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The International Tax Evasion Market in the Interwar Period

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SINCE THE CRISIS FIRST HIT, THE ECONOMIC DAMAGE CAUSED BY offshore finance has suddenly moved to the top of the agendas of major western countries.^[1] While governments have made substantial amounts of money available to bail out their banking industry and as tax revenues have contracted at the same time due to the economic downturn, the frenetic development we have seen in the last three decades in the international tax evasion market appears all the more intolerable as budget deficits brought about by the recession have prompted the imposition of drastic austerity programs that have hit low-income people hardest. Tax havens are conspicuous indicators of the power of financial capitalism, and so have been the targets of what have become the most widely supported regulatory efforts since the beginning of the twentieth century. These attacks by foreign tax administrations have, in particular, led to a partial weakening of Swiss banking secrecy, an institution whose impregnability is legendary. However, it seems that in global terms, the supply of offshore finance remains largely untouched by the intensification of measures to ensure cooperation against tax evasion.

[1] This article is a brief synthesis of a working paper that can be downloaded at the following address: www.ehes2011.com/papers/Farquet_-_EHESC_-_Swiss_Tax_Haven.pdf. The reader will find more specific citations in that paper, particularly concerning archival sources and statistics.





Given the present situation, an examination of the recent explosion of tax havens from a longer perspective is a useful exercise. The intuitive association of the issue of offshore finance with speculative behaviors and recurring scandals that have burst onto the scene in recent years obstructs a structural understanding of the phenomenon of tax havens and their role in the market economy. This myopic view of the situation disregards the repetitive nature of tax evasion on the part of the owners of capital which encourages minimization of the depth of the problem and the proposal of merely cosmetic solutions. By examining the interwar period, we will avoid taking a superficial approach to the issue. That era, like our own, was characterized by acute government financing problems resulting first from war debt and then from the crisis experienced in the 1930s, and saw the first rise of tax havens, followed by the initial efforts to combat them.

As topical and important as the subject may be, we must note that the history of international tax evasion prior to the Second World War is largely still an unplowed field. Innovative political science research has shown that tax havens are the offspring of the conflicts that arose in the late nineteenth century between the strengthening of nation-states on the one hand, and the emergence of transnational finance, on the other [Palan, Murphy and Chavagneux, 2010, 107–123; Palan, 2002; Picciotto, 1999]. That antagonism was heightened after the First World War as tax burdens became heavier, leading to growth in the number of tax havens. However, these studies have simply provided a list of cases to illustrate the phenomenon, such as Swiss banking secrecy or tax exemptions for corporations in New Jersey, which prove the existence of modern forms of offshore finance; they have not undertaken to provide a systematic analysis either of international tax evasion practices or of the extent of illegal capital flows during the interwar period.

While the historiography of taxation had already long focused on the extent of the evasion of tax on capital after the Great War [for example, Delalande, 2011, 293–374; Witt, 1987; Ardant, 1972, 493–515]—reactions to direct taxation that were part of the opposition to democracy on the part of a large fringe group of the European bourgeoisie—little work has been done on the international aspect of that resistance. Classical studies of capital flows have shown that the inflationary period during the early 1920s and the period of the Great Depression were characterized



by massive asset flights to tax haven countries, but the factors cited as being key to explaining the origin of this phenomenon are generally political upheavals, monetary instability or capital owners' intolerance of budget deficits, rather than taxation *per se* [for example, Eichengreen, 2003, 29–37; Feinstein and Watson, 1995; James, 1992]. In a nutshell, when we look at the interwar period, what we see is a body of literature on taxation that pays little attention to asset flight, studies on capital flight that disregard the impact of taxation, and along the way, a few sparse studies of tax havens.^[2]

This article is based on a search of archives in Switzerland, Germany, Belgium, France and Great Britain, and is an attempt to fill that gap, at least in part, in two ways. First, the study is an effort to produce unpublished data on the extent of tax evasion and the wide field of offshore finance vehicles available during the interwar period. The very extensive tax exemptions allowed for imported capital in all the major banking centers, the proliferation of opportunities for fictitious domiciles and the timorous inter-governmental cooperation undertaken against tax evasion made the 1920s and 1930s particularly well-suited to tax avoidance by way of capital relocation. Second, the analysis takes a narrow focus, concentrating on a comparison between Swiss and British policy in international negotiations relating to double taxation and tax evasion, the objective being to compare the internal functioning of a typical tax haven with that of the greatest European financial power. This second part describes how the Swiss ruling circles adopted a strategy of a significantly more aggressive defense of fiscal attractiveness than their English counterparts.

A European Tax Evasion Market

The end of the First World War marked an abrupt break in the history of taxation. Government's growing economic burden, because of the costs of the conflict and of reconstruction, led to a thorough-going reform of tax systems in every country. One significant manifestation of this reorganization of the principles of taxation was the much greater reliance on progressive direct income taxes than before the war. Those reforms were motivated by a desire to divide the tax burden up more equitably, or at least to appear to do so, in a time of intense economic upheavals and the growing strength of the labor movement, and took the form of increased demands on the wealthy classes, through heavier

[2] We do have to note that the historical literature on the Swiss tax haven is an exception in this regard [for example, Farquet, 2009a and b; Schaufelbuehl, 2009, 316–330; Guex, 2000].



taxation and expansion of the property tax base. The theoretically higher tax rates on income from capital reached heights at that time that were to be unequalled, in some countries, for the rest of the twentieth century. For example, on the profit from a fortune in shares owned by a childless married individual valued at five million Swiss francs—the equivalent in buying power of about 25 million present-day euros—the effective British tax rate rose from 12% in 1914 to 37% in 1924, while during the same period, French rates rose from 4% to 72%. Even in neutral countries such as Switzerland, the taxes on income of that kind reached 40% in the mid-1920s in Basel, Geneva and Zurich.

However, those rates conceal another phenomenon that was just as important: the rapid rise in theoretical withholdings was equaled only by the extent of fraud and tax evasion witnessed. In fact, in virtually all of the economically developed countries, a dual system for taxing income from capital was established after the Great War. The first mechanism was a proportional tax that applied uniformly to all earnings through source deduction. The level of these taxes on securities varied widely from one country to another: during this period, it fluctuated between 2 and 6% in Switzerland, while the averages were 16% in France and 24% in Great Britain. The second was a surtax that was again gradually imposed on the same income, starting at a particular threshold. Because of extreme resistance to the principles of redistributive taxation and the chronic underdevelopment of fiscal controls, taxes collected at source produced much more satisfactory returns than surtaxes, which were easily evaded.

The “*impôt des poires*”—the “mug’s tax” expression used in France after the war to refer to the systematic evasion of gradual taxation—is not a myth. Various assessments of the French direct contribution apparatus show that the portion of income from investment capital that fraudulently evaded gradual general taxation in France reached levels of 40 to 70% between the wars.^[3] The situation was no better elsewhere. In Belgium, between 1919 and 1924, again according to official figures, fraud involving the same type of income reached 66%.^[4] In Switzerland, according to low estimates by an informed observer of Swiss financial policy, nearly 50% of the taxable wealth of natural persons avoided direct federal taxation between 1929 and 1932 [Grossmann, 1939, 136]. And in Great Britain, the country regarded as a model of fiscal consent, the five hundred biggest taxpayers nevertheless

[3] Centre des archives économiques et financières (CAEF), Savigny-le-Temple, B 58613, memorandum to Maurice Bokanowski, rapporteur général of the Commission des finances of the Chambre des députés, February 17, 1923; memorandum prepared for Charles de Lasteyrie, Minister of Finance, delivered by André de Chalendar, Inspector of Finance, January 25, 1924; memorandum to Etienne Weill-Raynal, who worked with Vincent Auriol, Minister of Finance, July 1936.

[4] Archives générales du Royaume, Brussels, T 122, 601, report by Charles Clavier, Director General of Belgian Direct Taxation, 1925.

escaped the surtax on one eighth of their income in 1931–1932 simply by using legal schemes for disposing of property, such as trusts and gifts.^[5]

These data include both domestic fraud and international tax evasion. Avoiding income tax by expatriating capital, however, is facilitated by the fact that in all major banking centers, tax authorities apply taxation principles and practices that expressly favor imported assets. In an era of chronic upheaval in financial markets and repeated currency crises, governments also demonstrate their preference for attracting foreign capital over ensuring fiscal equity between residents and non-residents, and thus securing additional tax revenues. In the 1930s, again, interest on non-residents' bank accounts was not taxed under the tax laws of France, the Netherlands and Switzerland. In Great Britain, with complete disregard for the legislative framework, the Board of Inland Revenue “deliberately turned a blind eye” to that type of profit.^[6] For current accounts, specifically, according to a report in the mid-1920s by the Belgian Banque nationale, which saw this as an “obvious desire not to interfere in the free movement of international credit,” the absence of taxation seems simply to have been the norm: in addition to the countries mentioned, this was the case in Denmark, Finland, Germany, Italy, Norway, Spain, the United States and Yugoslavia.^[7] Things were no different in the case of foreign stocks and bonds, with significant tax relief on coupons being granted for non-residents in all of the major financial centers, sometimes on condition that an affidavit attesting to the owner's domicile be presented.^[8]

In addition to these incentives for international tax evasion, the non-transparency of financial flows is strongly guaranteed in two ways. First, banking secrecy in ordinary taxation proceedings is the rule not only in Switzerland, where there has been criminal law protection since 1935 that is unique in the world [Guex, 2000, 244], but also in the Netherlands, Belgium and Great Britain, with a few minor restrictions. Second, it was not until the end of the 1930s that we saw international agreements signed between the United States, France and Sweden to allow for the effective exchange of fiscal information about securities between countries [Farquet, 2009b, 108–110]. In short, as a result of the tax-free status conferred on assets imported to financial centers, the preservation of banking secrecy and the glaring lacunae when it came to cooperation among tax authorities, there were

[5] Public Record Office (PRO), Kew, IR 40/4574, confidential memorandum prepared for the Board's Committee on Evasion of Income Tax and Sur-Tax, September 1933.

[6] PRO, IR 63/126, memorandum from the Board of Inland Revenue for Richard Hopkins, Second Secretary to the Treasury, and Philip Snowden, Chancellor of the Exchequer, March 6, 1930.

[7] Archives of the Banque nationale de Belgique, Brussels, A 237/2, letter from the Banque nationale to Albert-Edouard Janssen, Belgian Minister of Finance, February 5, 1926.

[8] For taxation practices, see, in particular: League of Nations Archives, Geneva, F/Fiscal/ Evasion 1–34, responses to Fiscal Committee questionnaire, 1938.



extensive opportunities for capital exported between the two wars to be doubly untaxed, at both the source of the income and the domicile of the recipient.

As an illustration of the extent to which the international tax evasion-friendly nature of this situation was effectively exploited, we can cite the relatively convincing information about asset exports for two countries that were victims of capital hemorrhage in the interwar period: Germany and France. In the case of Germany, the study done by the McKenna committee, relating to the Dawes Plan for war reparations, estimated the German wealth that had been invested abroad at the end of the hyperinflation of 1924 at between 5.7 and 7.8 billion gold marks [Weill-Raynal, 1947, 567]. That figure is probably an underestimate; it is equivalent to between one tenth and one eighth of the German gross domestic product (GDP), approximately, or about 200 to 300 billion euros today. Over the years that followed, capital flight was not stemmed: the Reich Statistical Office estimated capital flight at 8.8 billion marks during the 1927–1930 period [James, 1986, 298]. The preferred destination countries for the assets in that exodus were not the big economies, but rather the small neighboring countries. According to some diplomatic sources, between 3.25 and 5 billion Swiss francs, (approximately 2.5 to 4 billion marks) in German capital found safe haven in 1930 in Switzerland alone [Loepfe, 2006, 55; Guex, 1999, 284]. After the Nazis came to power, State Secretary for Reich Finance Fritz Reinhardt still considered the Netherlands, Switzerland and Liechtenstein to be “the main destinations for capital flight.”^[9]

In the case of France, exhaustive research into the balance of payments starting in 1939 provides an estimate of the assets exported during two periods of intense capital flight, when the Cartel des Gauches collapsed in 1926 and under the Front Populaire in 1937, to have been 80 or 90 to 130 billion 1928 francs [Rist and Schwob, 1939, 536 and 543]. Comparing this again to GDP, that figure exceeds the German figure and is equivalent to a range of 450 to 800 billion euros today. It may also be compared with the figure of 25 billion dollars, or about 85 billion francs, of French capital exported between 1934 and 1938 that is provided by the U.S. Treasury Department [Drummond, 1979, 46]. Switzerland is again the country where a majority of those assets found safe haven, or at least transited: in 1937, those assets were worth between 4 and 10 billion Swiss francs (20 to

[9] Bundesarchiv (BArch), Berlin-Lichterfelde, R 2/19882, memorandum signed Reinhardt, sent to Franz Gürtner, Reich Minister of Justice, April 19, 1933.

50 billion French francs), including 3 billion in Geneva alone, according to data reported by the Swiss government.^[10] To quote a confidential exposé by the Association des banquiers privés suisses (the association of Swiss private bankers), Switzerland became, at that point, “the country of safe haven *par excellence*... for significant amounts of foreign capital” coming from, in order by volume, “France, Germany, Italy, Spain, Sweden, and even the United States.”^[11] A little earlier, in 1932, the Overseas Department of the Bank of England had described Switzerland as “Europe’s international safe.”^[12] In fact, more than a safe, Switzerland transformed itself into a veritable revolving door: the imported European assets were massively re-exported, under the Swiss flag, to their markets of origin.

While the value of the estimates cited lies in the indication they provide that the problem of capital flight reached significant proportions in the interwar period, there are two problems with figures like these, in addition to their inevitably approximate nature. First, it is very difficult to separate out the portion of the amounts in question that are a direct result of tax evasion. Alongside efforts to find profitable investment opportunities, there was no shortage of other reasons for expatriating capital in the interwar period, given revolutionary pressures and successive currency devaluations. Besides the fact that archival sources from the era consistently cite tax policy as a determining factor, this objection can easily be dismissed due to the fact that a majority of the capital exported escaped taxation in the country of residence, and thus constituted a *de facto* act of tax evasion regardless of the intentions of the owner groups. When the statistics for tax returns concerning exported securities are compared with the estimates referred to above of the portfolio actually held abroad by French residents, it is no exaggeration to conclude that between two thirds and nine tenths of the exported capital held by individuals was not subject to taxation in France in 1937.^[13] A better indication is the fact that in Germany, the exported wealth reported to tax authorities in 1925 was virtually nil.^[14]

The second problem raised by these estimates is that valuations of exported capital do not cover all international tax evasion practices. An important component of the offshore finance options available during the interwar period lay in the opportunities for sham domicile offered by tax havens, which did not necessarily mean that wealth was actually moved out. The small

[10] Archives fédérales (AF), Berne, E 2001 D, 1000/1555, vol. 15, proceedings of the Conseil fédéral, June 25, 1937. We would note that bank financial statements from that era cannot be used to estimate foreign capital because they do not include securities management.

[11] AF, E 2001 D, 1000/1555, vol. 18, report of the Association des banquiers privés suisses, April 21, 1937.

[12] Archives of the Bank of England, OV 63/1, memorandum from the Overseas Department, November 11, 1932.

[13] The exported capital reported for income tax purposes was 8.2 billion francs [Piatier, 1938, 79].

[14] It amounted to 129 million marks (BArch, R 2/19814, report of the Reich Statistical Office sent to Herbert Dorn, director in the Reich Finance Ministry, April 18, 1930).



[15] Archives of Novartis, Basel, proceedings of the 226th meeting of the board of directors of Ciba, September 22, 1927, 8–9.

[16] Bureau fédéral de statistique, *Annuaire statistique de la Suisse*, 1921–1939.

[17] *Annuaire Statistique.*, 1939, 309.

[18] CAEF, B 43380, letter from the Consul General of France in Geneva to Aristide Briand, President of the Consul, January 5, 1921[6].

[19] PRO, T 175/98, report by Gerald Canny of the Board of Inland Revenue to John Simon, Chancellor of the Exchequer, February 11, 1938.

European countries were in fact engaged in dumping, by conferring tax benefits for holding companies, domicile companies and other trusts. The proliferation of these formats then served to optimize the fiscal situation of multinationals, which cooked their books to repatriate profits to the corporation located in a tax haven. Transfer pricing manipulation was already common practice at the time: in the first half of 1927, the largest Swiss chemicals company managed to reduce the total profits reported by six European subsidiaries in this way by no less than 78.5%.^[15] Holding companies were also exploited by large European fortunes, since they were able to benefit from the tax relief granted to non-residents in their own countries, for example by depositing dividends through a jointly owned foreign company.

In that market, as in the securities management market, Switzerland was again in the forefront in Europe; the number of holding companies there rose to 2,017 in 1939 from 158 in 1921.^[16] To measure the growth in services of this type, we must also include foundations; the number of those in Switzerland rose from 384 in 1919 to 2,069 in 1939.^[17] The laws in the Swiss cantons, which were very advantageous in that they taxed only the nominal capital of the holding companies at an approximate average rate of 0.1%, and not accumulated profits, were copied by other tax havens. In Liechtenstein, between 1921 and 1945, 2,504 domicile companies were created, including over 1,000 that were actually controlled by Swiss asset managers [Lussy and López, 2005, 96–97]. In 1929, Luxembourg instituted tax privileges on the Swiss model for holding companies, which numbered 1,110 in 1938 [Delvaux, 1938, 8]. Even in countries that did not grant similar advantages, such as the Netherlands, incorporation was a quick and inexpensive process in the interwar period. Interwoven networks of front companies gradually then became a popular mechanism in transborder asset management. Under the Cartel des Gauches, “as a result of the French government’s tax policies,” there was an “explosion of new holding companies in Geneva.”^[18] During the Great Depression, the use of foreign trusts and holding companies by wealthy individuals for tax purposes reached such proportions in Great Britain that it led to the adoption of targeted enforcement measures in the *Finance Act, 1936*, with the 300 fraud cases immediately identified by the English authorities standing as evidence of the problem.^[19]

The Swiss Tax Haven and the British Financial Role in International Negotiations

The leaders of the major European nations were not impassive in the face of this blatant growth in opportunities for international tax evasion during the interwar period. As they emerged from the war, and as the legislative controls on financial flows that had been adopted during the conflict were gradually loosened, with an eye to greater free trade, tax authorities quickly began to complain about the impediments to assessing taxes that they faced as a result of their inability to determine the amounts of income derived from foreign investments. The issue became much politicized in the economic context of the day: in the early 1920s, while the public debt engendered by the conflict had still not been paid off in Europe, capital flight was stripping governments of substantial amounts of taxes and at the same time accelerating the currency crisis and the inflationary spiral. In addition, there was the fact that mass expatriation of German assets was depriving the Reich of the resources it needed to pay war reparations to the Entente Powers.

As a result, serious efforts to institute cooperation among national authorities to combat tax evasion were initially made on the diplomatic scene, both at the multilateral level, in the League of Nations [LN], and in bilateral negotiations. The issue of tax evasion was coupled with the issue of double taxation, a problem that essentially affected multinational corporations, whose profits could be taxed several times in the various countries where they operated. By connecting the two issues, it was possible for negotiations to include alternatives for countries that opposed international cooperation against double taxation. Nonetheless, as was noted earlier, the end result of these efforts was very disappointing. Debate at the LN quickly stalled because of the opposition from representatives of the major financial centers to any breach of banking secrecy. In terms of bilateral talks, while some 60 agreements to preclude double taxation were signed in the lead-up to the Second World War, only half of them committed the parties to cooperate to combat tax evasion, with that cooperation continuing to be very limited, in most cases, when it came to securities [Farquet, 2009b].

At first blush, the policy adopted by Great Britain in those negotiations does not seem to have differed significantly from the policy adopted by Switzerland. From the outset of discussions



at the LN, the English and Swiss delegates stood shoulder to shoulder in the camp opposing international oversight of tax evasion called for by the Belgian and French experts. In addition, although Great Britain continued to apply a relatively stringent agreement against fraud in the area of estate duties that it had signed with France in 1907, neither of the two countries signed any bilateral agreements to combat tax evasion in the interwar period. Beginning in 1923, after intense pressure was brought to bear by the influential Swiss Bankers Association, rejection of such provisions was elevated to the status of an article of faith in Switzerland. In Great Britain, the Chancellor of the Exchequer and the Treasury also expressed great resistance to procedures that might jeopardize the City's attractiveness [Farquet, 2009a, 103–108]. The decision by the British banking establishment not to participate, which was mirrored by its counterpart in the United States until the very end of the 1930s, demonstrates the extent to which the wealthy were able to obstruct direct taxation during the interwar period. Unlike what we saw in the post-war period, when numerous assistance agreements were signed, the loopholes in international law at the time provided tacit approval for the transborder tax evasion facilitated by the major banking centers.

In any event, beyond this general assessment, Swiss leaders followed an undeniably more aggressive policy than their British counterparts in international discussions. First, in the early 1920s, the Swiss delegates to the LN took the helm of opposition to cooperation by fighting not only limits on banking secrecy, but also any kind of international exchange of tax information. That line was not adopted by the British government, which intentionally showed more restraint in Geneva on a subject as diplomatically sensitive as tax evasion was at the time. The Swiss authorities continued their intensive efforts to short-circuit work on tax evasion and made it their business to obstruct even technical collaboration at the LN. In 1938, the Minister of Foreign Affairs failed to respond to a survey on the principles of non-resident taxation, calling all “publicity” about the Switzerland’s tax haven practices to be “undesirable.”^[20]

Second, in bilateral negotiations, the Swiss government not only rejected cooperation on tax evasion, but simultaneously signed three agreements against double taxation that granted substantial tax relief on assets exported by the Swiss financial

[20] AF, E 2001 D, 1000/1554, vol. 27, confidential letter from Giuseppe Motta to Albert Meyer, Federal Council member [minister] responsible for Finance, March 2, 1938.

center to bordering countries: with Austria in 1927, Germany in 1931 and France in 1937. The two sides of the Swiss revolving door were thereby consolidated via international tax law: the absence of any provisions to counter capital flight protected asset imports, and the double taxation treaties that were signed encouraged the reexport of the assets to their country of origin. On the other hand, and in spite of repeated complaints from the business community, the British authorities took a wait-and-see position on reducing double taxation, and no general agreement was signed by Great Britain in the interwar period [Picciotto, 1992, 25–26]. A senior official with the Inland Revenue summarized this position in 1938: “Our policy on double taxation is Make Haste Slowly.”^[21]

These divergent approaches to financial liberalization, as represented by the double taxation conventions, were part of the British and Swiss investment strategies: the exports of English capital withdrew from the imperial market in the interwar years, while Swiss investors were expanding their investments throughout Europe. Those dissimilarities, however, were mainly a result of the respective autonomy and influence of tax authorities after the First World War. In Great Britain, the absolute priority given to balancing the budget at the end of the conflict—which was decisive for achieving the City’s ultimate goal, restoring the pound sterling to its pre-war parity—prompted the business world to consent to a corresponding increase in direct taxation and strengthening of the machinery for collecting taxes, which essentially relied on effective source deduction mechanisms. As a corollary to that key role, which fell to the tax authorities, the decision-making process concerning taxation was dominated by the Inland Revenue and the Treasury [Daunton, 1996, 915–918]. The same was true for international taxation: those two bodies played the central role in the circle of decision-makers, which also included the Chancellor of the Exchequer and, to a lesser degree, the Foreign Office and the Board of Trade. Left on the sideline, the business world was reduced to playing the role of lobbyist in order to assert its interests.

The obvious exclusion from the decision-making process of industry players, and especially bankers, encouraged a strategy in international negotiations of preserving the tax base. While some senior British officials expressed approval during the 1920s of reciprocal detaxation measures for foreign investments with

[21] PRO, IR 40/6156, letter from Ernest Copleston to John Winniffrith, of the Treasury, May 28, 1938.



p. XII

[22] PRO, IR 85/10, memorandum from the Board of Inland Revenue on double taxation, November 1919.

[23] PRO, T 160/956, letter from Kenneth Peppiatt, Chief Cashier of the Bank of England, to Warren Fisher, Permanent Secretary of the Treasury, December 30, 1935.

other countries, when the Great Depression began, tax authorities and the Chancellor of the Exchequer began to downplay double taxation talks, which would have led to a loss of tax revenue. When the war ended, the Board of Inland Revenue cautioned against “the giving up of considerable amounts” that would result from the erection of barriers to double taxation^[22] making it necessary to partially forgo tax either on British profits earned abroad or on taxes at the source on the English revenue of companies and individuals domiciled outside the United Kingdom. Because of the closely-woven connections between the Treasury and the City, conservatism was unquestionably prevalent within the British government; although efforts to combat fraud intensified in the lead-up to the Second World War, the Inland Revenue never seriously challenged banking secrecy before 1939 and remained on the outside of international cooperation efforts against tax evasion. The Bank of England also did not hesitate to relay pressure from the City to the government, when the government nonetheless made a pretense of supporting limited fiscal assistance, as it did in negotiations with France in 1935–1936.^[23] The British authorities, essentially for fiscal reasons, still did not deliberately encourage the expansion of British capitalism via double taxation agreements.

In Switzerland, on the other hand, because that country had not been involved in the conflict, taxation of capital retained its pre-war characteristics. Direct taxes on personal property were levied not through source deductions, as in Great Britain, but rather, almost exclusively, on the basis of taxpayer returns. The collection and oversight system depended on underdeveloped regional authorities [Ceni, 2008]. Federal taxes themselves, in a sign of how decentralized direct taxation was, were collected by the local tax authorities; as well, standardization of tax collection methods among the cantons was not undertaken until the mid-1930s, and there was no regular system for the exchange of information among the cantons. In reality, in terms of direct taxation, Switzerland was an agglomeration of minute tax havens in the center of Europe that engaged in heated competition to attract capital. The Federal Tax Administration, the central body responsible for international tax negotiations that consisted of fewer than 100 employees during the 1930s (as compared to the 24,000 civil servants working for the Inland Revenue), thus had no real interest to defend in those talks, in terms of tax revenue: direct taxation was the business of the cantons, which, with only

a few minor exceptions, collected no tax at the source on non-residents' investments.

Tax officials were particularly amenable to the demands of the business world as it had become very well organized into its corresponding employer associations, which played a decisive role in the conduct of all Swiss economic policy. Alongside the Federal Tax Administration and the Foreign Affairs Division, the Swiss Bankers Association and the Swiss Trade and Industry Union were continually included in the decision-making process regarding international taxation issues. In the guise of experts, the members of those associations also participated in the final phase of the inter-state negotiations. With nothing to stand in the way of their advocacy for the interests of capital owners, the Swiss negotiators simply arbitrated between the views of industry players and bankers at those talks. In 1935, in negotiations with France, this subordinate role was expressly stated by the Minister of Foreign Affairs to a leading Geneva private banker: "It is understood that the authorities will do nothing that is not initiated by, or at least that is without the consent of, the interested parties."^[24]

The stunting and decentralization of the tax collection machinery was met by cohesion and integration of the business world on the other side, thus fostering the institution of a policy of tax exemption on the part of senior Swiss officials in the interwar period. The objective of the policy, while making no concessions regarding efforts to combat capital flight, was to secure the largest possible exemptions on exported Swiss investments. To facilitate the conclusion of double taxation agreements, the Swiss government was fully prepared to put that subject on the table in the negotiations, tying it to other economic issues under discussion with foreign countries. In addition, alongside the official talks, the entrées into circles of power in other countries enjoyed by Swiss embassies and consulates, in particular, were continually used to secure tax exemptions for Swiss investments. One striking example of the extent to which the Swiss government was subordinated to financial interests was that in resolving disputes about the application of the double taxation convention between Germany and Switzerland, the director of the Federal Tax Administration knowingly supported the fraudulent use of a Swiss holding company by a German taxpayer.^[25] In contrast to the English policy, which struck a more even balance

[24] AF, E 2001 C, 1000/1536, vol. 15, letter from Motta to Albert Pictet, February 1, 1935.

[25] AF, E 2001 D, 1000/1555, vol. 13, Letter from Hans Blau to Maxime de Stoutz, head of the Foreign Affairs Division, September 16, 1935.



between the views of the Treasury and the demands of financial interests, a radical strategy of protecting Switzerland's fiscal competitiveness was taking shape.

Conclusion: The Political Function of Tax Havens

The analysis outlined in this article supports the idea of early development of tax havens as an integral part of the implementation of modern direct taxation systems. In the interwar period, the process by which policy on the taxation of capital in Europe developed is characterized by a hiatus, which has not yet been adequately explored in historical literature, with a rapid rise in theoretical taxation on one side, and on the other, a continuation of the liberal taxation principles that had applied in the nineteenth century. What asset owners gave up in legal terms they largely preserved when it came to practice. In many financial centers, intolerance of taxation on wealth led to broad detaxation of imported assets and to little transparency being granted to tax authorities. While the fiscal vise was tightening throughout the period, with modernization of oversight techniques and growth in the size of tax bureaucracies, the supply of offshore finance was expanding at the same time. Even the stringent currency controls instituted in the central European countries when the financial crisis of 1931 struck were hard pressed to effectively counter capital flight.^[26] The Great War had presaged both egalitarian taxation and the first European tax evasion market.

From that general observation, this article has suggested that there were at the same time clear distinctions in the international fiscal policies of the banking centers, as the comparison between Switzerland and Great Britain illustrates. A vigorous strategy of preserving its fiscal attractiveness, bringing together the worlds of business and government, was implemented by Switzerland but found no counterpart in the United Kingdom. Nonetheless, the success of the Swiss defense is only half explained by the common front that arose in that country to protect Swiss capitalism's competitive advantages. To conclude, therefore, it is worth taking another brief look at the reasons for that success, since it raises questions about the role and persistence of tax havens in the market economy. At first blush, the successful track record of the Swiss negotiators may seem surprising, given that foreign states had little interest in entering into double taxation agreements with that country: fiscally, signing a convention brought about a loss of revenue, and economically, it

[26] On how those controls were circumvented, cf. Ellis [1941].

offered only a minimal benefit for capital exported to the Swiss market, which was already amply detaxed by Swiss legislation. That success therefore cannot be understood without referring to the multiple forms of collusion—sociological, economic and ideological—between the European élites and the tax haven that was Switzerland, all of which were fundamentally the product of the migration of foreign capital to Switzerland. In other words, while Switzerland's specific position in the field of fiscal competitors exposed it to pressure that was stronger than the pressure brought to bear on the City, it was ultimately an asset at the international table.

This densely woven web of interests can undoubtedly be subsumed under the political function taken on by the Swiss tax haven, which became, after the Great War, a weapon in the hands of the forces of European conservatism. To take the example of France, both under the Cartel des Gauches in 1924–1926 and under the Front Populaire in 1936–1937, a similar scenario played out: the left came to power and announced stringent fiscal measures affecting capital, there was a massive flight of capital to Switzerland, and the result was French pressure against Swiss banking secrecy, at the LN during the 1920s and in the course of bilateral relations during the decade that followed. In addition to the French government's difficulties in funding its domestic activities, given the resistance from the wealthy, it also found itself unable to secure support from Swiss banks, which were not very interested in granting loans to their adversaries. The public accounts crisis set the stage for the collapse of the left-wing coalition. The new government was farther to the right, and subsequently lightened capital taxation and stopped putting pressure on Switzerland, which then granted France substantial public loans, underwritten at least in part by the French wealth that had fled the country [Perrenoud, 1999, 388–397; Guillen, 1982, 166–171]. Having evaded taxation, the wealth that had fled thus received a bonus dividend when it was repatriated. Because of the proximity of the Swiss tax haven, the French government's ability to secure financing was even more vulnerable to what Alfred Sauvy calls the “capitalist blackmail” of capital flight [Sauvy, 1965, 383]. Ultimately, the Swiss tax haven played a role in perpetuating an impoverished government and non-egalitarian taxation in France. ■



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