Putting a Face to International Tax Avoidance

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Omri Marian, The State Administration of International Tax Avoidance, 7 **Harv. Bus. L. Rev.** (forthcoming, 2016).

The world of international tax avoidance is a colorful one. There are the legal structures, with names like the “Double Irish Dutch Sandwich,” the exotic locales, like Bermuda and the Cayman Islands, and the identity crises presented by “hybrid” entities and financial instruments. But rarely does international tax avoidance have a human face and one could be forgiven for getting the impression that falling effective corporate tax rates are as inevitable as water flowing downhill. Corporations, acting in the interests of their shareholders, maximize their after-tax profits. States, acting in the best interests of their residents, set tax policies that are incongruous with the policies of other states. The “bad actors,” if there are any in this story, are corporate aggregates of one sort or another, multinational corporations and tax haven countries.

But the LuxLeaks scandal has given us one human face that stands out from the crowd of aggregates. This is the face of Marius Kohl or “Monsieur Ruling,” the former head of the Luxembourg agency, who gave rulings to taxpayers on the tax treatments of their proposed transactions. In *The State Administration of International Tax Avoidance*, Omri Marian does a wonderful job of explaining how this one bureaucrat acted to facilitate massive tax avoidance by engaging in “arbitrage manufacturing.” Marian argues that rogue individuals pose an ongoing threat to international tax cooperation. His paper clearly explains how arbitrage can be manufactured, documents how it was done in Luxembourg, and draws from the LuxLeaks episode an important lesson about the need to integrate micro reforms of tax administration into the macro project of international tax harmonization efforts.

This emphasis on individual actors, including not only Kohl but also the relatively small number of accountants and tax advisors working in on behalf of US and UK clients in Luxembourg, is one of the significant contributions of the paper. States and their regulatory agencies do not make decisions, individuals do. Those individual decisions are the results of their own private calculi, and shifting attention to individual incentives and constraints is an important analytical step. We cannot assume that tax administrators’ preferences necessarily align with best interests of their own country. Shifting attention to the incentives and constraints of the decision-makers themselves will force us to confront the monitoring, supervision, and optimal incentive structure problems for tax administrators that we do in other settings. The problem with Kohl was, in some sense, another example of regulatory capture, but one that has received little attention in the international tax compliance context where, as Marian notes, the focus has been on the harmonization of substantive tax laws.

Marian grounds his argument in an original data set. By thoroughly reviewing 172 tax rulings, Marian is able to provide a broad account of Kohl’s ruling practices as tax administrator. He reports descriptive statistics about the kinds of taxpayers who sought rulings, the time that was spent reviewing the applications, the legal issues on which rulings were sought, and the names of the tax advisors who submitted the rulings. Marian is generally persuasive in arguing that it is implausible that Kohl could have given the applications more than a cursory review, given the time that he spent with them; however, he cannot completely rule out the possibility that the ruling applications merely reflected agreements negotiated in advance between Kohl and the taxpayers. But this is a minor point in light of all of the other evidence Marian presents to suggest that Kohl was fully pliant. Although Marian does not compare the merits of the positions taken in the ruling applications with the particulars of Luxembourg law, the indirect case he makes for Kohl rubber-stamping the applications is compelling. Most damning is that Kohl afforded the same financial instrument different treatment in order to comply with different taxpayer requests.

Marian has done a service by compiling a dataset from these rulings, but in addition to the effort involved in hand-coding this new dataset, there is much to admire about the restraint and care that he demonstrates interpreting it. He is forthright about the limitations about what can be generalized about tax administration from this one episode, and fastidious about noting potential issues. When evaluating any empirical study, the reader must be able to assume that the author has done the analysis with integrity and has carefully considered and set forth the key assumptions of the approach. This paper gives every indication that Marian is a trustworthy guide.

The OECD's project on base erosion and profit shifting includes a proposal that would address the particular debt/equity arbitrage that was most common among the transactions approved by Messr. Ruling. This proposal would require matching, so that a payment that was not includible in income in the payee country could not be deductible in the payor country. This is a good rule. But Professor Marian's point, ably illustrated by the case of Marius Kohl, is that it is insufficient to harmonize substantive tax laws. Certainly this needs to be done, and harmonization must cover as many countries as possible. But in the final analysis it will be individuals who make enforcement decisions and rule on ambiguous cases.

In this realm, like so many others, we need to think about how to police the police. Doing this effectively requires understanding what motivates bureaucrats and regulators but, unfortunately, investigations into the LuxLeaks scandal have provided few answers to this question. Neither Marian nor the journalists who have covered the story have been able to explain why Kohl acted as he did. Was he compensated? Did he relish the power to give people what they wanted? Was he merely indifferent to the performance of his duties? Marian provides a valuable contribution in drawing attention to the powers of individual actors. Further work should focus on what motivates those actors, so policymakers can design the proper incentives and monitoring regimes to regulate them.

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