligations under those Agreements (WTO, 2000).

Despite a reasonable period of compliance initially set at for October 2000, it was not until 15 November 2000 that the US presidency repealed the FSC tax scheme. The US administration would not wait long before adopting a new preferential tax regime for exporting companies called ETI.

5) Extra Territorial Income Act (ETI)

Adopted as part of the text repealing the FSC status, the Extra Territorial Income Act (ETI) follows the same logic as the DISC and FSC. The European Union, tired of the battle but still engaged, again calls on the WTO Appellate Body, this time to rule on the issue of ETI. The decision will again be in favor of the European Union, and the DSB of the WTO without delay will adopt this decision, based on the same legal bases as the previous decisions of the Board. Thus the tax treatment granted to US companies by the Extra Territorial Income Act contravenes the Agreement on Subsidies and Countervailing Measures, and the Agreement on Agriculture.

Indeed, the FSC Repeal and Extraterritorial Income Exclusion Act only transformed the name of the FSC into ETI, and removed FSC-related rules in Articles 921 to 927 of the US Internal Revenue Code, replacing them with a partial tax exclusion, by computing income and the amount of extraterritorial income to be reintegrated by the parent company. The existing FSC therefore have until 31 December 2001 to comply with the new regime, which is new in name only. Nothing has changed except that the new tax system adopted by the

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US authorities no longer plans for the obligation for a legal structure separate from the parent company such as an FSC abroad. Only the confirmed existence of significant economic involvement abroad (over 50% of the value chain) is required to benefit from this favorable tax treatment in the context of exports from the US.

Tired of noncompliance with WTO rulings, the Dispute Settlement Body authorized the EU to adopt a series of measures to the tune of $4 billion annually. According to the OECD, this is the estimated amount of tax benefits that American companies receive annually through the FSC and ETI regimes (Qureshi & Sassi, 2002).

In 2003, the European Union Trade Commissioner, Pascal Lamy (who later became the WTO Director-General) announced*:*

> The Commission hopes to pass a very clear message to the US that their continued failure to implement three years after the expiry of the original WTO deadline is unacceptable. I have just been to Washington and have clearly explained our position. Still, we have opted for a measured approach and have actually left the door open for US action before countermeasures are to be applied in March 2004. I hope the US will seize this opportunity (European Commission, 2003).

The American presidency, facing the pressures of the WTO and retaliation from the European Union, promulgated in October 2004 the American Jobs Creation Act. This ends the Extra Territorial Income Act while maintaining transitional measures until 2006 and furthermore grandfathers in the possibility for contracts signed before 2003 to benefit from tax benefits of the ETI until their completion.

Once again, the European Union believes that the United States is not respecting the rulings of the DSB, and therefore decides to request that the WTO form a new panel in May 2005 to resolve the dispute quickly. The results of the

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panel will again be in favor of the EU, holding that the United States did not respect the previous decisions of the DSB, in particular concerning the introduction of transitional measures and protecting contracts signed before 2003 - the grandfather clause mentioned above (WTO, 2005). The case would then be processed in Appeal and the decision of the Appeals Body would confirm the decision of the panel, thereby allowing the European Union to retaliate.

The United States cancelled the validity of the grandfather clauses to prevent the implementation of the European Union measures.

This would end nearly three decades of legal procedures between the United States and the European Economic Community then the European Union, while crowning the WTO action in the framework of this trade and tax litigation.

Conclusion

The WTO cannot remain idle on this topic, as the institution is faced with an upsurge in dispute cases between WTO member States on tax issues, a key example of which was the various stages of the "political-legal drama" just reviewed. This trade dispute between the US and the European Union is most instructive about the power plays in question and the relationships between states in the defense of their economic interests. We can ask ourselves whether the WTO should not integrate into prior agreements specific and clear recommendations on taxation. The aim of this chapter is to show that the WTO, while remaining in line with its mandate, could reinstate tax items to ensure compliance with the agreements signed within it. These findings show that it would be perfectly legitimate for the WTO to adapt, over time, the legal framework of trade agreements signed to allow clarification of the tax treatment of multinationals in line with the courts of the member States of the WTO.

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Yet, in the conclusions reached by the WTO Appellate Body in the FSC dispute between Europe and the United States, the WTO held to remind its neutrality vis-à-vis the taxation of its member countries, which remains a preserved domain of national sovereignty. The institution thus reiterates its determination to stay out of any discussion about taxation, in order to respect the mandate that it was given when created.

The institution thus stated:

> We wish to emphasize that our ruling is on the FSC measure only. As always, our responsibility under the DSU is to address the legal issues raised in an appeal in a dispute involving a particular measure. Consequently, this ruling is in no way a judgment on the consistency or the inconsistency with WTO obligations of any other tax measure applied by any Member. Also, this is not a ruling that a Member must choose one kind of tax system over another so as to be consistent with that Member's WTO obligations. In particular, this is not a ruling on the relative merits of "worldwide" and "territorial" systems of taxation. A Member of the WTO may choose any kind of tax system it wishes – so long as, in so choosing, that Member applies that system in a way that is consistent with its WTO obligations. Whatever kind of tax system a Member chooses, that Member will not be in compliance with its WTO obligations if it provides, through its tax system, subsidies contingent upon export performance that are not permitted under the covered agreements (WTO, 2000).

Only the breach of the agreements signed between Member States can allow the WTO to rule on tax issues, if these directly affect the fulfillment of these agreements, particularly the founding principle that is the respect for free competition. This was the case for DISC, FSC and ETI. This could again be the case in future litigation, provided that it impacts the trade agreements of the institution.

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In April 2013, the European Parliament Committee on Development in a report to the Committee on Economic and Monetary Affairs addressed various proposals to limit tax evasion, tax avoidance and the excessive development of tax havens. Its rapporteur, former French judge Eva Joly, a European MP, proposed that the UN and the WTO seize on these issues in order to provide comprehensive and concrete answers. The report calls for the signature of multilateral agreements on tax matters within these international institutions, rather than the signing of bilateral agreements between states. Bilateral agreements would have a tendency to encourage the excessive use of transfer pricing (European Parliament, 2013).

The WTO should take the issue of tax treatment and tax haven exodus seriously. It was the WTO who partially permitted their takeoff in the late 1990s, liberalizing financial services worldwide through its "framework agreement": The General Agreement on Trade in Services (GATS). Advocated by Western countries to promote international growth and expansion of Western banks in emerging countries, the agreement has certainly allowed real progress but also resulted in longer-term undesired outcomes.

The European Commissioner for financial services in 1997, Mario Monti, was far from the concerns of his counterpart Eva Joly. Now head of the ECB where he spearheads the regulation of tax havens, Monti said at the time of the signing of the GATS:

> It is in the interests of all WTO Members - developed as well as developing countries - to table offers that guarantee a substantial measure of market access and liberalization in all financial services markets (European Commission, 1997).[1]

[1] The European Commission stated: "Negotiations in the WTO on the liberalization of financial services markets aim to allow banks, securities and insurance companies to establish and operate in foreign markets and benefit from the same treatment as domestic service providers. The talks also aim to allow the cross-border supply of financial services between markets. This will mean that new capital and services can be provided and savings channeled into productive investments in order to fuel economic growth."

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The European Commission, still in 1997, stated that: "Liberalization of financial services in the WTO will contribute to the process of financial stability by providing more liquidity in markets." The outlook evident in these statements with those of the Rapporteur Eva Joly, shows how the political will on displayed in Brussels has evolved over the last 15 years.

The WTO could therefore legitimately renegotiate the agreement in order to set limits to current excesses of many multinationals and small nation states. It is still necessary for the political to be present. It is indeed not certain that the view of the Economic and Monetary Affairs Committee of the European Union is the same as that of all the member states of the WTO.

The blockages among international regulators seem to be of a much more political than legal nature. The next chapter will also address the fiscal and economic impacts of such international legal arrangements created by the United States. A first substantial impact has been the growth of offshore financial centers in the vicinity of US territory, fed by American liquidity. A second non-negligible impact in terms of competitiveness for the United States, this may explain their reluctance to permit any regulation that is overly binding internationally. The next chapter will also deal with the positive and negative effects of tax havens, and the will that results for each State to push for regulation of tax havens, or not.

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III) On the historical responsibility of British and American free-market thought on the creation of today's tax havens

A) OFCs & Capitalism

The concept of fiscal sovereignty is intimately tied to issues that arise from more intense regulation of OFCs and international financial flows. The previous chapter showing possible paths forward through the use of the WTO to more effectively regulate OFCs often comes up against a British and American school of thought that opposes any additional regulation by Hard Law.

Why indeed do Britain and the United States resist any additional binding regulations for OFCs? Could the promotion of soft law be based on historical reasoning? Or is this value based quite simply on economic reasoning as it would be very beneficial to the US and the UK in the current context?

The controversial question of history and pure economic interest is far from being settled. However, it is essential to bluntly inquire about this issue today since interconnections between OFCs and these two great nations remain strong.

Is liberal economic thought responsible for the creation of OFCs, which may have no other purpose than to serve unfettered capitalism that is largely financial today?

Relations between the UK and its overseas territories are one place to look as they reflect the diversity of legal models for OFCs arising in the wake of the politics of decolonization in Western Europe. Through a political, legal or economic perspective, these overseas territories or “associated free states” as pertains to those relating to North America, reflect the growing constraints that globalization places on relations between the territories of a given region of influence, be it economically or in terms of security.

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The formation of tax havens and the architecture of international finance today show that the role of the Caribbean region for the United States, and the many territories previously the colonies of the British Empire illustrate the relevance of an historical analysis and the role of "guardian nations". While London, New York, Hong Kong and Singapore are now top financial centers, the historical stock markets of Paris, Milan and Frankfurt are slowly but surely declining. This evolution can only strengthen the appearance of an affiliation of globalized finance to an Anglo-Saxon heritage.

The importance of interdependence rises, by definition, in proportion to the extent of globalization. In response, sovereignty can no longer be thought of as a free and inalienable choice for a state but instead it must be understood as the freedom to choose these interdependencies in a context of increased globalization in which liberal economic thought based on the theories of Adam Smith still predominates.

The question is not to address the issue of the appearance of overseas territories or free associated states as alternatives to the nation-state, which could demonstrate the ability to rethink the concept of sovereignty so that it remains logical.

Instead, the question that is addressed here, beyond the debate on legal dependence, is that of those semi-independent states that have a tendency to play out globalization by "selling their sovereignty." Thus, according to Marie-Christine Steckel-Montes, tax sovereignty "belongs to" the state to the extent that the central government freely creates taxes of all types and freely uses this income (Steckel-Montes, 2005). However, from the moment that a variety of states or territories adjust their tax legislation in direct accordance with the evolution of tax systems in the United States or the United Kingdom with the sole purpose of attracting more capital, it is reasonable to wonder if these states are indeed sovereign.

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The overseas British territories have benefited from the protection of the British Crown and the confidence that this inspires in terms of political stability, a system based on Common Law, the use of the English language and the extensive presence of British banks. They then sell their sovereignty by attracting financial flows from the City of London and all over the world (Asia, New York, etc).

Thus the link between growth of financial centers such as London and New York and the development of OFCs seems inseparable. OFCs are beneficial to the growth of the financial activities of the United Kingdom and the United States. To avoid having to develop market deregulation policies, the government has in fact allowed avoidance strategies to develop. Avoidance strategies have led to the growth of capital markets through OFCs and free zones such as in Delaware and the Cayman Islands for the United States, and the City of London with Jersey, Guernsey and elsewhere.

This two-part chapter first analyzes the liberal doctrine according to which greater financial market development leads to greater, more rapid and more sustainable economic growth. This theory, held by many in the British and American worldview, has led many overseas territories to move in this direction of financialization of their economies. According to a study in 2014 by Janna Rogers, Sarah Baldwin and Jerome McElroy, this bet has paid off, as island territories that have opted for this development strategy are today developed economies with high living standards. This positivism is pushed to the extreme by the theory that may result, for which the OFCs have a positive impact on the economic development of neighboring or 'guardian' economies. The study of Rose and Spiegel analyzes the ins and outs of interconnections between OFCs and the major developed economies. A positive impact is seen both from the perspective of developed economies and the offshore territories involved, but also for all the economies of the OECD, even though some, such as France, are resistant to the presence of OFCs.

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Moving on from the globally positive observation that OFCs can have on the economic development of other nations, the second part of this chapter considers the British and American influence on the political, legal and economic development of OFCs in the post-World War II period. We will look closely at the commodification of sovereignty that aims to capture capital and ultimately to indirectly participate in the economic and financial development of their tutelary nation: the United Kingdom or the United States. Conversely, the case of the overseas French territories is analyzed to understand the dichotomy of the two different development models for French and British overseas territories, and their respective impact on the development or lack thereof, of a strategy of financialization of their economies.

1) Positive economic impact of OFCs globally and in OECD economies.

The English-language financial press has long adopted a liberal pro-OFC attitude that has been typical of the mentality of liberal economic elites since the early 1990s. The American and British economic world, while not going so far as to provide a positive image of tax havens, draws a bleak picture of a Europe that is suffocating its economy via restrictive and outdated tax and financial legislation. *The Economist* cites Andrew Moris of the University of Alabama in the United States who argues that OFCs have a positive influence on Western economies, forcing them to be more competitive in terms of regulation and capital flows, arguing that OFCs "impose an important discipline on offshore jurisdictions through innovative regulation to lower transaction costs" (The Economist, 2013).

It may well be tempting to extrapolate and consider the following hypothesis: without OFCs, developed economies and emerging countries suffering from excessive legislation (or over-bureaucratization, such as Brazil or India and even France and Italy) would not be pushed to modernize their financial laws and

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regulations. This lack of competition would make local laws less optimal, more outdated and even poorly adapted to the needs of international markets, limiting the flow of trade to a strict subsistence level.

My analysis is in part reflected in the work of two economists and researchers from the Federal Reserve Bank of San Francisco. Their work is very similar to the position of Olivier de Serre of the OECD in an official publication in 2006, which takes up the liberal positions of the Economic Review of the OECD.

A second sub-section will consider the positive impact for a small economy (often an island that is isolated) to take the path of financialization of its economy in order to accelerate its economic development. Researchers from St Mary's College in the United States have worked on the subject, focusing primarily on the sizes of small island economies, some of which are discussed later in the section of this chapter on the Anglo-Saxon and French colonial legacy.

The analysis of the impact of OFCs on Western economies is the heart of the research of Professor Andrew Rose at the University of California, Berkeley and Mark Spiegel, vice president of Economic Research at the Federal Reserve Bank of San Francisco. They built a gravity model using OLS (Ordinary Least Squares) techniques in their research paper published by the National Bureau of Economic Research (Rose and Spiegel, 2006).

Rose and Spiegel attempt to demonstrate through this OLS gravity model that the presence of the OFCs near a developed economy (which we call the Alpha economy) can have many benefits in economic terms. Despite the fact that the profits of the banking sector of a developed economy are negatively impacted by the presence of an OFC (called the Beta economy) near its borders, the mass of outstanding credit in the Alpha economy is nevertheless higher than it would have been without the presence of the Beta economy.

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Under pressure from the banking and financial services in the Beta economy, the Alpha economy is positively stimulated on the technical level. Thus its banking sector tends to be more competitive and more developed compared to that of a generic developed economy (called the Lambda economy) not affected by the proximity of a Beta economy. The study states that the number of banks in an Alpha economy is significantly higher than in a Lambda economy. The Alpha economy also benefits from increased financial depth through improved financial intermediation through the following three economic elements: 1) credit allocation to the private sector in GDP terms, 2) liquidity and 3) monetary aggregate M2 (M1 cash + checking deposits + saving accounts and short-term credit of less than two years) also in relation to GDP.

According to microeconomic theory, the role of financial intermediation in the proper functioning of an economy is essential, its basic utility being to convert funds borrowed into loans whose form and due dates are suited to the needs of borrowers. The study of Rose and Spiegel, by affirming that financial intermediation has improved the Alpha economies due to the presence of OFCs, credits these OFCs with a certain role in promoting investment and therefore long-term growth. The very Manichean vision considering OFCs to be purely negative is thereby weakened, with the situation appearing more nuanced than it would have seemed originally.

The point of this study is to counteract the negative image of OFCs that for many “encourage bad behavior in source countries, since they facilitate tax evasion and money laundering. [...] OFCs are best characterized as parasites, since their attraction stems in part from allowing their source-countries’ clients to engage in activities detrimental to the well being of their home nations”. Thus the study concludes by tempering the strong feelings of some against OFCs, by stating that they “enhance the competitive behavior of the monopoly bank and may increase overall welfare. [...] and conclude that OFCs are better characterized as symbiots.”

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Offshore financial centers as symbiots or as entities with a beneficial relationship of Anglo-Saxon liberal capitalism? The authors do not go further in their thinking on a very liberal perspective of this subject, a perspective that is divergent, as seen in the fact that the results of this study have not been widely diffused despite the quality of the analysis.

The historical position of the OECD has long been that the functioning of the financial system of a country can have a strong impact on long-term productivity and growth. Indeed, many empirical studies demonstrate a strong correlation between the size of the financial sector of a country and the ability of its economy to grow over the long term. And empirically, according to the OECD, everything points to the fact that a country should strive to develop its financial sector to the maximum in order to strengthen economic growth.

The study of Alain de Serres, economic adviser at the OECD, of financial regulation and economic growth published in the OECD *Revue Économique* argues that competition in banking in OECD countries will support economic activity (De Serres 2006). According to de Serres, the liberalization of capital markets is one of the main ways to facilitate competition in this key sector for developed economies. Countries that have liberalized their financial sectors in recent decades "have not suffered from instability" that is greater than those countries that maintained stricter laws on capital markets and banking regulation. These results from 2006 may need to be qualified following the 2008/2009 crisis.

An article in the same journal in 1995 by two OECD economic advisors, Malcolm Edey, today Assistant Governor to the Australian Central Bank and by Ketil Hviding today an IMF economist, showed that deregulation of the financial sector led to its expansion, and to greater overall growth of the country in question, creating proportionally more jobs than other sectors. In terms of stability, however, the study found a more nuanced result than that of Alain de Serres. Indeed, according to Edey and Hviding, successive deregulation can cause

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crises that are difficult to control[1] , taking the example of foreign exchange in Western Europe in the early 1990s and the 1994-1995 Mexican crisis (Hviding 1995).

This duality is at the heart of the dichotomy of economic strategies implemented by countries following a more liberal economic path compared to the more conservative financial culture of the European continent. Growth and productivity are the values promoted on the one side by proponents of liberal economics, while the Social Democrats in European economies seek financial and macro-economic stability. The stakes are high and the financial crisis of 2008 clearly changed perspectives on these issues, but the central question remains the same in terms of the use of OFCs by the financial sectors of the developed economies of the OECD, as their use seems essential for the proper functioning of the system according to classical economic philosophy.

This cultural dichotomy greatly influenced small island states under British and American influence in their choice of economic development strategy. A choice backed up by the results of the study by Janna Rogers, Sarah Baldwin and Jerome McElroy on the economic success of states having opted for an OFC-type economic model.

2) The success of economic strategies of OFCs of British and American influence

Beyond the impact of tax havens on developed economies, it is important to consider the power of attraction of international finance for economies that are not greatly diversified and are therefore highly dependent on external flows as

[1] According Edey and Hviding "Although episodes of financial instability have been in no way limited to the periods that followed deregulation, it appeared in a number of cases that instability was linked to the deregulation or that it had been made more difficult to manage because of the structural changes that accompanied it. We can give as an example the crises in financial institutions from several countries, severe debt problems in the business sector and households in some countries as a result of financial liberalization and extreme tensions which have occurred on the exchange rate in European countries in 1992 and 1993 and in Mexico in late 1994. "

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were the British OFCs of the past. The economic success of European OFCs such as Switzerland, Liechtenstein and Luxembourg in the post-World War II period drove many island economies, yesterday isolated because of their location, to turn to financialization in a forced march for their economies. Globalization, the communications revolution, and computerization have allowed these economies to be at the heart of the broader Anglo-Saxon financial model.

Yet, is it really a significant and beneficial step for these small economies? Does the fact of becoming an OFC actually provide more wealth for a small state? Does this economic growth positively impact the standard of living of its inhabitants (according to the HDI, the Human Development Index) or does the growth accentuate inequality? In other words, does the wealth created by the financial sector remain confined in the hands of an elite and a corrupt state as it can be argued that revenues from oil are captured by these parties in West Africa?

Such questions help to understand the economic impact and the potential virtuous circle advocated by liberal theorists and generated by such political strategies.

These questions are important because demonizing tax havens without taking into account the human and societal impact on these isolated economies would be unfair. International institutions do not consider this question, perhaps out of negligence, or more likely for fear of offending their member states, or judging these issues to be simply anecdotal.

Janna Rogers, Sarah Baldwin and Jerome McElroy from Saint Mary's College in the United States recently published a study on this subject focusing specifically on small island economies (SIEs). The objective of this study published in 2014 and entitled “Offshore Financial Centers, the best strategy for island economies” is to compare the standard of living of small island states having opted for a development strategy based on rapid financialization of its economy to small island states that have not made this choice and chose the

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traditional sectors of the islands such as agriculture and tourism with a strong public sector presence.

To carry out this study, 30 small island states having chosen to orient their economies towards an OFC-type model were selected[1] (OFC SIEs), also included were 26 small island states that did not make this choice (non-OFC SIEs). Macroeconomic data are from *The CIA World Factbook* published annually, allowing to determine 25 socio-economic and demographic variables.

Through a means difference clustering analysis, it was thus possible to determine that the small island states having oriented their economies toward an OFC model have a standard of living well above the average of the other SIEs (small island economies).

Among the economic and human development indicators that seem most relevant in this study to confirm the hypothesis mentioned above are the following:

- GDP: the GDP per capita is on average twice as high for OFC SIEs ($25,793) as for a non-OFC SIE ($12,188).
- Unemployment rate: the unemployment rate is significantly lower in the OFC SIEs (9.98%) than in non-OFC SIEs (18.2%).
- Infant mortality: the infant mortality rate was significantly lower in OFC SIEs (10.22 per 1000 births) than in non-OFC SIEs (21.3). The world average is 49.02 according to the *CIA World Factbook* in 2011, compared with a 4.49 rate for the EU as a whole.
- Life expectancy: Life expectancy is slightly higher in the OFC SIEs with an average of 76.74 against 72.2 years for non-OFC SIEs.

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- Immigration: Taken together, the OFC SIEs attract large quantities of foreign labor through immigration that is sustained over time and enhanced due to a relatively low unemployment rate, while the non-OFC SIEs face the reverse, with substantial emigration (also due to the relatively high unemployment rate).

These results are striking, mainly because of the large sample of 56 states studied and the flattering correlations in favor of the OFC-type economies. The difference in the infant mortality rates and life expectancy show that health services are more developed and more effective in OFC SIEs, most likely indicating a higher human development index (HDI) for the first. Their labor market seems more dynamic, with higher revenues and attraction of migratory flows throughout their region.

At first glance, everything seems to suggest that the development of financial services for the international market helps develop the local economy and increases the living standards of the population. Nevertheless, the conclusions arising from these correlations obtained in the crossing of data should be considered closely.

Indeed, if the SIEs having adopted an OFC-type model are more developed, more politically stable, have better infrastructure, and are socially more advanced (higher HDIs) than SIEs without OFCs, it is not necessarily due entirely to the mere presence of a highly developed financial sector. There is a question of the direction of causation. The OFCs may also have been able to develop for the same reasons and thus be the result of these characteristics and not be the cause of this human and economic development.

A significant array of tourism facilities as well as the use of the international language of English would also have allowed for the development of basic infrastructure and context necessary for the expansion of the financial industry (political stability and security, communication systems, etc.). The tourism sector is an important example and should be looked at closely. If we take the

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data from the study, the OFC SIEs have annual per capita tourist revenues of $5,203 against $1,107 for non-OFC SIEs (J. Rogers, 2014), a significant difference from a macroeconomic perspective.

Similarly, although geographical proximity is a variable in this study, it is not used or discussed in the final results, while this seems an essential component for an optimal interpretation of the outcomes.

The SIEs located close to the hubs of world finance (Europe, the United States and Hong Kong) saw their economic development model facilitated by this proximity. This assumption is partly developed by Harvey Armstrong, professor of geography at the University of Sheffield, who created the concept of GCD (Great Circle Distance[1]). The GCD establishes a correlation between economic and financial development of an SIE and its proximity to a specific political and financial metropolis: Los Angeles and Washington in the United States, Brussels in the heart of Europe, and Tokyo in Asia (Read, 2014).

	Variable	Correlation
1.	GCDEU: great circle distance from the island to solely the EU (log, km)	-0.445
2.	GCDGLOB3: GCD to nearest of EU, USA or E. Asia (log, km)	-0.490
3.	GCDREG: GCD to main city in island's global region (World Bank definition of region) (log, km)	-0.390
4.	GCDNEAREST: GCD to nearest large city (e.g. Auckland for many South Pacific islands) (log, km)	-0.318
5.	GCDMETROP: GCD to capital city of former or existing metropolitan power (e.g., London for Cayman Islands, Paris for Tahiti) (log, km)	-0.395

Fig. 3.1. Correlation coefficients between GNI per capita and GCD (Read, 2014)

For the OFC SIEs in Rogers, Baldwin and McElroy, the GCD is 3892 kilometers away on average, while the distance is 5840 km for non-OFC SIEs, demonstrating

[1] The results of Harvey W. Armstrong and Robert Read in 2014 on the correlation between an economic center of influence and an SIE. The results are conclusive and show some correlation with the economic development of an SIE and its proximity to Europe, the USA and East Asia.

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the crucial importance of the geographical factor in the development of the economic activity of an OFC. Infrastructure, tourism and political stability are therefore not the only factors of success of an OFC SIE, even if they appear to be major prerequisites. Both the geographical position and its political or state affiliation to a developed country are factors that appear to be just as important and possibly even determinant in the context of economic development strategies adopted by an SIE.

Nevertheless, the many socioeconomic risks that OFC SIEs are subjected to should be taken into consideration. The choice to direct an economy towards an OFC model can clearly be a success, both from a human and economic development point of view. The longer-term risks remain quite important however, with strong legal, economic and fiscal dependence on the revenues earned from the excessive financialization of their economies. The lack of diversification of the economies of OFC SIEs in sectors other than finance can also become a significant vulnerability for them in case of strengthening of tax legislation in the countries of the OECD.

Indeed, the islands of Nauru, Tonga, Niue, and the Marshall Islands, which were considered OFCs in the early 2000s are gradually reorienting their economies towards other sectors as they try to manage the difficulties encountered by their financial industries. Previously competitive in an international framework that had little regulation, they have lost ground to more specialized and better equipped OFCs (with more qualified labor, greater financial expertise, and big name banks) while the international community and Western nations have gradually legislated and strengthened the regulatory arsenal against offshore finance.

Elsewhere, the economic stagnation and political dependence of Puerto Rico and the US Virgin Islands with respect to the United States federal system since the 2008/2009 financial crisis also underlines the stated problem, especially as

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the strengthening of the ETI legislation has strongly impacted their local economies.

The colonial history of SIEs appears as a major element in the context of economic development strategies adopted by an SIE. Their geographic location, the language imposed by the colonizer and its legal model shaped the economic development of Anglo-Saxon and French overseas territories and helped determine their continued relations with the colonizing country, including their choice of an SIE economic development model.

We will see in the next section that the colonial relationships between countries that are former British colonies or current American territories have shaped the world of international finance as we know it today. The very evident and visible role of the United Kingdom in the development of OFCs worldwide can only challenge the international policies proposed for their regulation.

B) British & Anglo-Saxon Colonial Policy and Influence

The preceding analysis has shown that the OFC-type SIEs have been largely able to prosper due to relatively stable political systems, modern infrastructure and a non-negligible tourist industry (with the English language as one "currency"). Financial liberalization also ultimately allowed these island economies to grow more significantly than their non-OFC counterparts. This very liberal vision of economic development of OFCs leads us to consider a related hypothesis: Could OFC-type SIEs be a direct result of liberal economic thinking? Could they be the tools, the helping hands, and the "link" between liberal economic (and financial) policies?

The argument that the OFC-type SIEs could directly result from liberal economic thinking, specifically US and UK economic policy over the last forty

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years, does not seem incongruous. The cities of New York and London have become major financial centers they are today thanks to their positioning as the relay points of international finance (i.e. OFC-type SIEs). Financial liberalism of future economic growth and the freedom of action granted through the annex financial centers of the Cayman Islands or Guernsey allowed the US and the UK to establish themselves as the world's largest financial powers of the post-Bretton Woods era.

Indeed, the US and the UK are both considered tax havens in many economic studies, it is therefore not surprising that their overseas territories are as well.

The analysis of the colonial history of the United States and the United Kingdom and the economic polices imposed upon the territories under the control of these two countries, in parallel with French colonial policy will allow us to highlight the influence of the British and American model of development of OFCs worldwide. The study of legal systems (Common Law / Civil Law) by Rose and Spiegel and their influence on the development of financial activities in the SIEs has subsequently confirmed the above hypothesis: that OFC-type SIEs are the direct result of liberal Anglo-Saxon thinking.

1) The United States and a capitalist vision of its overseas territories.

Unlike the United Kingdom, colonialism in the United States is not an intrinsic part of the domestic and political consciousness. Thus the correlation between a “liberal colonialism” in the US and the development of OFCs worldwide is difficult to identify. However, one must not overlook the impact that the United States has certainly had on the development of OFCs worldwide, and especially since the 1990s. Both directly through colonialism and liberal economic policies (in Puerto Rico and the US Virgin Islands), or indirectly by the

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influence of New York-based finance in the financial centers using the English language with otherwise British culture.

Historically, the concept of imperialism is equated with territorial colonialism and political domination by one nation. This traditionalist view reinforces the idea of a different imperialism, American style, far from the model followed by European nations. That aside, perhaps, the case of Puerto Rico and the Philippines where the United States opted, in a rare instance, for a "classic" colonialism following the European tradition.

Against a backdrop of international tensions in the early twentieth century and the rise of communism, the primary objectives of the United States during the expansion of its territory through colonies or Congress-controlled territories, were the promotion of capitalist economic culture (the spread of a liberal developmentalist ideology) and the security of its territory and its marine trade routes through the establishment of military and naval bases beyond the historical borders of the United States (as in the Caribbean and Asia).

a) Economic colonialism through the dissemination of liberal ideology such as that of the "last frontier"

American expansionism in Latin America is primarily related to the search for economic opportunities and strategic enclaves, but not only. Soon the United States was looking to expand its zone of economic influence in Latin America in the late nineteenth century to provide economic opportunities for US producers while also promoting the American values of democracy (related to political freedom) but also of economic freedom.

In contrast with the European model of more traditional colonialist domination, the United States opted for a model of "soft" domination, both cultural and economic in nature.

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European nations built their colonial policies on a willingness to Christianization indigenous populations, while providing education and infrastructure in the service of the mainland. Indeed, Europe educated in exchange for an economy dedicated to serving the mainland (this was both the English and French model with the creation of trading counters).

The United States chose another path. As a former British colony itself, and then a young and independent state, the United States did not have the intention of following the example of France and the United Kingdom. However, liberal economic theories are deeply rooted in American public opinion that has as much faith in god as in free markets.

Convinced that the rapid and exemplary economic development of the United States is the fruit specifically of the liberal doctrines of the nineteenth century, the American ruling class continues to see the promotion of these values that are considered “universal” as an opportunity to expand potential markets for exports for companies for which the US domestic market has reached maturity. Thus democracy, political stability and economic development are actively advocated through the open market by the American political system and large private institutions. (Rosenberg, 1982)

This neo-liberal colonialism applies particularly to the case of Latin America. Exports of US manufactured goods increased substantially in the direction of Latin America starting in 1890.

According to Rosenberg, the specificity of US exports of capital goods to a mass market, of agricultural products, manufactured goods for agriculture (tractors, machine tools), gave an almost humanitarian aspect to these exports and morally justified their introduction to these emerging markets. The United States no longer exported with the only objective of expanding their markets but also to bring to the whole world, the American model of life.

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This cultural and economic intervention was fully assumed by major American companies and the federal government that saw nothing other than a democratizing mission and the freeing up of markets. Heavily influenced by the American vision of democracy and economic openness, the IMF, based in Washington DC, would support only this pattern of development until the late 1990s.

According to Aaron Ramos, “American imperialism developed at this time by combining a strong capitalist impulse with weak political institutions (...) this process is not underpinned by institutions and the ideological coherence that led to the success of the British model and other colonial endeavors “(RAMOS, 1997). The United States has thus not intended to create a colonial empire in the image of the United Kingdom or France; the first objective is the rapid and broad dissemination of capitalism.

b) Colonialism with a security objective in the Caribbean, mixed with the economic challenges of globalization.

This model, still present in Latin America and the Caribbean, has gradually incorporated the element of national security with the evolution of the Cold War areas and the multi-polarization of the modern world.

Security issues today are thus as important as economic issues for the US administration. Colonized for security reasons, some US-controlled territories have gradually had to adapt to the changing international military context. Previously the strong arm of US foreign and security policy, these territories have now become, by the force of circumstances, the strong arm of a liquefaction of financial flows, exports, and of maintaining the competitiveness of US companies in terms of exports (the case of the US Virgin Islands and the ETI outcome is one example among others).

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The Island of Guam in Asia, Puerto Rico and the US Virgin Islands were the main territories of this one-time expansionist foreign policy with a defense and security goal: preventing the installation of foreign military powers in the region.

This security inclination on the part of the United States is reflected in particular by a strong presence around the globe and on its oceans through military and naval bases.

Puerto Rico was invaded by the US in the late nineteenth century. Spain could do nothing but ratify this situation and as of 1917 the island of Puerto Rico was officially attached to US territory although the people of the island still do not have the right to vote.

At the end of the Second World War and to secure this region of the Caribbean, the US federal government granted the status of a Free State to the island. Washington thus confirmed its authority over the island while militarily securing the region. Puerto Rico thus abandoned its military and diplomatic sovereignty to the US federal government. This situation is unusual because the inhabitants of the island, although having the right to a US passport, cannot vote in presidential and congressional elections.

The geostrategic situation of this island territory in the Caribbean Basin across from Cuba and the Panama Canal allowed the island to become one of the first US military bases abroad. The annexation of the island of Vieques in 1941 to establish military bases in addition to those already established in Puerto Rico, marked the will of the United States to assert its military superiority in the region.

The many referendums proposing independence for the island have all failed, and also mark Washington's willingness not to impose itself permanently on the local chessboard (unlike the French state in its overseas territories, for example) while the Caribbean region seems less strategic today than it did after the

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Second World War due to the opening of diplomatic relations with Cuba and the political stabilization of the region.

US military and federal grants have therefore declined precipitously over thirty years on the island due to rapid demilitarization, forcing local economic actors to diversify their activities, a task accomplished with some difficulty.

The economic situation of Puerto Rico has led the territory to be increasingly willing to further integrate into American territory, even while it has gradually withdrawn from contact with the US government (at least economically). Negotiations are well underway to transform Puerto Rico into the status of the 51st US state and in this way to end the increasing problem of public debt.

Geographically and politically close to Puerto Rico, the United States Virgin Islands (USVI) have a similar legal status to that of Puerto Rico.

The purchase of the Danish West Indian Islands in 1916 by the United States for the sum of $25 million was not motivated by a desire to increase American possessions in the Caribbean as did France and the UK, but instead for security reasons. In the midst of World War I, the objective was to prevent Germany from seizing the island to establish a naval base near the US coast.

Residents of the USVI are US citizens, but cannot participate in the election of the President of the United States, though they may elect a delegate to the US Congress. As discussed in the next chapter, their political representative ardently defends the economic interests of the island, especially in the late 2000s in terms of the relevance of maintaining a DISC / ETI status in the United States so as not to impact negatively the economy of the US Virgin Islands that depends greatly on this tax status.

A traditional economy that was based on US military aid and military and naval bases and the forced march to the conversion of the USVI in favor of a market economy has not been accomplished without pain, US federal government grants were considerable due to the weight of the army and the

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public sector in the economy and now are less so. With the gradual demilitarization of the island (and lower federal subsidies) the US federal government has decided to grant many tax benefits to the local economy to develop rapidly in order to offset lower military spending. The famous ETI regime favoring US exports via overseas territories is one of the many examples of special tax arrangements which have long benefited USVI and pushed the island to opt for a development strategy based on the financialization of its economy.

c) US CONCLUSION

US security policy has evolved tremendously over the past two decades; this has not been without impact on traditional US military bases in overseas territories. Thus the significant change in US foreign policy towards Asia Pacific, with the rise of security challenges in the region (the simmering Chinese and Japanese conflict over territorial issues, regional claims in Southeast Asia, etc.) has changed the geographic position of US military forces around the globe.

The Asia Pacific region saw its bases strengthened and staffing significantly increase: this on the island of Guam, an "unincorporated territory" since 1950 (on the same model as the US Virgin Islands) is ideally situated, equidistant between Japan, China and the Philippines, and has seen increased investments over 20 years. Between 2015 and 2020, the US Navy will invest $8.7 billion for the establishment of a new naval base, with the military already indirectly holding 60% of the wealth of the island according to the Economic Observatory of Harvard University in 2012. The army is also the owner of 50% of the island territory, making it the most important military and naval base outside the United States.

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Following this rebalancing which is accompanied by a massive military presence, US military forces will have nearly 65% of external forces in the Asia-Pacific region by 2018 (R. Haussmann, 2012).

At the same time, the more peaceful situation in the Caribbean and Latin America has led the Pentagon to scale back on existing bases in the region.

The transition from a largely militarized economy for the historical islands of Puerto Rico and the US Virgin Islands, to a diversified economy, was accomplished relatively quickly in the 1990s. Lower appropriations for the military and fewer direct federal subsidies in the economy were then offset by a series of special tax regimes, thereby boosting the local economy, sometimes artificially. The aim is to restore some economic independence to territories previously receiving more massive American economic assistance.

There were two main results: an all-out use of special tax treatments (ETI, for example, for the US Virgin Islands) to maintain stable living standards on the islands, coupled with the creation of massive debt on behalf of local authorities (such as in Puerto Rico today).

While England favored the emergence of OFCs to provide a financial relay and thus to enhance the activities of the City of London; the United States has created tax havens indirectly and unintentionally in the beginning. The conversion and demilitarization of overseas US territories came at the price of tax exemption and the creation of international financial centers.

2) The British crown model and the development of offshore finance

The British Empire as it was in the past no longer exists today. However, despite the independence of numerous territories, the British Crown retains dependencies around the globe. These territories comprise what are called the

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overseas territories, the most important are Bermuda, the British Virgin Islands, the Cayman islands, and the Turks and Caicos.

While about 40 to 50% of OFCs in the world were at one time part of the former British colonial empire, it is difficult to imagine that the British colonialist policy alone could have caused the development of these OFCs.

Among these territories are Anguilla, Antigua and Barbuda, the Bahamas, Barbados, Belize, Bermuda, the British Virgin Islands, the Sultanate of Brunei, the Cayman Islands, the Cook Islands, Cyprus, the Dominican Republic, Gibraltar, Grenada, Guernsey, the Isle of Man, Jersey Island, the Maldives, Malta, Mauritius, Montserrat, Nauru, Seychelles, Singapore, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, the Turks and Caicos and Vanuatu. All this without mentioning the territory of Hong Kong and the Republic of Ireland, today hotbeds of international finance and tax optimization.

To understand the development of such a network of OFCs, we must start from the root and heart of the British Empire, the City of London, the financial center of the British Empire and British policy in the 1960s, the time of decolonization.

According to Paul Sagar, who studied the links between the British Treasury, the Bank of England and overseas territories, three main factors can explain the creation of a British Empire based on the significant presence of tax havens:

- At the end of the nineteenth century the significant increase in global financial flows due to the beginning of globalization is one of the factors, Great Britain had already been specialized in financial services at this time.

- The British Common Law legal model, particularly suited to the development of financial activities, enabled British overseas territories to be perfectly calibrated to its activities, which the Rose and Spiegel theory seen previously also proposes.

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- British colonization concerned a large number of small territories, the legal and political systems were therefore easily malleable and were aligned with British financial law by English administrators.

In the development of financial activities, the Euromarket in the 1970s also resulted in increased activity on the islands that acted as satellites of the City. The explosion of activity in the City was indeed associated with a parallel development of the Euromarket in the heart of the tensions between Western and Eastern Europe. The dollar was the currency of reference internationally London soon stood out as the heart of the European market for Euromarket credit practices.

Bank loans in dollars amounted to almost nothing on European financial markets in the late 1950s, yet the steady increase in bank lending in dollars until the mid 1970s culminated in a staggering $135 billion in 1974. London's monopoly on dollar transactions in Europe was such that it held more than 80% control of the market throughout the 1970s.

Quickly, the islands of Guernsey and Jersey specialized in this growing and very profitable market. The number of banks on the islands exploded at the same time as the intensity of financial flows with London. This financialization of the economy was favored by pro-British local elite who were pleased to see the arrival of capital in these small economies that had previously been isolated (Paul Sagar, 2013).

British territories in the Caribbean were not immune to the financial frenzy, also lauded by the local elite amid an almost non-existent financial regulation. The Bank of England did not protest, event to the point of considering that the growing influence of the British banking system would only positively enhance the strength of the pound abroad.

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Conversely, Inland Revenue, responsible for taxation in the UK, is logically concerned about the possibility of tax evasion via the offshore financial centers that have already been noted: the Channel Islands, Bermuda, the Bahamas, Cayman Islands, the Isle of Man, and the Turks and Caicos above all. In 1967, Inland Revenue attacked the Bank of England head on, finding that the presence of tax havens in the area of influence of the British pound was uncalled for and asking the Treasury to act quickly to stop the hemorrhage (Paul Sagar, 2013). However, the Bank of England preferred not to recognize the issue, even going so far as to pretend not to see it, and the parliament did not want these embarrassing questions to be heard outside of the spheres of government, they therefore remained in a position of weakness.

The only acceptable argument in the eyes of the British authorities was the risk of imbalances in the British balance of payments that could greatly worsen if these small territories continued to become more and more aggressive on taxation and local regulation, specifically targeting British and American companies and banks. Capital flight would be likely to destabilize the British economy, thus the Bank of England could only put an end to these practices which could turn against it. However, it was difficult to reverse this trend without alienating all the territories concerned.

It must be remembered that the British Overseas Territories are intimately bound to the British crown. Before being called British Overseas Territories, these territories were called “Dependent Territories” and even “Crown Colonies”, names that were considered too “simplistic and dating from another time”, specifically that of the British Empire and its colonies. Thus, the British Overseas Territories Act of 2002 gave these entities a more acceptable international status, similar to the French Overseas Territories. According to the French Constitutional Council, the new title for the British Overseas Territories

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is primarily intended to "highlight the relationship of these territories with the United Kingdom and is based on a voluntary choice[1]."

The British Overseas Territories often enjoy broad autonomy and their own constitutions, even though they are often linked to an act of the British parliament. The reference in this area that is often used is that of the Turks and Caicos Islands with the West Indies Act passed in the British Parliament in the 1960s.

The Queen of England remains the Head of State of each of the overseas territories still attached to the United Kingdom although their separate legal capacity is guaranteed by the constitution. The overseas territories are directly attached to the Ministry of Foreign and Commonwealth Affairs, except for the Channel Islands and the Isle of Man which are attached to the Ministry of Justice because these territories are not technically dependent on the United Kingdom. These differences in treatment contribute to the complex and ambiguous image of existing legal regimes for British Overseas Territories, despite the "so-called" modernization and harmonization conducted through the British Overseas Territories Act.

Most of these territories have their own constitutions under the leadership of the United Kingdom and are generally highly independent, the sovereign of the United Kingdom nonetheless retaining some political and legal prerogatives. Such is the case of the local government. The Queen can influence a bill or even eliminate a law which appears to be strong contradiction of British jurisprudence, however this prerogative is not commonly used. This was invoked however upon the decriminalization of homosexuality in all British Overseas Territories in 1991. In fact, the intervention of the Queen had little effect, but her aim was primarily symbolic to show her disagreement with local legislation and to influence the jurisprudence of these territories.

[1] http://www.conseil-constitutionnel.fr/conseil-constitutionnel/francais/nouveaux-cahiers-du-conseil/cahier-n-35/les-etats-europeens-et-les-territoires-ultra-marins-places-sous-leur-souverainete.105485.html

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The constitutions of the British Overseas Territories are primarily intended to give them greater political autonomy and not to allow them an immediate access to independence. This perspective, however, cannot be ruled out even though most British overseas territories have not opted for such an option, because of their small size, their significant maritime territories are difficult to secure and increased financial dependence in the 1970s on Britain. The British crown appeared at the time as an important protector in a troubled international economic and security environment in the Caribbean.

The United Kingdom can also easily represent these territories within international bodies, while logistically assisting local governments to administer their territories. These territories cannot however sign treaties or international agreements without the permission of the British crown. Considerable autonomy is granted for drafting agreements concerning them but the British government must always and ultimately provide their blessing so that agreements can be ratified. This was the case during the signing of tax information exchange agreements with OECD member states and the EU for example.

Studies commissioned by the British authorities on the economic situation of the Cayman Islands and Turks and Caicos in 1970 showed that the local population wanted the rapid development of their economies in order to see their living standards meet those in the developed Western economies. Tourism, real estate and the financial sector are thus the desired three pillars for growth that would be considered sustainable.

An additional report, the result of the work of an interdepartmental working group in 1971, confirmed the importance of the development of OFCs in the British Isles under the influence of the internationalization of the pound. The report also made the observation that the islands having opted for development based on an OFC-type model are those that least need direct financial assistance

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from the United Kingdom. That was a positive point, as the deficit in Britain rose to a record 3.86 billion pounds that year.

In 1972, the political situation continued to evolve as the United Kingdom wished to join the European Economic Community (EEC) and therefore worked on harmonizing a number of taxes with those of EEC member countries. Concern focused on the Channel Islands and Gibraltar, both on the doorstep of the EC and regularly attacked by European officials for their fiscal laxity. Britain needed to adopt a stricter attitude to its overseas territories in their opinion. While no major changes were made, they paid lip service to the notion and the UK was allowed to accede to the EEC on May 3, 1973.

After accession to the EEC, the UK authorities again closed their eyes with the blessing of the Bank of England for which the development of OFCs in the British territories could only have advantages: strengthening the influence of the pound internationally and lowering direct subsidies to the British crown overseas territories. The financial argument is important to underline as it is similar to the policy of the United States undertaken subsequently in order to withdraw financially from its overseas territories.

The intense lobbying of British authorities by the City also partly explains how this British offshore system could grow so quickly. These offshore financial relays are in fact vital to the City of London to extend its economic and financial influence to the four corners of the world.

The exponential development of the City of London in the 1970s goes hand in hand with the development of the Euromarket and the explosion of the financial activities of OFCs under British influence. The City owes much of its economic success to its political and legal influence on English institutions and offshore financial centers that have been important in the past and that are steadily increasing. Studying OFCs, international finance and regulation without considering the City and its ramifications is thus impossible.

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The financial district of the City, in the heart of London, quickly became the world's top financial center, on level with New York. The financial industry since the early 1980s has been a key sector of the British economy, largely due to the accession to power of Margaret Thatcher.

The over-representation of the financial sector in the British economy is impressive, approaching the levels of smaller economies with a strong OFC presence (i.e. Switzerland and Luxembourg). Thus in 2015, the financial sector accounted for almost 450% of GDP in Britain, against 315% in France and about 106% in the United States.

This is explained by the fact that the UK financial sector (the majority of the City) is the only one in the world to be represented formally in parliament and to have the right to access diplomatic chancelleries.

The Lord Mayor of the City of London is indeed elected by the residents and businesses of the district of the city. Influential and powerful, he (or she) has a seat in the House of Commons, and a diplomatic title of first place (the same level as that of a minister). Responsible for representing residents and businesses in the City, the mayor is, in fact, the spokesman of the UK financial sector, which is thus granted the right to vote. Of the 39,000 voters in the city, 7,000 are residents, the remaining 32,000 voters correspond to companies that are granted voting rights based on the number of employees.

A public and formal authority, the Corporation of the City of London is the strong arm of British finance with a lobbying budget of over $14 million in 2014 in the UK and the rest of the world (Nick Mathiason, 2012).

Richly endowed, established in parliament and in the key ministries of the British Crown, the corporation has certainly managed to influence reforms. Reforms for the lowering of corporate taxes as a whole, and for subsidiaries of British banks abroad have largely been due to the lobbying efforts of the City to Westminster and the Prime Minister's office. The competitiveness and the

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bottom line of the English financial sector should therefore continue to increase in the coming years.

The all-powerful position of the financial sector does not go entirely unnoticed and without causing some turmoil within the ruling political class. For instance, Sir Vince Cable, the UK Secretary of State for Business, Innovation and Skills in 2015 said: "If Britain is going to grow on a sustainable basis we need smaller banks and more competitive banking focused on supplying credit to British business. Yet there has been strong resistance to bank reform." It will, however, be difficult to put into question the power of the corporation, which Nicolas Shaxson considers as the oldest and the most influential institution worldwide in terms of lobbying in financial regulation (Shaxson, 2012).

An ancient power dating back to the Middle Ages, William the Conqueror was even offered contracts in the 11th century, the City of London therefore financed his wars in return for financial, and above all, political independence. Since then, the City has always benefited from this agreement which allowed England to establish itself as a military and financial power internationally. A state within a state, the City has been protected by the British Crown that has only seen advantages in this financial windfall. The tolerance of the English powers regarding the City have resulted in the ability of the City to extend its influence into the overseas territories.

The relationship between British territories and international offshore finance is stronger than ever today, despite the denial of the British authorities on the matter. The Tax Justice Network tried in early 2016 to warn the Queen of England who reigns over nearly 50% of OFCs in the world by sending a copy of its annual report on the activities of tax havens in the world. This correspondence was ignored, and the revelations in the case of the Panama Papers show how the British elite (including the monarchy and politicians) are thoroughly involved in offshore activities through Family Trusts and myriad sophisticated financial structures. Although the UK is ranked 21st in terms of tax

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and financial transparency in this report, which is relatively good, the report states that "the UK is the most important player in the financial secrecy world."

We can quickly notice that the French and British models of management of their overseas territories are profoundly different. This reflects a vision of the state and the administration at two extremes, which largely influences the political and economic futures of these island territories. British territories, with almost total judicial, political and economic autonomy, have opted (with the blessing of the British crown) to choose largely free-market development strategies, and tourist-oriented offshore finance to enjoy the growing power of the British banks and the City of London.

C) France: Political integration and centralized economic planning

1) A forced march to political integration

The expansion of the French colonies in the nineteenth and twentieth century was not a smooth process done according to a predetermined plan as may have been the case with some of the process of colonization in North America. The creation of what came to be called the French colonial empire was instead done piecemeal through acquisitions of territories during different political regimes in France. Acquisitions that had taken place under the Ancien Regime (the West Indies, Reunion, Saint Pierre and Miquelon, and some trading posts in India and Guyana) are a relatively small proportion of the French overseas territories.

Most of conquests were in fact subsequent to the July Monarchy. Napoleon III considerably enlarged French territory in Algeria and Senegal and began the conquest of Vietnam, Cambodia and New Caledonia in what is called French Polynesia today.

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The impetus that the Third Republic gave to colonial expansion would be considerable, particularly with many politicians encouraging the "civilizing work" of France. A colonial administration was established such as the federations in French West Africa (*Afrique Occidentale Française* or AOF) and French Equatorial Africa (*l'Afrique Équatoriale Française* or AEF) created in 1895 and 1904 respectively.

With nearly 12 million square kilometers and almost 70 million inhabitants, the French colonial empire in 1939 was the second largest in the world after that of England. The comparison between the two colonial empires stops there, however, as they are different both administratively and politically.

France, unlike Britain, ended in the late nineteenth century a forced march to integration of its colonial empire, called colonial assimilation. This doctrinal concept of assimilation is rooted in principles of colonization and colonial legislation and its book of reference is by historian Arthur Girault, published in its first edition in 1894. This French concept, whose origins can be said to be found in the 1789 revolution, was intended to extend the model of the French state and French language and culture beyond the historical boundaries of the nation, in particular via the colonized territories.

As of the mid-nineteenth century, many economists began to worry about the growing role of the state in the public sphere, the economy and the overseas territories—not only in France but also in England and Germany. Otto von Bismarck, the Prussian statesman who was powerful throughout Europe at this time, described the phenomenon of the "Boa constrictor of bureaucracy." Similarly, the economist Herbert Spencer described the action of the state as being "an iron hand represented by bureaucratic despotism" in opposition to the invisible hand of Smith. Frederic Hayek, economist and philosopher, went further, saying that the growing role of the state and its action in the public sphere, was the biggest threat to free enterprise and democracy.

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This notion of a central state that annihilates any economic freedom is however not the original will of those in France advocating centralized administration from Paris. French liberals of the eighteenth century wished indeed to end the power of the Ancien Regime at the local level, slowing them down with the action of a modern state. Centralization and administrative uniformity were therefore advocated by the liberal movement of the late eighteenth century (Legendre, 1968). Yet soon, French liberals in the nineteenth century attempted to limit the scope of the administration at its level of the time and to prevent its uncontrolled growth, and to move to defend the trend which was being imposed throughout Western Europe: capitalism and the free market. The French state would then be constantly attacked by French liberal thinkers of the time at whose head the economist Pierre Paul Leroy-Beaulieu elected to the prestigious *Collège de France*, was the leader, then calling John Stuart Mill a liberal with a socialist bent.

The arrival of the First and the Second World Wars enabled the French State to impose itself on the legislative and economic landscapes both permanently and almost totally. The premonition of Tocqueville was thus realized: "war almost necessarily centralizes in the hands of the State the management of all men and all things." (Legendre, 2015)

Successive governments of France gradually in the first half of the twentieth century, then took on the habit of legislating through regulatory power and abandoning the use of the law. This lowering of the legislative power of Parliament in the face of regulatory power alarmed liberals without however reversing a dynamic that was well under way.

In the colonies, French rationalism imposed itself as a clear choice in the territories controlled by the mainland. Thus the image of France itself was projected onto the overseas territories through laws made in the French capital and imposed upon the colonies. Only French protectorates seemed to escape this general rule. On site, the Governors had broad powers, and were obliged to

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publish texts from France but could also issue decrees instead of working with local democratic representation. This principle dates to the Ancien regime, particularly the Legislation Commission of the French colonies (*Commission de législation des colonies françaises*) created in 1761 in order to bring local legislation more in line with French law. The French Directory (*Directoire)* that led the country in the four last years of the Revolution (1795-1799) did not stray from this method, saying that the colonies "are integral parts of the Republic and will be divided into departments" and imposing financial assimilation of colonial and metropolitan departments with no distinction whatsoever (The Constituants, 1791).

Centralization, therefore a center stone of the structure of the French administration, was again imposed on the colonies. France opposed self-government in the English style or what we might call free colonization.

The French colonial administration primarily aimed at the gradual homogenization of territories administered on the model of the mainland itself, and by imposed rapid cultural and linguistic transformation.

The example of Madagascar in 1909 can be considered as an example of this approach. The following formula is taken from one of the judiciary decrees of the island: "indigenous courts apply the law and local customs in everything that is not contrary to the principles of French civilization "(decree of 9 May 1909, Article 116). The French administration thus tended to undermine the traditional institutions of these regions by imposing the French model: that of a modern central state, with the spread of French standards (codification of the law and standards).

The law maintains equality between citizens, and it is for this reason that laws appear as of the French Revolution as the keystone of an egalitarian state and unifying policy throughout the French territory and its colonies.

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Thus the French administration imposed a progressive codification of local customs that often only existed at the time as oral laws. Soon after, the creation of judicial courts followed (such as indigenous jurisdictions and the authorization of appeals courts). Economically, the administration also set the pace through the strict planning of state investments, as private capital was often lacking in the region. This so-called "oriented capitalism" shocked the English at the time, for whom economic planning is contrary to the liberal spirit that should animate the economy. And yet it was the revolutionary spirit inherited from 1789 that was nevertheless strongly egalitarian that made the French state continue to favor the equality of citizens (in economic terms in both France and in the colonies). The law maintained equality between citizens, and it is for this reason that the law appears as of the French Revolution as the keystone of an egalitarian and unifying foundation throughout the French territory and its colonies.

Egalitarian and unifying because this is one of the founding principles of the French Republic. According to Girault, "assimilation should be thought of as the direct heir of the project of the French Revolution, as the Constitution of the Year III (1795) stated that the settlements were 'an integral part of the Republic.'" This process of assimilation, not demanded but widely institutionalized, passed first, however, via the legitimization of indigenous elites and therefore reinforced the existing system of castes in the colonies and strengthened social inequalities. On this specific point, France would approach the British attitude which also aimed to champion local elites (as in India and Rwanda). However, the aim of France was not to empower local governments through an indigenous elite, but to teach the French language and culture of the French administration to the elite that would take the lead and eventually obtain French nationality.

Granting French citizenship should help ensure the continuous oversight of territories that would then be administered by a local elite having become

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French in part and being attached to its status as a ruling class approved of by the mainland.

This paradox between nationality and citizenship concerned the United Kingdom in addition to France. While the United Kingdom maintained a strict dichotomy between the two concepts, and still does so at present for British Overseas Territories, France decided relatively recently to opt for total assimilation and citizenship for its citizens overseas. In theory, this principle was officially acted by the Legislative National Assembly of the First French Republic in April 1792 (Betts, 1961). Yet, although inhabitants of the French colonies were promptly granted French nationality, people not from the mainland did not obtain full citizenship and therefore can neither vote nor settle on the mainland. This created a two-speed system of French citizenship in opposition to the founding principles of the Legislative National Assembly. It was not until the end of the war in Algeria that the French overseas territories saw their populations gain access to French nationality and citizenship.

The concept of assimilation thus reached its climax with the gradual but complete integration of colonies that were transformed into French departments, as was the case for Guyana, Martinique, Reunion and Guadeloupe, or more recently the Island of Mayotte. Also according to Girault, this assimilation allowed for "the most intimate union between the colonial territory and the mainland territory" (Girault, 1894).

Reunion, Guadeloupe and Martinique were thus fully integrated into the French state, becoming departments and being incorporated into the European Union with the single currency, the euro. The most recalcitrant islands were the subject of a violent political standoff with Paris, like New Caledonia until the 1980s calling the French position "neocolonialism" and fighting all the way up to the international courts. Conversely, Mayotte voted in a referendum in 2009 with a 95% vote in favor of its permanent and total annexation by France, and

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achieved the status of a department and region (DROM) in 2011, formally joining the European Union.

This forced statism and increasingly oriented capitalism in the colonies is achieved at the expense of freedom of enterprise, which quickly became secondary: this was French colonial liberalism, far from the ideals of Leroy-Beaulieu and what is undertaken later in the British overseas territories.

This participation of the state in the economy and colonies is well rooted in two centuries of French history, and the planning imposed under the Fourth and the Fifth Republics is the culmination of this trend with the creation of a Planning Commissioner General (*Commissariat Général au Plan* or CGP) to administer and modernize the French economy from 1946 until 1993 through five-year plans. The idea was to prevent France and its overseas territories from suffering economic stagnation at the end of World War II, the image of what had been experienced in the 1930s.

2) This forced statism and an increasingly oriented capitalism has a decisive impact on the structure of the economy in the long term

Drawing a parallel between the colonial policy of France and the United Kingdom with the divergent economic situations of the former French and British colonies in Africa could be an insightful exercise. The cultural and political differences of these two colonizers could well be the key to understanding the opposing economic directions that former colonies in sub-Saharan Africa and beyond the island territories still under the control of the two European nations.

Paris and its political culture wanting to favor a model of assimilation to the image of French territory for five centuries: state-led and centralized in Paris, aimed at glossing over local economic and cultural differences; whereas the British aimed at recreating political architecture like that of the UK, the model being free association and the reproduction of the Commonwealth and by

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extension a system of liberal federalism. France gave itself the vocation of educating its colonies on the French model, both through education and a pervasive and centralized administration with an economic culture like that of the state-administrator. The rulers had well hidden ambitions to create areas similar to that of France on the scale of an Empire.

This dichotomy in the colonization process of the two European powers is perfectly explained by Patrick Sevaistre, member of the Executive Committee of the French Council of Investors in Africa (*Conseil Français des investisseurs en Afrique* or CIAN). According to him "French colonization was one of colonial officials and missionaries, while British colonization was a settlement of traders and farmers with a strong footprint in the private sector. What results is that the British governed their colonies by retaining local institutions (indirect rule). In its colonial expansion, the British Government never sought to assimilate the subject populations and retained their organizations, their customs and languages in a logic of association which combined to add to the wealth of the empire, the Commonwealth" (Sevaistre, 2014).

Private sector competitiveness, administration reduced to the strict minimum and the use of the English language all appear as key elements of the economic success of former British colonies as evidenced by the ranking of African economies by the World Economic Forum. Thus, according to these ratings, today the most dynamic countries in Africa— those having the highest growth rates on the continent—are the former British colonies with the top three being Mauritius, South Africa, and Botswana.

In the ninth position is Gabon, the only former French colony in the rankings, for which the WEF says that despite a rather high GDP for the region, "on most other measures of competitiveness it ranks just as poorly. It also lacks good health and education services and suffers from high levels of corruption."

The former French colonies appear to be bearing particular negative characteristics that British neo-liberal economists like to think are the heritage

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of the culture of the French welfare state: excessive administration, competitiveness slowed by too much legislation and regulation, a private sector that is too small, increased corruption because of the importance of the weight of the state in the economy in which democracy and transparency of political life remain undeveloped.

This parallel between the former French and British colonies with the current status of overseas territories of the two countries may perhaps appear overly evident, but it remains very relevant indeed. It highlights a cultural aspect of the economy, a certain relation to globalization and two visions of the role of the state that are diametrically opposed, with significant impacts on the financial industry of island territories and the choices of economic policies that have been made in these last thirty years.

D) Conclusion : colonialism & impact on political and economis strategies

The study of Rose and Spiegel shows a significant correlation between the potential of the creation of an OFC and the nature of a legal system (Common Law, Civil Law/French Law) in place in a given territory (Rose, 2006) that goes along with colonial heritage and its effect on economic development. Thus via an analysis of the investment of over 200 countries in the CPIS (Coordinated Portofolio Investment Survey) database of the IMF, cross-referenced with the results of the research of Glick and Rose on the legal systems in the world (Reuven Glick, 2002), it is possible to say that countries with a legal system based on Common Law have a higher probability of becoming an OFC than a country with a legal system based on the French civil law model.

This first correlation therefore strengthens the hypothesis that British legal models (Common Law), coupled with liberal economic thought, would have an impact on the economic development strategies of a given state. And case law in

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the Anglo-Saxon style, and as opposed to civil law (codified law of the Roman or French type) lead directly to the formation of offshore financial centers.

This triptych between Common Law, economic liberal theory and development of OFCs, far from obvious at first, is inherently difficult to refute. The absence of excessive regulation, reduced as it is with Hayek (classical liberal economist and philosopher opposed to statism and any interference in the economic world) to simple general legislation arising from tradition and from what he then defined as Common Law is one basis of economic liberalism.

Also according to Hayek, legislation must be limited to mere general principles of life in society and the first general principle is to not interfere with other economic actors: the limitation of legal rules on the market and economy has the purpose of promoting absolute freedom of enterprise. This unusual and very classically liberal vision of law (liberal law as opposed to the law that is excessively codified) was largely taken in by neo-classical economic theorists in the postwar era and influenced the economic development of many island states that became OFCs through political and state influence.

A second correlation is again advanced in this study that is unrelated to the legal system in place. The geographical proximity between both territories and countries facilitating the flow of capital, the closer that an SIE is to a major economic power (the USA, Europe or Japan), the more it will be able to develop OFC activities. These results thus overlap with those of Harvey Armstrong and his concept of Great Circle Distance discussed in the previous section. A further distinction that the study of Rose and Spiegel (2006) demonstrates is that the GDC is all the more relevant and proven if the language is shared between the SIE and the country that is the political and financial center or mainland.

British overseas territories are perfect targets to become OFCs, due to their proximity to the UK and the USA (as both are financial centers), the sharing of a common language (English) and their use of compatible legal models that are based on that of the British Crown (Common law). The three criteria of Rose and

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Spiegel are met regarding the British Overseas Territories, and explained as meaning that a high proportion of British territories overseas became financial centers favored by the City of London or by New York.

France, conversely, has its overseas territories far away from its coast. Moreover, these overseas territories are politically highly integrated into the French Republic, and are therefore under French law (and not under common law that is more favorable to the formation of OFCs). Both Rose and Spiegel criteria are not met, despite a common language (French).

The French overseas territories in the Caribbean could nevertheless have had closer ties to the US since they are physical close, but the language barrier and legal culture are such that two of the three criteria of Rose and Spiegel are again not met.

The French territories are statistically unlikely to become OFCs according to the criteria advanced in this study. In practice, these conclusions are relevant, as none of the French territories overseas is considered a leading OFC.

OFC-type SIEs are thus often affiliated with two major countries, the USA and the UK. The level of independence they demonstrate politically and legally in their ties to a third nation is paramount in understanding the development of their financial sector. Thus the OFC-type SIEs are statistically more dependent on a tutelary nation (an affiliated island) with v; (0 corresponds to an island with no political independence of any nature whatsoever; 1 corresponds to a fully independent and sovereign island) than non-OFC type SIEs who get a 0.615 result (Rose, 2006).

This study refutes the impact of the political affiliation of SIEs on their ability to become an OFC. The authors state that in fact “the jurisdictional status was an insignificant variable in the present study since roughly a dozen politically affiliated islands were included in both OFC and non-OFC island groupings.” Therefore six non-OFC islands of the group were not politically affiliated, half of

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those of the United States (the Marshall Islands, American Samoa and Guam) and half in France (New Caledonia, French Polynesia, and Saint Pierre and Miquelon). Nonetheless, adjusted for the inclusion of the islands under French guardianship or administration, the correlation seems significant.

If the data are again considered by looking at these six islands, Guam and the Marshall Islands are in many studies considered OFCs in view of the financial activity of these two territories. Regarding the French islands, their political attachment to France is not without importance on the development of an OFC as suggested by the study. Rather this attachment to the French state cannot explain the development of OFC activity on these islands. Indeed not one French island in the world is considered an OFC, even though France has the second world maritime area after the United States, including a large number of islands and overseas territories politically attached to the French mainland.

A strong case can therefore be made on the basis of this study that the United States and the Caribbean, the United Kingdom and its colonial empire all greatly influenced these territories that are still heavily dependent economically, militarily and therefore politically on the United Kingdom and the United States.

A model based on common law, a strong liberal influence combined with a mastery of the English language has allowed the development of tourism and a financial industry favored by the ties to places such as London and New York.

The policy of the United States and the United Kingdom has been to make these territories freer in terms of financial and administrative obligations while maintaining economic and diplomatic guardianship over these islands: the British Crown for the UK (via the Commonwealth), Congress for the United States.

Economic strategies adopted by these territories were largely influenced by the neo-liberal doctrines popular in the English-speaking world including Hong Kong and Singapore, which were seen as role models. The development of

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economies based on offshore finance is legion: today Britain and its affiliated islands account for 50% of OFCs in the world.

France has led a very different colonial policy than that of the United Kingdom. Decolonization was laborious and sometimes even bloody and conflictual, France does not wish to abandon its territories that were its national pride (as seen in the world exhibitions of the colonies in mainland France). France followed economic planning and a tradition of a strong central state after the Second World War, leading to full political integration and the imposition of the French language, its central administration and French civil law.

The French vision of law and the economy is opposed to that of British and American schools of thought. French overseas territories (both independent or those remaining French) have taken an opposite path from that of British and American territories: they have highly regulated economies and the presence of a strong central state with economic planning. This development model far from free-market diktats has not allowed the financial sector to develop and none of these SIEs have chosen a business model suitable for the OFC-type of development.

The contrast between a British colonial model based on a philosophy of local government called Indirect Rule, and a French model based on an assimilation of the local population now appears outdated. It describes two extremes with the French side being a "Jacobinism that is a great leveler, aiming for uniformity at whatever the price" that is often exaggerated by British and American intelligentsia. The difference in treatment in the two models aiming for optimal governance in the colonized territories clearly has an impact on the long-term political, legal and economic structure of the overseas territories of France and the United Kingdom.

This dichotomy between the French and British or American colonial policy marks the beginning of a split in the economic development of the island territories that were colonized or formerly colonized throughout the world.

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British territories, with considerable judicial, political and economic autonomy, have opted (with the informal blessing of British institutions) for a largely neo-liberal economic model, based on tourism and offshore finance to take advantage of the growing power of British banks and the City of London.

This network of offshore financial jurisdictions represents an attractive alternative to any financial deregulation that goes too far in mainland France in the image of what Margaret Thatcher tried in the UK. Liberal tendencies of financial deregulation represent significant risks politically. The issues of banking and financial deregulation are rarely popular with the electorate as seen in the protests by Occupy Wall Street in the US that had such a tremendous impact among US voters in the face of the full force of the financial players on Wall Street. This movement was part of the reason that the debate on income inequality and the perverse effects of excessive neo-liberalism again became the questions du jour.

Internationally, a state can hardly claim to want to deregulate without risking offending its economic partners, like the United States during the Nixon era or the European states that severely judged economic reforms or the UK whose recent activism in tax and financial matters has upset its European partners and Brussels.

The alternative that has been found is to facilitate trade with offshore territories rather than deregulating excessively on the mainland. This is what the US has done with the promotion of the system of DISC via OFCs bordering the US mainland, and Britain by allowing the Bank of England to close its eyes to the activities of the City and by extension the pound as it spreads throughout the Crown's overseas territories. The UK therefore decides, without admitting it, to create a network of OFCs that are internal to the British Empire so they serve as relay points for the City of London around the globe. Anointed by London, these small British island territories thus began a restructuring of their economies to open up to the financial sector then in full development in England. This salutary

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conversion is facilitated by the language skills of these territories, weak regulation of financial activities, and correlated with an explosion of global financial flows through the internationalization of trade and the rise of telecommunications and information technologies.

As this chapter shows, the origin of tax havens as we know them today dates from the end of the Second World War with the creation of an international financial system based on the ubiquity of the dollar and to a lesser extent the British pound. The influence of Anglo-Saxon economic culture of the overseas British and US territories largely explains the development of OFCs instead of diversified economies and more dependent on the public sector or mainland subsidies (like the French overseas territories).

This omnipresence of Anglo-Saxon culture at the origins of OFCs and their mode of operation, also allows us to ask ourselves about the choice of Soft Law as the mode of regulation that is also purely British. The relevance of this choice can be bewildering upon the reading of the previous chapter on the model of Soft Law. Island economies, with deeply liberal and autonomous culture, can only remain unmoved in the face of legislation as "soft" as that advocated by international organizations for thirty years under the guidance of an Anglo-American current led by the United States and the United Kingdom.

This choice for "soft law" touted by the English-speaking world seems to go against the ever increasing need to regulate, or at least to make international financial flows more transparent. France and continental Europe have long remained isolated and are the minority in negotiations and have not been allowed to offer an effective alternative to counter the rise of soft law on the issue.

Nevertheless, the repeated scandals since the 2000s seem to mark a major turning point in international negotiations, with a growing number of summits and multilateral meetings on the issue of regulation of offshore financial centers. The Enron scandal and UBS in the US, Parmalat in Italy, Clearstream and

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Cahuzac in France, and Offshore Lex, LuxLeak and the recent case of Panama Papers in Europe, have regularly inflamed Western public opinion and forced politicians to react ever more violently, promising sanctions and strengthened regulations. We are still waiting for the results however.

The next chapter will attempt to explain the establishment of a more repetitive pattern still today. Financial scandals are multiplying, with an impact through the media and increasingly important political outcomes. The chain reactions and the media circus aiming to provide sufficient political impetus for further regulation. Financial scandals and international political summits go one after another with the aim ultimately to regulate more and better.

The economic impact seems limited however, the use of tax havens is still increasing, regulations seem to be quickly bypassed by the continued evolutions of the financial system that is rapidly changing, such as with these politico-financial scandals that never end and regulations that keep expanding.

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IV) A political dichotomy between Anglo-Saxons and Europe that undermines the efficiency of the implementation of G20 and OECD recommendations

Over the last decade, Europe and the international community have developed a common desire to put an end to the abuses of tax evasion and the use of tax havens. This apparent activism, in which the United States and the United Kingdom have largely participated, hides a growing gap between a pro-active European Union and the United States whose double speak seems to give star billing to national interests in a deleterious political climate. The United Kingdom, for its part, seems today to be departing gradually from the unified discourse advocated by Brussels, in view of an inevitable Brexit and the maintenance of a leading financial sector on its territory.

The previous chapter has demonstrated a strong correlation between the US and the UK, countries of Anglo-Saxon heritage, and the economic activity and financial flows of OFCs around the world. This historical link, this colonial past for some, partly explains the path taken by the small island OFCs but also increasingly explains the strategy currently put in place by the United States and the United Kingdom. Indeed, since the end of the Second World War, and particularly since the early 2000s, there has been an economic and ideological gap between the two great Anglo-Saxon nations, the United States and the United Kingdom, Continental Europe. This ideological and political shift has shaped economic strategies, trade agreements and even international policy.

This liberal shift has deeply affected the American and British positions, further weakening their willingness to apply at the national level an international legislative framework for combating tax evasion and improving fiscal and financial transparency in whose development they had actively participated.

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Against a backdrop of international tensions, budgetary rigor, and uncertainties linked to lower levels of global growth, the United States and the United Kingdom are setting themselves apart more and more from the hard line of France and Germany.

While the OECD is attempting to build an ambitious normative framework in which Soft Law plays a major role, the question of its effectiveness arises when a significant proportion of stakeholders delay its application at the national level, which is currently the case in the United States, where Congress is holding back the entry into force of the new OECD recommendations.

For a long time, the United States has slowed down any overly binding international legislative framework for the exchange of tax information and the transparency of international financial flows under the Bush Republican presidency, with the exception of questions relating to the financing of terrorism. Following the attacks of September 11, 2001, the US administration pushed for the adoption of Title III of the Patriot Act in 2001 and the adoption of the 2002 Suppression of the Financing of Terrorism Convention Implementation Act (Freifeld, 2009).

The important position of the financial industry in Britain (including the City of London) and the dominant role of OFCs in the world in the case of the United States, which has been used to improve the cost competitiveness of companies on international markets, have led these two countries to rely on many OFC that have thereby gradually become symbiotic with the US and British economy. This has weakened any willingness on the part of Washington or London to agree on any legal transpositions necessary for the implementation of the latest OECD international recommendations.

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The position of the United Kingdom in terms of its own OFCs and the debates between the Bank of England and the British Treasury set out in the previous chapter shows how London has long had a double language on the question of its links with offshore finance.

The United States, which was discussed at length in the chapter dealing with the WTO, has used and abused OFCs adjoining their territory to facilitate the exports of large US companies.

This massive use of OFCs, beyond the historical ties between these territories, was facilitated by a neoliberal reform and a pro-business political class at the end of the 1970s. The beginning of the 2000s marked the beginning of an awareness about this issue, but any change was halted in its momentum by a political class whose inaction is due to the economic stakes that offshore finance represents for the Anglo-Saxon economies.

In the first part of this chapter, the impact of neo-liberal fiscal policies in the United States and the United Kingdom will be considered. These policies were established to make it so that methods of corporate taxation could allow major companies to become more competitive without the need to relocate their activities and headquarters abroad. This was a common objective in the two countries, the methods of which were, however, almost opposite: a massive drop in tax rates in the United Kingdom with a political will to limit tax breaks and an the other hand an incredible stability of tax rates in the United States (among the highest in the world) offset by numerous tax breaks that have been complex but profitable for the companies present on the international markets.

This state of affairs today creates considerable distortions at the global level. These aggressive tax strategies run counter to the unity shown against increased tax competition, or even tax dumping, among OECD members.

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International political will is thus blurred by neoliberal fiscal strategies, where national interests outweigh the general interest.

In the second part of the chapter, it will be seen that these same strategies, apart from affecting the fight against interstate fiscal dumping, affect the United States and the United Kingdom in their propensity to combat tax evasion (not only nationally but internationally as well).

Because this is the crucial issue that has been facing the international community since the early 2000s. OECD member countries are actively fighting against tax evasion at the national level. At the international level, while the OECD has finally set up an effective model of information exchange, the United States seems to try to continue playing a waiting game.

The United States quickly became the top OFC on the planet through a finely conducted strategy between FATCA enforcement, a diversity of fiscal and regulatory landscapes within the various US states coupled with internal political conflicts in Congress delaying implementation of the recommendations of the OECD. This policy, called the prisoner dilemma, is a case study of game theory in economics and international politics and has allowed the United States to use the system without having to be constrained by it in the short term, leaving other countries to cooperate while the United States pretends to do so.

For its part, the United Kingdom is faced with an upsurge in European tax dumping and the country is unable to replicate the American FATCA model which is not adaptable to the British regulatory landscape. The potential exit of the European Union from the United Kingdom and its single market has also fueled doubts about the willingness to implement the latest measures of banking and financial regulation announced by Brussels. Technical measures that the

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United Kingdom could avoid, risk taking the British economy further away from the trajectory set by Brussels and the OECD.

This cross-cutting analysis will lead to a better understanding of the historical positioning for the United Kingdom and more recently for the United States internationally in terms of the problems of tax evasion and transparency in a context of enhanced global competition to attract international capital.

On the other hand, this positioning, which is increasingly out of step with the willingness of international bodies to put an end to the opacity and transfer pricing practices of multinationals and OFCs, appears to be a question of the use of Soft Law in an Anglo-Saxon world where national interests and unilateralism prevail over international cooperation.

A) The United States and the United Kingdom: Different tax strategies for one common goal: making companies as competitive as possible in a context of increased globalization

The latent war on taxation aiming to make economies competitive and more attractive is not new. Reagan in the United States and Margaret Thatcher in the United Kingdom both used this tactic, which arose with the rising neoliberal trend of the 1980s.

Although methods differ, Europe and the international community reject a strategy that more and more resembles tax dumping.

The case of the dispute over the tax treatment of exports by American companies and the implementation of Reagan's economic policies in the United States based on the OFCs today still underline the break between the world's leading economy and continental Europe's approach to taxes. The decline in

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taxation on companies has arisen at the expense of a social model, which has been limited to a bare minimum and financed by the social contributions that are seeing their share increase significantly in the US federal budget.

Beyond the Channel, this gap in corporate taxation may widen even further following the UK's potential exit from the European Union, reviving the debate on corporate tax cuts with a dramatic drop in the corporate tax rate from 20% in 2016 to less than 15% in 2020, close to the level of Ireland and its 12.5%.

A fiscal dichotomy between a divided Europe and an Anglo-Saxon world that contrasts with a desire for fiscal transparency at the global level. This double play where Soft Law is advocated as the ideal tool for building a global architecture aimed at ending outdated practices is puzzling. Would Soft Law then be a tool for demagogic purposes going forward, since its main defenders are none other than those who do not apply it? This is the question that this chapter will attempt to answer.

1) A US tax model to make US firms more competitive in international markets.

The fiscal and economic impacts of the various legal arrangements put in place by the United States to consolidate US manufacturing production for export are major. Thus, American production, which is largely subsidized due to it being less taxed, grew at a high rate until 2006. Beyond the productivity gains, American multinationals wishing not to repatriate the profits of their foreign subsidiaries maintain large amounts of capital abroad.

Following the abolition of the ETI tax system, one could have imagined the introduction of a new tax regime in favor of American exporting companies. However, this was not the case and no new, comparable tax regime was

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introduced. The end of the ETI regime did not result in a loss of competitiveness for US exporting companies producing on American soil, as these derogations were, as specified in the previous chapter, considered by the WTO to be export subsidies. In the years following the end of the plan, the net after-tax profits of the companies benefiting from the ETI regime benefitted from excellent economic conditions allowing for continuous improvement in the overall cost competitiveness of the US (cost of employment, energy, etc.). This largely explains why the end of the ETI regime has not been catastrophic for US exports, offset by positive external factors.

Of course, profits made abroad by foreign subsidiaries that are dependent on a parent company in the United States are still partially exempt from tax in the United States, allowing the end of the ETI regime to not impact major business groups. This US tax regime for deferring foreign profits has led to an explosion of the cash reserves of American companies abroad over the last ten years.

In 2015, the majority of the S&P 500 companies' cash reserves were located abroad, mainly in OFCs. New technology companies (Apple, Microsoft, Google, HP) are the first to use these facilities offered by the US administration for non-repatriation non-taxation of their profits made abroad. Companies with more traditional activities such as General Electric, Boeing or Coca-Cola use the same methods of tax optimization to such an extent that the share of cash reserves held abroad accounts for nearly 90% of the total cash available to Apple, more than $157 billion were kept overseas in 2015 (Richter, 2015). For General Electric, this portion is only 69% but still represents more than 62 billion dollars.

These very large sums increased from $500 billion to $2 trillion dollars between 2005 and 2015 (Richter, 2015) showing the side effects of the US tax model. Although they weaken US tax revenues and decrease overall tax collection for

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major corporations, this cash position represents a considerable asset for US multinationals, offering them significant opportunities in terms of self-financing abroad.

The M & A market is thus largely supported by these cash reserves. Thus the purchase of the energy branch of the French industrial conglomerate Alstom, bought in 2015 for nearly 12 billion euros was facilitated by the large reserves of cash that General Electric held offshore.

An unavowed strategy of the US administration, this tax system allows the United States to remain very present on the market of mergers and acquisitions, particularly in industry and new technologies.

This could largely explain the reluctance of the US authorities under Bush's presidency to accept overly restrictive international regulation of offshore financial centers. As the border between tax optimization and tax evasion is tenuous, there is a need to better understand how the United States has built the most complex tax system in developed countries, while at the same time having an effective tax rate among the lowest in the world.

a) A complex US tax system with many loopholes that are a pleasure for multinationals

During the 20th century, there were three periods of significant tax cuts in the United States before those of the G. W. Bush administration: Harding Coolidge's tax cuts in the mid-1920s, Kennedy's tax cuts at the beginning of 1960s and the Reagan tax-cut of the 1980s.

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To better understand the contexts of these repeated tax cuts, it is best to look back to the level of WWII. Indeed, at this time the US federal government was obliged to raise taxes to its highest level in its history because of the costs of the war.

The United States was not alone in this regard, and did the same as all Western countries engaged in the conflict. Between 1941 and the end of the conflict in 1945, the level of imposition on the various income tax brackets rose to 23% for the lowest tax bracket, and up to 94% for the highest one (incomes over one million dollars). As a result, the share of the GDP of the US Federal Government went from 7.6% in 1941 to 20.4% in 1945 (Budget, 2013).

Historically, the same increase in taxes occurred in the First World War. The federal income tax had been introduced just before the war with a marginal rate of 7 per cent, which is relatively low. However, due to the conflict in Europe and the increase in federal expenditures, this rate increased gradually to 77 per cent in 1918. Through a series of measures, the tax cuts during Coolidge's presidency then reduced the highest marginal rate back to 25 per cent in 1925. In the previous presidential mandate, real tax revenues had fallen, then over the next four years, tax revenues remained volatile but increased on average in real terms. The economy picked up quickly and unemployment fell.

This was enough for American economists to consider this decline in taxation as the cause of the economic recovery and to cite it later as a case study. This analysis would then be widely repeated in the context of the economic strategies of Reagan and Thatcher.

In the 1930s and up to the Second World War, the upper marginal rate of income tax in the United States exploded and reached an unprecedented level of 94% in 1944. The rate stabilized at around 90% at the end of the Kennedy Presidency.

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When the latter came into power in 1961, the marginal federal income tax rates (tax brackets) varied from 20% to 91%.

Quickly the Kennedy administration adopted a tax cut unprecedented since that of Coolidge. The highest marginal rate was lowered to 70% and the lowest marginal rate was dropped to 14%.

Periods of very high growth rates in the Kennedy era were in fact associated with tax cuts proportionally larger than those seen in the Reagan years of the 1980s. This is something that is now forgotten. Four years prior to 1965, federal tax revenues adjusted for inflation increased on average by 2% per year, while in the next four years, government revenues increased by an average of 8% per year. In other words, tax revenues not only increased as a result of the tax cut, they increased at a faster pace than previously, again attesting to the effectiveness of tax cuts to boost the economy and ultimately tax revenues.

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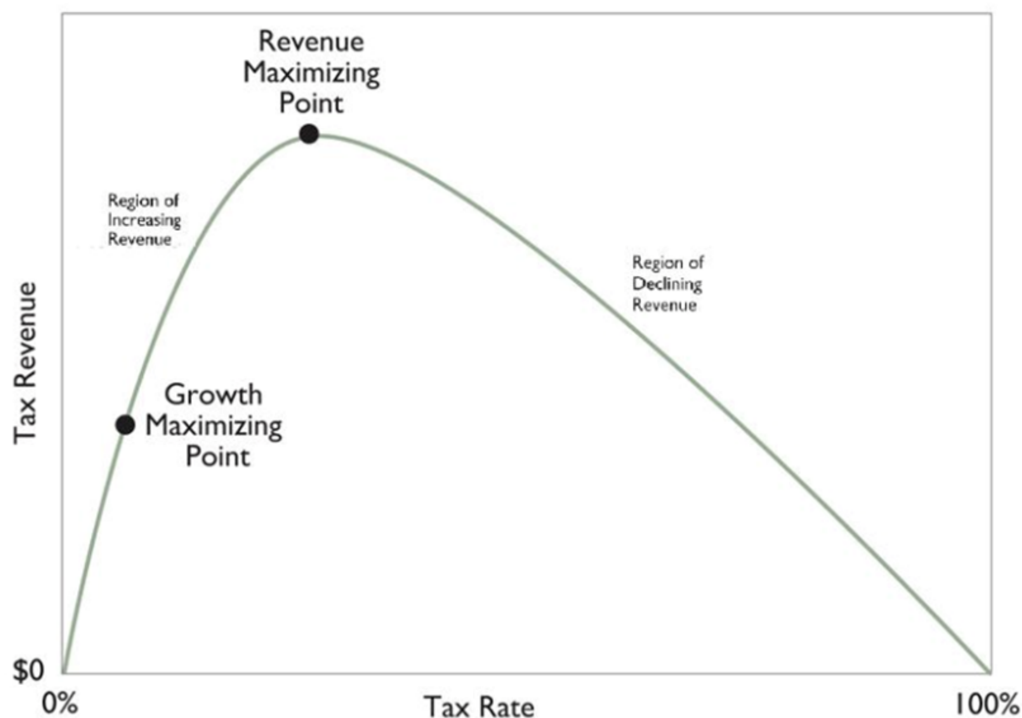

Fig. 4.1. Laffer Curve

The economic idea is that there is a link between tax rates (whether for income tax or corporation tax) and the amount of tax revenue. Lower tax rates have two revenue impacts: a short-term effect and a long-term effect.

In the short term: Lower tax rates result in lower budget revenues in the same proportion, and higher tax rates result in greater budget revenues.

In the long-term: The tax rate has an effect on investment and hence on economic growth and labor supply, increasing the expected tax revenues in the short and medium term.

Short-term effects and long-term effects are always opposite. This is partly one of the neo-liberal foundations that ensure that returns to a tax system are not

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always increasing (in proportion to the higher taxes). Incidentally, the marginal tax rate on capital income rose to a staggering 98% in the United Kingdom until the Conservative government of Thatcher in the midst of a crisis of economic growth brought it back to a level comparable to those of OECD member countries.

This finding that a lower rate on an expanded tax base led to a more transparent and efficient tax system, with rising budget revenues, gave Reagan a major argument for the third largest tax cut in the modern history of the United States, both in terms of corporate tax and income tax.

Reagan's measures, undertaken at the same period as those of Thatcher, were based on a very neo-classical approach to deregulating the U.S. economy. The term "Reaganomics" refers to Reagan economic reforms, based on four major ideas: the reduction of government spending, the deregulation of the financial sector, and the control of monetary tools such as the Fed.

In his first inaugural address in January 1981, Ronald Reagan said: "Government does not solve problems, it subsidizes them[1]." Reagan used this way of speaking of "subsidies" in the negative to express his low opinion of government intervention and regulation. He was also not a fan of the welfare state.

Reagan's tax reforms in a law called the Economic Recovery Tax Act of 1981 was enacted in 1981 in order to improve the competitiveness of American-based companies. In 1986, a second major reform was enacted, cutting tax among the American middle and upper class taxpayers[2]. In 1981, the top percentile of Americans paid on average 77% of their income to the state; in 1986 this amount fell to 28%.

[1] Ronald Reagan*, First Inaugural Address.* January 20, 1981

[2] Dennis S. Ippolito. *Why Budgets Matter: Budget Policy and American Politics*. 2004

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Against the expectations, this aggressive fiscal policy did not lead to an increase in budgetary revenues. Conversely, due to these policies, the United States public debt that had been decreasing since the Second World War began to increase for the first time in 25 years. However, many neo-liberal economists applauded Reagan's politics as the American economic situation improved, and unemployment decreased over Reagan's two terms.

According to the White House Budgets archives, the proportion of individual income tax revenues in the total US government revenues has been stable for the past sixty years at around 51 per cent, while social security receipts went from 10 per cent in 1953 up to 38.4 per cent in 2013. Nothing unusual here, as social security spending is rising due to America's aging population.

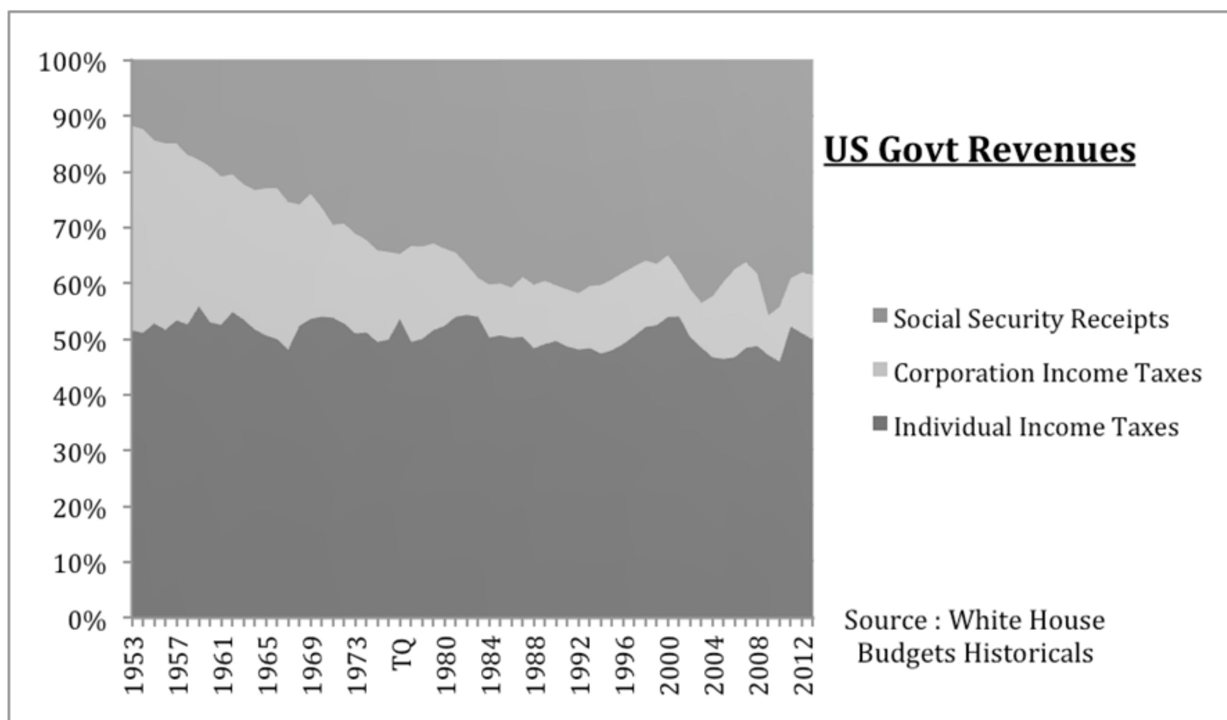

Fig. 4.2. United States Government Revenues since 1953

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However, how can such a drop in corporate income tax revenues be explained? Corporate income tax rates had been going down since the 1960s, but this does not explain the falling share of US tax revenues in the total US Federal government revenues. Indeed, individual income tax rates also went down as of the 1960s under Carter and Nixon, but their share remained the same in terms of government revenues. A rising population combined with higher individual revenues also compensated for the fall in income tax rates over the previous half century. The same equation should have led to stable corporate tax revenues.

Two explanations can be found. First, due to a complex fiscal framework in the United States companies reinforced their fiscal and legal teams. As a result, American companies began to "play" with the fiscal system, using more and more loss carryforward accounting procedures allowing companies to decrease revenues on tax returns seven years after a loss occurred, combined with bonus depreciation provisions, allowing companies to depreciate equipment faster and receive higher tax deductions.

A second hypothesis that could explain falling revenue percentages is transfer pricing and new geographic profit allocations. Globalization and offshore financial centers allowed for foreign profits to rise faster than domestic ones as American firms expanded their activities overseas. Conveniently, foreign profits are usually less taxed than in the US.

b) A federal taxation with regional accents

We must look at US taxation from several angles. First there is the federal tax system, which is uniform and on which each natural or legal person depends, and to this one must add an additional tax system specific to each of the 50 states that make up the United States.

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This structure results in legislation and a tax burden specific to each state. Thus, while some states have very low tax rates (the tax on natural or legal persons remains non-existent to date in seven states - Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming), others have much greater tax burdens (New York State: up to 7.1% for corporate income tax or 8.84% in California).

These large regional differences allow US companies and the wealthiest households to optimize their taxation by privileging certain states for the establishment of their assets or subsidiaries.

Corporate income tax - The concept of global taxation.

Companies headquartered in the United States are liable for federal income tax on all US and foreign profits (i.e., worldwide taxation of earnings). The results of foreign branches are therefore included in taxable income in the United States. Foreign companies (not incorporated in the United States) are subject to taxation only on account of their US source profits.

- The determination of tax payable by a resident company

The "normal and necessary" expenses incurred during the financial year (including taxes levied at state level) are deductible from the results of the financial year.

Companies resident in the United States that receive dividends from US sources may exclude between 70% and 100% of these dividends from their taxable income, depending on the level of participation. Foreign-source profits do not generally benefit from this provision.

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At the federal level, the progressive corporate tax rate ranges from 15% to 39%:

These rates are thus in 2016

15% up to $50,000

25% on $50,000 to $75,000

34% from $75,000 to $10 million

35% over $10 million.

The rate is increased from 34 to 39% from $100,000 to $335,000 and from 35 to 38% from $ 15,000,000 to $18,333,333

These increases are intended to reduce the benefit of reduced rates by 15% and 25% from 34% on the one hand and to reduce the rate advantage by 34% compared to the 35% rate.

To avoid double taxation, income taxes paid abroad are, under certain conditions, deductible from US federal taxes. However, this tax credit is limited to: US corporate tax x (Foreign tax income / corporate income tax) in order to limit abuses.

- <u>The determination of tax payable by a non-resident corporation</u>

The profits of a foreign company operating in the United States are subject to tax according to the rules applicable to residents (subject to tax treaties with the partner country). In the absence of business, US profits (generally investment income) received by the foreign company are subject to tax under US domestic law (tax withholding of 30%) or otherwise if subject to a specific tax convention.

- <u>Many loopholes weaken the US tax system</u>

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Taxpayers (natural or legal persons) benefiting from preferential schemes for the determination of income or tax profits are liable for a minimum tax. This minimum tax (Alternative Minimum Tax) is calculated at the maximum rate of 28 per cent for individuals and 20 per cent for corporations. When this amount exceeds that of an ordinary tax, the Alternative Minimum Tax replaces the latter in order to avoid any substitution of the tax. This is the main "safeguard" of the US tax system.

In theory, US taxation on corporations is supposed to be perfectly calibrated to prevent tax avoidance and tax optimization. Yet because of a tax code that includes several thousand pages, US taxation is so said to be so complex and with so many regimes, that it is now possible for large groups to escape taxation thanks to their internal departments responsible for taxation or to the Big Four (the largest audit groups in the United States).

SMEs, on the other hand, suffer from a lack of knowledge of an overly complex system for smaller organizations and thus pay the bulk of corporate tax in the United States.

Many loopholes weaken and thus undermine the American tax system, while also weakening its credibility internationally.

As taxation of overseas profits is not onerous, American multinationals can thus maximize their taxable net profits in the United States through three major tax measures that allow them to drastically reduce their global taxation.

The main measure used is the "deferral of income from controlled foreign corporations", whose annual cost is estimated at about $34 billion for federal revenues in 2015. The second most common measure is the "deduction for domestic manufacturing" that allows these groups to deduct from their profits a

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large part of the production located on American soil (and exported). This deduction arises from the various tax relief programs that had been the subject of a drawn out fight between the European Union and United States within the WTO. This measure is mainly aimed at limiting the risk of relocation of US manufacturing activities (including, for example, film production). These tax benefits have amounted to more than $58 billion over the past five years.

Financial activities o the other hand benefit from a specific regime through the "deferred taxes for financial firms on certain income earned overseas", enabling them to also cumulate almost $30 billion in tax benefits over the last thirty years. This strengthens the competitiveness of the country's major financial institutions.

The "deferral of income from controlled foreign corporations", already quickly addressed in the chapter on the WTO, remains among the biggest loopholes in the current American tax structure. Thus, since 1913 and the Revenue Act, the United States has established global taxation of US business income. In order to avoid double taxation, a deferral or tax credit was introduced for all profits not repatriated at the level of the parent companies located in the United States.

This measure allows American multinationals to make substantial profits abroad and to store them in low-tax countries without being repatriated to the United States. Major US companies thus retain a large share of their profits abroad, favoring the OFCs with taxes that are lower than the US (which is often the case). The delta between the tax rate of OFCs and the United States can thus be postponed almost indefinitely in time. According to various studies of the American treasury and merchant banks in the United States, the sums stored abroad could be between 1.3 and 2 trillion dollars, or a total shortfall of between 455 and 700 billion dollars in unpaid taxes that would go to the US federal government (the equivalent of the annual budget of the functioning of the French

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state for one year or between 8 and 20 per cent of the annual US federal expenditures of 3.8 trillion in 2015).

The measure which had the objective at the time of its creation of avoiding double taxation of foreign income, should not lead to the lack of repatriation of these profits to the United States over the long term.

One of the major problems in recent years has indeed been the fall in the repatriation rate of these offshore profits. Before the year 2000, this rate was close to 40 per cent of the income realized each year abroad. Today, the repatriation rate has fallen to less than 20 per cent according to a study conducted by the American Congress in 2012 by Jane Gravelle (Gravelle, 2012). The main explanation for this fall seems to be the Bush administration's use of a temporary tax exemption in 2004 called a "repatriation holiday", with repatriated dividends being taxed at an average rate of 5.25%. The primary objective in 2004 was to renew investment efforts within the United States.

The downside of this policy was a fall of the repatriation of these incomes in the years that followed this "repatriation holiday", with American companies hoping for the repetition of a similar measure in the ensuing years.

In such a context, the cash inventories of American multinationals exploded abroad as they remained overseas, undermining the very logic of global taxation of profits and the application of the deferral of income from controlled foreign corporations.

Yet the questioning of these tax measures is not on the agenda of current Democrats, as the weight of lobbies is strong and the recovery of growth is fragile overseas in a context of global instability.

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Beyond the question of profits made abroad and their tax treatment, the question of the heterogeneity of the American tax model raises the question of its relevance in a globalized context. This applies in particular to the diversity of the tax statutes and legal frameworks offered by the various states that make up the United States.

For instance, if one takes the particular example of the State of Delaware, the advantages offered by it are numerous in comparison with other American states: low taxes, case law very favorable to companies and a guarantee that their secrets (administration and banking) will be preserved.

The level of taxation alone (although attractive) is not the decisive factor for the establishment of a company in Delaware. Indeed, beyond taxation, Delaware is considered a regulatory and jurisprudential paradise perfectly suited to the interests of shareholders.

The state courts are thus considered to be the most favorable of the country - from the point of view of the companies and the shareholders, and their jurisprudence almost always favors a shareholder who is concerned to protect his interests.

The Delaware courts have an influence far beyond the borders of their state, a company brought before a California court can transfer the case to Delaware, once it has a legal address there.

The State of Delaware, like that of Nevada, also offers a major advantage for the companies that settle there: it guarantees a culture of secrecy that is almost infallible. It is possible to create a company while remaining totally anonymous. The names of directors and shareholders are not required to appear in any document or public record at the regional or federal level. Only the name of the

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company, agent and the accountant or lawyer representing it is recorded. In the event of an investigation by a tax authority (whether national or foreign), the identification of the shareholders of the company is impossible.

Beyond listed companies, Delaware also has hundreds of limited liability companies that are often opaque. The anonymity and culture of secrecy of the beneficiaries is so entrenched that it is now even easier and has become preferred to create a shell company in Delaware than in many OFCs.

A study conducted by Findley, Nielson and Sharman on shell companies around the world reveals an alarming fact. Among the countries tested across the globe, the United States (through Delaware and Nevada) would be second in the world for the ease of establishment and the durability of the legal security of a shell company used for money laundering purposes (Findley, Nielson and Sharman, 2014).

This situation has led to a worrying increase in the number of registrations of shell companies established in its territory, whose only aim is to launder profits from drug trafficking, corruption and arms trade.

With their American addresses, these money laundering companies (often with links to Mexico) can open a bank account in any bank in the country. California is also known for its laxity in the collection of banking data.

Under the FACT law further discussed later, this anonymity will prove to be an undeniable asset for Delaware internationally, allowing the state to offer a banking secrecy almost superior to that of Switzerland.

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This situation today places the United States among the least transparent jurisdictions of the OECD countries, highlighting a paradox difficult to defend for the American administration against its European counterparts.

2) A British tax system with an offensive strategy: to be the economy of Western Europe that is fiscally the most competitive.

The United Kingdom, like the United States, has undergone a profound change in its taxation since the neo-liberals came to power. The new Conservative party's 1979 victory over the Labor Party marked the end of a European welfare state based on the post-war model.

On the side of individuals, tax rates were revised downwards, especially for the wealthy classes. The upper marginal rate of income tax fell from 83% to 40% in 1988, to slightly increase again thereafter, with the maximum rate in 2016 reaching 45%, following a similar trend in the marginal rate curve for higher incomes in the US. At the same time, the minimum marginal rate of income tax decreased from 33% in 1979 to 20% in 1994.

On the corporate side, Margaret Thatcher's Chancellor of the Exchequer, Geoffrey Howe, decided to lower the maximum corporate tax rate in order to make them more competitive.
This rate thus fell from 52 per cent in 1979 for large firms to 35 per cent in 1983, falling further to 30 per cent in 1988 under Nigel Lawson. Small businesses have benefited from a reduced tax rate since 1973, following the introduction of the new regulatory framework the Advance Corporation Tax (ACT). This rate fell from 42 per cent in 1979 to 40 per cent, then decreased further to 38 per cent in 1982, then to 25 per cent in 1983 and 19 per cent in 1988.

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The decline in the tax rate continued under the Labor government of Tony Blair, when the Chancellor of the Exchequer of the time (Gordon Brown) decreased and then abolished taxes on profits of less than £10,000 between 1999 and 2000. At the same time, income on profits between £10,000 and £50,000 were brought down to the lower rate of 19 per cent regardless of the size of the firm (this move brought the country close to a standardization of corporate taxes in the UK).

The terminology evolved in 2010 when HM Revenue and Customs decided to change the name "Small Companies' Rate" to "Small Profits Rate (SPR)". These rates came closer over the years to the tax on large companies then called the "Main Rate" (MR).

The SPR thus rose from 19% in 2006 to 20% in 2007 and 21% in 2008 and declined again to 20% in 2011, with the government justifying the increase in the low level of corporate tax to curb tax fraud on behalf of liberal and independent professions in the United Kingdom, which had taken advantage of the SPR rather than paying income tax. This increase put British small businesses at a disadvantage, while the tax on multinationals and large enterprises continued to decline.

Thus, the MR increased from 30% to 28% in 2008, to 26% in 2011, 24% in 2012, 23% in 2013 and 21% in 2014 and 20% in 2015, its historical low bringing it to the same level as the SPR.

At the same time, the taxation on VAT at 8% in 1979, rose to 15% that same year, and then went up to 17.5% in 1991.

In terms of social contributions, the increase is similar to that observed in the United States but also throughout the OECD member states. But where these contributions were added to pre-existing taxation in order to keep afloat the

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financing of the social model of Western countries, Great Britain chose the principle of communicating vessels. Thus, the increase in social security contributions compensates for the fall in taxation on the highest assets and companies. A transfer of taxation is set up from companies to employees.

The evolution of compulsory social contributions relative to the United Kingdom's GDP clearly shows that this tax transfer strategy has had no notable impact on the overall tax level in the United Kingdom. Thus the rate fell from 44 per cent in 1979 to 40 per cent in 1990.

The typology of liberal economies confronted with a growing globalization of their economies and trade has long served as a pretext for this change in tax structure.

Indeed, the British economy is characterized by a stop-go model, followed by Boom-Bust, which combines a cycle of rapid economic growth with a moderate recession cycle during a slowdown in the global economy. In order not to affect the budgetary stability of the state, it was decided more or less unofficially to tax the stable masses (wages, and domestic consumption) to the detriment of the fluctuating masses (corporate profits, dividends, high wages).

It should be noted, however, that in the current course of corporate tax rate decline, where the United Kingdom seems to be leading the race with Ireland, this drop in the nominal rate is not correlated with a corresponding decline of the revenue to be collected.

Thus the rapid decline in the corporate tax rate in Great Britain and Ireland has reduced the yield of this tax at a relatively low rate, and the comparison with France raises another paradox. While France has not lowered its corporate rate

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over the past 15 years, its yield has also declined, but at an even more rapid rate than in England and Ireland.

The data aggregated by the OECD clearly show a downward trend in returns to the corporate tax rate in Western Europe, while on average in the OECD countries the effective corporate tax rate does not appear to be declining.

Below is a table listing all the OECD statistics for France, the United Kingdom and the United States from 1999 to 2014 concerning the relationship between the level of corporate income tax and the GDP of each country:

Fig. 4.3. OECD - Corporate Income Tax and GDP Ratio: France, UK and USA

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Thus, France, despite having a higher nominal rate than the United Kingdom over the past 15 years, has seen the return on its corporate tax (as a percentage of GDP) decline over the past decade, even though its corporate rate has remained stable.

The United Kingdom has seen the same decline in the return of its corporate income tax, but the nominal rate has been falling freely for a decade.

Nonetheless, in 2014, the yield of the corporate tax fell to 2% of GDP in France, while the United Kingdom has seen a return of 2.4% for a much lower nominal rate (20%) than that of France (33%).

Below is a table listing OECD statistics for France, the United Kingdom and the United States from 1965 to 2014 showing the relationship between the level of corporate income tax and the overall fiscal revenues of each country.

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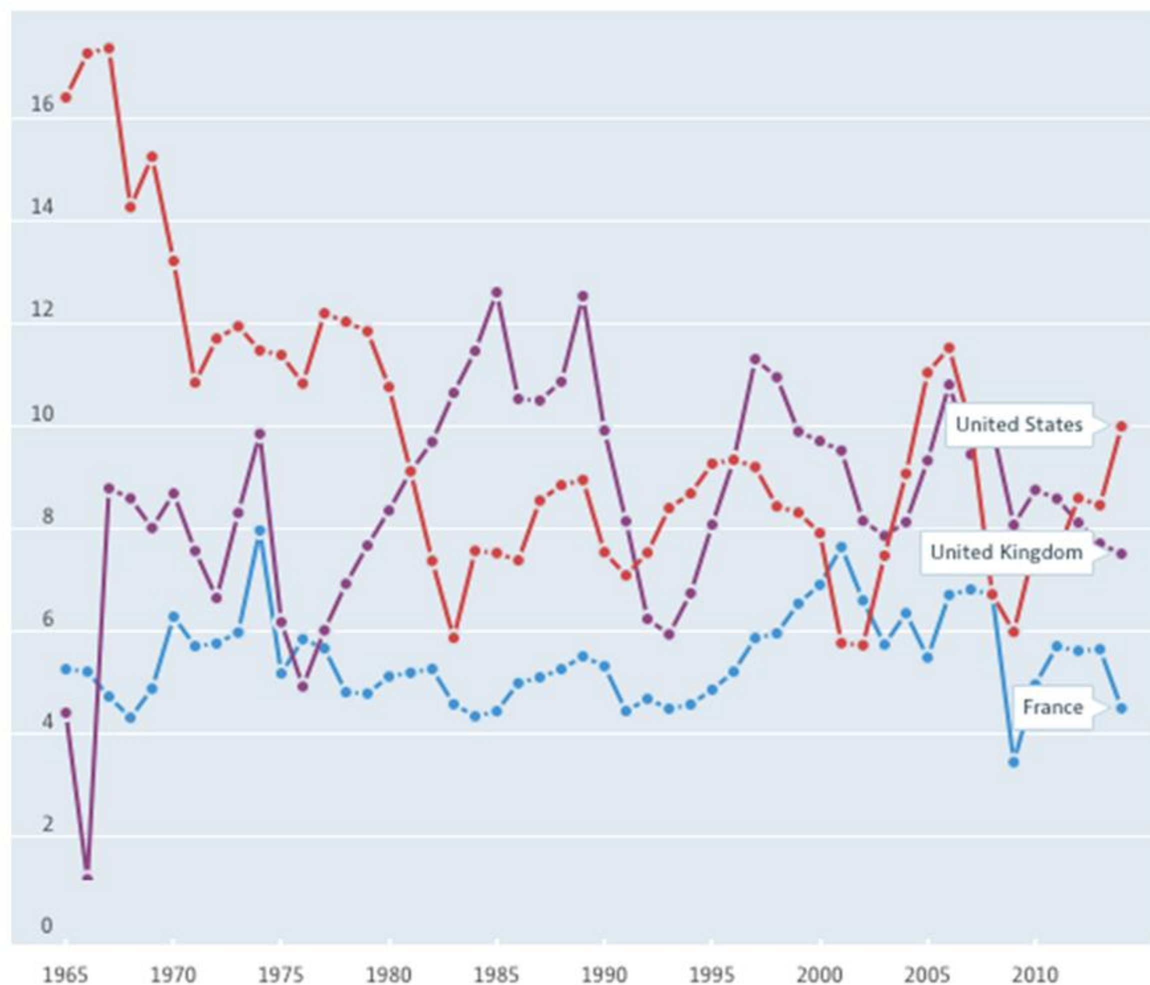

Fig. 4.4. Share of corporate tax revenues over total fiscal revenues from 1965 to 2014
Source OECD 2016

The table following shows the same data in more detail over the period 1999 to 2014.

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Location	1999	2000	2001	2002	2003	2004	2005	2006
France	6.5	6.9	7.6	6.6	5.7	6.4	5.5	6.7
United Kingdom	9.9	9.7	9.5	8.2	7.9	8.1	9.3	10.8
United States	8.3	7.9	5.8	5.7	7.5	9.1	11.0	11.5

Location	2007	2008	2009	2010	2011	2012	2013	2014
France	6.8	6.7	3.5	5.0	5.7	5.6	5.7	4.5
United Kingdom	9.5	10.0	8.1	8.8	8.6	8.1	7.7	7.5
United States	10.0	6.7	6.0	7.7	7.5	8.6	8.5	10.0

Fig. 4.5. Corporate Income Tax and Fiscal Revenues Ratio: France, UK and USA

Source OECD 2016

Thus France has seen the share of corporate tax (in percentage of tax revenue for the country) decline for about ten years just as has been the case in the United Kingdom. However, this share has remained stable for forty years in France, but has always remained below the level of its British neighbor.

In 2014, the share of the corporate tax fell to 4.5% of tax revenues in France while the UK shows a share of the corporate tax that is much higher than 7.5% for a much lower nominal rate than that of France. The United Kingdom thus demonstrates a better capacity to levy taxes on companies, some will speak of tax dumping to the disadvantage of France and continental Europe.

Paradoxically, the US with an extremely high nominal corporate tax rate at nearly 40% has one of the lowest OECD yields--much lower than that of France and the United Kingdom.

France and the United States thus share a high nominal rate and lower yields for their corporate tax. The explanation is to be found in the many tax deductions

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established since the end of "The Glorious Thirty" in France, and since the arrival of President Nixon in the United States.

A closer analysis of these corporate income tax rates shows that the share of corporate tax in the tax revenues of these three countries is very different overall and, contrary to what might be expected from the nominal corporate tax rate.

Paradoxically, the United States, whose nominal rate is high but whose yield as a percentage of GDP is low, nevertheless ranks among the top member countries of the OECD because of their ability to raise this tax in relation to their budgetary receipts.

From this statistical point of view, the US administration would have an efficient corporate tax system, unlike France. These statistics must be taken with some reservations, as the share of US tax revenues relative to GDP is significantly lower than that of France and most OECD countries (this represents 26% of GDP in the United States in 2014, compared to 33% in the United Kingdom, 45% in France and an average of 34% in the OECD countries). Mechanically, the share of the corporate tax is thus more important than in the rest of the OECD countries.

This comparative analysis of returns for different corporate tax rates offers a dual perspective.

First, the UK, despite an aggressive fiscal policy over the past decade, has seen its tax revenues fall slightly, but it is expecting stabilization in the medium-term. The reduction of the rate should be offset by a widening of the tax base (a mechanical influx) and the reduction of tax deductions, going back to the sources of corporate tax—a low rate on a broad base.

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This desire to reduce the corporate tax system to the essential would mark a will to restore a tax system with multiple tax deductions, and therefore to tax evasion by multinationals. The United Kingdom is striving to maintain the image of a firm reformer in the context of renewing its tax system for sustainable growth in a context of increased globalization.

A second perspective offers a less flattering consideration of British intentions in a volatile financial environment with exacerbated fiscal competition between developed countries and OFCs. The boundary between the two is now increasingly blurred.
Indeed, the tax dumping currently in vogue in the OFCs is pushing many Western countries to revise their corporate tax rates in order to limit the loss of the tax competitiveness of their economies, causing a drop in their tax revenues in the short term.

Developed economies opting for the status quo and deciding to keep their corporate taxes at their current level are also reducing tax revenues. France, which until recently had maintained a relatively high corporate tax rate, has seen its tax revenues decline in the face of the flight of profits to more lenient jurisdictions (the Netherlands, Ireland and the United Kingdom today).

The United Kingdom has therefore taken the lead by lowering its corporate income tax rate to a level close to that of "tax havens" such as Switzerland and Ireland. By putting forward tax harmonization from below, the United Kingdom runs counter to the goals set by the G20 and the European Commission. Brexit's recent victory and the immediate response of the Cameron government to further reduce the corporate tax rate in the UK confirms the assumption that the United Kingdom seeks not to remove existing tax deductions, but primarily to simplify its tax system while drastically lowering the tax burden on large groups in order to attract them to its territory. Such methods are similar to those practiced

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by OFCs, and the recent announcement of Brexit could accelerate a process already well underway in the UK.

The next part of this chapter explores how Brexit could affect the ability of the UK to align its economic and fiscal strategy in the direction of those of the OFCs around the world, particularly within the Common Wealth.

B) The Ambiguous Role of the United States Abroad: A vague policy that persists and a very unilateral application of the FATCA legislation.

1) America trapped in its own economic interests

In addition to the high-profile dispute over the FSC / DISC / ETI tax system, the United States exhibits an increasingly dishonest naiveté in relation to banking secrecy throughout its territory, allowing any foreign holder of non-American revenues to operate in all discretion from the soil of the United States.

Although OECD efforts have intensified since the end of the 1990s to limit the lack of transparency of flows to OFCs, the end of the Clinton Presidency in the United States marked an end to the willingness to reform on the North American continent.

The new Republican administration under the Bush presidency was far more skeptical to the measures proposed by the OECD. The Secretary of the Treasury under the Clinton Democrat presidency, Larry Summers, made the fight against tax havens a priority in the then ongoing discussions at the OECD, calling the fight against tax fraud and money laundering a major step forward for both developed and democratic economies.

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Yet shortly after the arrival of the new republican Secretary of the Treasury, Paul O'Neill, the affirmed position of the United States in the regulation of OFCs seemed to gradually fade. The strategy developed by the OECD through large-scale multilateral signatures was considered slow, inefficient and too intrusive in terms of fiscal sovereignty by the US administration.

The Treasury then announced that the signing of bilateral treaties should become the priority as soon as the US dominant position allowed for a rapid and efficient implementation of these treaties.

This notable change in the position of the US Treasury in international regulation and transparency contrasted with the position of the Clinton administration and surprised the OECD. Paul O'Neil affirmed that the free market and therefore liberalism must take precedence over any other value—including taxation and information exchange— for which respect for national sovereignty is a new priority.

Such a reversal is the result of a long political battle during which conservative lobbies weighed in heavily. Indeed, Paul O'Neil appeared, at the beginning of his mandate, as favorable to the approach initiated by the OECD and by the previous Democratic administration. He went so far as to say in February 2001 at the end of a G7 meeting: "I fully support the priority placed on transparency and cooperation to facilitate effective tax information exchange".

These confessions would not, however, be to the taste of some funders of the Republican campaign, in the front rows of which was the Center for Freedom and Prosperity (CFP). Intense lobbying then began in order to evolve the position of the Bush administration towards the recognition of the necessity to allow the debate on taxation and the exchange of tax information to remain a symbol of an American perspective like the freedom of expression or the right to bear arms.

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This ideological shift supported by the conservative fringe of the Republican party, as well as by the economic and financial elites pushed the Bush administration to reverse their stance.

Paul O'Neil, in a letter to the G7 finance ministers in June 2001, clearly announced the new official position of the Bush administration on the subject[1].

This political and demagogic shift, however, did not have a sound basis, since the OECD does not advocate standardization of tax rates or even of models of taxation, but only greater transparency in the context of international financial flows.

The Bush administration then clearly played on words and did not bother to consider the details to the delight of its conservative electorate and the large multinationals that funded its election campaign. The three largest donors had been the financial sector through Super PACs between 1999 and 2000 (Federal Election Commission, 2002).

At the 2004 fundraisers, Morgan Stanley, Merrill Lynch and the consulting firm PricewaterhouseCoopers were again at the top of the list of G.W. Bush donors.

Weakened, the OECD emptied its recommendations of their substance and changed its method. Direct attack and the threat of sanctions against non-compliant OFCs was quickly abandoned.

2) A Democratic administration more inclined to reform: establishment of FATCA.

1 "Countries must be free to adopt tax policies that encourage investment and promote economic growth. We should not interfere in any other country's decision about how to structure its own tax system when that system does not serve as an obstacle to enforcing our own tax laws. I have concluded that the United States should attempt to refocus the OECD project on its core element: the need for countries to be able to obtain specific information from other countries upon request in order to prevent non-compliance with their tax laws." (Sullivan, 2007)

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In 2008, the victory of Barack Obama marked a return of the Democrats, a saving grace for pro-regulation issues. The Foreign Account Tax Compliance Act of 2010 is thus the result of a marked determination to put an end to the laxity of eight years of Republican presidency with a rising fiscal deficit and tax revenues that fell as a result of the economic crisis.

Intended to limit the exodus of tax revenues abroad, FATCA aimed to reclaim part of the revenue lost due to tax fraud on behalf of US tax residents who placed money in the OFCs. This was estimated at $70 billion a year by the OECD in 2000 (Mitchell, 2000) or nearly $130 billion by the Congress's economic services at the time of the FATCA package of measures.

The FATCA regime, which is supposed to better identify and control the holding of financial assets by US citizens or relatives abroad, imposed its new rules on most countries in the world with a banking system linked to that of the US.

Any Foreign Financial Institution (FFI) that is not compliant with the regulatory obligations imposed by FATCA is subject to a withholding tax of 30% of all its flows (sale or purchase of shares, bonds and other securities) to or from the United States. In order to impose FATCA on the banks of the world, without the latter being in a position of violation of the laws of their country of origin (banking secrecy in Switzerland for UBS for example), the United States Bilateral established country-specific agreements called Inter-Governmental Agreements (IGA).

Two types of IGA bilateral agreements were created called Model 1 and Model 2. In Model 1, the FFI collects the data requested by the US authorities and forwards it to the competent authorities of their country of origin, which then transfers them to the American IRS. Model 2 allows a faster transmission of data collected

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directly from the FFI which is sent to the IRS without the intermediary of the foreign government.

The vast majority of agreements are based on the Model 1, with signatory countries preferring to retain a hand on information collected and transmitted to a third-party foreign authority (even if it is the United States that collects the data, sovereignty of the foreign nation remains important).

Within the Model 1, two sub-types of IGA are emerging: Model 1A and Model 1B. In Model 1A, the agreement provides for a reciprocal exchange of information between the two signatory countries, in which the United States indicates that it will communicate the information available to the signatory country of the agreement. Since the United States has very little information on holders of bank accounts within its own borders, the importance of this clause seems limited and the interest of Model 1A almost nil for the other country signing the agreement. Nevertheless, the country retains its sovereignty and honor, and officially both countries are on an equal footing.

Model 1B provides for a one-sided exchange of banking information from the signatory country to the United States without the need for the United States to provide any feedback. The signatory countries of Model 1B are rarer but nonetheless present, such as certain OFCs or the United Arab Emirates.

As the Emirates does not levy direct taxes on income, the need for a reciprocal agreement made little sense.

Countries, initially resistant to the idea of ratifying IGA of either Model 1A or 1B, nevertheless quickly signed the agreement. The US authorities' persuasive force on foreign banking operators (FFI), coupled with threats of sanctions on flows through the United States, prompted the FFI to call for early ratification of IGAs

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by their countries of origin, arguing that a lack of signature would have catastrophic repercussions for their activities and the integration of the financial centers of their country of origin on the world stage.

The effectiveness of FATCA was such that much capital was repatriated to the United States to avoid reporting to the IRS.

3) A US administration paralyzed by a Congress hostile to any application of the OECD recommendations: a windfall for the economy - Challenging the effectiveness of Soft Law

The massive flow of capital entering the United States following the entry into force of FATCA was reinforced by the new international recommendations for the exchange of banking information (OECD standards) which are not applicable for the time being in the United States as they are blocked by the Congress with a Republican majority in 2015 and 2016.

This combination of measures is favorable to the flow of capital to the United States.

The Common Reporting Standard (CRS), developed by the OECD was established in 2014 at the request of G20 member states (including the United States). The CRS thus appeared after the FATCA legislation, and FATCA was indeed strongly inspired by it. Not being part of the OECD EPSO, it complements it in the field of tax fraud.

Thus, the CRS should replace the mechanisms previously put in place by the OECD in terms of an exchange upon request of tax and banking information, with the objective that automated exchanges be more efficient and rapid.

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The CRS is similar to FATCA as it advocates an exchange of information about holders of bank accounts in a given country, but it also includes the shareholders of a company having a bank account in that country. It is thus supposed to block shell companies and trusts of any kind. In order to establish the CRS as rapidly as possible at the global level, the OECD launched the Multilateral Competent Authority Agreement (MCAA) at the end of 2014, which states that signatory countries must bring their regulations in line with the CRS as of September 2017, or September 2018 (OECD, June 28, 2016).

Although Switzerland and the United Kingdom are signatories, the United States is largely absent, despite the fact that the MCAA has already been ratified by 83 countries.

In order to ensure the application of the CRS within the member countries of the European Union, the EU has integrated the CRS into the DAC2 Directive, as will be seen below.

The United States justifies its lack of will to apply the CRS, for now, as they consider that FATCA corresponds to the CRS line by line. The very fact that the CRS was largely inspired by the FATCA regulations seems sufficient to the American authorities.

However, the founding principles of FATCA and CRS are not identical and are even far removed. While the CRS is a bilateral agreement for the exchange of information between two countries, FATCA only permits a one-sided exchange of information exclusively in favor of the United States. Since the United States cannot disclose any information on its own bank accounts—since this information is not currently collected by the US authorities. Only bank accounts receiving US income are subject to mandatory reporting at the federal level indicating the identity of the account holder.

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This paradox of the United States imposing on its international partners legislation which they are not able to apply themselves has long irritated Switzerland and other OECD member countries. The believe that the OECD should be more insistent with the United States so that they comply with the international standards advocated by the international community.

The American charade was soon found by creating the FATCA IGA Model 1A thereby creating an empty shell in practice but politically correct in form and marking the political will of the US government to support any legislation at the congressional level allowing the collection of banking information susceptible to be shared within bilateral agreements encouraged by the OECD.

This Model 1A, accepted by the OECD as a show of respectability, allows the United States to escape the implementation of the CRS in the immediate future, while profiting from the transparency of FATCA and a respectability preserved on the international stage.

A fool's game in short, as the United States has thus become the top tax haven in front of everyone's eyes, without any tax or regulatory tool that can be opposed to them.

This surprising position that is contrary to the current thinking of the member countries of the OECD is not exclusive to the United States, the situation is also increasingly tense with the UK.

C) The United Kingdom and the Brexit

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The striking result of the referendum in the United Kingdom opens a new page of history for the country, both geopolitically and economically. Against the backdrop of the European construction, this exit of the British people marks the return of a growing Euroscepticism across Europe.

The rise of populism is of course one of the causes of this political earthquake, linked to the growing precariousness of the less favored social strata of the United Kingdom and a feeling of increasing insecurity. Even if the economic elites (including those in the financial sector of the City) are overall pro-European, they must take note of and take into account the outcome of a referendum that thwarts their growth prospects.

From a strategic point of view, if and when the country leaves the European Union, there will be little chance that it will move far away from the European Union which is its top trading partner.

Thus the economic logic (and the ongoing lobbying in London) would like the exit from the European Union to be translated into membership in the European Economic Area (EEA), which includes, in addition to the members of the EU, Iceland , Norway and Liechtenstein. Thus the UK could be granted access to the European single market (including its financial market), but would no longer be governed by all European legislation.

1) An access from London to the EEA in order to preserve the interests of an all-powerful City

Members of the EEA are subject to a number of legislative frameworks in areas as diverse as social, consumer and environmental law as well as laws and standards on fauna and flora, business and accounting and finance and banking. These

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national regulations that need to be brought into conformity with the European texts concern three quarters of the texts in question.

On the other hand, members of the EEA enjoy greater freedom and independence on agricultural and, of course, customs matters.

On the side of financial and banking standards, the United Kingdom and the City if they opted for a Norwegian model within the framework of the EEA, should continue to comply with the new package of European texts in this field grouped under the name European System of Financial Supervision (ESFS[1]).

This series of new financial and banking regulations aiming at greater stability OF financial and banking markets of the common market through a number of regulatory authorities such as the European Systemic Risk Board (ESRB), the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA), as well as the Directive for Alternative Investment Fund Managers (AIFM Directive), the Credit Rating Agencies (CRA) Regulations and the well-known European Markets Infrastructure Regulation (EMIR).

Indeed, having access to the European common market (as regards goods and services - including banking and financial services), the United Kingdom would thus leave its internal market open to the member countries of the European Union and the European Union, EEA, and therefore under the supervision of the European institutions set up to ensure the stability of this common market.

National regulatory authorities, national central banks and other regulatory authorities, which are responsible for regulating and supervising the common market are thus relegated to a secondary role with the status equivalent to that of

[1] Legal basis in the EU legislation : art. 26, 114, 127, 290, 291 of the TFEU Treaty on the Functioning of the European Union.

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regional agencies as they are now only applying European regulations. These National Competent Authorities (NCAs) are responsible for the supervision of standards at the national level and no longer responsible for the development of these standards at the European level.

This change of direction and shifting of roles in the development and application of standards is at the heart of the strategy for regulating banking and financial activities in Europe.

The countries that are currently members of the EEA have thus adopted all the aforementioned recent banking and financial reforms of the European Union within the framework of an integration of these new regulations within the EEA agreement, linking the common market to each one of the member countries.

Many Norwegian public actors consider that their national sovereignty is limited in terms of financial regulation because of a large number of European texts imposed on national legislation.

For example, the recent adoption of the ESFS measures package had to be adopted by a three-quarters majority in the Norwegian parliament, the majority necessary when adopting a text restricting national sovereignty in the framework of international agreements. Thus limited sovereignty, but always with the agreement of the parliament and therefore in compliance with the rules of democracy in Norway.

Indeed, effective UK independence will most likely be restricted from a regulatory point of view on financial and banking matters, with the United Kingdom opting most likely (and this is the wish of the business community) for integration into the EEA.

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The risks of regulatory drift that could lead the UK to become more like an OFC are therefore limited to fiscal and monetary issues on which it will have complete freedom.

2) A model for Switzerland with bilateral agreements on each of the common market issues

The United Kingdom, instead of opting for the EEA model, could also opt for a model based on the Swiss structure by signing bilateral agreements on common market issues of interest to the UK (financial services, industrial goods, automobiles, etc.).

This model would allow the UK to recover a number of national prerogatives while maintaining a comparative advantage in certain key sectors. Switzerland and the United Kingdom also have in common the use of successive referendums to determine the level of membership they wish to have with European institutions.

Switzerland joined the Common Market initially in 1972 via a referendum adopted by more than 72% of the population (Federal Department of Foreign Affairs FDFA, 2016). In the spring of 1992, Switzerland applied for accession to the European Community in order to progressively integrate all the European institutions and become an integral part of the European Community. Nevertheless at the end of 1992 a national referendum rejected the proposal to join the European Community.

In January 1993, the Swiss Government took note of the decision of the Swiss people but decided nevertheless to maintain close relations with the European Community through the signing of numerous bilateral agreements on the free

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movement of goods and persons with the European Community—the framework of so-called sectoral negotiations.

The Swiss Confederation then signed about 20 major bilateral agreements in two major rounds, the first in 1999 called Bilateral Agreements I, which entered into force in 2002, and the second called Bilateral Agreements II, including financial services, which represent a large part of the Swiss economy (a situation similar to that of the United Kingdom).

The European Union, its member states and public opinion were at first reluctant to sign agreements related to Swiss financial services. The Swiss financial sector was considered at the time to be responsible for a large part of the capital flight affecting the public finances of most European Union member states. The European Commission finally agreed to study the signing of bilateral agreements on sectors to be mentioned with the aim of combating tax evasion more effectively (technical measures in favor of Member States' tax administrations were thus integrated). Nevertheless, the specificities of Swiss banking law were mostly preserved, and banking secrecy remains untouched in the confederation.

The signing of this second round of bilateral agreements was nonetheless long and tedious because of a major dispute over the taxation of savings. This is a point on which the member states of the European Union remain intransigent as issues of tax fraud remain central to the concerns of European public opinion.

Switzerland finally ceded in 2004 by reforming its taxation of savings and agreed to collect a flat-rate tax on the savings income of European tax residents whose bank accounts are declared in the confederation. Switzerland thus deducts a withholding tax of about 35% on the savings income of the Swiss bank accounts of European tax residents. The proceeds of this tax shall largely be remitted to the country of which the holder of the bank account is a tax resident (75%). A

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commission of 25% is retained by the Swiss authorities for the cost of collecting the tax.

Switzerland also agreed to reform its legislation on combating tax evasion in areas such as VAT and customs duties, which were hardly affected by the Swiss tax administration, which then concentrated its efforts on corporate taxes.

The fight against tax evasion in Switzerland was improved in 2015 with the signing of the agreement on the automatic exchange of tax information (EAR), which is intended to replace the agreement on the taxation of savings in the Bilateral Agreements II of 2004, and is expected to enter into force on January 1, 2017.

a) A market open to Switzerland but not wholly owned by the financial sector

These important trade-offs to which Switzerland has agreed provide the country with wider access to services markets and to European public procurement markets: Switzerland enjoys equal treatment with that of a Member State in the context of calls for bids for European public offerings.

Nevertheless, in terms of financial markets, Swiss banking institutions do not have the possibility of operating within the common market, since they are obliged to open branches in a Member State of the Union. The large banks in Switzerland must therefore face additional costs in order to reach the 505 million potential customers of the common market.

The costs are mainly linked to the creation of a dedicated branch, a specific capitalization fee, and a dedicated legal department in the face of the increasing complexity of European banking legislation, which the parent companies are unfamiliar with because they are not impacted directly. These fixed costs are

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important in view of smaller branch sizes, making these establishments less competitive because of their small size on the European market.

This is a point on which the United Kingdom will be impacted if its banking and financial legislation gradually moves away from the European regulatory framework. Large banks can afford these extra costs, but second-tier institutions would face an increased difficulty in accessing the European market. This glass ceiling to the marketing of financial products through the common market is quite often a reality for small banking establishments and "shops", small-sized management companies on specific sectors.

This model is far from ideal and imposes on Switzerland a number of constraints including the free movement of people and goods. The free movement of services is only partially hindered, particularly with regard to financial services.

Thus, in order to gain access to Europe's common financial market, Switzerland must often pass through London and use the financial passport of banks established in the United Kingdom. The UK should therefore theoretically, if it leaves the European Union and opts for a Swiss model, rely on a European financial center (Amsterdam, Paris or Frankfurt) to obtain this famous European passport for the financial activities of the City.

Of the 5.5 trillion pounds managed by the British funds, nearly 1.2 trillion came from European customers. The European passport allowing the authorized fund to offer their products to customers of the European single market is therefore a major problem for the UK financial industry. The legal uncertainty surrounding this European passport could seriously hamper the future development of these products with European customers.

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The UCITS funds of the UCITS III European Directive is of little concern to the City, as most of them are located in Luxembourg, which offers a simplified legal architecture dedicated to these funds.

It must also be understood that the implementation of Swiss bilateral agreements depends on strict compliance with the rules on the free movement of persons within the European common market. The adoption of quotas of foreign workers on its soil by Switzerland following a 2014 referendum risks upsetting the balance of the bilateral agreements signed by the confederation over twenty years. In this sense, the Europhobic parties in the United Kingdom, which also wish to limit the free entry of European citizens into British territory, are thus likely to block any agreement with the European Union and thus severely penalize the City's financial center in the short term as they would be temporarily confronted with additional barriers with European markets.

The strong point of the City is precisely to be at the center of the financial connections of the planet. A marginalization of the European market and the establishment of a necessary partnership with a European financial center to commercialize its financial products would tarnish its image and its attractiveness on a global scale.

b) Regulatory uncertainty on the future of the City and the British financial sector

From an economic point of view, the impact is at present uncertain between the fall of the pound and short-term capital flight to the continent. Nevertheless, on the tax side, the question of the radicalization of the positioning of the United Kingdom is a hot topic.

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While rural areas have predominantly voted in favor of Brexit and a rediscovered "independence", London and the big cities voted in favor of staying in the European Union.

Economic players also voted in favor of staying in, fearing for their exports to the European single market. The City, the EU's top financial center, indicated during the debates and through its declared positions that it supported staying in the EU, so much so that the impact on its business could be significant in the case of Brexit, even though the United Kingdom is not a member of the Eurozone. The question of the financial passport of establishments established in the United Kingdom is of paramount importance for the good health of the latter.

Yet a very popular sector in the City is pleased with recent events, because of the potential additional activity that could be generated in the medium term: speculative investment funds. Uncertainty about the future of the British economy creates unstable markets in the short term, enabling them to make significant profits, and in the longer term, the potential regulatory easing could allow them greater flexibility in tools used to date.

Beyond this domaine of niche sector, the impact on the financial sector is likely to be major, since the UK has an excellent record trading with its European partners, with close to a 20 billion pound surplus in 2015 in the financial sector alone. This record trade surplus is by no means an advantage for the United Kingdom, which will be in a weak position to negotiate an agreement on the financial sector, with EU member states seeing little benefit in facilitating an agreement in a Sector where the EU is structurally deficient. The European Parliament or the European Commission could thus take retaliatory measures with regard to this strategic and politically emblematic sector. English banks and investment funds would thus have limited access (financial passport) to the European financial market.

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In the case of a Norwegian scenario where the United Kingdom would still have full access to the European Union, the country would nevertheless be politically disadvantaged on political and legislative grounds.

Then how can one explain to the British voters that the kingdom would lost most of its influence over European institutions whereas London, *in fine*, regains no advantage over border controls?

It will also be difficult to explain to investors that London, the leading financial center in Europe, must apply European financial regulations, whose development no longer takes into account British participation. British banking lobbies will see their impact diminish. And this in the image of the AFME, the Association of European Financial Markets whose main members are the English banks and whose geographical location in the heart of the City will come into question after the Brexit.

In such a context, it seems difficult to maintain a constant flow of foreign direct financing to the country, even though more than 49% of such financing was concentrated in financial services in 2013. This is the main risk for the United Kingdom, as simplicity of mobility (where asset relocations are easy) is one of the characteristics of the financial services sector. This decline in foreign direct investment flows in the financial sector could in the medium term adversely affect UK growth, the influence of UK financial institutions and the strength of the pound sterling.

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c) A British financial sector liable to succumb to the temptation of deregulation.

However, the City does not count on remaining with their arms at their sides until after the cataclysm of Brexit. Indeed, the risks that weigh on its growth and on the credibility of the City as a financial center, should push the British authorities to actively promote London as a financial hub.

The strategy should be twofold, obtaining the maintenance of the European passport for English banks, and in parallel pushing the British authorities to maintain London's preeminence over global finance.

For this strategy to work, the financial sector must maintain hope in a difficult economic context, and in an increasingly regulated financial sector within the European Union. The financial sector must also adapt its financial regulation to the global context of increased fluidity of capital. Great Britain could thus see the emergence of regulations tailored to its financial sector in order to improve its competitiveness, reputation and attractiveness.

The British government is currently spending nearly £7 billion on banking and financial supervision in Britain, so the new British government could save between £1.4 billion and £4.1 billion annually (Stephen Booth, 2015) by deregulating financial services, and reallocating these funds to the promotion of UK banking and financial services abroad.

Beyond the savings generated by the abolition or downgrading of certain regulations, a large number of sectors could find freedom of action hitherto limited by the European directives transcribed in British law.
Nevertheless, the regulations applicable to the UK financial sector are not only retranscriptions of European Union directives.

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Prudential standards on the international level that are applied via Europe currently will still need to be applied by the United Kingdom following its eventual exit from the European Union. Indeed, of the ten main financial regulations imposed by Europe, at least three are imposed as a result of international prudential standards. For example, the Capital Requirements Regulation and Directive IV (CRD IV or Basel 3), anti-money laundering recommendations (Financial Action Task Force or FATF recommendations) and International Standards on Auditing (ISA) via the International Auditing and Assurance Standards Board (IAASB) provide regulations that the United Kingdom will not be able to avoid.

As the CRD IV is currently being supervised by European institutions, with the United Kingdom leaving the union, it will be able to modulate the establishment of the rules of the Basel Committee whose application differs strongly between continents. The European view of the question is not necessarily the most relevant, since the application of the Basel criteria in Europe is considered uncertain even by the Committee itself. Thus, in a note by the Bank for International Settlements (of which the Basel Committee on Banking Supervision is a part) published in 2014, the Basel Committee states its surprise at the evaluation methods applied by the European Union in the analysis and application of the minimum criteria set out in the CRD IV for banking institutions in Europe (Basel Committee on Banking Supervision, 2014).

The Basel committee thus considers via the Committee's Regulatory Consistency Assessment Program, RCAP[1], that the European Union is globally compliant on

[1] The RCAP mainly aims to "assess the consistency and completeness of a jurisdiction's adopted standards and the significance of any deviations in the regulatory framework. The RCAP framework promotes full and consistent adoption of the Basel framework by identifying domestic regulations for internationally active banks that are not in line with the Basel standards and (...) The RCAP also helps member jurisdictions

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meeting the criteria for quantifying the required capital levels and on measuring market risks. On the other hand, it seems to fail in its methods of credit risk assessment, mainly through the standardization of its methods and the analysis of credit counterparties.

These criticisms of the European methodology of application of the rules of the Basel committee could be an argument in favor of a change of the application of these rules.

On leaving the European Union, the United Kingdom would thus be able to define its own plan for the evaluation of UK banks, enabling, as the case may be, a method that would be more flexible and advantageous for UK financial institutions, while respecting the principles of the Basel Committee.

In addition, a number of regulations will be able to be relaxed such as the AIFMD, MiFID I and II, Solvency 2 and UCITS IV, all of which are Community legislation.

AIFMD, or Alternative Investment Fund Managers Directive 2011 is a European directive regulating hedge funds, private equity funds and real estate funds. This directive aims to make the investment fund sector more transparent following the 2008 crisis and thus covers the entire European market. This now highly regulated sector could be fully deregulated in the UK. Nevertheless, the direct and not insignificant sanction would be the loss of the European passport for UK financial products.

MIFID I and II are the Markets in Financial Instruments Directive established in 2007 by the European Union to improve and harmonize the financial markets of the different European countries. At this level, the rules of good conduct and the

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identify deviations from the Basel framework , Weigh the materiality of any deviations and undertake necessary reforms." According to the BIS - BASEL Committee.

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recommendations with regard to investment companies could be relaxed quickly on British soil. Similarly, the current implementation of MIFID II, adopted by the Council of the European Union and published in May 2014 in the European Union Official Journal (EUOJ) to be implemented as of January 2018, could be delayed, canceled or profoundly reduced for its application in the United Kingdom, since ESMA (in charge of monitoring the application of these European directives) would no longer have authority over the United Kingdom. It is also likely that the transposition into national law imposed by the European Union whose deadline is set for July 3, 2017, will be delayed if the United Kingdom activates the procedure of Article 50. The uncertainty of the timetable for implementation may push the British legislator to reject any new European directives. However, the non-application of these directives may also jeopardize access to the European passport for UK banks and management companies.

Solvency II is for the moment a purely European directive, international insurance standards being for the time being in their early stages. The United Kingdom will nevertheless find it difficult to reverse the progress made by Solvency II as the international dynamic is aimed at enhancing transparency, particularly at the level of the FSB and the G20. The insurance sector of the City of London could nonetheless lobby to ease minimum capital requirements and solvency capital requirements which are increasingly stringent under Solvency II and effectively limit the competitiveness of British players vis-à-vis their counterparts across the Atlantic.

The new regulations around the Undertaking for Collective Investment in Transferable Securities, UCITS IV Package— which will strengthen the unification of the European market for investment funds and their financial vehicles —will be difficult to circumvent, as the UCITS IV model is the one that is being adopted internationally. Even though many overseas jurisdictions are inspired by the European developments in this field, the creation of a passport for management

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companies offers the possibility of bringing together funds from different countries into the common market, while still offering greater transparency for the investor regardless of the origin of the fund in the European Union.

European regulations concerning money laundering are primarily inspired by the 40 recommendations of the Financial Action Task Force. Any departure from the European Union will being about a respect of these rules in whose development the United Kingdom had actively participated and whose questioning would be difficult to justify without it bringing immediate benefit to the British economy.

Nonetheless, the current supervision of anti-money laundering legislation will be transferred from European authorities to British authorities. Certain regulations may be weakened at the margins since the European Union has recently been in the forefront of the application of FATF rules since the first European directive in 1991.

This new regulatory framework adopted in 2015 aims to strengthen transparency about the origin of capital in the European Union, in particular via the strengthening of monitoring of trusts and tax societies (that mange other people's estates) guaranteeing the anonymity of a beneficiary and often acting as a real roadblock to the fight against money laundering and the financing of international terrorism.

Tax societies thus have a framework in this new directive to collect and maintain information on beneficial owners of a trust, thus suppressing the anonymity that reigned in a sector for which British supremacy is firmly established.

The entirety of information collected must be addressed to the competent national authorities without the parties involved in the trust being informed. The European directive being public, it is difficult to imagine that the parties could not

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be informed of regulatory changes, thus impacting negatively the activity and the creation of trusts.

In the event that a trust would have tax consequences, trust companies must disclose a certain amount of information on the beneficial owner of a trust to a national central registry. Nonetheless, access is limited to competent national and European authorities in the framework of a procedure upon the demand of British authorities in order to preserve the principle of confidentiality of trusts in the United Kingdom.

It is precisely on this point that the United Kingdom would regain an increased freedom of action in the case of Brexit, as this directive would go beyond what is for the moment required by the FATF.

d) Strategic refocusing of UK finance on Offshore financing and BRICS

At the global level, Great Britain and the City will also be able to negotiate or renegotiate trade agreements with emerging countries and the United States, with a focus on the liberalization of the financial sector and greater liquidity of capital flows between countries.

This repositioning towards emerging countries would, according to PricewaterhouseCoopers, be a winning strategy in a context of the forced globalization of the banking and financial sector. The BRICS (Brazil, Russia, India, China and South Africa) should then see their global share of banking and financial assets increase from roughly 8% in 2005 to more than 32% in 2050. At the same time, France, Germany Spain and Italy should see their share divided by two, falling to nearly 12%.

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The United Kingdom, with its strong Commonwealth network and increased deregulation, could thus become the world's foremost financial center firmly anchored in the newly developed financial markets of the BRICS.

As we have seen, the United Kingdom, like Ireland, whose corporate tax rate is currently 12% in 2016, are aggressively pursuing in terms of tax policy on companies. The recent Brexit vote reinforces this movement initiated under Margaret Thatcher. On July 4, 2016, Georges Osborne announced that the corporate tax rate should decrease from 20% in 2016 to 17% in 2020 to reach 15% in ten years in order to limit the relocation of companies to mainland Europe (or Ireland). The OECD found in a confidential and internal memorandum that such a reduction in corporate taxation would be contrary to the principles advocated by the institution for 20 years and that the United Kingdom—if it implemented such a decreased tax rate on corporations—could be considered a tax haven by the international institution.

However, this is indeed the stated objective of the government formed by Theresa May: to retain companies on British soil and to offer the most competitive fiscal framework possible in order to prevent the relocation of London headquarters to Amsterdam, Paris or Frankfurt. This position is attracting the wrath of Brussels with Ireland once again reflecting on lowering their main corporate tax rate, as is the Netherlands, opening the door wide to fiscal dumping on the European continent.

D) Soft Law weakened by the duality of Anglo-Saxon interets on the international scene

The impact of tax and regulatory changes in the United States and the United Kingdom is now major. On the economic front, success is undeniable, with relative growth above continental Europe starting from the 1980s. London and NYC quickly became the world's largest financial centers, allowing the United Kingdom

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and the United States to remain hubs of world exchanges. Conversely, continental Europe has seen its financial sector and growth regress for the past 20 years, although the economies are more stable than the Anglo-Saxon countries, they are generally weaker.

On a societal level, the benefits of such reforms need to be nuanced. Thomas Piketty's latest work on social and economic disparities in the United States (Piketty, 2013) presents a bleak picture of American society (and Anglo-Saxon economies in general), rich and developed yes, but the benefits only reach a small fringe of the population and weaken the poor. These economies with a welfare state "at a discount" see a large proportion of their populations affected by insecurity, unequal access to care and income largely dependent on the vagaries of economic growth. This is not the focus of this section of this work, but since economics, law and societal questions are closely linked, this subject could not be totally avoided.

The most important impact, far from the historical debate between the competitiveness and growth of liberal economies in comparison with the social democratic economies, concerns the massive increase of tax policies that resemble a more or less avowed fiscal dumping and that undermine the application of recommendations of the G20 and the OECD on fiscal transparency and the automation of tax and bank information exchange procedures around the world.

Thus in the United States with the FATCA regime, or in the United Kingdom with the ever more powerful City and a tax administration in open conflict with the Bank of England, it seems difficult to achieve a situation where large-scale tax evasion will be fought vehemently.

Gabriel Zucman, an economics professor currently at the University of California at Berkeley, goes so far as to speculate that it is probably impossible to adopt a more restrictive legal framework worldwide through a democratic process (Zucman, 2015). The weight of lobbies in the United Kingdom (with the City) or

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in the United States seems to slow down or prevent the adoption of efficient measures in this area.

The study conducted by Zucman shows that the United States is subjected to a fiscal exodus both in terms of personal income tax and corporate tax. These losses are estimated annually at nearly $200 billion in income taxes and almost $130 billion in corporate taxes.

FATCA has helped curb income tax evasion in the United States through strong public pressure and the positioning of the Obama administration. On the other hand, large multinationals and wealthy foreign investors are still spared, partly because of political stagnation made possible by a democratic process that is failing to pass laws.

The fear of seeing the US economy negatively impacted by a reinforcement of the legislative arsenal against tax evasion and the end of tax deductions benefiting major groups, fosters a political climate refractory to all changes at a time when the OECD is fully involved in seeking ways to put an end to tax opacity and transfer pricing.

The political weight of conservative Republicans backed by neo-liberals and libertarians paralyzes Washington and leads to almost complete stagnation, even as the US advocates the utmost intransigence in international tax evasion.

In May 2016, a group of American lobbies asked Congress to stop any funding to the OECD (the United States being the top financier of the international organization). According to the Coalition for Tax Competition, which includes thirty-five think tanks and other lobbying organizations, the US economy is particularly targeted by the legislative arsenal advocated by the OECD. Thus the objectives put forward by the OECD, and supported publicly by the United States, through the Base Erosion and Profit Shifting (BEPS) program, would be contrary to American interests.

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The activity and the not inconsiderable influence of these lobbies and libertarian currents on American policy explain in particular the current impossibility of the United States to put in place on their own territory what they recommend to their international partners. The recent election of the ultra-nationalist populist Donald Trump, whose campaign promises announce an end to the signing of free trade agreements with Europe (TTIP) and the Asia-Pacific region (TTP) and an exit from The World Trade Organization can only reinforce American isolationism.

The situation in the United Kingdom is not much better, Downing Street currently is a very proactive speech on the subject of tax evasion and transparency, especially in the European summits and the G20.

Internally, David Cameron's Conservative government's position had been more timid, fearing to thwart a conservative electorate hostile to the new constraints imposed by Brussels, and a business world refractory to the new measures put forward by the OECD. The new government of Theresa May, formed following the Brexit whose consequences are still uncertain for the UK's banking and financial legislative framework, shows little confidence in meeting its international commitments on fiscal and financial transparency.

How in such an international context can we imagine that Soft Law could bear fruit? Even as the United States and the United Kingdom seem to play the lone wolf when international efforts have for 15 years focused on increased collaboration among nations to make multilateralism the norm.

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V - The failure of soft law in the regulation of offshore financial centers

For the last four decades, neoliberal fiscal policies in the United States and the United Kingdom have relied on OFCs to create the conditions that allow companies optimal competitiveness while maintaining their economic activity on American or British soil. In a context where the national economic interest overrides the national interest in a broader sense and where national regulations exclusively defend these national interests, a true willingness on the part of the Anglo-Saxon countries to see the emergence of a new world order on the issues of fiscal transparency is clearly undermined.

This dichotomy and this increasing division makes Continental Europe face off against the United States and the United Kingdom at a time when FATCA is considered sufficient for some, and where Brexit pushes others to financial and fiscal one-upmanship aiming to maintain a financial role for the UK at the heart of the world wide web of OFCs.

While the OECD is attempting to set up an efficient model for the exchange of information at the global level to combat tax optimization by requiring OFCs to provide greater transparency, the United States, the United Kingdom and even China seem to be ignoring issues that in their eyes mostly concern Europe, the first continent impacted and the first to act.

Can soft law and the approach of the OECD be the answers to a global problem in spite of the divergence of the key actors on the answers and the necessary means to put in place? It is possible to doubt that this is the case in the face of the inconclusive results in the fight against tax havens over the last decade.

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This three-part chapter shows why soft law does not appear today to be able to curb the tax optimization of multinationals that resort extensively to the use of OFCs to freely move their profits earned across the world.

The complexity and the regulatory logorrhea spelled out in the 1,900 pages of the BEPS plan risk making it into yet another brick to throw into a regulatory ocean whose loopholes are constantly revealed. Tax experts, commercial banks and the tax havens themselves discover and exploit these with glee. This could even be seen as a planned failure due to the lack of an ambition to genuinely reform and the absence of coercive measures associated with the proposed range of technical measures.

A) Ineffectiveness of soft law in the face of the strong economic interest of deregulation

Following the Brexit vote, the UK financial sector finds itself in difficulty compared to other financial centers in Europe. This is due to the fact that the Euro zone is showing its desire to assert its near monopoly on EU financial activity thereby risking to threaten the predominance of London in the banking sector, which is likely to be challenged as regards the market in data clearing services for instance.

The City may well be left out of the Capital Markets Union (CMU) project, an ambitious project with the aim of reducing the obstacles to capital movements within the EU. The City also risks the loss of rights related to the "European passport" and the loss of any influence on the development of rules and regulations governing the financial sector on the European continent.

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> If the discussions around Britain's divorce with the EU turn sour, the City could also choose to become an OFC accessible to European companies too sensitive to regulation and taxation (Guarascio , 2016).

On the other side of the Atlantic, Donald Trump, the newly elected American President from the Republican party, is also likely to respond to the siren call for further deregulation, both general deregulation of the economy and specifically in banking. This could include the proposed decrease in corporate taxes in the United States or the announced reform of the Dodd Franck Act of 2010 in order to give more freedom to banks, showing that the United States is moving in the opposite direction of Europe that is instead evincing the desire to better regulate finance and international taxation.

In the Anglo-Saxon context of banking and financial deregulation, and the race to tax dumping, it seems inconsistent to expect any strong political support for the measures recently announced by the OECD even though they are based on a soft law model and are therefore not binding. Faced with the weak legitimacy of soft law, economic interest takes the upper hand whether we speak of OFCs, the United States or the United Kingdom. Continental Europe is clearly alone in its struggle for tax fairness, which it must be said is also in its economic interest. Thus, each territory is ultimately engaged in a struggle for its own interests.

1) Inadequacy of the principles underlying soft law to the problem of the international regulation of offshore financial centers: the notion of common interest

The emergence of soft law took place in a context of a change in the relationship to the rule of law and the relationship to authority in general. The conception of the rule of law was up until a point, strongly imbued with the notion of

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constraint and submission. This conception was theorized by Kelsen for whom law is an "order of constraint" (Kelsen, 1962). According to him:

> As an order of constraint, the law is distinguished from other social orders. The element of constraint, that is to say the circumstance that the act instituted by the order as a consequence of a situation considered socially harmful must be carried out even against the will of the individual whom it must reach and, in the case of resistance, by the use of physical force—that is the decisive criterion" (Ibid).

Henceforth, the law no longer corresponds to this conception. The rule of law has changed and must be achieved through dialogue, involvement of the recipients, and a search for the adhesion of these recipients.

This change in the relationship to law can be seen in everyday examples that seem insignificant but which actually reflect an important underlying change: we go from "Don't walk on the lawn" to "The quality of green spaces is everyone's business." In buses, the order to "advance to the back of the bus" has been replaced by "advancing towards the back of the bus makes it easier for others to enter". We thus move from injunction or prohibition to the "explanatory-incentive" (Thibierge, 2003).

It is therefore a model of rules that tries to make the recipients aware that it is in their interest to respect the rule, and that they must respect it not because there is a sanction, but precisely because it is in their interest—the notion of common interest.

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The law has not escaped this change and even more so international law for which soft law has always been a privileged instrument insofar as there is no superior authority capable of imposing a binding rule.

The philosophy underlying soft law can be effective at the international level in the field of the environment, for example, in so far as it is now understood that it is in the interest of all to remedy ecological problems. But this philosophy seems inadequate to the regulation of OFCs which have no interest in seeing themselves regulated. As has been pointed out, their economies have undergone a hypertrophy of finance and the banking and financial sector is attracted to the deregulation that these centers purposefully maintain.

On the other hand, some argue that the absence of a sanction in soft law does not deprive this law of the legal character as Kelsen's conception would have it because the sanction would not be inherent in the rule but external to it. In this regard, we can cite the fact that "international public law and administrative law have the principle that there are no means of enforcement against the state" (Jestaz, 1986)[1].

Companies, for example, may be encouraged to comply with recommendations of good behavior regarding standards of hygiene, consumer protection, respect of decent working conditions etc. They know that by failing to comply with such recommendations, which are in the common interest, they run the risk of experiencing a reputation deficit threatening their existence.

But it must be noted that this mode of constraint has no effect when it comes to regulating non-cooperative financial centers. Numerous gray or black lists of such places have been established: in June 2000 the OECD published a list of 35

[1] « *le droit international public et le droit administratif, avec ce principe qu'il n'y a pas de voies d'exécution contre l'Etat*» (Jestaz, 1986)

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uncooperative tax havens and shortly thereafter the Financial Stability Forum published a list of 42 territories to be monitored. The FAFT also published a list 29 of dubious places. The London G20 continued with a three-tiered list.

This period called "name and shame" produced no significant effect. This is because, unlike a company that is afraid for its reputation and is afraid of losing its clientele, the non-cooperative state is not afraid of being designated as not following the recommendations of financial regulation since this absence of regulation constitutes precisely its goodwill and represents the asset that attracts to it international finance.

The second main obstacle to the effectiveness of the Soft Law model in international regulation comes from the dispersion of the authorities that are the source of this law and consequently from the weakening of the rules that compose it.

The multiplicity of entities creating soft law in financial matters can only work against it: IMF, OECD, World Bank, Basel Committee, Committee on Payment and Settlement Systems, WTO, International Committee of Accounting Standards etc.

The lack of a central authority that issues soft law on financial issues according to a clearly identifiable procedure weighs heavily on the credibility and legitimacy of this mode of regulation: who creates the rule, by what procedure, who are the participants and who are those for who the soft law is destined? How significant is the sanction and what is its extent?

With this mode of regulation, one does not knows or one no longer knows where the approval of behaviors comes from. Neither does one know who has the legitimacy to approve or to condemn these behaviors.

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"There is always a moment when it would be good to be able to report on something clearly" (Grégoire, 2012)[1].

Some speak of a gap in the legitimacy of a normative system that begins to operate in the form of soft law. "It would undoubtedly be reasonable today—in order to re-establish with authority the right impact of the common good over mercantile strategies—to advocate the rehabilitation of classical economic law, anchored on the foundations of traditional legitimacy and moderated in order to produce, in a more precise fashion, norms that are comprehensible, predictable and stable "(Grégoire, 2012)[2].

The two principles underlying the effectiveness of soft law are the adhesion of the recipient to a common objective and the existence of a sanction outside the rule are, in the domain of interest to us, non-existent and therefore inoperative.

2) A failure of soft regulations aiming to limit the use of OFCs for tax optimization purposes

Attempts to use soft law tools have thus multiplied for many years: the proliferation of lists of offshore territories, the introduction of exchange of tax and banking information on demand, today it is the Automatic Exchange of Information (AEOI) or more recently the OECD flagship effort: the Base Erosion and Profit Shifting (BEPS) project.

Examples are not lacking and attempts to regulate are multiplying due to the abundance of actors.

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[1] *« Il y a toujours un moment où il est bon de pouvoir rendre compte clairement »* (Grégoire, 2012).

[2] *« Il serait sans doute raisonnable aujourd'hui, pour rétablir d'autorité la juste incidence du bien commun sur les stratégies mercantiles, de prôner la réhabilitation du Droit économique classique, ancré dans le socle de légitimités traditionnelles et modalisé de manière à produire, de façon plus synthétique, des normes lisibles, prévisibles et stables »* (Grégoire, 2012).

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Paradoxically, in parallel to these numerous initiatives, one can observe, if not an increase, at least a maintenance of the involvement of CFOs in the world economy. Successive scandals that have arisen of late (Luxleaks, SwissLeaks, Panama Papers) and various economic studies attest to this fact, including the work of Gabriel Zucman that we will consider here.

For example, the latest United Nations Conference on Trade and Development (UNCTAD) report shows a flow of foreign direct investment to OFCs reaching $72 billion in 2015, a figure that is stable compared with 2014 (UNCTAD, 2016).

The simultaneity of the proliferation of regulatory attempts and the continued involvement of OFCs in the global economy is undeniable evidence of the failure of soft law in their regulation.

The fundamental cause of this inefficiency lies in the very definition of soft law. According to the French Council of State, this law has three characteristics: its purpose is to modify or direct the behavior of its recipients by encouraging, as far as possible, their adhesion; it presents, by its content and method of elaboration, a degree of formalization and structuring which link it to the rule of law; and it creates no rights or obligations for its recipients.

According to this definition, soft law has no binding force in itself, contrary to hard law, no compliance exists on its own and its effectiveness rests entirely on the "adherence" of its recipients to the rules it proposes. In order to be effective, it is necessary that the recipients, states in this case, have the will to implement it effectively. In practice, this means that when institutions such as the OECD issue soft law rules, this will of the states to implement it effectively must be lead to the incorporation of these rules into their national laws. As no authority

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prevails over states, they are the only masters to decide whether or not to incorporate these rules of law into their national laws and, if so, to what extent.

Therein lies the great inadequacy of soft law. For, in practice, the rules advocated by this law remain either unapplied by its recipients, applied at the margin, or applied in disparate ways. The ineffectiveness of soft law, when not applied, is obvious. It is less so when applied at the margin and in disparate ways, but it is nonetheless real. Indeed, as already pointed out by Miller in the 1980s, this possibility of applying "à la carte" rules creates gaps in regulations that allow for gaps to proliferate in which economic actors can make themselves comfortable, achieving the best arbitrage between the different regulatory models in their cross-border operations (Miller, 1986).

In a certain way, soft law conceals in itself a part of the causes of the very effects it is trying to modify.

In this respect, the example of the OECD BEPS project speaks for itself. When the BEPS report appeared in October 2015, some American commentators stated that:

> If the United States expects to adopt some recommendations on reporting and documentation, including the country-by-country declaration (...) they have decided that little or no change in their internal tax laws will be necessary due to already existing rules in line with the BEPS project (Kellar and Hellkamp, 2015).

This shows that ultimately, there is still a lack of political will in many countries. This is all the more so because, given the principle of reciprocity prevailing in international relations, the reluctance of certain governments to transcribe the rules of soft law into their national law may bring about other hesitancies. States

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which are not very much in favor of implementing the provisions of the BEPS project will therefore soon rely on the American attitude to justify their own refusal to transpose the project measures into law or their hesitant version of such a transposition. Such projects may therefore remain totally ineffective, or be counterproductive.

The effectiveness of soft law also arises in terms of the legitimacy of this law. Indeed, since the effectiveness of soft law is based on the need for adherence by those for whom the law is destined, the latter must therefore regard it as legitimate. This presupposes that soft law adopts ideas that are accepted by consensus, but also that the process of elaboration of this law includes all those who are recipients. At present, however, the process of developing soft law in the field of international financial regulation does not truly involve all the actors concerned.

During the OECD work on the BEPS project, some criticized the fact that negotiations excluded all non-G20 countries, especially most developing countries (ActionAid, 2015). It is understandable that these states, whose participation in the negotiations was relative, were reluctant to implement a project in which they took part only at the margin and in which their point of view may have been heard, but probably not retained.

But beyond the reluctance of the actors excluded to implement soft law, it is the real intention of those who originated it that can be questioned: the lack of political will to implement soft law aiming to regulate OFCs mentioned above can be explained by the strong interconnectedness and the great complementarity that exists between OFCs and conventional financial centers. The globalized financial system has indeed been built upon the exploitation of the loopholes offered by the OFCs, which are now part of the network of interconnected nodes that is the global financial system.

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The IMF has highlighted several groups of countries, the most central of which is the trio of the United States, the United Kingdom and Luxembourg, around which a number of the most important OFCs (Cayman Islands, Liechtenstein, Jersey, Guernsey, Bahamas, Isle of Man, Bermuda), intermediate with funds arriving from the rest of the world (Moghadam and Vinals, 2010).

Moreover, by studying the geographical distribution of American capital in the world, particularly the question of liabilities, we can see the financial dependence of the United States vis-à-vis the Caribbean OFCs with which the United States has historical ties—as has been previously discussed. Among the main holders of private bonds and shares are Bermuda, the Bahamas, the Cayman Islands and the Dutch Antilles. The exposure of American banks to OFCs is also very significant.

The OFCs are therefore, and it must be reaffirmed, "actors perfectly integrated into the legitimate structures of trade and international finance". Some even assert that none of the tax havens "could have existed and prospered without the benevolence and sometimes the active solidarity of the great states" (Godefroy and Lascoumes, 2004).

The lists of non-cooperative states provided by the OECD support this hypothesis, a number of which are states dependent on states hosting conventional financial centers: the United States and the United Kingdom (Susani, 2007).

Consequently, the states hosting conventional financial centers and displaying a desire to regulate the OFCs, actually depend on the latter. It is therefore easy to understand that Soft Law, whose effectiveness depends on the will of its recipients to implement it effectively, is unlikely to see its objectives of

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regulation of the OFCs applied when it goes against the interests of OFCs but also against the interest of many conventional financial centers.

B) The BEPS project: the illustration of the failure of soft law

Symbol of an in-depth restructuring of international taxation, the BEPS Project, coupled with the AEOI was supposed to change the playing field for tax optimization. However the situation seems very nuanced on the implementation of the BEPS package and the effects actually expected.

According to Pascal Saint-Amans, Director of the Center for Tax Policy and Administration at the OECD, the BEPS project is a major step forward, even if it does not seem to call into question the very foundations of the arm's length principle and the notion of permanent establishment (Robert and Saint-Amans, 2015).

Does this mean that the OECD is standing down by describing the measures it proposes as representing a continuity with existing conditions? That would be difficult to imagine. Yet Pascal Saint Amans asserts as such, describing the BEPS project as a facelift in order to maintain a "consensual international framework". As such it is the opposite of a revolution (Robert and Saint-Amans, 2015). Yet urgency appears necessary and Saint Amans frontally attacks the inaction of the international community on these tax issues—including first and foremost the inaction of the OECD for nearly 20 years.

These are striking admissions. The G20 had wanted a flat-out renewal of the system to put an end to abuses and that is not what is being presented. The BEPS plan therefore appears to be simply an updating of existing measures, an update of nearly 1,900 pages all the same. The aim is therefore not to simplify, to make

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the current tax system more legible, but to supplement it by detailing measures to limit abuses.

This is therefore an additional complexity for national tax administrations for whom the 1,900 pages of this new report will be yet another source of perplexity, leaving emerging countries potentially helpless in the face of such a surplus of regulations.

The reluctance of the members of the G20 is clear in terms of the confrontation of the problem of the distribution of taxation among states, with the G20 insisting that the prerogatives of states on the questions of taxes be respected—including in the sector of the digital economy where debates rage on the share of value created and the resulting taxes to be imposed. The question of territoriality is therefore erased in order to respect the consensual principle that the OECD has set for itself, thus forgetting the significant reforms which could have included the implementation of tax withholdings at the source (finally differentiating the principle of the residence of a company and the source of its income) that have, however, been supported by emerging countries.

The BEPS project could thus have gone much further if the G20 countries had given the impetus and time needed to implement far-reaching reforms. Nevertheless, the demand imposed by the G20 to move very quickly forced the OECD to build an ambitious project in record time while seeking the widest possible consensus. This is probably the primary mistake of a consensual but extremely complex plan whose terms remain vague (in order to obtain a consensus that was not certain at the beginning).

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The success or failure of the BEPS project will only be apparent in a few years' time, even from the OECD, once its application is conducted on a basis that is as wide as possible in the world.

Nevertheless, the very nature of the BEPS plan as arising from soft law—which has made it possible to move quickly and to create the overall project in a consensual manner—is likely to be what will lead to the downfall of BEPS in the medium term. Soft law has allowed the emergence of BEPS, but will most certainly prevent its entry into rapid application in the coming years. Indeed, the recommendations, best practices and analysis of BEPS have no binding force, offering only two possibilities for their implementation: a modification of tax treaties already adopted throughout the world via Action 15, or the transposition of BEPS measures into national law.

The risk of international taxation "à la carte" may therefore be exacerbated by the absence of any obligation to adopt all the measures recommended (Laumonier, 2016). Thus, while experts applaud the concerted effort, they are unanimous in saying that the risk is that the results fall short of the objectives as originally determined.

1) Arm's length principle and the digital economy

While it should have been one of BEPS' flagship reforms, the arm's length principle is not in fact put into question—even though one third of world trade is considered to be intra-group and therefore subject to a risk of tax optimization.

The arm's length principle therefore remains a basis on which the taxation of intra-group transactions can be calculated and whose impact on these operations is very complex in practice because the different subsidiaries of the

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same group are considered to be legally independent entities. According to this principle, the selling price of a product or service between two companies of the same group must be at the market price.

This approach requires having points of comparison that often do not exist because in practice many products or services have too much singularity to be able to be compared effectively. As a result, tax administrations are often unable to assess the arm's length price, thus allowing firms to transfer assets to financial centers advantageous to them in tax terms.

Instead of replacing the arm's length principle with the value creation method, the BEPS project enshrines the arm's length principle by reviewing it only at the margin and making the rules that govern it even more complex. The value creation principle then complements the arm's length principle, since the latter is no longer able to distribute income optimally in the eyes of the tax administration on the basis of a value creation calculation method.

The question of the digital economy is an issue of the day (including the famous Google, Apple, Facebook and Amazon or GAFA mentioned in the first chapter) as some of these international actors have sought specific tax treatment in order to counter massive tax optimization because of the inadequate nature of current structures. With the aim of maintaining consensus, the OECD has always refused to modify the basic principles applicable to multinationals such as residence and sources of income by country. (The only exception has been value creation whose very nature makes it difficult to apply for tax administrations and national courts.)

This model that appeared in the 1920s seems, however to have reached its limits in the area of the digitization of the economy. The OECD has, however,

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considered that a reform that would mark a break with this model would be too difficult to achieve in a short time period.

Thus, tax administrations remain helpless in the face of the complexity of this issue of transfer pricing. In addition, when tax authorities perform a tax adjustment on the basis of a transfer price that does not comply with the arm's length principle, they are increasingly at risk of seeing this decision challenged before a judge by the company concerned: and the development of tax litigation on transfer pricing is therefore likely to increase considerably in the OECD member countries.

With value creation, the role and work of the administration will therefore increase with the burden of proof and access to many documents (country-by-country reporting for example). While this is theoretically a strengthening of the legal arsenal in favor of the tax administrations of developed countries, the question remains whether the tax administrations will be able in the medium term to develop the skills needed to implement the new measures developed by the OECD.

The BEPS project also only partly undermines the preferential tax regimes such as the "patent box" regime, which aims to introduce a favorable tax regime for intellectual property income. These tax regimes are at the heart of financial strategies using the OFC route as was the case in Europe with McDonald's, which used a patent box under Luxembourg law to avoid paying taxes on subsidiary companies in the various European Union member countries in which McDonald's operates. McDonald's transferred some of its intangible assets (for example, the transfer of its contracts forming its franchise network) to a Luxembourg subsidiary, which therefore collected all the profits of this network without having any real economic activity in this state. This would be treated differently in the future with the principle of value creation.

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The OECD project only partially jeopardizes these preferential tax regimes because it maintains them by allowing states to retain elements introduced before 2016 with the principle of non-retroactivity and in the absence of specific jurisprudence, proposes a model for the future whose complexity could be used by states to maintain the current regime in substance.

Many Anglo-Saxon tax specialists consider BEPS to be a beautiful facade whose true implementation will be impossible or at least emptied of substance. Herman Bouma, a tax specialist with Buchanan, Ingersoll & Rooney in the United States, considers the BEPS project to be a bitter failure, the effects of which will be minimal, while making the profession more complex due to the "Pandora's Box with its focus on value creation".

The overly wide range of subjects covered by the BEPS, the minute technical language, and voluntarily vague English that is difficult to understand for tax administrations whose mother tongue is not English and the very size of the document (1,900 pages) has condemned BEPS to failure according to many (Bouma, 2016).

On the other side of the Channel, the All-Party Parliamentary Group for Responsible Tax stated in August 2016: "BEPS is a sticking plaster on a system not fit for the twenty-first century", adding that it is only a first step for further reform on a larger scale that should be able to be monitored, which may not be the case for BEPS (APPG, 2016). Country-by-country reporting is a step forward, but its limitation to national administrations (for reasons of confidentiality) reduces the overall impact of the measure. The lack of transparency of the data collected will maintain a difficult and opaque division between countries.

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The good results achieved in the European Union since 2015 and the introduction of compulsory country-by-country reporting for banks has been generally satisfactory, allowing for strengthened banking sector monitoring without affecting profitability of banking activity in the EU. The idea of a World Financial Registry, based on country-by-country reporting and on private company databases managed by the IMF, is one example of an issue that will be studied in the future.

2) Developing countries left aside

While the fight against tax evasion seems to be at the heart of the concerns of Western countries, the main stakeholders should be developing countries. They are the first to be affected by massive tax evasion to the OFCs. According to a recent Financial Transparency Coalition study, nearly a third of the assets in the Middle East and Africa are held through companies located in offshore countries.

In Latin America, about one quarter of the assets of the continent are held offshore. This percentage falls to around 6% worldwide (FTC, 2016). The significantly higher rate in emerging economies is due to tax administrations that are not up to par and a high concentration of wealth within a small group of elite including some major family-owned groups.

Statistics and data are not lacking in this area. Indeed it is estimated that tax evasion and assets held abroad are in the range of 7 to 32 trillion dollars.

According to Global Financial Integrity (GFI), developing countries would have seen about 7.8 trillion dollars evaporate between 2004 and 2013. It is believed that the efforts of the international community to put an end to these illicit practices have resulted in a significant reduction in the amount of assets

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that have gone abroad each year. However, according to GFI, financial flows due to tax evasion from emerging countries to OFCs have continued to increase each year by 6.5% over the last ten years (Kar and Spanjers, 2015).

The data extracted from the report clearly show below the increase in illegal financial flows leaving developing countries each year:

Region	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Cumulative	Average Share
Sub-Saharan Africa	32.5	51.9	56.4	77.0	78.6	85.0	78.0	74.3	66.7	74.6	675.0	8.6%
Asia	174.6	191.9	209.1	236.5	277.5	277.1	381.7	361.1	456.7	482.0	3,048.3	38.8%
Developing Europe	107.3	118.4	133.8	190.6	233.8	204.9	221.8	295.5	242.5	250.4	1,998.9	25.5%
MENA+AP	29.9	31.0	33.3	57.4	80.3	51.9	53.0	81.1	68.2	70.3	556.5	7.1%
Western Hemisphere	120.9	131.4	111.0	137.7	157.8	128.1	172.0	195.8	201.8	212.8	1,569.3	20.0%
All Developing Countries	465.3	524.6	543.5	699.1	828.0	747.0	906.6	1,007.7	1,035.9	1,090.1	7,847.9	.

Fig. 5.1. Illicit Financial Flows from Developing Countries, by Region 2004-2013

(in billions of U.S dollars, nominal) – Source GFI

The Asian countries are particularly affected because of the rapid economic growth they are experiencing, while their national institutions seem to be unable to follow galloping tax optimization and tax evasion.

Eastern Europe and Russia are also in a critical situation in this area, as the large Russian multinationals have become specialists in tax evasion through European OFCs, of which Cyprus has for a long time been the standard-bearer.

The following table highlights the burden of tax evasion in the BRICS (Brazil, Russia, India, China and South Africa) countries, all of which are among the top ten countries in the emerging economies that have been affected by tax evasion.

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Rank	Country	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Cumulative	Average
1	China, Mainland	81,517	82,537	88,381	107,435	104,980	138,864	172,367	133,788	223,767	258,640	1,392,276	139,228
2	Russian Federation	46,064	53,322	66,333	81,237	107,756	125,062	136,622	183,501	129,545	120,331	1,049,772	104,977
3	Mexico	34,239	35,352	40,421	46,443	51,505	38,438	67,450	63,299	73,709	77,583	528,439	52,844
4	India	19,447	20,253	27,791	34,513	47,221	29,247	70,337	85,584	92,879	83,014	510,286	51,029
5	Malaysia	26,591	35,255	36,554	36,525	40,779	34,416	62,154	50,211	47,804	48,251	418,542	41,854
6	Brazil	15,741	17,171	10,599	16,430	21,926	22,061	30,770	31,057	32,727	28,185	226,667	22,667
7	South Africa	12,137	13,599	12,864	27,292	22,539	29,589	24,613	23,028	26,138	17,421	209,219	20,922
8	Thailand	7,113	11,920	11,429	10,348	20,486	14,687	24,100	27,442	31,271	32,971	191,768	19,177
9	Indonesia	18,466	13,290	15,995	18,354	27,237	20,547	14,646	18,292	19,248	14,633	180,710	18,071
10	Nigeria	1,680	17,867	19,160	19,335	24,192	26,377	19,376	18,321	4,998	26,735	178,040	17,804
Total of Top 10		262,994	300,565	329,526	397,912	468,623	479,289	622,435	634,524	682,086	707,765	4,885,718	488,572
Top 10 as Percent of Total		56.5%	57.3%	60.6%	56.9%	56.6%	64.2%	68.7%	63.0%	65.8%	64.9%	62.3%	.
Developing World Total		465,269	524,588	543,524	699,145	827,959	747,026	906,631	1,007,744	1,035,904	1,090,130	7,847,921	784,792

Fig. 5.2. Illicit Financial Outflows from the Top Ten Source Economies, 2004-2013

(in millions of nominal U.S dollars or in percent) - Source GFI

While the BEPS agreement is applicable in both OECD and developing countries, the effects of the plan will not be felt in the same way in these two different groups. Thus, while theoretically tax administrations in developing countries benefit from new tools to combat tax optimization and transfer pricing that undermine their public finances, they are likely to remain ineffective due to the complexity of the tools to put into place.

Developing countries face a triple penalty in the fight against the tax optimization of multinationals. While their tax administrations are less developed than in Western countries (lack of financial resources, human resources, legal and technical skills), in developing countries the share of corporate taxes in their tax revenues is twice as high as in developed countries, even though tax revenues account for 15% of GDP compared to 34% for

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developed countries (IMF, 2015). Corporate tax is therefore the main tax revenue of developing countries, since structures to collect income tax and VAT are less developed.

The collection of corporate taxes is thus a priority challenge but one that can only be conducted with limited resources, the BEPS plan in terms of this issue solves only a few problems and adds a great deal of complexity in the implementation of its measures.

The aim of the BEPS agreement is primarily to reduce corporate tax losses related to tax optimization worldwide, valued at between $100 billion and $240 billion a year. While Europe and the United States together account for the largest losses, as a proportion of GDP, developing countries suffer the most from tax evasion. Thus, while 1% of the GDP of the developed countries would be subject to tax optimization, this amounts to 1.5% of GDP in developing countries, a rate that is 50% higher than in the OECD countries.

Also, while the BEPS project adapts perfectly to the formal structure of developed economies, it may face serious difficulties in developing countries where the burden of the informal economy and the failure of the state in the collection of data and statistics (especially for taxation purposes) is a major constraint that is only partially addressed by the BEPS in the context of capacity building in developing countries (such as through training and the work of OECD experts in the field).

Similarly, the revenue level at which a multinational corporation must engage in country-by-country reporting—$750 million in the BEPS plan—effectively excludes 85% to 90% of multinationals (APPG, 2016) in the world. If one considers developing countries alone, this figure could even reach 95% of multinationals, limiting the effectiveness of the measure.

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Putting the treatment of the tax optimization problems of developed and developing countries on the same level therefore does not seem to be the optimal response in the context of global action on the question of tax evasion.

Is a global response even possible? The key to the distribution of a global corporate tax is to calculate it on the basis of the so-called Massachusetts method, as the European Union intends to do by 2021.

3) A Europe ahead of the CCCTB (a common tax base)

Is the creation of a European-wide corporate tax with a differentiated rate for each country and an identical tax base for the entire EU a utopian project? The European Commission wishes to believe that it is in fact possible and is aiming to achieve this objective through its project called the Common Consolidated Corporate Tax (CCCTB). Reform of an unprecedented scale if it succeeds, the establishment of the CCCTB would harmonize corporate taxes across the entire European Union.

The project originally conceived in 2011 was relaunched in 2015 and confirmed in October 2016 by the European Commission. While initially the taxation of companies through the CCCTB was to be on a voluntary basis, the Commission decided in the end that groups with a turnover of more than €750 million a year must abide by this board.

The Massachusetts method divides tax receipts between different countries in which an enterprise carries out its economic activity according to three key factors: capital mobilized, payroll and revenues earned locally.

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According to the European Commission, CCCTB would make it possible to unify the taxable base of companies in the 28 countries of Europe, reducing the volume of tax optimization by 70% while reducing the compliance costs for European companies by 2.5% on average.

The adoption of such a project, for which the European Commission hopes implementation will take place by 2021, would give a new look to European taxation and in particular the question of transfer prices and tax distortions created by patent box tax regimes.

Take the example of Google, which is part of the famous GAFA of the new digital economy—its European turnover of $12 billion was practically tax exempt in 2014 with only $1 billion taxed and the other $11 billion being located in Switzerland or Luxembourg thanks to the famous patent box. With the implementation of the CCCTB, the situation would be radically reversed, the share allocated to Switzerland and Luxembourg would be limited to $1 billion dollars, making the remaining $11 billion dollars taxable in countries with high taxation, such as France, Germany or Italy (Lamy, Monsellato, Aujean, Pellefigue, and De Vogüe, 2015).

The establishment of CCCTB is not envisaged until 2021, but only then if no institutional or political blockade slows down the adoption of a package of measures that would revolutionize a rapidly evolving European regulatory environment.

4) The United States generally lags behind the work of the OECD

Unlike the European Union, which has been very proactive on the issue, the United States has generally remained in the background during the development of the BEPS. This refractory attitude of the United States worries the OECD while

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the application of the CRS has already been delayed by the American Congress under the Republicans.

The US Treasury nevertheless praises the quality of US tax legislation, which they have said is largely in conformity with the "intentions" of the OECD BEPS plan. As for the complementary measures of the BEPS, it is necessary to allow time for the American administration to study the necessary measures without haste (ie, unlike the European institutions). Nevertheless, the US Treasury insists that many of the reforms to be adopted to comply with the BEPS must go before Congress to enter into force. Passage of laws going in this direction in the current political context appears difficult if not impossible (Kellar and Hellkamp, 2015).

The United States is thus rapidly becoming, as already mentioned above, the top OFC of the planet through a strategy finely carried out between the implementation of their FATCA law, a diversity of fiscal and regulatory landscapes within the different states and internal political conflicts in Congress delaying implementation of OECD recommendations. This policy, called the solitary prisoner dilemma, is a case study of game theory in economics and international politics and allows the United States to use the system without having to be forced to do so in the short term, leaving other countries to cooperate (those of the OECD) while the United States only pretends to collaborate.

The BEPS is thus no exception to this American individualistic and nationalist logic. US positions on the subject of the OECD aggravate many. Congress and the private sector are the first concerned as they see in the BEPS a threat to the interests of American companies. The European Union advances its own interests and many argue that the EU is trying to recover an undue share of taxes that would rightfully accrue back to US companies.

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The US Treasury is trying to temper the ardor of many US politicians as they would like to avoid the need "to openly oppose the developing international consensus” in order to “retain a seat at the table as new norms of global taxation evolve" Kellar and Hellkamp, 2015).

This is the paradoxical position of the United States, between Democratic leaders and a tax administration that is generally favorable to international progress in the fight against tax optimization, and a US legislative and executive power with a Republican majority that opposes any interference by the OECD on sovereign issues. The recent victory of Republican Donald Trump for US president may further isolate the United States from the global process initiated by the OECD with the CRS and BEPS.

C) Measures still need to be explored in the fight against tax evasion

Faced with the bottlenecks that the OECD and the international community are confronting today, a number of innovative measures can be explored in order to revolutionize the relationship between society and states in the fight against tax evasion.

Given the difficulties in setting up a transparent system to trace the origins of funds in the world, Gabriel Zucman, for example, proposes the setting up of a World Financial Registry consisting, on the model of the French cadaster, of a financial registry of the owner of any title, stock, bond or share of company in the world. According to Zucman the implementation of an AEOI can only be effective with the combined implementation of such a registry to automatically target the jurisdictions and companies concerned. The institution most likely to manage such a financial cadaster is the IMF (Zucman, 2015).

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Zucman reminds nevertheless that without the power of a sanction, either a cadaster such as this or the AEOI would be ineffective. Only sanctions can make the OFCs get into line, with financial or commercial penalties. The solutions proposed by Zucman are interesting but sometimes unrealistic, such as the introduction of 30% customs duties on imports from Switzerland, or the exclusion of Luxembourg from the European Union.

1) The introduction of financial penalties

Yet coercive measures and sometimes severe sanctions could completely reverse the balance. France has already tested this on the Principality of Monaco in the 1960s as Zucman reminds us, when Charles de Gaulle decided on a partial embargo on the principality on October 12, 1962 in order to make the micro state obey the demands of France to reinstate the French tax on companies with less than 25% of their revenues in the principality, and to impose income tax on French residents. Faced with a diplomatic crisis and the risk of economic crisis, Monaco quickly yielded to French demands and signed an agreement with France on May 18, 1963.

Even without sanctions it is quite likely that the exchange of information advocated by the OECD will take place and that its implementation will be effective in most of the signatory countries of the conventions in order to comply with the requirements of the OECD. On the other hand, it is more difficult to imagine that the upstream identification by OFC tax administrations of bank account holders, titles or the like will allow a transmission of detailed and quality information as long as the massive use of shell companies remains possible in jurisdictions with the least transparency.

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Faced with this problem of identifying beneficiaries, the developed countries could decide to generalize withholdings at the source for dividends and financial interest paid to jurisdictions whose cooperation is deemed insufficient. This withholding at the source could amount to 30% as is the case for FATCA, but this would often mean less taxation of these incomes than in their country of origin where the levies generally range between 30 and 60% for OECD countries. An arbitrary rate of 60% could therefore be applied to this income in order to limit the interest of using non-cooperative financial centers whose AEOI is partial and unreliable for the tax administrations requesting this information.

Some countries have not waited to put in place such practices. France, for example, taxes financial income that is paid to entities located in so-called non-cooperating countries at a rate of 50%. In 2016, this list included Botswana, Brunei, Guatemala, the Marshall Islands, Nauru and Niue (French Tax Authority, 2015). The retaliatory measures of the French authorities have brought results, leading to the exit from this list of the British Virgin Islands, Jersey and Montserrat thanks to the progress they made in exchanging information with the French tax administration. The recent financial scandal in Panama also brought the Ministry of Finance and Public Accounts that manages this list to actively monitor Panama, which can be added to the list if evidence accumulates as to financial and fiscal opacity in the country.

The effectiveness of the French retaliation measures shows that it is indeed possible to positively impact interactions with the OFCs—especially if the whole international community takes similar measures. It is nevertheless difficult to imagine the United Kingdom doing the same with the states and territories of the Commonwealth which represent more than 50% of the OFCs in the world. Without UK financial sanctions and without a world financial registry, shell companies will always be able to use relay points in the City of London to obtain the payment of their dividends or interest coming from France. As a last resort,

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the companies will avoid investing in France and will therefore escape French controls just as with the American FATCA. Indeed, some banks avoid US investments to keep their clients outside of US supervision and sanctions.

These retaliatory measures can be envisaged against micro-states in which it is almost certain that almost no legitimate financial activity takes place. Sanctioning Switzerland or Singapore on the other hand is more complicated, diplomatically first of all, but economically as well. How can one put the Swiss economy on hold, whereas a very large part of it is entirely legal? This would not be possible. The retaliatory measures must then be accompanied by an international registry allowing the targeting of opaque and potentially illegal structures in the country.

2) The introduction of trade sanctions

To impose trade retaliations would be an option for larger OFCs only—not as France did with Monaco in the 1960s, but by appealing to the WTO as proposed in the previous chapter.

The WTO mandate lends itself perfectly to the establishment of such sanctions, as pointed out in 2013 by the Development Committee of the European Parliament, which detailed proposals to limit tax evasion in the report by Eva Joly to the Committee on Economic and Monetary Affairs by suggesting that the WTO could decide on these issues in order to provide comprehensive and coercive responses.

As soon as a banking sector or a tax system would unfairly compete with a WTO member, the organization could then allow the establishment of temporary customs duties as long as competitive distortion persists.

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Gabriel Zucman has succeeded in quantifying the shortfall in the public finances of many countries. For example, by taxing Swiss exports to France by 30%, the French state would recover a sum equivalent to the amount of tax evasion in Switzerland. These customs duties could be raised to 40% for Luxembourg or even 100% for the Cayman Islands.

France does not have any interest in launching this trade war alone, however, only coordinated action at the level of the European Union or the WTO would be able to bear fruit.

3) Luxembourg and Ireland: the thorny issue of fiscal sovereignty for the EU

The problem is nevertheless even more arduous in the case of Luxembourg or Ireland, for example, because they are part of the European Union and cannot in fact be forced to withstand such retaliatory measures because customs duties are prohibited within the European Union. The evolution of the economies of these countries since their accession to the single market was not foreseen and Brussels is thus facing a moral dilemma with these two countries that facilitate the tax optimization of multinationals within the European Union itself.

Although in Ireland the condemnation of Apple is a sensitive subject with the Irish authorities (who turned a blind eye to the unpaid corporate taxes), Luxembourg is even more at fault in the eyes of European institutions. The Luxleak scandal in 2014 highlighted the principle of tax rulings for which Luxembourg has become the European reference and shook the European institutions and the international community. While Luxembourg is at the heart of the Union's institutions, it is also one of the main OFCs in the Western world to openly sell its fiscal sovereignty to multinationals, with a tax ruling allowing

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newly established groups in Luxembourg to negotiate, in advance, the amount of tax to be paid in the years to come.

While Zucman proposes purely and simply to exclude Luxembourg from the European Union in order to unblock an EU allegedly paralyzed by the presence of OFCs within it, it seems important to consider all the options available to European institutions and the OECD on tax-ruling issues which could thus be severely limited in the medium term.

Since 2014, the European Union has been collecting all the tax rulings established within its member states and considers that it has a right of review over the modalities of these tax rulings in order to identify those which may be similar to disguised subsidies. Of the 1000 cases of tax ruling studied over the past three years, 600 were in Luxembourg and were revealed as part of the Luxleak scandal. This was the case for tax rulings attributed to Fiat, Amazon and McDonald's for which the European Commission, after validation by the European Parliament between 2015 and 2016, requested reimbursement from Luxembourg of the benefits granted by these tax rulings, thus weakening the tax credibility of the latter.

Ireland experienced the most resounding fiscal scandal in the summer of 2016 with the decision of the European Commission to cancel the tax ruling granted by the Irish tax administration to Apple, condemning the latter to pay more than $14.5 billion to Ireland.

It is thus clear that Zucman's position on Luxembourg seems counterproductive and overly strict. The reversal of the European Commission's position on these tax ruling documents shows, on the contrary, that the European Union is better able to influence the policy of the States which are members of the Union than those external to it.

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4) The establishment of a World Financial Registry

The recent establishment of the AEOI is an important step in improving global fiscal and banking transparency. Nevertheless, just as is the case with the monetary union, which was for a long time unbalanced in the absence of a banking union in Europe, the AEOI may be weakened by the absence of an organ capable of grouping all the data exchanged in order to make it freely accessible. This body named the World Financial Registry by Zucman should be managed by the IMF in his eyes.

This global repository, or financial registry, would be nothing but a compilation of the data of all settlements of securities transactions in the world. This registry would consolidate and cross-check the data of national depositories such as Euroclear, Clearstream, and the Depository Trust Corporation (DTC) which track the movements of securities and receivables throughout Europe and the United States following the digitization of financial exchanges in the 1960s. It is Zucman's most intruiging idea to imagine compiling all the data from these national depositories to obtain a World Financial Registry that could trace the identity of the owner of any title in the world.

The IMF, in charge of this registry, could ultimately require national depositaries to reinforce their policy of identifying owners of securities (efforts which are currently fragmented) in order to improve the quality of registry data. The national tax administrations would then have access to this registry and would rely on its data within the framework of the AEOI with third-party tax administrations.

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The idea of this World Registry advanced by Zucman is co-elaborated with Thomas Piketty whose book on the economics of inequality is concerned about the growing gap due to the abandonment of public authorities of the question of increasing inequalities with an elite that does not play by the rules.

Is the establishment of such a world registry utopian? Probably—given the little attention that America, whose participation would be indispensable, is paying to the subject.

The proposal by Piketty and Zucman is likely to remain a dead letter, especially when they propose to use the World Registry to tax all the world's financial assets at a rate of 2% if they are not declared in their country of origin to escape such a tax. This tax on wealth, as it exists in France (*Impôt sur la Fortune* or ISF) is likely to produce the opposite effect than that expected, and may be used to scare away anyone who dares to support the (nascent) idea of a World Registry.

5) A revolution in corporate taxation at the global level

While the creation of a global capital tax is likely to be seen as scare-mongering in the direction of the creation of a World Financial Registry, the idea of creating a global corporate tax is regularly resurfacing. In order to best distribute the tax on profits actually realized, the taxable base could be established at the global level and then distributed equally among the different participating countries that would tax it on the basis of the allocation granted by the IMF at the rate of the corporate tax applied in each country. Each country would thus maintain its corporate tax rate and the method of calculating the distribution of profits could be conducted according to the value creation method announced by the OECD under the BEPS plan.

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The European Union and its CCCTB plan discussed previously also gives interesting calculation possibilities, using masses of wages, capital and the product of sales allows the creation of an innovative and pertinent distribution tool. The implementation of this coordinated corporate tax in Europe would make it possible to test the concept on a European scale.

This global tax would be facilitated by the implementation of country-by-country reporting under the BEPS plan. It could permanently reform the tax for companies with a turnover of more than $750 million if the current OECD thresholds are resumed or lowered to $100 million—if we agree to help developing countries to effectively fight against tax optimization.

Establishing a unified corporate income tax base on a global scale would thus be able to reduce the tax optimization game through the misuse of international transfer pricing.

With the TTIP apparently dead and buried today following the rise to power of a new Republican administration in the United States, it seems impossible to set up a transatlantic agreement on a global taxation of the profits of Western companies.

For decades, the United States has allowed its multinationals to place their profits in OFCs, it is certainly not for the European Union to recover part of them. Apple's shock in Ireland in response to the appetite of the European Commission was not welcome news to some in the United States, as they considered that the Europeans were taking away from the Americans one part of their taxes. Lobbying for the introduction of such a tax will be long and tedious.

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Conclusion:

It is believed that the BEPS project will not have the effects expected initially, and will suffer the same fate as the numerous directives or conventions aimed at limiting bank secrecy or tax optimization. The effectiveness of the latest measures of the OECD since the early 2000s have all experienced relative failure and it is difficult to imagine that the BEPS project or the AEOI will experience a more envious fate.

In the absence of sanctions, the soft law model is likely to show its limits. Many countries, including the United States, are already questioning the legitimacy of these measures by refusing to participate in the AEOI and openly criticizing the BEPS measures that could negatively impact US multinationals—and especially Silicon Valley—which actively support US growth. Conversely, the European Union seems to be powerless in the face of the growing dichotomy over these issues between Europeans and Americans.

Europe is thus trying to impose on its own the needed impetus that the OECD seems to have difficulty putting in place—as it is required to work on the basis of consensus but has few means at its disposal to pursue that aim. Within the EU, the will is also strong, through the numerous directives on tax matters and the major advances they bring to the common market. In some ways, the EU is close to the United States, which through FATCA and a fierce unilateralism are trying to go it alone in order to fight against the tax optimization of American nationals.

This is a direct approach with uncertain results, as it is difficult to verify the information provided by third countries and foreign banks. FACTA has succeeded in being adopted by the whole of the planet and most financial institutions but it seems almost impossible for the United States to check that

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the information transmitted by the partner banks is accurate because of the proliferation of shell companies, the ingenuity of which efforts is increasingly complex.

In Europe, the problems of identification of account holders are the same. When implementing the 2003/48/EC Directive on the taxation of savings mentioned earlier, the European Union had a large-scale project for an automatic exchange in the European Union—countries not participating in the exchange were hit with a tax of 35% at the source, two thirds of which was paid to the country of the tax resident. This measure can only be a half-way success, as shell companies are not affected by the Directive (due to the difficulty of controls and implementation). Between January 2005 (date of entry into force of the Directive) and July 2005, the number of shell companies in Switzerland increased by nearly 20% in order to escape the new measures of the European Union.

In such a context and without control of the actual identity of beneficiaries of perceived financial income, it is difficult to imagine that tax optimization will decrease. The measures taken by the OECD thus have every chance of being confronted with a growing opacity and complexity of tax arrangements which grow out of the flaws of international conventions and treaties. The revolutionary solution of a global tax linked to a World Financial Registry under the supervision of the IMF is ambitious but unrealistic in the short and medium term in front of the reluctance of the international players at the forefront of which are the OFCs but also the Anglo-Saxon countries related to these same OFCs.

It should be recalled that the implementation of global tax reforms can only serve one objective: the common interest. This thesis attempts to show that the common interest—though visible in the fight against the financing of terrorism

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after the attacks of 9-11—does not yet exist in terms of taxation. France, Germany and Italy probably share a common interest on this issue, but far from it are the OFCs, the United Kingdom, the United States or even China.

The common interest seems unattainable when it comes to combating tax optimization, since the main aim is to protect the social model of the welfare state in continental European countries. A dichotomy of size at the time when the Anglo-Saxon countries are increasingly lacking in such a model.

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